

Performance Audit 22-01: Purchasing Division Procurement Process

July 2022

City Auditor

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OFFICE OF INTERNAL AUDIT

Stan Sewell, City Auditor

July 6, 2022

To: Mayor Tim Kelly
City Council Members

RE: **Procurement Process Audit (Report #22-01)**

Dear Mayor Kelly and City Council Members:

The attached report contains the results of our procurement process audit. We concluded the City's procurement process substantially complies with Tennessee law and the City Code. However, we determined that the City's *Procurement Instructional Manual* does not provide clear guidelines for some procurement activities, which increases the risk of non-compliance with state law and City Code purchasing requirements. We also identified opportunities for the City's Purchasing Division to strengthen procurement internal controls to enhance business value and minimize risk.

We would like to take this opportunity to thank the management and staff of the City's Purchasing Division for their courtesy, cooperation and assistance during this audit.

Sincerely,

Stan Sewell, CPA, CGFM, CFE
City Auditor

Attachment

cc: Audit Committee Members
Joda Thongnopnua, Chief of Staff
Brent Goldberg, Chief Financial Officer
Ryan Ewalt, Chief Operation Officer
Julia Bursch, Deputy Chief of Staff
Kevin Bartenfield, Director of Purchasing
Jim Arnette, Tennessee Local Government Audit

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AUDIT PURPOSE

This audit was conducted in accordance with the Office of Internal Audit's 2022 Audit Agenda. The objective of the audit was to determine if the City's procurement process complies with Tennessee law, the City Code and the City's *Procurement Instructional Manual*.

BACKGROUND

The City's Purchasing Division is responsible for procuring supplies, equipment, materials and services required to maintain City operations. To ensure compliance with Tennessee law and City Code requirements for procuring goods and services, the City developed and implemented the *Procurement Instructional Manual* ("Procurement Manual"), which establishes policies and procedures for all departments to follow when performing procurement functions.

Procurement governance

The Procurement Manual establishes different procurement requirements depending on the amount of the purchase. For example, departments can use City purchase cards (P-cards) for purchases up to \$1,000 without submitting a requisition; and purchases up to \$5,000 can be made without formal advertisements or bids.¹ For purchases between \$5,000 and \$24,999, the Purchasing Division must obtain three (3) competitive quotes. For purchases \$25,000 and over, competitive solicitations are generally required and bid solicitations must be publicly advertised to promote open and fair competition.²

Suppliers are not required to register with the City to submit bids, but are strongly encouraged to do so using the City's Supplier Portal.³ Purchase agreements are generally awarded to the supplier with the lowest and best bid. Requests for Proposals and Qualifications are awarded to the highest scoring supplier based on the criteria specified in the request documents.

¹ For purchases between \$1,000 and \$4,999, three (3) quotes are recommended but not required. Purchases under \$5,000, excluding blanket purchase, cooperative agreements and P-Card transactions, require at least one (1) formal quote, which must be submitted with the requisition by the requesting department.

² Competitive solicitations are not required for single source purchases, emergency purchases, fuel purchases, contracts for professional services, and other purchases designated by law. All expenditures \$25,000 and over must be approved by City Council.

³ The City launched the Supplier Portal on the City website in July 2021, enabling suppliers to register for electronic notifications whenever bid solicitations pertaining to their business are advertised. Registering on the portal also allows suppliers to provide important information about their business.

Procurement database

The City maintains a centralized procurement database using the Oracle system.⁴ The Oracle purchasing module is designed to automate purchasing transactions and provide Purchasing Division buyers information and insight into exceptions, status, and actions required. Routine tasks can be streamlined, such as creating purchase orders from approved requisitions without manual intervention, and keeping track of expiring blanket purchase agreements up for renewal.

Financial information

Exhibit 1.

<i>Procurements under \$5,000</i>	
<i>CY2019</i>	\$292,483,410
<i>CY2020</i>	\$137,575,326
<i>CY2021</i>	\$309,061,258

<i>Procurements \$5,000 to \$24,999</i>	
<i>CY2019</i>	\$12,888,226
<i>CY2020</i>	\$7,040,392
<i>CY2021</i>	\$18,718,759

<i>Procurements \$25,000 and over</i>	
<i>CY2019</i>	\$274,419,098
<i>CY2020</i>	\$126,400,812
<i>CY2021</i>	\$280,771,191

Source: Oracle (dollar amounts based on purchase orders issued)

AUDIT FINDINGS

Policies and procedures governing the procurement of goods and services

We determined the City’s procurement process substantially complies with state law and City Code purchasing requirements. However, the Procurement Manual does not clearly define the processes governing the following procurement activities:

Competitive sealed proposals. Subject to restrictions, state law and the City Code allow for purchases using competitive sealed proposals if the governing body (City Council) determines competitive bidding is neither practicable nor advantageous. Sections 2.13 and 2.20 of the Procurement Manual briefly describe alternative procurement methods when competitive bidding is impractical or bid prices are unreasonable. However, the Procurement Manual does not clearly

⁴ Requisitions, purchase orders, agreements and supporting documentation for most procurements are maintained in the Oracle system.

define the process for using competitive sealed proposals in accordance with T.C.A. § 12-3-1207 and City Code § 2-554. For example, competitive sealed proposals may only be used when the City Council determines qualifications, experience, or competence are more important than price in making the purchase and:

- 1) more than one (1) solution to a purchasing issue exists and the competitive sealed proposals will assist in choosing the best solution; or
- 2) no readily identifiable solution to a purchasing issue exists and the competitive sealed proposals will assist in identifying one (1) or more solutions.⁵

Single source purchases. Section 2.05(3) of the Procurement Manual does not address the requirement in T.C.A. § 6-56-304(2) that documentation of single source and proprietary purchases must include the amount paid, the items purchased, and from whom the purchase was made. Moreover, Section 2.05(3) does not address the directive in T.C.A. § 6-56-304(2) requiring that a report be furnished to City Council and the Mayor documenting all single source or proprietary purchases.

Contracts for information management services. The Procurement Manual does not define the process for procuring contracts for information management services, increasing the City's risk of non-compliance with T.C.A. § 12-3-1209(e).

Cooperative purchasing agreements. The Procurement Manual does not define the process for participating in, sponsoring, or administering cooperative purchase agreements, increasing the City's risk of non-compliance with T.C.A. § 12-3-1205.

Public improvement contracts. The Procurement Manual does not define the process for procuring public improvement contracts, increasing the City's risk of non-compliance with City Code § 2-560.

Recommendation 1: The Procurement Manual should clearly define the processes designed to ensure compliance with state law and City Code requirements for: (1) competitive sealed proposals; (2)

⁵ City Code § 2-554 states the Purchasing Agent may recommend to City Council the use of competitive sealed proposals in appropriate circumstances (*cf.* Section 2.20 of the Procurement Manual which states the Purchasing Agent shall determine when contracts may be competitively negotiated). Additionally, City Code § 2-554 requires City Council to adjudicate bid protests and allows aggrieved parties to file protests with City Council within seven (7) calendar days after the intended award is announced (*cf.* the Procurement Manual Section 2.25 which requires bid protests be filed with and decided by the Purchasing Agent and allows only three (3) working days to file a protest).

single/sole source purchases; (3) contracts for information management services; (4) cooperative purchase agreements; and (5) public improvement contracts.

Auditee Response: *We agree with the audit finding and recommendation.*

Supplier selection and vetting

It is essential for the City to choose responsible suppliers that deliver quality goods and services. Establishing a standardized process for vetting suppliers is a key step toward effectively managing risk and ensuring quality service delivery. Vetting potential suppliers provides insight into past performance, potential legal or financial issues, and insurance compliance.

Section 2.22 of the Procurement Manual acknowledges that supplier performance and responsibility are critical factors in determining best value. However, there are no established criteria for evaluating the performance history and responsibility of potential suppliers. Our analysis of best practices for government procurement programs affirms that a robust procurement process should involve a determination of the supplier's qualifications and eligibility to serve as a supplier for the City.

Recommendation 2: The Procurement Manual should outline the process for evaluating whether potential suppliers meet the following standards of responsibility:

- Adequate financial resources to perform the contract;
- Ability to meet the required delivery or performance schedule, taking into consideration all existing commitments;
- Satisfactory record of performance;
- History of integrity and business ethics;
- Be neither debarred nor suspended from federal, state or local government programs;
- Necessary experience, operational controls, and technical skills;
- Compliance with applicable licensing and tax laws;
- Necessary production, construction, equipment and facilities;
- All other qualifications necessary to receive an award under applicable laws and regulations,

Auditee Response: *We agree with the audit finding and recommendation.*

Supplier price increases

A price escalation clause allows the supplier to increase the price of a product or service in the event of rising costs. Contracts procured by the City commonly include a price escalation clause, which states: "If

as a result of a general change in prices or discounts, the Contractor has changed prices to all of its customers, the price under this contract may be adjusted accordingly. Contractor may be requested to show proof of alleged price changes prior to approval of any price adjustments.”

Our audit confirmed that, in most cases, the Purchasing Division requires suppliers to provide some level of justification to support a proposed price increase after the initial contract term. However, the Procurement Manual does not establish guidelines for negotiating proposed price increases, or the specific information suppliers must provide to justify price increases.

Recommendation 3: The Procurement Manual should establish guidelines for negotiating proposed price increases and describe the specific information suppliers must provide to justify price increases.

Recommendation 4: The price escalation clause should include language requiring the supplier to revert to the price(s) in the original purchase agreement in the event the supplier can no longer justify the price increase.

Auditee Response: *We agree with the audit findings and recommendations.*

Procurements of educational and social services for the Head Start program

Our audit disclosed the procurement of educational and social services for the City’s Head Start program that bypassed the City’s standard procurement process. The Head Start program acquired the services with federal funds awarded by the U.S. Department of Health and Human Services (HHS). Even so, federal regulations require procurements under HHS grants to follow the documented procurement procedures established by the non-federal entity, which reflect applicable state and local laws and regulations.⁶ Failure to follow the City’s normal procurement process can result in a violation of federal regulations, state law and the City Code procurement requirements.

Recommendation 5: Procurements by the Head Start program for educational and social services should follow the standard procurement process prescribed by state law, the City Code and the Procurement Manual.

Auditee Response: *We agree with the audit finding and recommendation.*

⁶ See 45 CFR § 75.326 *et seq.* (Procurement Standards for HHS Awards) and Grants Management Common Rules (GMCR)

**Documentation
of Procurement
Actions**

Our audit disclosed instances where procurement documentation was missing from the Oracle system (or the Purchasing Division contract file) making it difficult to determine performance compliance. We examined a sample of 29 procurements \$25,000 and over from the audit period and found four (4) blanket purchase agreements procured after receiving only one (1) bid without supporting documentation explaining why the services were not rebid as required by the City Code and the Procurement Manual. We also found three (3) blanket purchase agreements where documentation concerning renewals/extensions of contracts and public advertising was missing.

Recommendation 6: The Procurement Manual should establish specific requirements for storing and maintaining all supporting documentation for procurement activities.

Auditee Response: *We agree with the audit finding and recommendation.*

APPENDIX A: SCOPE, METHODOLOGY AND STANDARDS

Based on the work performed during the preliminary survey and our assessment of risk, the audit covers the administration of the City's procurement process from July 1, 2021 to March 31, 2022. When appropriate, we expanded the scope to meet our audit objectives. We reviewed source documentation and records from Oracle and the Purchasing Division. We used original records and copies as evidence verified through physical examination.

We examined evidence on a test basis and applied other procedures required to meet our audit objectives. Those procedures included:

- Reviewing applicable procurement laws, regulations, policies and procedures;
- Evaluating the internal control framework governing procurements of goods and services;
- Reviewing best practices and governmental standards for procurement programs;
- Conducting a risk assessment to identify high-risk activities and potential fraud risks; and
- Interviewing management and staff responsible for procurement administration.

The sample size and selection of the data we examined for the audit were statistically generated using a desired confidence level of 90 percent, expected error rate of five (5) percent, and a desired precision of five (5) percent. We used statistical sampling to extrapolate the conclusions of the test work performed on the data sample to the entire population from which it was drawn and obtain estimates of sampling error. When appropriate, we used judgmental sampling to improve the efficiency of the audit.

We conducted this performance audit from December 2021 to June 2022 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our audit findings and conclusions.

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