

Authority to enter into a non-competitive contract with Ernst & Young to support Category Management and Strategic Sourcing

Date: September 21, 2020

To: General Government and Licensing Committee

From: Controller and Chief Procurement Officer

Wards: All

SUMMARY

The purpose of this report is to request approval for a non-competitive contract with Ernst and Young LLP (EY) for continued support of Purchasing and Materials Management Division's (PMMD) Category Management & Strategic Sourcing (CMSS) Unit.

The continuation of these services with EY is a cost mitigation strategy to help with the City's financial situation by realizing financial benefits through the strategic sourcing of procurements within the City's top 6 categories of spend: Construction & Maintenance, Technology, Facilities Management, Fleet, Professional Services, Refuse and Waste Management which contribute to the \$20 million in year savings target. PMMD, with the assistance of EY, has been able to obtain \$41 million in benefits to date (between 2019 and April 2020) as part of the implementation of Category Management ("Phase 1"). The City entered into a new contract with EY to cover the period of May to October. This further contract extension ("Phase 2") will deliver additional financial benefits of an estimated \$110 million incremental to the \$41 million in confirmed benefits to date.

Further to the strategic sourcing opportunities that will be pursued as part of Phase 2, EY will also work with PMMD to create the governance framework and operationalize this practice in addition to the creation of category profiles and strategies to incorporate Divisional and City objectives and priorities.

EY was originally retained through a competitive process for Phase 1 and completed their main contract for a value of \$4.5 million in April 2020. PMMD entered into a non-competitive contract to extend EY for an additional 3 months for \$0.5 million which was subsequently amended for another \$0.5 million for a total contract value of \$1.0 million. This proposed further extension would increase the contract value by \$3.485 million for consultancy work plus a 5% success fee for EY to assist the City in completing strategic sourcing events and achieving an estimated \$110 million in additional confirmed benefits which will equal an estimated success fee of \$5.5 million. Overall this will

increase the total contract value by \$8.985 million net of HST (for a total contract value of \$9.985 million) and extend the contract until end of March 2022

RECOMMENDATIONS

The Controller and the Chief Procurement Officer recommends that:

1. City Council authorize the Controller to negotiate and enter into an amending agreement with Ernst & Young LLP to continue supporting Purchasing and Materials Management Division's Category Management and Strategic Sourcing initiative by increasing the value of the contract from \$1.0 million gross (\$1.018 million net of HST recoveries) by an additional \$8.985 million gross (\$9.143 million net of HST recoveries) to a potential upset limit of \$9.985 million gross (\$10.161 million net of HST recoveries) broken down by:

a. adding \$3.485 million gross (\$3.546 million net of HST recoveries) for consulting services related to developing category governance, improving reporting, strategic sourcing support and the development of a supplier relationship and contract management framework;

b. including a 5% success fee for EY's support in obtaining an estimated 110 million in benefits from category management and strategic sourcing events for an upset limit for a success fee of \$5.5 million (\$5.597 million net of HST); and

c. extending the term of the agreement to March 31, 2022

FINANCIAL IMPACT

The total increase to the City is \$3.485 million gross (\$3.546 net of HST recoveries), plus an estimated \$5.5 million (\$5.597 million net of HST) resulting from a 5% success fee for achieving \$110 million in estimated benefits.

Table 1: Cost Summary for Extension of EY Contract (Without HST)

Cost Centre	Service	2020	2021-2022	Total
FS0212/4089	Consulting	\$0.420	\$3.065	\$3.485
FS0212/4089	Success Fee at 5% of confirmed benefits achieved estimated at \$110 million	\$1.794	\$3.706	\$5.500
Total Incremental Cost to the City		\$2.214	\$6.771	\$8.985

As noted in Table 1 above, the contract will also allow EY to earn a success fee if they are able to assist the City and its agencies in achieving confirmed benefits from strategic sourcing events. For Phase 2, the estimated confirmed benefits is approximately \$110 million which would equate to a \$5.5 million success fee which will be the upset limit.

Table 2 below shows the estimated annual benefits that the proposed Phase 2 is to generate. The total estimated benefits are further provided as operating and capital, and by type of benefit - cost avoidance or cost reduction.

Table 2: Estimated Annual Benefits against Consulting Fees for Phase 2 (May 2020 to March 2022)

	May 1, 2020 to Dec 31, 2020			Jan 1, 2021 to Mar 31, 2022				Grand Total (\$M)
	Capital (\$M)	Operating (\$M)	Total (\$M)	Capital (\$M)	Operating (\$M)	Total (\$M)	Additional opportunities (\$M)	
Estimated Confirmed Annual Benefits (for City and Agencies)	30.11	5.77	35.88	12.40	13.10	25.51	48.62	110.00
Realized Cost Reduction (for City)	21.21	4.02	25.23	12.41	13.10	25.51	TBD	50.74
Realized Cost Avoidance (for City)	0.25	0.85	1.10	0.00	0.00	0.00	TBD	1.10
Consulting Fixed Fees	0.00	0.42	0.42	0.00	3.07	3.07	Included	3.49
Success Fee (5% of estimated Confirmed Annual Benefits)	1.51	0.29	1.79	0.62	0.66	1.27	2.43	5.50
Total Estimated Consulting Fee			2.21			4.34	2.43	8.99
NET Confirmed Annual Benefits (for City and Agencies)			33.68			21.17	46.19	101.01

In the event that extension for phase 2 of the EY CMSS engagement is not approved, the risk to the City is the inability to deliver estimated benefits by the end of March 2022 is approximately \$25 to \$40 million versus the \$110 million with the assistance of EY.

The Chief Financial Officer and Treasurer has reviewed this report and agrees with the financial implications as identified in the Financial Impact section.

DECISION HISTORY

At its meeting of December 19, 2019, Executive Committee received a report for information from the Chief Financial Officer and Treasurer entitled "Value-Based Outcomes Review: Findings" which discussed the use of category management and strategic sourcing as a means to obtain savings from contracts. A copy of the decision document can be found at:

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2019.EX11.1>

At its meeting of November 14, 2016, Government Management Committee received a report for information from the City Treasurer entitled Purchasing and Materials Management Review: Strategy for Category Management and Strategic Sourcing. A copy of the Decision Document can be found at:

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2016.GM16.5>.

Ernest and Young LLP was the successful proponent in the Competitive RFP No. 9101-17-7262 for Professional Services for Procurement Transformation April 12, 2018 adopted in BA 73.2. The Decision Document can be found at:

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2018.BA73.2>

COMMENTS

Background - Phase 1 of Category Management and Strategic Sourcing:

In 2018, Purchasing and Materials Management Division's (PMMD) embarked upon a journey to transform the procurement processes and implement Category Management approach to drive sustainable savings.

Category Management is a systematic and disciplined approach to procurement whereby an organization segments its spending into discrete groups or categories, depending on the functions or uses of the goods and services. Category Management involves developing strategic projects that produce improved business results that are constantly re-evaluated to optimize value to the organization.

Strategic Sourcing is one part of the Category Management approach to procurement. It relies on analyzing information about the supplier market, anticipated volumes and dollar value of purchases. Negotiation with suppliers and periodic assessments of supply transactions are hallmarks of effective Strategic Sourcing. Applied to the City, Strategic Sourcing is intended to leverage the City's purchasing power to find the best possible values in the marketplace.

PMMD retained EY through an open competitive procurement to help the City with the transformation. The original agreement with EY was executed on April 18, 2018 at a total cost of \$4.5 million. As part of that agreement, EY was to create and deliver the

various workstreams required to stand up category management and strategic sourcing within the City and pursue target benefits of \$41 million.

To operationalize the Category Management and Strategic Sourcing (CMSS) function, EY facilitated a series of workshops with cross-representational teams from various Divisions across the City to understand the traditional procurement practices in place and to collaboratively create the new CMSS processes. The EY team delivered the training to both PMMD and non-PMMD staff across the City involved in procurements. The City now has an operational CMSS function that is actively involved in large value, strategic procurements involving the City and participating agencies.

With respect to the benefits of \$41 million, EY undertook a comprehensive spend, contract, and process analysis of City’s annual spend across divisions to identify opportunities to reduce and/or avoid cost in key spend areas (top six categories accounting for 80% of the annual spend). As part of the Phase 1 Agreement, \$2.7 million of the total contract value was at risk if EY was not able to achieve the target benefits of \$41 million. By April 2020, this target was realized with a dedicated team of procurement experts from EY to work hand in hand with PMMD to create, develop and train the City personnel on-boarded for the CMSS Unit within PMMD.

Table 3 sets out the sourcing opportunities that were completed in Phase 1 that allowed the City and EY to achieve the \$41 million in confirmed benefits.

Table 3: Confirmed benefits for Phase 1

Opportunity	Initiative Completion Date / Benefits Confirmation Date	Total Confirmed Annual Benefit for City and Agencies (\$M)
Service Area A - Multi-year contracts for ECS Water Main Replacement Program	06/01/2019	\$2.50
Reducing contingent labour spend by hiring FTEs/STEs (demand management) - I&T division	11/27/2019	\$5.19
Develop an outcome based RFP approach and updated sourcing approach	12/15/2019	\$1.44
Increase competition for fuel supply contract in next call through flexible pricing mechanism	12/31/2019	\$11.39
Reducing contingent labour spend by hiring FTEs/STEs (demand management)-all remaining divisions	02/27/2020	\$ 6.62
Outsourcing opportunity (MSSP)	04/29/2020	\$14.79

Opportunity	Initiative Completion Date / Benefits Confirmation Date	Total Confirmed Annual Benefit for City and Agencies (\$M)
Total for Phase 1		\$41.92

It should be noted that the savings through a strategic sourcing project are "confirmed" when a new contract is awarded through a strategic sourcing project. Realized savings are what the City would expect to actually realize the savings through use/performance of these newly formed contracts. The "in-year" realized savings is calculated based on completion dates of sourcing projects.

As a result of the foundational work that EY completed with PMMD, the City and its agencies have realized financial and non-financial benefits from the strategic sourcing opportunities. Through application of sourcing and non-sourcing value levers, these strategic sourcing opportunities have resulted in \$41 million in annual recurring savings for the City and its agencies. In addition to the benefits, the opportunities have set up mutually beneficial relationships with the suppliers that result in improved overall value and service. For these procurements the City has reduced risk of supply, incorporated terms in agreements that improve supplier service levels, reduced future procurement effort, and helped integrate innovation in service delivery.

Request for Phase 2 Extension (May 2020 to December 2021):

Based on the work done with EY and the successful strategic sourcing opportunities, additional opportunities were identified that could be pursued under Category Management. At the end of April 2020, PMMD retained EY under a non-competitive contract for an additional 3 months from May to July, at a total contract value of \$0.5 million gross. This was to ensure PMMD continued to have support for opportunities that had launched during Phase 1 but were not complete, and to launch new opportunities. Extending the contract with EY was consistent with the goal of achieving the \$20 million+ in realized savings target set forth in the 2020 budget. The intent was to proceed to Council with this request, however that was delayed until October. As a result, a further 3 month amendment was added to the non-competitive contract, bringing the value to \$1,000,000.

Given the City's current financial situation and the success that has been achieved to date, Staff are recommending that we continue to have EY support us through the execution and deliver on the opportunities identified as the CMSS Unit continues to recruit and onboard procurement professionals to continue this work beyond 2021. Attachment 1 provides a high level summary of the opportunities and estimated confirmed benefits that can be achieved in Phase 2.

The intent with EY's support on new strategic sourcing opportunities is to also create an incentive to ensure that the City obtains benefits (either cost avoidance, cost savings or both) from the execution of contracts from the opportunities. The incentive will be in the form of a success fee. If EY is able to assist us in achieving up to \$100 million in benefits, then they will be paid a success fee of 5% of benefits achieved or \$5 million. If EY helps us achieve less than \$100 million, then the success fee will be calculated based on 5% of amount of benefits achieved. The current estimated benefits that can be achieved by end of March, 2022 is approximately \$100 million which will act as an upset limit for the success fee.

In addition to supporting the strategic sourcing opportunities, EY will help with improving on reporting of the benefits achieved, rolling out the category management governance and help design a contract management and supplier relationship management process that will assist Divisions in managing their contracts and drive further savings through contract management. Designing a contract management and supplier relationship management process will also assist the City to address various Auditor General Reports with respect to contract management.

In the recent months, PMMD has been requested by some of the divisions to utilize the CMSS unit to assist with procurement of high priority goods and services (e.g. Electronic Voting Machines, Financial Services Transformation, Reservation Booking Tool etc.). These procurements, while may not result in direct financial benefits, are critical to help the City improve the services it provides to its residents. EY's help is critical to augment CMSS's available bandwidth to support such critical procurements while also operationalizing the savings opportunities identified in the roadmap for Phase 2.

In the event that Council does not approve Phase 2, the risk to the City is PMMD's inability to deliver on the identified financial benefits in the timeline indicated due to the lack of resourcing within CMSS Unit of PMMD, reducing the estimated benefits by March 2022 to approximately \$25 to 40 million. These strategic sourcing projects require full project management disciplines, resourcing for various functions within the strategic sourcing project phases and strategic sourcing procurement expertise. As CMSS recruits and on-boards new hires, EY is a key component of the on-board training of the new hires as the expertise in training of new staff on category management and strategic sourcing does not exist today within PMMD to train.

As PMMD has grown the CMSS unit, the recruitment of these category management and strategic sourcing professionals has taken longer than expected to have the full team in place. While the recruitments receive high numbers of applicants there are very few in the marketplace who meet the criteria the City requires in particular with the experience in strategic sourcing for the categories. The hiring that has been conducted in 2019 and 2020 has been successful for the Category Managers and Category Leads however there was also a learning curve in joining a new organization.

The caliber of Category Management and Strategic Sourcing professionals that have been hired all have the experience and background required to execute on the mandates of the role and the objectives established. The current team is working alongside the EY team who has been instrumental in identifying the sourcing opportunities within the categories while the Category Managers and Category Leads carry out the execution with their support. As the Unit matures and continues to hire roles into 2021 the dependency on EY will reduce as we move through Phase 2 of the engagement. The intent is to have the Unit fully trained on all of the functions that EY is currently fulfilling during the Phase 2 period. This will include further training and development of category management strategies, processes, governance and data analytics.

EY's continued support will assist PMMD in ensuring that there are sufficient resources to be able to achieve the \$110 million in targeted benefits. These strategic sourcing projects require full project management disciplines, resourcing for various functions within the strategic sourcing project phases and strategic sourcing procurement expertise. As CMSS recruits and on-boards new hires, EY is a key component of the on-board training of the new hires as the expertise in training of new staff on category management and strategic sourcing does not exist today within PMMD to train

Also, EY's deep knowledge of the City's spend areas and related subject matter experience, understanding of the systems, processes, and perspective on constraints faced by divisional stakeholders is critical to executing the identified savings opportunities in Phase 2. It is anticipated that CMSS and EY will develop category strategies for key spend portfolios across the City that focus on demand-side levers to drive process efficiencies and savings related to enhanced demand management, better use of assets and resources, alternative service delivery models etc. This will help the City identify opportunities to reduce administrative burden while maintain or exceeding service levels in a resource constrained environment, especially in the context of the recovery phase past the current pandemic. Furthermore, sourcing strategies developed as a result of the opportunities will take into consideration prior audit recommendations to ensure integration of leading practices and compliance with City's procurement policies and procedures.

It is expected that the next phase of the engagement will be from November 1, 2020 to March 31, 2022 considering the existing workload of the CMSS staff, implementation timelines for future opportunities, and sequencing of category management activities related to governance that will be undertaken towards the end of the current calendar year.

CONTACT

Sandra Lisi, Project Director, Category Management & Strategic Sourcing, Purchasing and Materials Management. T: 416-677-9665, E: sandra.lisi@toronto.ca

SIGNATURE

Andrew Flynn
Controller

Mike Pacholok
Chief Procurement Officer

ATTACHMENTS

Attachment 1 - Estimated Annual Confirmed benefits for Phase 2 by year

Attachment 1: Estimated Annual Confirmed benefits for Phase 2 by year

Opportunity	Initiative Completion Date / Benefits Confirmation Date	Total Confirmed Annual Benefits for City and Agencies (\$M)
Service Area B - Multi-year contracts for ECS Water Main Replacement Program	06/01/2020	\$3.00
Multi-year contracts for Toronto Water sewer rehabilitation program (in progress)	06/15/2020	\$1.40
Multi-year contracts with consolidated requirement and standardized rates for Custodial Services	06/15/2020	\$1.90
Pre-qualification for ice rinks	06/15/2020	\$0
Negotiable RFP for rate standardization and alternative pricing mechanism through long-term contract for IT Professional Service (Contingent Workforce)	10/01/2020	\$16.63
Long term MSA and SRM for Engineering Services	10/30/2020	\$7.90
Multi-year contracts with unitized and regional pricing for Tree Maintenance	11/01/2020	\$1.95
Consolidation of various electrical maintenance contracts	12/31/2020	\$0.75
Providing Winter and Summer services to the properties of City of Toronto which includes all labour, material and supplies	12/31/2020	\$0.27
Multi-year contracts with consolidated requirement and standardized rates for Mechanical and HVAC Services	12/31/2020	\$2.08
Total for 2020		\$35.88
Various Outcome based contracts whereby suppliers must achieve the specific goals & is compensated based on meeting the goals established. For example Winter Maintenance snow clearing.	01/01/2021	\$10.70
Electronic voting machine	01/01/2021	\$0.02

Opportunity	Initiative Completion Date / Benefits Confirmation Date	Total Confirmed Annual Benefits for City and Agencies (\$M)
Demand management approach to forecast and plan for Hardware/Software servers for multi-year contracts	03/01/2021	\$0.83
Direct negotiation with Microsoft for Office Licenses	03/01/2021	\$0.98
Multi-year contracts for Toronto Watermain re-lining program (In progress)	03/31/2021	\$1.01
Multi-year contracts with consolidated requirement and standardized rates for Electricians and Electrical Contractors	04/01/2021	\$1.30
Multi-year contracts with consolidated requirement for office modernization, operational and SOGR	04/01/2021	\$1.10
Sourcing of services related to new water and sewer connections at industrial, residential and commercial sites - site servicing (Condo, office tower, residential) - emergency repair (removed out of scope)	06/01/2021	\$3.17
Multi-year contracts for ECS Local Road Resurfacing	12/31/2021	\$3.77
Multi-year contracts for low complexity ECS Basement Flooding Program	1/1/2022	\$2.64
Total for 2021 - 2022		\$25.50
	Total	\$61.38
Additional Opportunities to be added to Phase 2 pipeline which are being explored include but are not limited to: Trunk sewer, Water Treatment Plant, Asset Management of Road & Water Infrastructure, Gardiner Expressway, Off-Road Vehicles, Data Centre, Refuse Management contract consolidation for various sub-categories as examples.	TBD	\$48.62