

Supplementary Report: City Needs to Improve Software License Subscription Tracking, Utilization and Compliance

Date: July 13, 2021
To: Audit Committee
From: Auditor General
Wards: All

SUMMARY

City's Settlement for Non-compliance with Software Agreement

This report provides additional information on the Auditor General's review of an allegation of waste and the final settlement that transpired because the City did not comply with a vendor's software user agreement. The Auditor General's report on her review of the allegation was considered at the July 7, 2021 Audit Committee¹ meeting.

The City settled with the vendor on its non-compliance with the license agreement by purchasing new annual software licenses earlier than planned. We estimate that the cost of the unused license subscriptions (prorated to May 1, 2021) is approximately \$775,000. If all subscriptions are further renewed in 2021 without being needed, the costs for the unused subscriptions will continue to rise.

The Audit Committee directed the City Manager to report directly to the July 14 and 15, 2021 meeting of City Council on the approach taken by staff to resolve the dispute as noted in the report from the Auditor General. This supplementary report provides additional information to the Auditor General's first report tabled at the July 7, 2021 Audit Committee.

This report provides clarity on the following areas of concern where we found:

1. The City's advance purchase of software licences was made to settle a financial liability for non-compliance with the vendor's software agreement terms.

¹ <https://www.toronto.ca/legdocs/mmis/2021/au/bgrd/backgroundfile-168699.pdf>

2. The transaction to purchase new licences occurred because the City was required to make additional compensating payments to the vendor for non-compliance such that the waste of assets was not apparent.
3. There is a need for improved transparency to City Council where payments are made to resolve disputes with vendors.

The Auditor General has made one recommendation in addition to the recommendations made in her earlier report, to strengthen controls and improve transparency in this area.

RECOMMENDATIONS

The Auditor General recommends that:

1. City Council request the City Manager, in consultation with the Chief Procurement Officer, to review all instances of settling or resolving contract non-compliance or contract disputes that have occurred in the past and recommend changes to the financial control bylaw and purchasing bylaw to consider a requirement for divisions to report to Council through General Government and Licensing Committee on financial transactions to settle or resolve contract non-compliance or vendor disputes exceeding delegated signing authorities.

FINANCIAL IMPACT

The recommendation contained in this report has no financial impact, however it will strengthen controls and improve transparency on financial settlements that the City enter into for contract non-compliance.

DECISION HISTORY

On July 7, 2021, Audit Committee directed the City Manager, in consultation with the Auditor General, to report directly to the July 14 and 15, 2021 meeting of City Council on the approach taken by City staff to resolve the dispute as noted in the report (June 23, 2021) from the Auditor General.

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2021.AU9.13>

Management provided its July 13, 2021 supplementary report to the Auditor General for information.

The Auditor General is independently reporting on the approach taken by City staff to resolve the dispute and providing additional information or clarifications on the matter.

COMMENTS

The following sections provide additional information on the terms and conditions of the license and the City's settlement for non-compliance with the vendor's license agreement.

WHY THE CITY SETTLED WITH THE VENDOR

Vendor's Software License Agreement

The City has been using this vendor's proprietary software for over 10 years to manage some information technology services on its servers.

In a 2011 license review, another settlement was made with the same vendor because the actual software license users were greater than the number of licenses initially purchased. The City settled the matter by purchasing license subscriptions retroactively as provided in our Confidential Attachment 1 to the July 7, 2021 Audit Committee. This payment was made to reflect the number of license subscriptions the City was using and some licences for potential future growth.

The vendor's proprietary software license agreement offered clients two ways to license their server-based software:

1. Licensing for the entire number of servers the City had regardless of license usage.
2. Licensing based on actual usage, which has significant benefits, but only if the City installed the vendor's license tracking tool and reported the usage to vendor on a periodic basis.

The City executed the vendor's agreement on December 20, 2011 based on option 2.

According to the license terms and conditions, the City was required to install the vendor's license reporting tool to track and report application usage on City servers. Failing to report through the vendor's reporting tool meant that the City would be required to pay for licence subscriptions based on the total number of servers the City had instead of actual servers using the software.

City's Final Settlement for Non-Compliance

The license agreement allowed the vendor with reasonable notice to conduct a license review to verify the City's conformity with license terms and authorized usage limits. If the verification found non-compliance with the terms of the license the vendor could pursue additional licensing costs and other liabilities as determined by the review. As part of the license review the City was required to provide auditable records. These records were to be generated using the vendor's reporting tool.

The City encountered technical issues and was not able to fully implement the vendor's reporting tool as required by the agreement. Service tickets were created with the vendor, but the issues were not resolved, and the tool was not installed.

In 2018, the vendor hired a professional services firm to audit the City's compliance with the licence agreement. The vendor's auditor determined that the City was non-compliant as it did not fully implement the vendor's reporting tool and therefore could not provide the required reports. As well, the City did not properly track the licence deployment, an issue raised by the Auditor General several times in the past. The City provided manual reports from its own tracking system; however, the auditor found the reports were incomplete and did not cover the full compliance review period.

In early 2020, the City had the following choices to fulfill its contractual obligation for non-compliance with the license agreement:

- Purchase additional new software products in addition to existing products and deploy the vendor's license reporting software going forward; or
- Pay for the total number of servers the City has regardless of usage.

City Makes Advanced Purchase of Software License Subscriptions

To settle its contractual obligation for non-compliance, the City agreed to make advance purchases of new annual software license subscriptions that management said was for two projects already planned. Internal communications showed that management *"asked that the penalty be made as small as possible and offset by an increase of purchases. I think it would be better for the City to get assets instead of paying a penalty with no assets"*.

Although staff noted that the licences were purchased for Council approved projects, the licenses were not ready to be deployed. Internal communications from senior information technology personnel confirmed that the licences were purchased *"1 to 2 years in advance before production deployment"* to settle the dispute. Management then signed the settlement agreement that showed the licence subscriptions expiring 12-14 months later. They confirmed to us that *"The licenses were bought early as part of the settlement, not bought per the [software] project schedule, so underutilization is expected"*.

As of May 1, 2021, almost one year after the settlement, an aggregate of only 17 percent of all acquired licenses are being used.

TRANSPARENCY AND ACCOUNTABILITY

Given what the Auditor General reported at the July 7, 2021 Audit Committee and the additional information provided in this supplementary report, the Auditor General has concluded that the City was required to make a financial settlement with the vendor for non-compliance after a license review.

While it appears that bylaws have technically been complied with, had the Auditor General not received the complaint about the settlement, she would not have been aware the settlement was effected as a software procurement instead of a financial settlement for non-compliance. The cost of the unused license subscriptions (prorated to May 1, 2021) is estimated to be approximately \$775,000, which includes a one-time set-up fee, annual subscription and maintenance and support costs that expire between June and August 31, 2021.

If all subscriptions are renewed in June and August 2021 for another year without being needed, the costs for the unused subscriptions will continue to rise if there are further delays in the implementation of the new project. Management advised that all license subscriptions are expected to be in use by the end of 2022, meaning they expect the capital project implementation to be completed for all relevant divisions by the end of 2022.

The Auditor General has concerns that by not disclosing the dispute or the settlement which used the purchase of assets in lieu of a financial settlement as the vehicle to settle the matter, the waste of assets would not have been apparent. There is a potential that even larger settlements may go unreported to Council. And further, that the settlements could consume a portion of the procured value of the contract and that City Council would not know the approved contract was used up to purchase potentially idle assets. The Auditor General has made one recommendation to strengthen controls and improve transparency in this area.

The work performed in relation to this report does not constitute an audit conducted in accordance with Generally Accepted Government Auditing Standards (GAGAS). However, we believe we have performed sufficient work and gathered sufficient appropriate evidence to provide for a reasonable basis to support our observations and recommendations.

CONTACT

Syed Ali, Audit Director, IT & Strategy, Auditor General's Office
Tel: 416 392-8438, Fax: 416-392-3754, E-mail: Syed.Ali@toronto.ca

Gawah Mark, Senior Audit Manager, Auditor General's Office
Tel: 416-392-8439, Fax 416 392-3754, E-mail: Gawah.Mark@toronto.ca

SIGNATURE

Beverly Romeo-Beehler
Auditor General