

Follow-Up Review of Direct Pay Purchasing Methods in the County of Santa Clara

Prepared for the
Board of
Supervisors of
the County of
Santa Clara by
the
Management
Audit Division

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March 27, 2014

County of Santa Clara

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March 27, 2014

Supervisor S. Joseph Simitian, Chair
Supervisor Ken Yeager, Vice Chair
Board of Supervisors' Finance and Government Operations Committee
70 West Hedding Street
San Jose, CA 95110

Dear Supervisors Simitian and Yeager:

We have completed the *Follow-Up Review of Direct Pay Purchasing Methods in the County of Santa Clara*. This review was requested by the Board of Supervisors as a follow-up to a prior review of direct pay purchasing conducted by the Internal Audit Division of the Office of the Controller-Treasurer, and was added to the County's management audit program pursuant to the Board's power of inquiry specified in Article III, Section 302(c) of the County of Santa Clara Charter. This audit was conducted in conformity with the United States Government Accountability Office (GAO) Audit Standards.

As stated, the original purpose of the project was to conduct a follow-up review to determine if implementation of recommendations in a 2009 Internal Audit Division report on use of Direct Pay Codes in the County accounting system had been successful.

Board of Supervisors:

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District 5 

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Those recommendations included reducing the number of codes, and greater utilization of two alternative purchasing methods, procurement cards and field purchase orders.

However, at about the time work commenced on the follow-up review, in late 2012, news media reports of financial improprieties by a now-former member of the Board of Supervisors were published, and the member ultimately pleaded guilty to five felony and seven misdemeanor charges, including misuse of a County-issued procurement card (a County-issued credit card) for personal expenditures. Due to this incident, the Management Audit Division proposed, and the then-Committee chair agreed, that the scope of the follow-up review should be expanded, to thoroughly review actual transactions for procurement cards, field purchase orders and Direct Pay Code transactions, to determine, as much as feasible, whether abuses similar to those carried out by the former Supervisor were occurring elsewhere in the County.

Specifically, we reviewed a judgmental sample of 326 procurement card transactions, from a database totaling about 23,000 transactions, all of which were at least cursorily examined to identify ones about which we had further questions. We reviewed an additional judgmental sample of 378 field purchase order transactions from databases from the County's SAP accounting system and the Health and Hospital Systems Pathways Materials Management system. These two systems combined included about 22,000 purchase orders, all of which received some examination in order to pick those for which more documentation was sought. Finally, we sought more information or explanations on a judgmental sample of 7,629 direct pay coded purchases, out of a total database of approximately 104,000 transactions. All the transactions were for a one-year period from December 2011 through November 2012.

Our conclusion, after reviewing these judgmental samples, was no such abuses, similar to what occurred with the former Supervisor, were occurring. We did find various other opportunities for improving use of all three purchasing methods, and this report contains three sections with 16 recommendations. All recommendations were agreed to, partially or in total, in the response provided by the County's Chief Operating Officer.

Supervisor S. Joseph Simitian

Supervisor Ken Yeager

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We note that, among other recommendations, we have suggested expanded use of Countywide contracts, negotiated by the Procurement Department, that we estimate would save at least \$310,000 annually. Other recommendations would improve documentation and transparency when alternative purchasing methods are used by departments, promote greater use of competitive purchasing methods, including identifying situations where County contracts don't provide the lowest prices, and taking additional steps to guard against fraudulent use of procurement card numbers.

We have also noted, in the Introduction, the potential benefits of a broader review of Countywide procurement, both by the Procurement Department and in departments that use these alternative methods. Procurement has not been reviewed in depth since 1995, and its operations, and the way the County buys things generally, has changed markedly since then, in our view warranting a more in-depth review.

We would like to thank the Procurement Department, the Office of the Controller-Treasurer, and many departmental accounting, administrative and line staff that responded to our many detailed inquiries about specific purchasing transactions. We received detailed responses promptly and without complaint, and could not have completed this work without that assistance.

Respectfully submitted,



Roger Mialocq

Board of Supervisors Management Audit Manager

Cc:

Supervisor Chavez

Supervisor Cortese

Supervisor Wasserman

Project Staff: Jeff Segol

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Introduction

This *Follow-Up Review of Direct Pay Purchasing Methods in the County of Santa Clara*, was requested by the Board of Supervisors of the County of Santa Clara, and was added to the County's management audit program pursuant to the Board's power of inquiry specified in Article III, Section 302(c) of the County of Santa Clara Charter.

Purpose and Scope

In October 2009, the Internal Audit Division of the Controller-Treasurer Department issued *Internal Audit Report, Direct Pay Code Process-Internal Controls*, which examined use of Direct Pay Codes in the County accounting system to authorize payment of purchases of goods and services without the use of purchase orders, by identifying the particular transaction with one of 104 codes available at that time. The audit found that the system in existence at that time "does not effectively meet the current County business needs," because the list of codes did not align well with the types of purchases that were occurring. A simplified list of codes was proposed. The audit also found that the Direct Pay Code system "inhibits identifying potential contract vendors," because the data it generated were not being analyzed for potential Countywide contracts. Finally, it found that "certain code descriptions are ambiguous and are subject to misapplication," recommending descriptions of codes be clarified.

The Finance and Government Operations Committee (FGOC) of the Board of Supervisors received reports on implementation of the 2009 audit recommendations in April 2010 and September 2010 from the Finance Agency Director, and in December 2010 and September 2011 from the Director of Procurement. The Director of Procurement, who collaborated with the Controller's Office, Internal Audit and other County departments in the implementation process, proposed a reduction in the number of direct pay codes to remove those no longer used or not clear, and increased use of procurement cards and field purchase orders, two other purchasing methods that did not use traditional purchase orders processed by Procurement, as alternative to direct pay coded purchases. In part, the expanded use of these alternative purchasing procedures was recommended to ensure more control, visibility and accountability in the processes used by the County for the purchases of goods and services.

This proposed follow-up review by the Management Audit Division was approved by FGOC and the Board. At the conclusion of the December 2010 discussion, in accepting the progress report, Supervisor Yeager also stated: "I also move for the management

auditor to look at the status and outcomes of direct pay in December 2011 to see how the changes are working and to see if more changes are needed.”

Due to other assignments made by the Board to the Management Audit Division, work on Supervisor Yeager’s requested follow-up review did not begin until November 2012. At approximately the same time, news media reports of financial improprieties by former Supervisor George Shirakawa were published, and Supervisor Shirakawa ultimately pleaded guilty to five felony and seven misdemeanor charges, including four felony counts of perjury and one felony count of misappropriation of public funds, related to misuse of campaign and public funds for personal expenses, including use of the Supervisor’s County-issued procurement card (a County-issued credit card) for personal expenditures.

As a result of the incident involving the former Supervisor, the Management Audit Division proposed and Supervisor Yeager agreed that the scope of the follow-up review should be expanded, from a review of policies and procedures regarding direct pay purchasing processes, to a thorough review of actual transactions for the various direct pay processes then being used. The purpose of the expanded review was to determine, as much as feasible, whether abuses similar to those carried out by former Supervisor Shirakawa were occurring elsewhere in the County.

Audit Methodology

For this follow-up review, we conducted interviews with the Director of Procurement and the Procurement Card Administrator in the Procurement Department, as well as with relevant staff in the Office of the Controller-Treasurer, getting an explanation of the three direct pay processes, procurement cards, field purchase orders and direct pay coded purchases. We also received written procedure memoranda, training materials and related information on how each of those processes is supposed to work.

The bulk of the analysis, however, was the review of actual purchasing transactions made by County employees using the three methods. The transactions were drawn from databases that covered a one-year period, from December 1, 2011 to November 30, 2012, as follows:

Procurement Card Purchases-The database of procurement card purchases was obtained from the Procurement Card Administrator, in the form of monthly downloads

of procurement card transactions that she receives. We combined the monthly downloads, for the 12-month period into a single database.

Field Purchase Orders-Databases of field purchase orders were obtained from two sources, from the Director of Procurement, for field purchase orders in departments other than the Santa Clara Health and Hospital System, who process the orders through the County's SAP accounting system, and a second database, also from the Director of Procurement, of field purchase orders processed via the Health and Hospital System's separate Pathways Materials Management system.

Direct Pay Coded Purchases-A database of direct pay coded purchases, covering the same 12-month period, was obtained from the Internal Audit Division of the Controller's Office.

These databases included about 23,000 procurement card purchases totaling \$8 million, more than 22,000 field purchase orders purchases amounting to about \$30 million, and approximately 104,000 direct pay coded transactions totaling more than \$3 billion. However, it should be noted that the direct pay coded transactions included approximately \$2.2 million in payments to other government agencies, and employee payroll withdrawals that received only limited review, since they were almost always not payments for goods or services..

From these databases, we selected judgmental samples, in essence scanning every transaction and identifying those where the purpose of the transaction wasn't clear from the name of the vendor, the description of the item purchased, or other information in the database. For the items included in our sample, we then went back to the departments making the purchases and requested additional documentation and explanation, including copies of vendor invoices, requisition documents, chains of e-mail communications and other information to explain what was purchased and why, whether a competitive purchasing method was used and why or why not, and other explanatory information. In some cases, we gathered additional information by sending e-mail queries to line staff responsible for specific purchases. In response, we often received detailed explanations, usually within a day or two, of the history and reasons for a particular purchase, the process used to select a vendor, and other relevant details.

Based on this information, we identified specific weaknesses in the use of procurement cards, field purchase orders and direct pay codes by County staff, described in a draft report issued on January 16, 2014. We then conducted exit conferences on January 28,

2014 with the Procurement Department and February 04, 2014 with the Office of the Controller-Treasurer, the two departments most involved with administering these purchasing processes. We also issued the draft report to department staff in departments that assisted us with assessing the purchases in our sample, soliciting comments on the findings and recommendations of the draft report by phone and e-mail and limited face-to-face discussions through February 7, 2014. Based on the comments received following issuance of the draft report, we prepared this final report, including written responses from departments that chose to provide them, received via the Chief Operating Officer on March 7, 2014. Issuance of the final report was delayed by a paternity leave of absence for the primary report author.

Recommendation Priorities

Each audit recommendation in this report is ranked according to its priority based on a classification adopted by the Finance and Government Operations Committee of the Board of Supervisors, as follows:

Priority 1: Recommendations that address issues of non-compliance with federal, State and local laws, regulations, ordinances and the County Charter, would result in increases or decreases in expenditures or revenues of \$250,000 or more; or suggest significant changes in federal, State or local policy through amendments to existing laws, regulations and policies.

Priority 2: Recommendations that would result in increases or decreases in expenditures or revenues of less than \$250,000; advocate changes in local policy through amendments to existing County ordinances and policies and procedures; or, would revise existing departmental or program policies and procedures for improved service delivery, increased operational efficiency, or greater program effectiveness.

Priority 3: Recommendations that address program-related policies and procedures that would not have a significant impact on revenues and expenditures, but would result in modest improvements in service delivery and operating efficiency.

Control Versus Efficiency, and the Need for a Broader Review

The findings and recommendations in the three sections of this report propose improvements in the operation of direct pay purchasing processes in the County. Underlying the use of such processes, however, is a broader policy issue that the Board

of Supervisors and County departments face-the trade-off between controls to ensure that taxpayer money is wisely spent and that laws, regulations and policies are followed, and the need for departments to efficiently provide public services. This trade-off occurs not just in procurement, but in hiring processes, accounting processes, and other instances where there are central support agencies, such as the Procurement Department, the Office of the Controller-Treasurer and the Employee Services Agency, whose job in part is to make sure that proper controls are enforced.

In the case of procurement, the issue is providing departments authority to purchase items on their own in order to save time, rather than using the traditional method of making a requisition to the Procurement Department and having a buyer in that department assist them in buying the item, usually using competitive processes among several potential vendors, in order to ensure that the lowest price is achieved.

The Management Audit Division itself promoted increased use of such processes, including development of a procurement card program, in an audit of the Purchasing Department, which is now the Procurement Department, in 1995. Our recommendations in that audit, which included raising the dollar limits under which departments could buy items on their own, and studying implementation of procurement cards, resulted from finding that 72 percent of requisitions processed by the Procurement Department at that time were for less than \$1,000, and 48 percent were for less than \$500, when the cost of staff time to process each one averaged \$98. Overall, the audit found that the cost of processing the requisitions amounted to 43 percent of their value, which we found was an inefficient use of County resources.

Similarly, the present use of direct pay codes by departments, according to the 2009 audit by the Internal Audit Division, resulted from the adoption of the SAP accounting system in 2003, which resulted in significant decentralization of the County's accounts payable function from the Controller-Treasurer to individual departments, using their own accounts payable clerks.

These changes occurred against the backdrop of severe County budget problems, starting with the local high technology recession in the early 2000s, followed by the Great Recession starting in late 2007. Staffing in the Controller-Treasurer's Office was 82 positions in Fiscal Year 1999-2000, 86 positions in Fiscal Year 2008-09, but only 74 positions in FY 2012-13. Similarly, the Procurement Department, which was staffed at up to 41 positions in 1990, and 27.5 positions in FY 1999-2000, is now staffed at 32 positions.

Staffing in departments was reduced as well. Countywide staffing fell from 16,079 positions in FY 2002-03 to 15,339 in FY 2012-13, most of this reduction occurring in General Fund departments, which fell from 10,613 positions to 8,768. Often the positions that got eliminated were clerical and support function positions that could be reduced with minimal effect on direct services provided to the public. That means trying to conduct support functions, including procurement, more quickly, with fewer players involved, which mitigates against using more formal processes that may take longer to complete. Our review of documents during this review included finding e-mails and interdepartmental memoranda that showed that certain departments regularly requested more flexibility to use direct pay processes more often, with a broader array of vendors, which they said was necessary to get the goods and services they needed in a timely manner in order to maintain services to the public. We also heard anecdotally, in talking to departments during this review, of instances where attempts to work closely with Procurement Department staff in a more traditional purchasing process resulted in delays in purchases that adversely affected the ability to serve the public.

The decision regarding the proper balance between control mechanisms and efficiency mechanisms in the procurement of goods and services is a policy decision for the Board of Supervisors, since the Board is ultimately responsible for both the stewardship of taxpayer funds, and for efficiently providing direct services to County residents.

To better inform the Board's consideration of this policy issue, the Board may want to consider an audit of Countywide procurement processes, which have not been reviewed in depth since our audit of the then-Purchasing Department in May 1995. Due to the decentralization of procurement since 1995, adding a Countywide procurement audit to the Board's annual management risk assessment program, to be prioritized among the existing authorized audits as the Board instructs, may be of interest to the Board. We would envision such an audit as addressing the following:

- A review of Procurement Department functions and performance, including whether Procurement staff are focusing on activities that have the highest potential for obtaining savings on purchases, and whether Procurement Department staffing is sufficient to meet the needs of other departments to have purchases completed in a timely manner.

- A review of purchasing functions outside the Procurement Department, such as the Materials Management function in the Health and Hospital System, which appears to operate somewhat independently of Procurement, or purchases by the Social Services Agency, which has a small purchasing unit of its own. This review would include what methods those departments are using to work with Procurement, or to ensure themselves that competitive prices are obtained.
- A review of internal purchasing processes within departments, including who is assigned authority to coordinate procurements, when competitive quotations or other competitive processes are used, and how the need for specific items is vetted. The purpose of this review would be to identify best practices within County departments that could be compiled and developed to provide guidance for all departments.

Given the growth of purchasing processes that are outside the traditional Procurement Department function, a Countywide procurement audit would inform the Board whether the existing decentralized model is achieving a proper balance between stewardship of taxpayer money and efficient provision of County services. The goal of such a review would be to ensure that, to the extent operating departments are allowed to use alternative purchasing methods that do not involve the Procurement Department, that those alternative methods include and document policies and procedures that ensure purchases are made fairly, without favoritism, and that they seek the best prices for goods and services purchased, at appropriate levels of quality.

Acknowledgements

The Management Audit Division would like to thank the many County staff that assisted with this review, particularly accounting, administrative and line staff that responded to our many queries about specific purchasing transactions with additional documentation and detailed explanations. The level of detail provided and the promptness of their responses contributed significantly to our confidence that County employees are using these mechanisms in the spirit of accomplishing the public service mission of the County.

Section 1. Improving the Procurement Card Program

Background

Since 2001, the County has provided procurement cards to employees for small purchases. A list obtained in November 2012 identified 723 cardholders, and a database of all card transactions from December 1, 2011 through November 30, 2012 reported spending of about \$8 million in about 23,000 transactions.

Problems

Comparing separation dates from County service or the current position for 112 card holders over two years found it took a median of 112 days for a card to be cancelled. A judgmental sample of transactions revealed numerous opportunities to pursue or alter Countywide contracts for various types of goods and services to generate potential procurement savings. Periodic problems were found with fraudulent third-party charges using compromised County card numbers.

Adverse Effects

Although our review found no significant instances of improper procurement card charges by County staff, not cancelling cards when cardholders leave their position creates an opportunity for abuse. Not using procurement card data to identify where County buying power could obtain lower prices through Countywide contracts does not maximize procurement efficiency. Correcting fraudulent charges is an inconvenience for staff, and is preventable.

Recommendations, Savings and Benefits

The Controller's Office and the Employee Services Agency should develop procedures to terminate procurement cards within 30 days, or on another timely basis, when an employee leaves their current position, such as including a form for termination in separation materials. The Procurement Department should pursue Countywide contract opportunities identified in this section, and develop a method to analyze transactions for this purpose going forward. The bank issuing the County's cards should be asked to randomize card numbers, to protect against fraud.

History and Requirements of the Procurement Card Program

In August 2001, the Board of Supervisors authorized the Director of Procurement to implement a County procurement card program through the State of California. After a

pilot period, in April 2002, the Board agreed to expand the program Countywide. The program, as currently structured, operates as follows:

- Departments designate which employees should receive procurement cards.
- An approving official reviews and approves, on an after-the-fact basis, the purchases of the approver's assigned cardholders, based on documentation of charges provided for each monthly procurement card bill.
- An agency program coordinator in each department oversees card issuance throughout a department and serves as a liaison to the Controller's Office and Procurement Department on the program.
- A billing official in each department official receives the approved monthly bills, with receipts, from the approving official, and categorizes the procurement charges in the proper expenditure accounts for County accounting purposes.

The program also included policies developed by the Procurement Department establishing categories of goods that are excluded or restricted from card use, single-transaction and monthly limits on the amount of purchases and how exceptions are addressed, and other requirements. The program also includes training for cardholders, approving officials, department card coordinators and department billing officials.

As described in training materials for the program, procurement cards are designed to provide an efficient and cost effective method of handling small dollar purchases, reduced cycle time and paperwork, evaluation of spending patterns, ability for Procurement Department staff to focus on high-dollar transactions with more savings potential, and Procurement Department focus on customer service versus control.

Use of the cards is extensive. A list of cardholders obtained at the start of this review in November 2012 included cards issued to 723 different County employees. Furthermore, monthly lists of procurement card transactions, provided by the Procurement Department for all months from December 2011 through November 2012, revealed a total of 23,332 transactions, at a total cost, net of refunds, of approximately \$8 million.

The remainder of this section discusses improvements to be made in the procurement card process and the use of information from procurement card purchases.

Procurement Card Cancellations Do Not Occur Timely

Procurement Card procedures describe a detailed process for applying for a card, including identifying the cardholder, their approving official, address information, telephone number, the cardholder's single transaction and monthly spending limits.

Cancellation of cards, such as when an employee leaves County service or changes cards, are processed by the County P-Card Program Administrator in the Procurement

Department, based on forms provided by the Agency Program Coordinator in each department that authorizes employees to receive cards. The Program Administrator then notifies U.S. Bank, the County's card issuer, of the cancellation.

Management Audit staff decided to assess how timely card cancellations were occurring, because a card that remains active, once the cardholder is no longer using it, provides an opportunity for abuse, because of the potential for other staff to use the card inappropriately, such as by making on-line or telephone purchases that don't require a cardholder signature, or another form of identification.

Accordingly, we requested a list from the Procurement Department of cardholder accounts that had been deleted from November 26, 2010, through November 26, 2012. Separately, we requested from the Employee Services Agency a list of employees who had separated from County service, or switched positions within the County, during that same period. We then cross-checked the lists, comparing when the employee left or switched jobs, to the account deletion date.

This analysis identified 112 deleted accounts where the cardholder left or switched jobs. The median length of time, based on comparison of dates, between the date of job separation or change, and the account deletion date, was 112 days, or approximate 3.7 months. This included 18 instances where the account was deleted prior to or on the day the employee left the position. The longest an account remained open was 472 days, for an employee that transferred from the Employee Services Agency.

This problem should be addressed by including changes in procurement card authorization in the personnel process when an employee leaves County service, or changes positions. The procurement card administrative forms include a Cardholder Account Update form to be used when an account is to be cancelled, or there are other changes to be made in the account. A copy of this form should be included in the materials completed by a staff member and their supervisor when the staff member's employment status (position classification or assignment) changes. The form should then be routinely forwarded to the Agency Program Coordinator for the employee's former department, who would then be responsible for promptly forwarding it to the P-Card Program Administrator, so that the account is deleted in a timely manner, and procurement cards do not stay active when there is no reason for them to do so.

During the exit conference process for this report, Controller's Office and Procurement Department staff also reported that a current process to periodically provide Agency Program Coordinators with a list of current procurement card holders, asking them to verify that all card holders are correctly reported, and requiring them to advise the Procurement Department that they have reviewed the list, would be expanded to occur

monthly, as opposed to the current process of providing the lists periodically, but not on a set schedule. This expansion is proposed not only to address employees who leave the County or switch jobs, but also employees whose card use is very infrequent, suggesting they may not need it. Furthermore, the Office of the County Counsel, in reviewing the draft report, noted that revisions to procurement card policies established in December 2012 also stated that the Approving Official for a card holder is responsible for notifying the Agency Program Coordinator when an employee resigns, transfers or is terminated.

We endorse the Controller's proposal, and the additional language added to the policies, but believe the most effective approach is a specific process requiring card status changes for employees leaving County service or switching jobs be reported in real time as part of the employment-related processes.

Review of P-Card Transactions Sample Finds Little Employee Abuse

As described in the Introduction to this report, the purpose of this review of direct pay purchasing processes was to determine whether the current methods as of the time of the review, as regulated within the County "provide more control, visibility and accountability." In the case of procurement cards, the arrest and subsequent guilty plea by former Supervisor George Shirakawa on charges of misusing his procurement card for personal purchases unrelated to County business heightened the need to determine whether similar behavior was occurring among other County staff.

Accordingly, Management Audit Division staff conducted a review of a sample of procurement card purchases, to attempt to identify any other instances of improper use. To do so, we obtained from the Procurement Department monthly reports of all procurement card transactions for the months of December 2011 through November 2012, and combined the monthly reports into a single database.

For each procurement card transaction, the information we received included the name of the cardholder, the department, the approving and billing officials for the card, the card account number, the transaction date and amount and the name and location of the vendor. Also provided was the merchant's name and address and a "merchant category code description," which in some cases was the name of the merchant, and in other cases was the type of good or service that merchant provided.

Based on the merchant name, the category code description, the merchant location, and assisted frequently by information obtained from the Internet about the merchant, we examined every line of the 23,000-plus-line database, and drew a judgmental sample of items to further examine. The sample was judgmental, in that based on the type of merchandise sold by a particular merchant, in relation to the department where a staff

member was making the purchase, we were trying to identify purchases that appeared unrelated to a department's functions, were inordinately large, or otherwise didn't make sense on their face. The dollar value of each transaction was one factor, but not the only factor, in selecting the sample for further scrutiny.

Our initial review identified about 1,260 transactions to be examined, by going to departments and asking to see receipts and other documentation of the purpose of the purchases. To make this process less unwieldy, we further refined the sample down to 326 items. The additional refinement included taking a random sample of purchases from merchants, such as Amazon, Target, Fry's Electronics and grocery stores, where the range of items that could be purchased is very broad.

As stated, we then went to departments and physically reviewed documentation for the sampled purchases, looking for receipts or other documents explaining the purpose of the purchases. Generally speaking, receipts were readily available for our review, attached to the monthly procurement card bills retained in each department. Where a receipt itself did not provide sufficient assurance as to the purpose of a purchase, we asked the cardholder for additional information. In every case, we received additional responses within a day or two, often accompanied by lengthy intradepartmental e-mail chains, program fliers or other documents that illuminated the reason for the purchase. We took notes on the documentation provided, showing the explanation for each of the 326 purchases we examined.

Our review of 326 purchases identified only one instance in which a County employee used a County-issued procurement card for a personal purchase. This was an employee who mistakenly used her procurement card for a personal grooming item at a cost of \$20. The purchase occurred on March 30, 2012. When the employee reviewed the monthly bill, and identified the erroneous purchase, she reimbursed the department by check on April 24, 2012.

Rather than identifying any significant misuse of procurement cards, our review found that their use reflects the County's wide array of functions, and attempts by staff to use the cards to carry out their work more efficiently. Some examples:

- Several departments used procurement cards to pay for on-line advertising and other Internet services. The Public Health Department purchased advertising on Facebook for its *Lame Reasons to Smoke* campaign against youth smoking. The Tax Collector used dice.com and monster.com to post job openings for technical staff on the Tax Collection and Apportionment System computer project, after earlier efforts working with the Employee Services Agency failed to identify qualified candidates, despite 12 interviews. The Tax Collector then decided

Internet advertising was a better way to find candidates with specific skill sets, who then went through the formal County application process.

- The Sheriff's Office used procurement cards to pay for a number of items needed for the Sierra LaMar disappearance, including computer monitors used for field operations, about \$19,000 for food for staff engaged in the investigation, typically food for 50 to 60 staff at one time, air filter cartridges for diving equipment used during the search, and iPads purchased to access software provided by the FBI and used during the search. In another law enforcement use, the District Attorney's Office uses procurement cards to pay for lodging and other costs for witnesses.
- The Probation Department, as part of its increased responsibilities for parolees under the State's realignment program, used Amazon to buy used books for job training classes for participants. By using this route, the Department obtained the books for as little as \$2 each. Also, both the Probation Department and the Sheriff's Department used procurement cards to buy welding supplies and other materials for training programs for inmates at their facilities.
- Many departments used procurement cards to buy specialized furniture and computer peripherals to assist employees with workplace health problems. In every case, these purchases were documented with information from the Occupational Safety and Environmental Compliance staff on the employee's issue, who assessed their need for the special equipment, and what was recommended.

One limitation of our review was the decision not to review charges by elected officials or the County Executive, because of the detailed reviews of these officials carried out by the Controller's Office following former Supervisor Shirakawa's arrest. Another limitation was that, although our sample included some hotel, meals and transportation charges, travel expenses were not a major focus of this review, because the Management Audit Division conducted a *Management Audit of County of Santa Clara Travel Expenses* in 2009, and chose not to repeat that analysis in this project.

Based on the analysis of procurement card charges conducted for this project, we believe the incidents involving former Supervisor Shirakawa were aberrations involving one public official who deliberately chose to evade County policy, and was initially successful because he was one of the policymakers. We found no evidence of procurement card abuse among County line staff in any department.

Procurement Card Data Evidences Contract Savings Opportunities.

In examining the database we created of more than 23,000 procurement card transactions, which included conducting Google searches of many vendors to determine the nature of goods sold, we observed that the County in many cases was buying a large quantity of goods and services from one vendor, or similar types of goods and services from several vendors. These include purchases from both on-line and brick-and-mortar vendors. These situations create opportunities for the County to use its buying power to achieve lower prices, by putting these categories of goods out to bid through the Procurement Department, and offering one vendor the opportunity to become the County's sole supplier in return for discounts. This approach also makes it easier for departments to obtain goods, by dealing with a single supplier with whom they make orders via contract releases that are charged against a maximum total dollar limit for the Countywide contract negotiated by Procurement. This is the approach taken, for example, regarding office supplies, where Procurement negotiated a contract with Staples Contract and Commercial Inc. on prices established through a national cooperative agreement.

The following discussion describes types of goods where our review of the procurement card transaction database identified potential contracting opportunities.

Individual Vendors

Our review identified a number of individual vendors with whom the County spent more than \$25,000 during the 12-month period reviewed. The Procurement Department should contact these vendors and seek contracts with discounts based on the County's volume of purchases, or pursue a competitive contracting process with these vendors and others providing similar services, to achieve savings:

Section 1. *Improving the Procurement Card Program*

Vendor Name/ City	Type of Item Sold	Number of Transactions	Dollar Value
Air Filter Control/San Jose	HVAC Eqt./Filters	205	\$26,612
All Industrial Elec. Supply/ Burlingame	Electrical Parts	141	43,809
Allied Refrigeration/San Jose	HVAC Parts	174	31,236
Almaden Press/San Jose	Printing	16	32,256
Bakemark/Union City	Bakery	12	53,787
Blair Glass/San Jose	Auto Glass	159	35,222
Bruce Barton Pump Service/San Jose	Pumps/Motors	61	26,197
Central Equipment Service/San Jose	Auto Repair Equipment	20	26,587
Commercial Mill/Milpitas	Lumber	52	28,657
D and M Traffic Services/Santa Clara	Traffic Signs/Accessories	18	44,453
Extended Stay America/ Fremont/Pleasanton	Lodging	106	43,431
Finishline Body & Paint	Truck Body Paint/Repair	20	38,921
Formatop/Campbell	Countertops/Casework	20	34,744
Good Source Solutions/Carlsbad	Institutional Food Supply	12	37,677
Harry L. Murphy, Inc./San Jose	Commercial Floor Covering	45	60,958
Home Depot/Variou	Hardware	556	57,280
Image Sales, Inc./Concord	Photo IDs/ID Readers	19	30,020
Interstate Fence Co., Inc./San Jose	Fencing Design/Installation	24	36,696
Jasper Engine Exchange/Jasper, IN	Remanufactured Auto Parts	19	31,888
Kelly-Moore	Paint/Wallpaper	162	25,420
Lawson Products/Illinois	Hardware	38	27,892
Lowe's/San Jose, Gilroy*	Hardware	469	42,097
MWI Venterinary Supply/Idaho	Veterinary Supplies	71	37,274
Nixon Egli Equipment/Ontario	Road Construction Eqt.	46	30,901
S & S Welding, San Jose	Metal Fabrication/Repair	63	27,197
Stevens Creek Toyota/San Jose	Auto Parts & Repair	<u>127</u>	<u>27,203</u>
Total		2,549	\$895,090

*The County also conducted an additional 226 transactions worth \$7,303 at Orchard Supply Hardware, recently acquired by Lowe's for a total value of nearly \$50,000.

In total, these vendors were responsible for 2,549 transactions during the 12-month period reviewed, with a total value of \$895,090, as shown in the table. If 10 percent savings were achieved as a result of developing Countywide contracts with these

vendors, rather than using piecemeal purchases via procurement cards, savings of about \$89,500 per year would be achieved.

In addition to the previous list of individual vendors with larger numbers or dollar volumes of transactions, our review of procurement card transactions also revealed several categories of purchases where the dollar values from individual vendors were not more than \$25,000, but where transactions from multiple vendors selling seemingly similar types of items, based on Google searches, did exceed that value. As in the previous examples, putting such categories of items out to bid for exclusive Countywide contracts, based on set prices for regularly purchased items, or a blanket percentage discount for items ordered from the vendor, may generate significant savings for the County. The following discussion highlights key categories of goods where potential savings was identified.

Dining

County staff purchase meals out, or have food catered in from commercial food establishments, for staff meetings, training, recruitment interview panels, law enforcement emergencies, Board of Supervisors swearing-ins and other public events, and other County purposes. As an example of one requirement for meals, the existing collective bargaining agreement with the Committee of Interns and Residents of the Service Employees International Union, who work at Valley Medical Center, provides up to \$49 per week per resident for food purchases for lunch-time medical conferences for each resident, which can include food purchases from outside vendors.

Our review identified a number of firms that receive regular business from County staff, as shown in the following table:

Section 1. *Improving the Procurement Card Program*

Vendor Name/ City	Number of Transactions	Dollar Value
Bold Knight, San Jose	19	\$2,627
Casa Vicky, San Jose	5	4,933
Famous Dave's, San Jose	8	1,094
Golden Harvest Restaurant, San Jose	17	14,243
Happi House No. 1 & No. 2, San Jose	5	1,776
Le Boulanger, San Jose	21	8,387
Panera Bread, Various	81	10,461
Rosy's Fish City, San Jose	3	4,696
Maggiano's	2	3,043
Thai Chili Cuisine, Santa Clara	35	10,175
The Bread Basket, San Jose	5	2,074
The Drying Shed, San Jose	3	5,922
Togo's, Various	51	10,901
Tony Soprano's, San Jose	75	14,784
Union Chinese Restaurant, San Jose	43	5,835
Yiassoo Restaurant, San Jose	25	3,255
Boston Market, San Jose	20	6,626
Erik's Delicafe, San Jose/Morgan Hill	12	4,277
Lee's Sandwiches, San Jose	25	2,939
Starbuck's, Various	57	1,644
Subway, Various	36	6,875
Sweet Tomatoes, San Jose	9	1,102
Una Mas Mexican Grill, Campbell	87	18,665
Classical Catering, San Jose	52	15,060
Elegant Events Catering, San Jose	6	2,396
Specialty's Café and Bakery, San Jose	31	7,581
Greenfish Catering, San Jose	22	7,700
Getquik, Inc., On-Line Catering Service	80	14,689
Total from 28 vendors	835	\$193,760

As the table shows, there were 835 purchases from these 28 vendors, at a total cost of nearly \$200,000. The Procurement Department should consider putting out a request for bids to identify a stable of food providers, of various food types, in the hope of generating a blanket percentage savings from retail prices. If a 10 percent savings were

achieved, based on the expenditures in the table, nearly \$20,000 annually would be saved.

Promotional Items

During the 12-month period reviewed, County departments purchased a variety of promotional items, such as lanyards, USB storage devices, tote bags, pens, etc., costing nearly \$71,000 for distribution to the public at events and to employees as morale boosters, all for the purpose of promoting the County's work and programs. These purchases were from a wide variety of vendors, as shown in the following table:

Vendor Name/ City	Number of Transactions	Dollar Value
Motivators, Inc./New York	8	\$10,390
Promo Direct/Nevada	1	564
Prudent Promotions/New Jersey	5	1,643
Quality Logo Products/Illinois	1	1,226
Discount Mugs.com/Florida	2	985
Baudville, Inc./Michigan	5	2,280
Logo Express, Inc./San Jose	3	2,646
Positive Promotions/New York	9	5,402
Customink T-shirts/Virginia	1	568
Monroe Classic, Inc./San Jose	2	1,928
National Pen Co./San Diego	5	3,092
4 Imprint/Wisconsin	15	14,885
Crestline Co., Inc./Maine	4	2,084
National Printing Company/San Jose	13	14,001
Jam/Massachusetts	4	2,158
Just Buttons/Connecticut	1	113
Button King/Visalia	1	2,659
TJM Promotions/Florida	1	335
K-Log, Inc./Illinois	1	886
Comtread Promo USB/Florida	2	2,483
Myron Manufacturing/New Jersey	1	374
MTM Recognition/	1	69
CAS Enterprises, LLC	<u>1</u>	<u>189</u>
Total	87	\$70,960

This list again provides an opportunity to identify one or several vendors with whom Countywide contracts could be negotiated to obtain these items, in return for savings. Such contracts could also make the process of acquiring these items easier, by providing vendors that already have access to the County seal and other promotional information. If 10 percent savings was achieved by this step, about \$7,100 would be saved annually.

Safety Equipment

County public safety personnel, including the Sheriff's Office, Office of the District Attorney and Probation Department, purchase holsters, knives, flashlights, uniforms and other work related equipment using procurement cards, from various on-line and brick-and-mortar sources, with purchases totaling about \$72,000 during the period reviewed, as shown in the following table:

Section 1. *Improving the Procurement Card Program*

Vendor Name/ City	Number of Transactions	Dollar Value
Safariland/Florida	10	\$4,796
Cabela's.com/Nebraska	1	289
Galls, Inc./Kentucky	19	5,773
Summit Uniform Corp./San Jose	6	420
Ammo Bank Ammunition	1	71
U.S. Cavalry	1	401
5.11 Tactical/Modesto	12	1,089
Cold Steel/Ventura	2	663
Bagmaster/Florida	1	498
Refrigiwear/Georgia	3	947
Grip Force Adapters/Ohio	1	81
LC Action Police Supply/San Jose	36	33,493
Sig Sauer, Inc./New Hampshire	1	395
Smartstun/Texas	1	227
Tactic Tailor, Inc./Washington	1	977
Orion Safety Products/Maryland	1	624
Brownell's Inc./Iowa	10	3,457
Comade/Santa Ana	1	3,244
Colt Defense/Connecticut	1	450
Eagle Optics/Wisconsin	1	1,398
Glock, Inc./Georgia	6	2,896
HK Parts/Utah	1	273
Midway USA/Missouri	3	394
Midwest Shooter Supply/Washington	1	203
REI.com/Washington	2	244
Imagination Embroidery/San Jose	2	546
Bay Area Uniforms and Apparel/San Francisco	2	1,385
Copley's Labware/Connecticut	1	160
Gibson & Barnes/El Cajon	2	2,270
AramSCO/New Jersey	6	2,057
The Mallory Co./Washington	<u>7</u>	<u>2,711</u>
Total	143	\$72,432

As in the previous categories, this list suggests an opportunity for additional savings and convenience by identifying one or a few vendors to purchase safety equipment for an additional discount over posted prices. The Procurement Department should work with the public safety agencies to identify specifications for the most common items purchased, and then issue a request for bids to vendors to supply them. If 10 percent savings were achieved, about \$7,500 would be saved annually.

Based on these examples of individual vendors or categories of items where additional savings through contracts are possible, we also recommend that the Procurement Department use procurement card information periodically, perhaps every two to three years, to assess the potential to develop Countywide contracts for frequently purchased items, reflecting changes in purchasing patterns. The Department could do so by sorting information based on Merchant Category Codes, which provide information about the types of items particular vendors sell, and then using inquiries to departments, Google searches, and other relevant information to identify specific vendors, or categories of vendors, with whom such agreements should be pursued. In total, the potential savings from the previously described categories, based on a modest 10 percent discount, would amount to about \$123,000 annually.

Procurement Card Information Shows Existing Contract Weaknesses

In reviewing the detailed information maintained by County departments for the 326 procurement card transactions we reviewed, we observed that departments regularly attempted to comparison shop in making purchases, particularly from Internet-based retailers, usually going to multiple sites in search of the best price for items.

We also discovered instances where this comparison shopping provided lower prices for departments than were achievable from existing contracts negotiated by the Procurement Department. This occurred on nine occasions in our sample with the contract for SHI International Corp. for computer peripherals, on one occasion with the contract with CCT Technologies, Inc. (Computerland of Silicon Valley), which is also for computer peripherals, on five occasions with the contract with the contract with W.W. Grainger for industrial supplies, equipment, janitorial supplies, etc., and on two occasions with the contract for cellular phone service with Verizon, which includes replacement batteries, phone charges and other phone peripherals.

The frequency of instances in our sample where comparison shopping found prices cheaper than those on these Countywide contracts is a concern, because if some staff are

not comparison shopping against the contracts, the potential for additional savings is being lost. It also suggests that some items under the contracts may have become so commoditized, with extensive price competition among vendors that it may be more effective for departments to shop for the best prices on their own, rather than using a Countywide contract. Therefore, we recommend that the Procurement Department advise departments that in purchasing standard computer peripherals, and in purchasing industrial supplies, that they should comparison shop against the Countywide contract, buy at the lowest price when possible, and report instances where Countywide contracts are not the cheapest back to Procurement. Procurement should then use this information to verify comparability of product quality, and to attempt to get Countywide vendors to price match against the competition.

During the exit conference process for this report, Procurement Department staff concurred that the lowest price should be sought for this equipment, but noted that County-contracted vendors can add value in some cases, by assisting departments in identifying the item that best meets their needs at a fair price, when the lowest-priced item might not. Accordingly, the Department said Departments should give the contracted vendor a chance to match a price for the same item found elsewhere, before going outside the contracted vendor. We agree with this approach, while also retaining our recommendation that departments report such instances to Procurement, as a source of information it can use in negotiating Countywide contracts. This recommendation applies not only to the computer peripherals and industrial supplies where we found examples of this problem in our review, but to any other categories of goods where departments identify this problem.

Sequential Card Numbers Increases Risk of Fraudulent Charges

As part of the judgmental sample of 326 procurement card transactions we examined, we also examined every transaction, 35 in all, that occurred in a foreign currency, because we felt there could only be limited circumstances in which such use was justified. The review of these transactions revealed that except for three that were part of a Social Services Agency-authorized trip by a staff member to Russia, all such charges were fraudulent uses of an employee's card number without their knowledge. We verified that such charges were reported by the cardholder, disputed with the credit card issuer, via a form employees fill out when this occurs, and were credited back to the County in subsequent billing periods.

Although the loss of such charges is to the merchant selling an item, or the credit card issuer, and not to the County, such fraudulent charges are inconvenient for employees, and should be avoided if possible. Such charges easily occur when purchases can be made using credit cards by telephone or via the Internet, without the purchaser providing a signature or additional identification.

A large number of the fraudulent charges related to two procurement cards held by staff members in the Building Operations Division of the Facilities Department. When we were reviewing the disputed charges, we were advised by Department accounting staff that subsequent to the period we were reviewing, there had been several additional incidents of fraudulent charges on Division procurement cards. Reviewing information on those additional fraudulent charges and on Division procurement cards in general, we found that a number of its cards had card numbers that were close to each other, because they were issued about the same time. Although that was not an issue with the card that had the largest number of fraudulent charges in our sample, a second card, which had two fraudulent charges, was within 122 digits of another card that had fraudulent charges in a later period, and was 26 digits from a third card where fraudulent charges later occurred.

Due to the County's policy of paying its procurement card bills monthly, then having staff review and verify the bills after payment, fraudulent charges are normally caught only after they occur. It therefore is logical that someone who is successful in using a County card number for fraudulent spending might try and use another card number that is close in sequence in hopes of repeating the theft. In order to limit the occurrence of such fraudulent charges going forward, we recommend that the Procurement Department, as the primarily liaison to U.S. Bank, the County's card issuer, contact the bank to determine if it is possible to randomize the numbers when a number of new cards are issued at the same time, which would make such fraudulent use of County card numbers by third parties more difficult.

CONCLUSION

As of November 2012, the County had 723 active procurement cardholders, and expenditures for a 12-month period ending that month were about \$8 million. It took a median of 112 days for cardholders who separated from County service or their current position to have their account closed, which creates the potential for abuse. Furthermore, review of a judgmental sample of 326 procurement card transactions over a one-year period found only one instance of an inappropriate use, but found

opportunities existed to better use procurement card information to identify opportunities for Countywide contracting, and to identify weaknesses in existing Countywide contracts. Our review also found issuance of procurement card numbers in close sequence may increase opportunities for fraudulent use of County card numbers by third parties.

RECOMMENDATIONS

It is recommended that:

- 1.1 The Employee Services Agency, Controller's Office and Procurement Department ensure that procurement card termination forms are included in the packet of documents for employees who separate from County service or change positions, so that the forms are filled out and the accounts terminated as part of that process. (Priority 1)
- 1.2 The Procurement Department utilize procurement card information to identify additional opportunities for Countywide contracting, both with individual vendors and across categories of goods purchased, as described in this section. (Priority 1)
- 1.3 The Procurement Department request Departments using procurement cards to comparison shop against Countywide contracts, require departments to give contracted vendors the opportunity to match prices identified elsewhere, and have departments report instances where non-contract prices are less, so contracts can be renegotiated or elimination of such non-competitive items can be eliminated from contracts. (Priority 2)
- 1.4 The Procurement Department and Controller's Office request U.S. Bank to randomize the credit card numbers issued on the County's accounts. (Priority 1)

SAVINGS AND BENEFITS

Closing procurement card accounts as part of the employee separation or transfer process would reduce how long such accounts are open after the account-holder leaves, reducing the potential for abuse of such cards. Better using procurement card information to identify contracting opportunities would permit procurement savings through lower prices. A 10 percent savings across the vendors and commodity

categories identified in this section would produce savings estimated at approximately \$123,000 annually. Comparison shopping against Countywide contracts would also generate savings, by potentially permitting renegotiation of the contract prices, or at least alerting departments to the potential for lower prices outside the contracts. Randomized procurement card numbers would reduce the potential for fraudulent use of card numbers by third parties.

Section 2. Evaluating the Field Purchase Order Process

Background

Field purchase orders are a direct payment method where a department prepares a formal purchasing document for a vendor, receives the goods and an invoice, and pays it, without Procurement Department involvement. The appropriateness of the purchase, obtaining competitive quotes, and other purchasing control issues are reviewed only within the acquiring department. This method accounted for up to 22,374 transactions with a value of \$30 million during the 12-month period reviewed.

Problems and Adverse Effect

Examination of a judgmental sample of 378 field purchase orders found none that were not for County business purposes. However, documentation was less thorough and more varied by department than for procurement card purchases discussed in Section 1. Other problems identified included: 1) Health and Hospital System use of a separate electronic purchasing system, making it more difficult to review its purchases; 2) use of contractors for repair and maintenance work that potentially could be done by existing or additional County staff, including some contractors receiving more than \$100,000 of work without a formal contract, 3) inconsistent use of competitive practices for purchases, failing to maximize savings, and; 4) additional opportunities for Countywide contracting by analyzing field purchase order data.

Recommendations

The Procurement Department and Controller's Office should expand the current procurement card training to include training on field purchase order practices, including the need to use competitive purchasing methods and to better document purchases by attaching relevant documentation to field purchase orders in the SAP system. The Santa Clara Valley Health and Hospital System should be required to switch from its current PMM purchasing system to SAP, so purchases can be readily tracked and analyzed by County staff. Policies should also be established for when crafts contractors are used, and formal Countywide contracts should be negotiated with these firms. These steps will maximize control of this purchasing process and provide maximum opportunities for cost savings.

The Field Purchase Order Process

Field Purchase Orders (FPOs) are a direct payment method departments are authorized to use for purchases of less than \$5,000, in situations where, for example, a vendor will not accept a procurement card for payment, and no other supplier is available,

according to policies established by the Procurement Department in 2011. Departments using a field purchase order prepare documentation similar to a standard County purchase order, which includes requirements for evidence of insurance by the vendor, language indemnifying the County against liability, and other standard terms and conditions. A purchase order number is provided, along with the vendor name and address, delivery address, date and method for the purchase, and a thorough description of the items to be purchased.

However, a field purchase order does not involve the Procurement Department in the purchasing process. Consequently, issues such as the appropriateness of the purchase, obtaining competitive quotes or bids to ensure the best price, or other purchasing-type controls, are only exercised within the acquiring department, without oversight by the Procurement Department or other outside authority.

Use of this purchasing mechanism is extensive. A database of field purchase order purchases obtained by the Management Audit Division from the Procurement Department for the period from December 2011 through November 2012 included 9,295 lines in 4,654 individual purchase orders, as orders frequently included multiple items or services being purchased. Total value of the purchases was about \$4.9 million. Subsequent to the review of this database, Procurement staff provided a separate database described as field purchase orders from the Pathways Materials Management (PMM) purchasing system in the Santa Clara Health and Hospital System. That database included 38,170 lines on 17,720 individual purchase orders, with a value of \$25.1 million, although as will be explained later in this section, the number and value of HHS orders is probably very overstated.

No Evidence of Malfeasance, But Documentation and Use of Competitive Processes Could Be Improved

As in the case of the procurement card review discussed in Section 1, our primary goal in reviewing field purchase orders was to determine if there were any instances where this purchasing method was being used by County staff to purchase items for personal use, for other inappropriate purposes, or in a manner inconsistent with County procedures.

Accordingly, as in the case of procurement cards, we examined a judgmental sample of field purchase orders, using the database provided by the Procurement Department, and focusing on purchases where the reason for the purchase was not clear. The sample, for this database, which did not include PMM purchases by the Health and Hospital System, included 642 items or services on 318 individual field purchase orders. We selected the sample after reviewing text descriptions in SAP for purchases, which in

many cases were sufficient to determine the reason for the purchase, and by gathering supplemental information from Google searches. For the sample, we again requested documentation of each purchase from departments.

As in the case of the procurement card transactions reviewed in Section 1, we found no instances of purchases that were not for a legitimate County-business-related purpose. Also similar to Section 1, departments quickly provided supplemental information and explanations for purchases where documentation we reviewed in their offices or elsewhere was not sufficient. This occurred more frequently for fixed purchase orders than for procurement card purchases, and tended to vary based on a particular department's procedures.

For example, the Department of Public Health, the Social Services Agency and the Department of Parks and Recreation all routinely scan and attach requisition documents, invoices and other explanatory information to field purchase orders in the SAP accounting system. That documentation was usually sufficient to answer our questions. On the other hand, our sample of Social Services Agency purchases included one for food for an off-site training, and another for cookies for a meeting. Neither FPO included attaching the Non-Travel Business Meal Expense Voucher thoroughly documenting the purpose of the food purchases, who consumed them, etc.

By contrast, the Roads and Airports Department at the time of our review maintained this information in paper files. In some cases the documentation for a particular purchase was only a handwritten invoice or receipt from the vendor, with limited information on what was purchased and how it was to be used, requiring additional explanations to be requested. Another approach is in Fleet Management, where FPOs for outside vehicle repairs often did not provide the vehicle number and nature of the repair, which were maintained in Fleet's separate work order system. Sometimes the FPOs referred back to a work order number, but not always.

Complicating this documentation issue is many departments using field purchase orders with vendors that clearly would accept procurement cards, even though procedures issued by the Procurement Department clearly state that FPOs are supposed to be used only with vendors that don't take procurement cards. Some examples:

- Our sample included 29 FPOs in the Department of Parks and Recreation that were labeled payments to Citibank. Further review of documentation revealed that these were in fact purchases from Home Depot stores, with the Department remitting payment after-the-fact to the hardware firm's bank. Section 1 included Home Depot among the entities from whom the County makes numerous procurement card purchases. Parks Department fiscal staff reported that there

was no formal agreement with Home Depot for this pay-by-credit arrangement. That Department should be using procurement cards, which it possesses, for these purchases. We also note that one of the purchases was another situation, as discussed in Section 1, where Home Depot prices were less than the Countywide W.W. Grainger contract for the same items. Another purchase was one where the staff making indicated they weren't aware of the potential/requirement to use a Countywide contract, such as Grainger.

- Numerous departments used field purchase orders to buy items from Fry's Electronics, which was also a frequent vendor for procurement card purchases. Again, based on the Procurement Department policies, procurement cards should have been used for these purchases, and receipts provided as part of the procurement card verification process.
- The Social Services Agency spent about \$1,500 with LC Action Police Supply to outfit nine welfare fraud investigators with safety equipment, after assuming that function from the District Attorney's Office in 2011. As noted in Section 1, this vendor also was the subject of many procurement card purchases, which should have included those from the Agency.

The FPO policies also encourage use of competitive purchasing methods, stating:

"Departments are encouraged to obtain competitive quotes from more than one vendor whenever possible in order to demonstrate that the price paid is fair and reasonable. Orders for Field Purchase orders should be awarded based on lowest price, provided the quote is responsive and the vendor has been deemed responsible. . . . To the extent possible, departments should rotate vendors from which they solicit quotes, to eliminate the appearance of favoritism, fraud or collusion."

Departments' performance in meeting these standards was somewhat mixed. Often, departments made vendor selections they documented as being based on a vendor's past performance and the convenience of their location, rather than price. Some examples:

- Our sample included three vehicle repairs by the Airports Department, for three different vehicles, one each at Reid-Hillview, South County and Palo Alto airports. Each repair occurred at a shop near the airport location, with no evidence in the FPO documents that competitive quotes were obtained. It appears these repairs violated the Board of Supervisors Comprehensive Vehicle Policy, established June 21, 2010, which states in Section 3.52.3.10 that

“Departments shall use FAF maintenance and repair services for all County vehicles.” To the extent that some exception to this policy is being provided for these vehicles by Facilities and Fleet, that exception should be documented in writing, including making sure that the Airports Department has the proper workmanship certifications and guarantees for repairs made by non-County mechanics, in order to protect the County against liability resulting from faulty repairs.

- Similarly, the Parks Department had lock repairs and extra keys made for one of its park kiosks. The basis for the vendor selected, according to an e-mail was “Closest to the park-3 minutes away.” Another repair, to a trailer used by rangers, was taken to a San Martin repair shop, whose selection was explained by the location of the trailer, parked at a Sheriff’s Department substation a mile away. The staff person who chose the vendor said they were told the alternative would be to have Fleet Management do the repair in San Jose, adding “I was told that the shop (selected to do the work) is reliable, reasonably priced, and rapid. I work in a Gilroy field station, hauling a trailer around San Jose is not my idea of a good time.” A third repair, for electrical work at Los Gatos Creek Park, was awarded to a vendor described as “low bid and . . . produces high quality work,” although the specific project did not include quotes or bids. The responsible staff person stated he gets quotes for work exceeding \$2,500, but not for smaller projects. However, the \$2,500 informal limit is not authorized in the FPO policies.
- Another example is evidence bags used by the Crime Lab, part of the District Attorney’s Office. When asked about vendor selection, we were advised that the current vendor has been used since at least 2008, and was selected by staff that is no longer with the lab. Prior to that, another vendor was tried, and law enforcement agencies complained about the poor quality of the bags, and the Department returned to this vendor. The bags are not carried by any of the County’s contract vendors.
- The Clerk-Recorder’s Office used, for commemorative pins for an off-site training/retreat, a vendor it has used before for similar work. “They have all our specific parameters of our requirements,” staff responsible for the purchase reporting, adding they had telephoned County contract vendors, who said they could not do similar work.

Our review also found numerous instances where competitive processes were used, including the following:

- Environmental compliance staff for Roads and Airports report having a pool of contractors they select from for testing and repairs to underground storage tanks at their facilities. Usually the selection is based on the nature of the work and each firm's areas of expertise, as well as response time in emergencies. Roads staff also reported using two different vendors for saw repairs at South Yard. One is very close to the yard, another is 10 miles away. Staff initially used the closer firm, but more recently switched to the other, because it's "quality of paperwork" was better in terms of documenting what work was done and how long it took. The backlog of work at each firm is also considered, so repairs are done timely. Roads also reported getting competitive quotes for tree removals, and for duffle bags and t-shirts given away at a Department retreat.
- The Sheriff's Office used a private vendor to install a truck-bed cover and deadbolt locks on vehicles used by one of its task forces, after determining from quotes that the cost of the work would be less than using Fleet Management. The work was paid for from State funds supporting the task force. The vehicles were acquired as non-cash assets through the asset forfeiture program, and the use of a cheaper vendor, after checking with Facilities and Fleet, was appropriate.
- The Environmental Health Department purchased laptops for its inspectors using FPOs based on a process in the mid-2000s assisted by the Procurement Department. FPOs are used because only a few of the devices are purchased at a time. The vendor now used was selected in conjunction with Procurement, and continues to provide the low prices it did at the time of selection.
- The Probation Department, needing repairs to a refrigerator in the Juvenile Hall kitchen, solicited quotes and negotiated a contract with a vendor to do the work.

We believe the difference in the level of documentation of the purpose for purchases, and of the use of competitive procurement methods, or the basis for not using them, relates to training. All procurement cardholders, approving officials and billing officials receive specific training regarding that program, which emphasizes the requirement to review procurement card bills monthly and provide receipts and other documentation for all purchases, including when competitive quotes are obtained, and if not, why not. While a Materials Management Team comprised of Procurement Department and Controller's Office staff developed training materials regarding field purchase orders as

a follow-up to the 2009 audit, it's not clear who received them, or what formal training has accompanied the written documents.

Therefore, we recommend that either the existing training for procurement cardholders be expanded, to include training for County staff that regularly process field purchase orders, or that additional training be created, specifically to remind users of this method of the need to properly document FPOs as to the purpose of the purchases, and the use of competitive methods. This training should include the process whereby receipts, quotation documents, requisitions or other explanatory materials can be scanned and attached to field purchase orders, as some but not all departments are currently doing. This training should be based on materials developed by the Procurement Department and Controller's Office. This additional training would ensure that field purchase orders are properly documented.

Frequently Used Crafts Vendors Should Have Contracts

As in the case of the procurement card sample discussed in Section 1, our review of field purchase orders revealed various opportunities to negotiate Countywide contracts and potentially obtain lower prices. In fact, where a single vendor is getting more than \$25,000 in work via FPOs, the existing policies state that a Countywide contract negotiated with the assistance of the Procurement Department should be pursued. This situation was particularly pronounced in the number of vendors and amount paid to carry out plumbing, electrical, painting and other building maintenance and repair work that would now or in the past have been carried out by County staff. The following table shows, by craft, the contractors, the volume of work received, and the dollar value paid.

<u>Vendor Name</u>	<u>No. FPO Lines</u>	<u>Amount Paid</u>
<i>Plumbing</i>		
Kelly, Gary K.	205	\$34,993
Hamanjy, Jack	30	4,440
Lake, Kenneth	15	1,431
BP Plumbing	130	27,838
Cal-Steam	88	7,923
Ciari Plumbing	48	20,592
Ray L. Hellwig Plumbing and Heating	<u>197</u>	<u>110,385</u>
Subtotal-Plumbing	713	\$207,602
<i>Painting</i>		
Bento, Armando	16	11,501
Pyramid Painting, Inc.	26	17,249
Jerry Colombo, Inc.	<u>3</u>	<u>3,420</u>
Subtotal-Painting	45	32,170

Section 2. Evaluating the Field Purchase Order Process

<i>Flooring</i>		
Frederick's Carpeting and Linoleum	365	\$172,309
Harry L. Murphy, Inc.	<u>5</u>	<u>19,371</u>
Subtotal-Flooring	370	191,680
<i>Floor Cleaning</i>		
Stanley Steemer	41	22,918
Premier Maintenance Group, Inc.	<u>6</u>	<u>4,325</u>
Subtotal-Floor Cleaning	47	27,243
<i>Tree Trimming and Removal</i>		
Apolinar, Eliseo	12	18,615
Paradise Landscape	1	650
Commercial Tree Care	72	28,675
Anderson's Tree Care Specialists, Inc.	4	6,340
Fernandez, Jess	1	325
Smith, Richard	5	7,800
Bayscape Management Inc.	2	5,370
Pacific Firewood & Lumber Co.	<u>1</u>	<u>4,999</u>
Subtotal-Tree Trimming and Removal	98	72,774
<i>Swimming Pool/Fountain Maintenance</i>		
McFall, Guillermo B.	43	13,328
Aquatic Commercial Industries	25	11,677
Padilla Pool Remodeling Inc.	5	11,885
MC2 Pool and Spa, Inc.	<u>34</u>	<u>13,955</u>
Subtotal-Swimming Pool/Fountain Maint.	107	50,845
<i>Concrete & Paving</i>		
Noah Concrete Corporation	4	19,226
<i>HVAC Water System Repairs</i>		
Cannon Water Technology	56	48,598
Soares Plumbing and Mechanical, Inc.	<u>29</u>	<u>66,976</u>
Subtotal-HVAC Water System Repairs	85	115,574
<i>HVAC Maintenance and Repairs</i>		
Air Systems Inc.	67	33,551
Schneider Electric	62	62,477
Therma	<u>84</u>	<u>140,279</u>
Subtotal-HVAC Maintenance and Repairs	213	\$236,307
<i>Kitchen Equipment Repairs</i>		
Prime Mechanical	238	\$190,796

Section 2. Evaluating the Field Purchase Order Process

<i>Electrical and Data Cabling</i>		
Briarwood Communications	427	244,718
RK Electric	<u>63</u>	<u>100,605</u>
Subtotal-Electrical and Data Cabling	490	345,323
<i>Electrical Repairs</i>		
Sprig Electric	30	32,355
Wittmers Electric, Inc.	84	32,298
San Jose Electric, Inc.	<u>4</u>	<u>4,271</u>
Subtotal-Electrical Repairs	118	68,924
Total-All Categories	2,528	\$1,758,464

These contractors in many cases worked for various departments, but often either for the Facilities Department or the facilities unit at Valley Medical Center. Facilities Department management stated that planned maintenance work, and small unplanned jobs taking only one or two man-days are carried out using County staff. However, it was also reported that for plumbing work, one of the contractors was primarily given jobs unclogging sinks and other minor work that County craftsmen would rather not do, in favor of more challenging repair projects that fully use their skills. On the other hand, major maintenance projects that would cause County craftsmen to fall behind on reported work orders, or work requiring special skills, such as environmental controls programming in HVAC systems, or sheet metal work, are regularly outsourced.

Facilities Management stated during the exit-conference process for this report that carrying out in-house work now performed by these contractors would require hiring additional staff, and that contractors are used to supplement where County staff is insufficient, or for types of work that occur infrequently. Management also reported a practice of consulting with representatives of Service Employees International Union 521 whenever a contractor is being used for work exceeding \$35,000 in value that could theoretically be done by SEIU-represented staff. This consultation is needed infrequently, since these contractors generally perform work that otherwise would be carried out by construction craftsmen who are represented by a different union whose contract does not address issues of contracting out work.

Facilities also stated that the contractors listed typically have been used for many years, and the quality of their work and their low prices had been vetted over time, even though none have formal contracts with the County.

Meanwhile, facilities maintenance managers at the Health and Hospital System acknowledged that they need to do a better job creating and documenting a competitive selection process to develop formal contracts for work in excess of the \$25,000 standard for use of repeat FPOs, and stated they are beginning that process, noting that a shortage of resources within HHS and the Procurement Department slows that process.

We recommend that the County Facilities Department, in conjunction with the facilities management staff in the Health and Hospital System and other departments with large numbers of facilities, develop policies that address when County staff will be used for maintenance and repair work, versus contractors, and a process to develop formal contracts with the crafts vendors that currently do not have them, and are receiving work without a formal contract that exceeds \$25,000 annually. This process includes situations where a group of contractors are providing similar services, and consolidating the work to one contractor using a competitive bidding process has the potential to provide cost savings. Based on total expenditures in the various crafts categories of \$1,297,360 over the 12-month period reviewed, a 10 percent savings reduction from these changes would save nearly \$130,000 annually. Such a policy would most properly be included in Chapter 5 of the Board of Supervisors Policy Manual, which addresses County contracting policies.

Other Opportunities for Contract Savings

As in the case of the procurement card transactions reviewed in Section 1, our review of field purchase order transactions revealed numerous opportunities to obtain savings by negotiating additional Countywide contracts at reduced prices with vendors, either individual vendors with whom we have large purchasing volumes, or categories of vendors from whom we are buying similar goods, that could potentially be consolidated into competitively bid contracts. Many of these categories for field purchase orders were similar to those we found for procurement cards. These included:

Institutional Foods-We identified numerous vendors from whom significant values of food products, ranging from canned foods to meats to baked goods to condiments were being purchased, primarily for use in Department of Correction and Probation Department facilities, without a Countywide contract. The vendors and amounts are:

Citadel Enterprises, canned foods	\$62,226
LA Foods, condiments	4,068
Good Source, meat, cereal, condiments	39,902
San Jose Valley Veal, meat	12,801
Westco Bakemark, baking supplies	32,163
Zacky Farms, lunch meats	17,444
Gold Star Foods, beef, cheese, etc.	14,133
School Purchasing Group, Inc., meat	1,355
New Horizon Foods, Inc., flour, baking supplies	32,971
CHS, Inc., chicken strips, sausage, flavored beef	14,924
Global Foods, Inc., cereal, fruit cups, condiments	33,952
The Food Exchange, LLC, bulk cereal, Danish	7,906
National Food Group, Inc., rolls, pastries	8,177
Farmer Brothers Co., coffee	9,507
Howell Mountain Distributors, milk substitutes	<u>1,945</u>
Total	\$296,476

During the course of this audit, Countywide contracts have been initiated with both Good Source and National Food Group. Additional contracts should be negotiated with the listed suppliers, or items added to existing contracts with suppliers of similar goods, to achieve cost savings. A 10 percent savings by consolidating these contracts and competitively bidding them would result in savings of about \$30,000 annually.

Institutional Clothing/Toiletries-Our sample included field purchase orders totaling \$65,188 with Bob Barker Company. It is not clear why these purchases were made with FPOs, since the County has contracts for such supplies dating back to the mid-2000s with this vendor for these sorts of items, which therefore should have been purchased using contract releases under the existing contracts, rather than new FPOs. The purchases were made by the Department of Correction and Probation Department, the Facilities Department and the Health and Hospital System. The Procurement Department and the affected departments should review the FPOs to determine if contract prices were received, and seek rebates if they were not, and to determine why the normal purchasing method was not used. If it was because the items purchased were not include as part of the existing contracts, the list of contracted items should be expanded, based on the amount purchased. Access to the contract should also be provided to all departments that need it.

Custodial Supplies-Our sample included purchases from several custodial supply firms for paper towels, toilet paper, trash can liners, soaps, etc. These included:

Clean Source/Interline Brands	\$141,910
TADCO Supplies	<u>423,892</u>
Total	564,802

A review of the Procurement Department's list of Countywide contracts shows that a contract was negotiated with Interline in July 2011, shortly before the period covered by our sample. It is possible that departments did not use the contract, buying via contract releases, because they were not aware of it. A large number of the Interline purchases were also from the Health and Hospital System, and therefore may have been shown as FPOs due to a reporting problem discussed later in this section. No Countywide contract exists for TADCO. Such contracts, as well as the County's contract with W.W. Grainger for custodial/maintenance supplies, should be expanded to include items that are being purchased using FPOs, and a Countywide contract should be negotiated with TADCO. A 10 percent savings would potentially amount to about \$56,000 annually, based on the value of items in our sample.

Auto Parts-Our sample included a high dollar value of purchases, primarily by Fleet Management but also from other departments, from the following auto parts suppliers, not on Countywide contracts:

Royal Brass, Inc.	2,969
PAPCO	32,996
Golden State Supply, Inc.	121,828
Vic Hubbard Speed and Marine Corp.	97,272
Fast Pro, Inc.	28,781
B & A Friction Materials, Inc.	12,969
Kapa Auto Body Parts, Inc.	<u>9,661</u>
Total	\$306,476

During the period of this review, a Countywide contract was negotiated with PAPCO. Additional contracts should be negotiated with these suppliers, or with suppliers of similar products, on a competitive bidding basis. Saving 10 percent via this method would result in savings of about \$30,000 annually.

Law Enforcement Uniforms and Safety Equipment-Our sample included FPO purchases for uniforms, badges, safety equipment, gun-related accessories and similar items from a number of vendors, by various departments, including Probation, Corrections, District Attorney, Social Services Agency, Agriculture and Facilities. The vendors are as follows:

Summit Uniforms	\$25,664
Sun Badge Co.	12,324
Adamson Police Products	6,108
Natchez Shooters Supply	2,548
Peacekeeper Products International	1,186
Safariland	1,745
Mallory Safety and Supply, LLC	10,135
California Safety and Cleanroom	3,174
Sanderson Safety Supply Co.	9,379
Statewide Safety & Signs, Inc.	5,653
Cintas First Aid & Safety	30,448
Brownell's Inc.	1,429
Cabela's Inc.	1,133
Robert & Elizabeth, Inc.	211
LC Action Police Supply	28,174
Irvine & Jachens, Inc.	76
Absolutely Uniforms	3,605
L.N. Curtis & Sons	8,440
Workingman's Emporium	5,585
Cutty Clothing	<u>2,754</u>
Total	\$160,771

There was a contract with Summit Uniforms during the period covered by our sample, so it's not clear why FPOs were used for these purchases, rather than contract releases. These purchases should be researched to determine if contract prices were obtained, and rebates requested if not. Other vendors on this list also had contracts, but only for limited purposes. For example, LC Action Police Supply was contracted during the review, but only for purchasing body armor, and was renegotiated near the end of the period reviewed, but only through September 2014. Cintas also had a contract, but not for uniforms. Purchases in this category should be consolidated under Countywide contracts to achieve savings. Also, such contracts should be made available to all

departments that need access, based on their FPO purchases. Savings from such contracting, at a 10 percent level, would amount to about \$16,000 annually.

Promotional Items-As in the case of procurement card transactions, a large dollar volume of FPO purchases was for promotional items, often printed with department, program and/or County logos, for pens, tote bags, etc. We have also included in this category trophies, plaques and other awards. These purchases were made by a variety of departments, but in particular by the Santa Clara Valley Health and Hospital System, which spent \$191,000 in a 12-month period on such purchases. The vendors are as follows:

Stryker Enterprises	\$13,250
4Imprint	1,202
Accents and Artech	695
Baldwin, Elaine M.	1,464
Adplus, LLC	4,327
A4 Promotions and Incentives	34,197
All Premium Sportswear	9,508
Baudville, Inc.	543
Epromos Promotional Products	2,469
First Place, Inc.	130
JB Trophies	8,494
Levy-Miller, Shorron	4,641
Monroe Classic, Inc.	135,751
Screen Designs	1,641
Lalouh, Inc.	4,988
Medical Arts Press	154
Myron Manufacturing	1,999
Olympic Trophy Manufacturing Co.	2,967
The Image Group	7,960
Santa Rosa Uniform	928
Holbert, Charles Stephen	247
Bischel, Elizabeth	449
Verity Marketing Group	4,511
Brown Industries Inc.	<u>3,872</u>
Total	\$246,387

Purchases in this category should be consolidated into one or as few vendors as possible, with competitive bidding to achieve savings. A 10 percent savings would save about \$24,600 annually.

The purchases in these various categories represent \$1,574,912 in purchases through field purchase orders, where we believe there is opportunity for savings by negotiating Countywide contracts. Such savings, at a 10 percent level across all these categories, would save about \$157,400 annually. We believe there are probably other similar opportunities for savings that could be identified, based on regular analysis of FPO purchase patterns. This analysis should be conducted by the Procurement Department, in conjunction with its customer departments, to identify such potential contracts.

During the exit conference process for this report, Facilities and Fleet staff reported, specifically in relation to auto parts, that the variety of suppliers now being used occurred because a large parts supplier formerly used went out of business during the Great Recession. Facilities and Fleet staff further reported that the Procurement Department would not pursue contracts with a purchasing value of less than \$20,000.

They further asserted that many types of car parts are essentially commoditized, in the same way as some of the software and computer peripherals discussed in Section 1, and that negotiating contracts would therefore not necessarily provide lower prices than purchasing on a spot basis. Lastly, they said that the requirement to attach additional documentation to individual parts purchases in SAP using field purchase orders is administratively burdensome, and would require additional staff.

Facilities and Fleet management said one alternative they might propose is doing their own vendor selection process for car parts, using a market-basket of frequently used parts that vendors would be asked to provide quotes on, and from which one or more vendors would be selected to be used for field purchase order purchases going forward. Management Audit Division staff would support this approach, because it would provide a procedure to ensure that the vendor selection was unbiased, and geared toward buying parts at the best price commensurate with the quality needed. Our only proviso would be that such a system has to be subject to after-the-fact auditing, by retaining invoices for parts purchases under this arrangement, so that the County has assurance that the prices quoted by vendors during the selection process were in fact honored for actual auto parts purchases.

During the exit conference process, Controller's Office staff also suggested that the difficulty of attaching documentation to purchasing transactions in the SAP system could also be addressed by simply providing inexpensive desktop scanners to staff that frequently process purchases, which is the approach the Controller's Office said it has pursued with its own staff that process travel claims, and that the Social Services Agency had employed with accounts payable staff. A quick Internet search by Management Audit Division staff identified a desktop scanner offered by Canon which was PC Magazine Editor's Choice and cost only \$60.

Management Audit Division staff endorses either of these approaches, or the negotiation of Countywide contracts in conjunction with the Procurement Department. The objective, whichever approach is used, must be to document that a fair, unbiased purchasing process was used, geared to obtaining goods of acceptable quality at the lowest price. In other words, departments that are conducting purchasing activities in place of what the Procurement Department does, must demonstrate that they are doing so in the spirit of the policies that the Procurement Department is designated to follow, even if alternative purchasing methods are being used.

Separate Health and Hospital Procurement System Hampers Review

As noted at the start of this section, our review of field purchase orders occurred in two separate phases. First, we received from the Procurement Department a database of 9,295 lines in 4,654 individual purchase orders, which we were advised comprised all FPOs for the 12-month period to be reviewed. Subsequent to the start of analysis on that database, we were informed by Procurement that it included no FPOs for the Health and Hospital System, and Procurement provided a separate database for them. This database, from the Pathways Materials Management (PMM) system used by the SCVHHS Resource Management Unit, included 17,720 individual purchase orders with 38,170 individual transaction lines. The review of this database to select transactions for review was lengthy, and included identifying what appeared to be numerous opportunities for Countywide contracting, and other situations where additional information on purchases was needed. We ultimately prepared separate samples of dietary-related purchases, facilities maintenance related purchases and IT related purchases, and obtained additional information from those SCVHHS departments that satisfied us that those purchases were proper.

The vast majority of the SCVHHS purchases in our database were for medical equipment and supply items. The data we initially received from the PMM system, via

the Procurement Department, was not as detailed as information available from the Countywide SAP accounting system for field purchase orders in other departments. The Management Audit Division has direct access to SAP, but not to PMM. We requested the ability to review individual transactions in PMM, on site at SCVHHS, but ultimately agreed to instead accept additional reporting from PMM. To do so, we selected a sample of about 60 transactions, for which we received additional information from the PMM system, including the name of the person initiating the purchase. By limiting our inquiry in this way, this additional information, which included the staff person responsible for each transaction, and e-mails sent to SCVHHS staff, provided enough information to satisfy us that the purchases we examined were legitimate, although our inquiry for the PMM database ended up not being as broad as for the other purchasing databases examined.

Meanwhile, two responses we received from SCVHHS Resource Management staff also created uncertainty about the database of field purchase orders issued via PMM that was the basis for our inquiry.

First, staff reported that many of the purchases we identified as FPOs from vendors with whom the County has Countywide contracts, were in fact proper transactions that were miscoded in PMM. According to an Information Systems Analyst at the Resource Management Department who oversees PMM, SCVHHS buyers assign a classification to each purchase order they process, including either a field purchase order or a contract release. This designation is separate from the PO number itself, and therefore not observable from the information we received. If the wrong designation had been provided, a purchase would have been included in the data we received, even though it was in fact a contract release on an existing contract, not a field purchase order. In other words, SCVHHS staff are reporting that the PMM system has coding errors that make use of data in this system unreliable for reviews such as this one.

Second, Resource Management staff also said many of the vendors we identified as not having Countywide contracts were vendors from whom SCVHHS purchases via its Group Purchasing Organization (GPO) agreements with Novation. Under this arrangement, which dates to 1997, the County agreed to join its purchasing power for medical items with that of other medical organizations that become members of the GPO, which then negotiates agreements with vendors on the group's behalf. According to Resource Management staff and management, the County Director of Procurement approves any categories of medical items that are to be included in a GPO agreement, as it did when we last reviewed this program, in a 2000 audit of Valley Medical Center.

During the exit conference process for this report, the Director of Procurement indicated she was not certain that all purchases made by SCVHHS using FPOs and Novation contracts were made through Novation agreements that had been approved by Procurement, either via a letter of participation whereby the County agrees to participate in a nationally-negotiated Novation agreement, or in a situation where Procurement has assisted in negotiating a local agreement with a vendor that is also a Novation-connected vendor. She and her staff reported that they are reviewing data and meeting with SCVHHS Resource Management staff to address this concern, but noted one difficulty is that dollar amounts for SCVHHS purchases reported via the PMM system and the SAP accounting system differ substantially. Consequently, Procurement staff could not report to us specifically the dollar value or volume of purchases about which they have this concern. They indicated the miscoding of contract release purchases as field purchase order purchases, discussed above, was also complicating analysis and resolution of this issue with SCVHHS staff.

We anticipate reviewing the approval process, documentation of savings estimates, and monitoring of savings by the Procurement Department and by SCVHHS Resource Management for GPO-based purchases as part of the Countywide procurement audit suggested in the Introduction to this report. We note that the current dispute over whether the GPO agreements are being properly utilized and are generating savings appears unfortunately to be the same dispute that was reported in our 2000 audit of Valley Medical Center.

The result of these two systems-related situations is that the number of field purchase orders actually used by the Health and Hospital is likely substantially fewer than the number in the database we received. SCVHHS' use of a separate purchasing system, not the SAP purchasing module for field purchase orders, is yet another instance, as in budgeting and financial monitoring, where the Health and Hospital System's use of its own information technology, rather than the same system all other County departments are required to use, makes assessment of efficiency and effectiveness difficult, because problems with the SCVHHS system render it opaque. We recommend, as we have in the other instances, that the SCVHHS be required to switch from its existing Pathways Materials Management system to the SAP purchasing module to initiate purchase orders, so that its use of this purchasing method can be more clearly monitored.

During the exit conference process for this report, the SCVHHS Resource Management Director expressed concerns about a switch from PMM to SAP, saying such a switch

“does require some due diligence.” He said the switch at this time would require calling or faxing orders to suppliers, because the SAP purchasing module does not provide the electronic data interchange with suppliers that PMM does. It’s also not clear that the current SAP purchasing module would permit medical supply items used for care of individual patients to be charged to those patients’ bills, which PMM does. It should be noted that facility maintenance managers at SCVHHS have said they will migrate their purchasing, which is not directly charged to patient accounts, to SAP.

We acknowledge these concerns have to be worked out. But we also do not think having the separate PMM system is a feasible permanent solution, because that system, like the separate Valley Medical Center accounting system, does not provide sufficient transparency for oversight of SCVHHS activities in this area. Assuming the Board, as a policy matter, wants to maintain some centralized oversight and control over purchasing, via the Director of Procurement, there has to be a method to get accurate information over departments’ purchasing activity.

CONCLUSION

A review of 318 field purchase orders in the SAP and PMM purchasing systems found no instances of purchases that were not for legitimate County purposes. However, documentation of field purchase orders was often less thorough than was documentation of procurement card purchases reviewed in Section 1. The review also found numerous opportunities for development of Countywide contracts, particularly for crafts-type building maintenance services, where policies on use of contractors versus County forces are also needed. Our review was hindered by problems with a database generated from the Pathway Material Management system used by the Santa Clara Valley Health and Hospital System.

RECOMMENDATIONS

It is recommended that:

- 2.1 Existing training for procurement card use be expanded to include use of field purchase orders, or additional training be provided by the Procurement Department and Controller’s Office, focusing on the need to properly document the purpose of purchases and use of competitive purchasing methods. (Priority 2)

- 2.2 The County Executive remind departments in writing of the Comprehensive Vehicle Policy requirement that the Facilities and Fleet Department be used for all vehicle maintenance and repair services on County vehicles, and that other enforcement methods be developed to address any continued non-compliance. (Priority 3)

- 2.3 Policies should be developed by the Facilities Department and the facilities unit of the Santa Clara Valley Health and Hospital System to guide when contracts with crafts vendors are used for maintenance and repairs, rather than County staff, along with a process to consolidate the number of current contracts and select vendors through competitive processes. These policies should be included in Chapter 5 of the Board of Supervisors Policy Manual, which governs County contracting policies. (Priority 1)

- 2.4 The Procurement Department should regularly analyze field purchase order data, in conjunction with end-user departments, as occurred in this section, to identify opportunities for cost savings by negotiating Countywide agreements using competitive bidding processes. (Priority 1)

- 2.5 The Santa Clara Valley Health and Hospital System should be required to shift from the current Pathways Materials Management software system to the purchasing module of SAP to process purchases, as all other departments have, or to develop some other method to make its purchasing activity more transparent for third-party review than the PMM system provides. (Priority 2)

SAVINGS AND BENEFITS

Improved documentation for field purchase orders, as the result of expanded training, would ensure that purchases occur for legitimate County business purposes, and use competitive purchasing processes, as required by existing policies. Developing policies for use of contract versus County crafts workers would ensure that County staff is utilized for the highest priority work. Consolidation of contracts and use of competitive processes, assuming a 10 percent savings only on the categories identified in this section, would result in cost savings of about \$287,000 annually, although we believe additional categories of purchases could be found for contracting, raising that figure. Requiring SCVHHS to use the SAP purchasing module, or to develop some other method to improve the transparency of its purchasing data, would enable the

appropriateness of its purchases and use of competitive processes to be monitored in the same manner as other departments’.

Section 3. Adding Clarity to Use of Direct Pay Codes

Background

Departments directly pay vendors by designating a vendor payment with a specific code in the County's accounting system, tied to a list of purchase types the Board of Supervisors has authorized for this direct pay mechanism. Such purchases do not require a purchase order document, and therefore do not have the match between a purchase document, receiving document and vendor invoice normally required for payment. They also do not have the extensive after-the-fact documentation of procurement card purchases, and are the least restrictive purchasing method available. Despite creation of the two alternative methods, use of Direct Pay Codes is still extensive. Excluding payments to other government agencies, and employee payroll withdrawals, Direct Pay Codes still accounted for 90,519 transactions worth approximately \$793.3 million¹ during the 12-month period reviewed.

Problem and Adverse Effect

Review of a judgmental sample of 7,629 transactions, across 25 codes where potential problems were identified, found no transactions that were not for legitimate County business purposes. It identified instances involving 13 codes where a different code or purchasing method should have been used, instances where the application of a code wasn't clear, and instances where County staff did not understand how the codes are to be used. These errors result in this payment method being used where it is not appropriate to do so under policy of the Board of Supervisors.

Recommendations

The Controller's Office and the Procurement Department should clarify the definitions for when selected Direct Pay Codes should be used, and provide additional guidance to departments as described in this section, which it has begun to do as part of the most recent change to the codes in 2013. In addition, the Controller's Office should formally assign an individual as a direct pay liaison position to answer questions from departments about application of the codes, and to recommend changes in codes based on the experience of end-user departments. These steps would ensure that this payment method is used appropriately.

¹ We calculated this value by excluding all payments under Code H13, mandatory payments to other government agencies; H18 payroll related payments for union dues, employee benefit costs, income taxes, and similar items; and H19 property tax and assessment apportionments to other government agencies, which also included debt service payments. While there were some issues with H13, as discussed in the section, the other two codes were appropriately used.

Direct Pay Coded Purchases Explained

Direct Pay Code purchases were the subject of the 2009 Internal Audit Division report to which this review is a follow-up. Direct Pay Code purchases are purchases to which accounts payable clerks assign a specific code, designating the transactions as being for a particular type of purchase. Codes are selected from a direct payment list maintained by the Controller's Office, which is known as the Direct Pay Ordinance, although until 2013, it was not maintained as part of the County Ordinance Code per se, but was a list of purchase transaction types authorized for this payment method by various actions of the Board of Supervisors. During the purchasing period that was the subject of this review, December 2011 through November 2012, that list included 64 codes, based on changes approved by the Board through September 2011. The current list, codified as Ordinance NS-300.859, includes 58 codes.

By using a Direct Pay Code, a department is permitted to process a vendor payment with limited information. The transaction includes the department name, vendor identifying information, the amount of the payment, and a limited amount of information provided in a text portion of the transaction that can hold only 40 characters. It also includes, but not for all transactions, the name of the staff member that approved the transaction. It does not require a formal purchasing document, as does a field purchase order, which provides additional information on the purpose of a purchase and permits purchasing and receiving documents to be matched with a vendor invoice prior to payment, and it does not require the detailed after-the-fact auditing and documentation of transactions that procurement cards require. It thus is the least restrictive of the purchasing and payment mechanisms reviewed in this report.

Despite the existence of field purchase orders and procurement cards as alternative purchasing methods, Direct Pay Coded purchases continue to be extensively used. A database of all such purchases from December 2011 through November 2012, obtained for this review, included 104,106 transactions with a value of slightly more than \$3 billion. By comparison, the 2009 audit of Direct Pay Coded purchases by the Internal Audit Division of the Controller's Office noted 141,362 transactions with a value of about \$2.5 billion during Fiscal Year 2006-07.

However, many of these transactions are not for goods or services, but are legally required transfers of funds conducted in this manner for convenience under Board policy. For example, Codes H13, Mandatory Payments to Other Government Agencies;

H18, Payroll Related Payments, such as employee PERS contributions and other benefit costs; and H19, Property Tax and Assessments Apportionments, accounted for only 13,587 transactions, but nearly \$2.25 million in Direct Pay value. While we found some issues with Code H13, most of its payments, and all payments in the other two codes, appeared to be appropriate.

In addition to the recommendations regarding use of specific codes made later in this section, Management Audit Division staff believes improved documentation is needed generally when Direct Pay Codes are used to purchase goods and services, because the existing Direct Pay Code process does not require specific documentation justifying a particular purchase, or describing the method of vendor selection. Consequently, there is no way for a third-party to easily monitor such transactions on an after-the-fact basis, or for Controller's Office claims staff to assess them before authorizing payment, beyond the limited information provided in the accounting system transaction itself.

Specifically, we recommend that Direct Pay Code transactions that are for purchases of physical goods, or of services, have documentation attached, similar to that now being provided by many departments for field purchase orders, showing the purpose of the purchase, and the process used to select the supplier or service provider, including whether any competitive/comparison processes were used, and what they were. Exempted from this requirement would be payments to other governmental agencies that are simply pass throughs of revenue, such as the H19 property tax and assessments apportionments discussed above, many of the H13 Mandatory Payments to Other Government Agencies, and H18 Payroll Related Payments.

Use of Direct Pay Codes Requires Further Clarification and Justification

As in the case of the procurement card and field purchase order processes reviewed in Sections 1 and 2 of this report, our review of Direct Pay Coded transactions was based on reviewing information on actual transactions, and seeking additional information as to the purpose and justification for items where it was not immediately clear.

Specifically, we obtained a database of all Direct Pay Coded purchases from December 1, 2011 through November 30, 2012, and separated them by the Direct Pay Code used. We then at least cursorily examined each transaction, looking at the department making it, the vendor, the amount and the brief text description of the purchase in relation to the description on the Direct Pay List in effect during the period reviewed.

We then selected a judgmental sample of transactions where the use of a particular code, or the purpose of a particular transaction, was not clear. We sought further information on those transactions through Google searches, and requested by e-mail from department or Controller's Office accounting staff additional description or documentation of the transaction. This judgmental sample comprised 7,629 transactions covering 25 different Direct Pay Codes, out of the 64 codes in existence. For the other 39 codes examined, all transactions appeared to be appropriate on their face, making additional inquiry unnecessary. Because the transactions we questioned were often multiple transactions with a single payee, or many transactions that appeared to be similar in nature, the information obtained from departments was frequently a description of the types of purchases for which a particular code was used, why the purchases were necessary, how the purchase falls within the description of a particular Direct Pay Code, and a sample of the documentation maintained within the department supporting that type of transaction.

The remainder of this section describes, by code, problems we identified with Direct Pay Coded transactions in 13 different codes. As in the case of the procurement card and field purchase order transactions previously discussed, departments were able, to our satisfaction, to explain the purpose of transactions sufficiently for us to conclude that none occurred for non-County business purpose. However, the errors we identified did indicate there are continuing problems resulting from a lack of understanding of when and how to use Direct Pay Codes in many departments.

Code A

The Direct Pay List formerly identified this code as for:

“INCIDENTAL PAYMENTS OR FEES NECESSARY TO IMPLEMENT A BOARD APPROVED CONTRACT, POLICY OR PROJECT NOT OTHERWISE PROVIDED FOR BY THE BOARD ACTION, THAT DOES NOT REQUIRE THE PROCUREMENT OF GOODS OR SERVICES e.g. title search and insurance expense in land sale contracts, etc.”

Under new Ordinance NS-300.859, it now applies simply to “Payments approved by the Board as evidenced in an approved Board agenda.”

As one departmental fiscal officer stated in regard to our inquiries: "Basically the definition of Code A was vague. Generally if the expense was approved by the Board, it qualified to apply DP code A."

As an example, this code was applied to payments to various law firms of grants to service unmet civil legal needs, as approved by the Board during the County budget process. This use does not meet the strict definition of the code, since the payments are not incidental to the Board's action, which was to authorize the payments themselves.

Similarly, this code was used to pay expenses of the County's various sister city commissions that were paid neither using procurement cards, because a vendor wouldn't accept them, nor via field purchase orders. Clerk of the Board staff, which assist those committees, noted that this problem has been corrected with creation of a new code, H22, specifically for sister city commission purchases, which come out of special funds generated by commission fundraising, and are not a General Fund expense.

It was also used by the Clerk-Recorder to pay about \$225,000 for participation in the California Electronic Recording Transaction Network Authority, based on the fact that the Board approved participation. However, this payment probably should have been coded as a membership, code H9, as again the payment was an integral part of the Board's action, rather than something incidental to it.

Some departments specifically acknowledged using this code incorrectly. The code was used by the Controller to pay a consultant that assists with projecting various sales tax sources, a direct purchase of services. During the exit conference for this report, Controller staff said they did so because the Controller obtained Board approval many years ago to utilize these services. Nevertheless, use of this code was incorrect, because the payments were not incidental to a Board contract, but were a direct payment for services rendered. The Department is now going to develop a formal service contract with the firm via the Procurement Department for these services, addressing the issue. The Controller also has used Code A to pay the County's monthly procurement card bill from U.S. Bank, as all bills are paid at once, with after-the-fact auditing. The Controller's Office concurred that Code H46, which are bank charges, is more appropriate. The Office of Pretrial Services acknowledged using the code, rather than a more appropriate field purchase order, to buy cups for drug testing on a trial basis.

Lastly, the Department of Communication used Code A to pay \$25,162 for membership in a joint powers authority related to development of a regional communications system. The Department head said he considered using Code H9, for memberships, but did not, because that code required Legislative Committee and Board approval for costs exceeding \$2,000. "This payment path was not selected by my Department at that time because we did not believe we could meet the added (dual) approval requirements within the time remaining to pay, so we used the Code A approach."

This illustrates a problem we identified elsewhere in this review. Departments, seeking the ease of using Direct Pay Codes in order to accomplish their missions, rather than using more laborious purchasing methods, stretch to find a code that will be acceptable, whether or not the purchase they are making strictly fits the code definition. This approach illustrates the need to review the list of codes regularly, providing additional definition, or even new codes, and deleting unused ones as County purchasing patterns change.

As noted earlier, in 2013 the definition of Code A was revised in Ordinance NS-300.859 to provide for use of this code for: "Payments approved by the Board as evidenced in an approved Board agenda." We believe this expansive definition provides insufficient control over such payments, because it would permit any service or goods purchase approved by the Board to be paid using this mechanism. We believe this could potentially divorce the payment process from other Board priorities regarding purchases, particularly for services. For example, numerous audits of social and human services contracts have documented problems by departments in ensuring there is evidence in invoices that services being paid for have in fact been provided, or that the services provided achieve performance goals included in the approved contracts. Providing blanket authority for departments to pay contractors via this process totally decentralizes monitoring of these contractors to departments, without oversight by the Board or anyone else. We recommend that the definition of Code A, either in the Ordinance Code or via supplemental instructions developed by the Controller and the Procurement Department, be expanded to require departments, in presenting agreements to the Board, to explicitly state the planned use of the Direct Pay Code mechanism as part of the transmittal to the Board, and how contractor performance will be monitored in the payment process.

Code B3

This Code is defined as:

“Expenses of the Sheriff, Corrections, District Attorney, County Counsel and Public Defender departments (not including general office supplies, books, educational expenses) under Gov. Code Sections 27642, 29601, and 29602, including but not limited to the following: a) Expenses of Laboratory Criminalistics for outside lab work; b) Investigative expenses; c) Pre-booking medical care expenses.”

The Government Code sections cited are broad ones describing the duties of County Counsel and the fact that expenses related to his function, that of the District Attorney and Sheriff, and those related to support of criminal defendants in custody are costs of the County.

Our review identified two significant issues. First, departments other than those named in the description are using this code. One is the Employee Services Agency, which is using it for investigations of claims covered by County insurance accounts overseen by the Agency. According to ESA accounting staff, the investigations are actually initiated by County Counsel, which approves the invoices and sends them to ESA for payment from the relevant accounts. ESA also supplied a previous e-mail from the Controller’s Office authorizing its use of the Code. Similarly, the Social Services Agency used the Code to pay for services by a firm that provides process serving, acquisition of transcripts and other court documents, and other legal services. These services are actually required by County Counsel in its role representing SSA. Earlier this year, County Counsel had directed client departments to pay for such expenses, other than costs of County Counsel legal hours, themselves, but agreed to continue to pay this cost for SSA, after being informed that SSA is not eligible to use this Code for direct pay charges.

To address this issue, we recommend amending the Ordinance Code language to provide for payment of “Expenses of . . . County Counsel, including legal-related expenses of other departments ordered by County Counsel and authorized by County Counsel in writing. . . .” This would permit other departments to use Code B3 for these legal-related expenses that are really for services County Counsel uses in representing a client department, as in the case of ESA insurance investigations and SSA.

The other issue identified for this Code is the existence of department-paid credit cards, other than the County's formal procurement card program. We found these codes based on the Direct Pay Code payments to Bank of America for the credit card bills.

These department-paid credit cards exist in the County Counsel's Office, where Department administration reported they pre-date the Countywide program, and are used to pay court filing fees, telephonic appearances and other court-related charges where a credit card is needed. For the 12-month period reviewed, we identified charges to this card paid under this Direct Pay Code, and under Code F (travel), Code H61 (books, periodicals and subscriptions) and Code H62 (registration and seminar fees without travel). Total charges for the one year period were about \$14,100.

There is also a department-paid card in the Office of the District Attorney. According to Department accounting staff, that card is used by DA investigators to pay for costs related to field investigations, and its use is controlled by one of the lieutenants that supervises the investigative staff, who generally don't have individually issued procurement cards.

Our review did not include looking at individual items charged to these cards for appropriateness. However, we believe that departments should not have credit cards that are outside the Countywide procurement card program, because charges to such cards, whose bills are paid via Direct Pay Codes, would not receive any review outside the cardholder department, as do procurement card charges. Nor would there be any requirement for such cardholders to receive the training and proper use and documentation of credit card charges that is part of the procurement card program. Further, authorization for such cards and spending limits are at the discretion of the departments.

Accordingly, we recommend that the Controller's Office review Direct Pay Coded charges, and other sources, to determine if there are any other credit cards that departments hold outside the Countywide procurement card program.

Any such accounts identified should be terminated, and replaced by procurement cards within the Countywide program, while meeting any specialized needs that caused a department to have separate credit cards. For example, the District Attorney's Office advised that its internal credit cards are issued to the Bureau of Investigation, and are used by investigators at a supervisor's direction, rather than being issued to named individuals. The District Attorney is also concerned about dollar limits on card use, since the cards are often used for witness transport or investigative travel that can't be

arranged in advance through County travel vendors, and where cost is not certain. There is also concern, depending on timing of an investigation and the related purchases, about the need to keep expenditure details confidential, so an investigation is not compromised.

The District Attorney's Office and the Procurement Department should jointly determine whether standard procurement cards can be issued to the Bureau of Investigation, rather than to named individuals, and should develop a protocol for expenditure review and limits, that does not compromise the needs of investigators. There is precedent for this approach. Eight investigators were issued procurement cards for work on the California Witness Relocation and Assistance Program. Based on a memo from the lieutenant overseeing the investigators, explaining the emergency nature of the purchases, and confirming that receipts would be kept under County policy and for State reimbursement of expenditures, a blanket exemption on dollar and use limits for this card has been approved, on a fiscal year basis, most recently by the County Chief Operating Officer for Fiscal Year 2013-14.

If issuing County procurement cards in place of the existing departmental credit cards is not feasible, we would support retention of separate credit card programs in selected departments, based on demonstrated special needs, with two provisos. First, all card users should be required to attend the County's procurement card training program, to be reminded of the need to obtain receipts for all purchases, and for the other legal and ethical elements of that training. Second, any credit cards retained by the District Attorney, or other County departments, must be subject to the same audit of receipts and other records as procurement cards, subject to limitations, such as the timing of the audit, that are needed to address confidentiality of investigations or other needs of specific departments. This would provide the same transparency and accountability for these credit cards, as the County is attempting to maintain for procurement cards.

Code C3

This Code is one of two identified in the code list and current ordinance as "Payments Required by Court Order," and is further defined as "All other payments ordered by court."

Included in these payments were numerous payments by the Social Services Agency to vendors for goods and services for children that are under protection of the Department of Children and Family Services at the direction of the dependency courts. These

include tickets for theme park trips, camp and recreational fees, purchases of school yearbooks, costs for counseling and medical care, and other expenses.

According to a Project Manager in DFCS' Administrative Support Bureau, the Superior Court generally orders social workers to provide support to foster families caring for children, and State and federal regulations require any placement for a foster child include at minimum a bed, a dresser, a car seat if required and other minimum furnishings and equipment. The C3 coded items included the following total payments to furniture merchants.

<u>Merchant Name</u>	<u>No of Purchases</u>	<u>Value of Purchases</u>
San Jose Furniture Warehouse	54	\$19,551
Furniture Super Discount	155	71,706
La Bodega Bay Furniture, Inc.	1	1,400
Econo Furniture, Inc.	<u>20</u>	<u>12,131</u>
Total	230	104,788

According to the Project Manager, the three primary firms were initially chosen by caregivers in DFCS cases. Subsequently, the Department decided to standardize the purchasing process for these items, and a staff member formerly responsible for purchases within the Department reviewed the vendors selected most often, determined that these three vendors had similar prices, and chose to use all three, leaving the choice of which one to use to a foster child's caregiver.

Given the volume and value of such purchases we identified, we recommend that a more formal competitive process be conducted, with the Procurement Department assisting DFCS in identifying a vendor or vendors for child care furniture items through a competitive bidding process. We note that the dollar value of the Furniture Super Discount purchases alone exceed the \$25,000 for field purchase orders, where Procurement Department policies indicate a formal Countywide contract should be obtained.

Additionally, our review identified significant purchases, totaling \$93,998 over the 12-month period reviewed, from Target Bank. The DFCS Project Manager reported that Target had been selected as the major vendor chosen for non-furniture purchases of bedding and other items needed by foster families to care for children, and that the payments to Target Bank reflect a credit arrangement DFCS has with the vendor where

it pays the accumulated charges on a monthly basis, similar to the arrangement the Parks Department has with Home Depot as discussed in Section 2 of this report. The Project Manager reports that WalMart was approached for a similar arrangement, but refused.

Similar to the furniture purchases, we recommend that vendors for purchase of other items needed by foster families should be selected by a formal competitive process, overseen by the Procurement Department working with DFCS, and resulting in a Countywide contract for this purpose, which will hopefully result in additional cost savings, based on the vendor providing a discount from its retail prices. Based on the total dollar value of the furniture and Target purchases during the 12-month period reviewed, a 10 percent savings in these categories would save about \$20,000 a year.

Code D1

Code D1 is defined as “ESA Insurance Payments-Board granted approval authority up to \$7,500 by individual adjuster, up to \$20,000 by Insurance Claims Supervisor and up to \$50,000 by Director of Risk Management.” We identified payments exceeding the \$50,000 limit, and were provided documentation showing that they were authorized by the Board in closed session. The code definition should be expanded to state that “settlements exceeding \$50,000 may be paid using this code following approval of the settlement by the Board.”

Code D3

Code D3 is defined as “Purchases by Central, Los Altos and South County Fire Districts.” In 2013, this Code was eliminated by adding these districts and other special districts to Code L, which was used for payments by the County Library District.

We have no issue with providing broad Direct Pay Code authority to the South County and Los Altos Hills County Fire districts, as those districts are governed by separate boards of directors who are responsible for their financial oversight.

We do have a concern in providing the former Central Fire District, now known as the Santa Clara County Fire District, which is overseen by the Board of Supervisors, with broad authority to use this mechanism for any purchase, rather than requiring use of field or standard purchase orders, contract releases against Countywide contracts or

procurement cards that provide more documentation for the purpose and process of purchases.

This concern relates to the 2005 audit conducted of then-Central Fire, which included findings and recommendations regarding the District's purchasing process. These included:

- Four consulting contracts, ranging in expenditure amount from \$12,384 to \$127,192, that were not presented variously to the Director of Procurement, the Office of Budget and Analysis, or the Board of Supervisors for approval, in violation of then-County contracting policies. We recommended following the County policies. Our review of Code D3 charges for this report found that two of those firms were still contracting with the District, and that there are several other consultants receiving large sums for work with the District.
- Opportunities to buy bulk fuel on Countywide contracts were not being accessed by the District, which instead bought its own fuel at higher prices. According to the D3 charges, the District continues to buy its own fuel.
- The District was not taking advantage of opportunities to reduce long-distance telephone costs by participating in Countywide contracts for telephone service. Code D3 charges indicate the District continues to acquire and pay for telephone service on its own.
- The District was paying more for cleaners, paper towels, toilet paper and other household goods to stock fire stations that the prices available under Countywide contracts. Based on the Code D3 charges, the District appears to still be buying those items on its own, rather than through the available Countywide agreements.

While the District agreed to recommendations in the 2005 audit, it is not clear that the recommendations were in fact implemented. A review of Finance and Government Operations Committee minutes showed that the District presented a six-month implementation report to that Committee, which directed that further implementation would be overseen by the Housing, Land Use and Transportation Committee. There is no record of that Committee or the full board receiving subsequent 12-month or 18-month reports on implementation of the 2005 audit recommendations. The District's

Director of Business Services, who has joined the District since the audit occurred, confirmed that no 12- or 18-month status reports were submitted, based on his records.

In addition to the previous audit findings, this review identified the District as having numerous credit cards of its own, under a separate contract with U.S. Bank. These cards are not subject to the restrictions of the County's procurement card program, although the Business Manager stated that the District has its own user manual, and employees receive training from District finance staff on proper use of the cards. The review also found that the District is paying \$284,104 for insurance. The Director of Business Services noted that the Board had never directed the District to use the County's Risk Management Department for insurance, and that the firm used specializes in insuring fire departments, and gives the District favorable rates based on its claims experience.

In response to our concerns, the Director of Business Services for the district reported that while the District's practice has been to mirror County policy on competitively bidding service contracts, its Purchasing resolution, approved by the Board in 2011, does not require competitive bidding for supplies, materials, equipment or other personal property required by the District. That resolution also designates the Fire Chief to negotiate services contracts of up to \$100,000 without Board approval or review, including ongoing contracts where the annual expenditure does not exceed \$100,000.

The broad purchasing authority given to the District, to the County Library or other non-General Fund entity governed by the Board, including use of Direct Pay Codes for the vast majority of its purchases, is a policy decision for the Board of Supervisors, sitting as District directors, since it basically allows District staff to conduct most of its procurement without any centralized oversight, other than the Board itself. We believe that this authority is too broad, given that District procurements are still made with taxpayer property tax funds.

Code F

Code F was defined, during the period of this review as: "Travel expense, lodging, meals, or meals for persons providing services without compensation and Sacramento and Washington office expenses incurred incidental to providing conferences, discussion and meeting."

As part of the 2013 creation of Ordinance NS-300.859, new language clarifying this Code was provided, defining it as:

“Travel, lodging, or meal expenses incurred by any, person, group, appointive board or commission providing services to the County without compensation or commission or by any representative designated by the Board to maintain Sacramento or Washington offices in accordance with Ordinance Code Section A31, the Travel Policy Desk Reference Manual, and other applicable Board policies. Restricted for use by the Controller-Treasurer and SSA.”

We noted previously, and reiterate here, that travel expenses were not an express target of this review, because they were reviewed previously by the Management Audit Division, with numerous recommendations made, in a 2009 audit specifically addressing County travel. The Controller’s Office agreed with recommendations in that audit.

Restricting the use of this code to the Controller-Treasurer and the Social Services Agency (SSA) makes sense, since of the 4,202 Code F transactions in the one-year period we reviewed, 63.4 percent were processed by the Controller’s Claims Unit, while another 29.7 percent were processed by SSA.

We recommend that both departments standardize and improve the information provided in the 40-character text field in SAP that is the only electronic description of the purpose of the travel. This information is particularly important because, in some instances, we found that transportation, meals and lodging for conferences and training were paid using this code, while conference registration fees were paid using a different code, making it difficult to match up trip costs with the purpose of the trips.

The Senior Accountant overseeing the Claims Unit reports that its staff provides in the text field whether a payment is a final payment, an advance reservation payment, or a registration fee, plus the location of the travel and dates. If at all possible, this information should be expanded to include the name or acronym of the organization sponsoring a conference or training, or other information on the purpose of travel. This would permit easier assessment of the appropriateness of the travel, without having to review travel authorization information which is still maintained only in paper form.

The Social Services Agency should follow this same approach for conference or training-related travel. For client-related travel, the Agency needs to provide acronyms, a numerical coding system, or another way to indicate the purpose of travel expenses, which are now described only with the case number, and the first name and last-name-

initial of the client. It's not clear from this information whether the travel was for a social worker to visit the client, emergency shelter expenses and meals for a client, or other purposes.

Code F is also one of the Direct Pay Codes where it would be very helpful for staff to attach additional documentation to the electronic payment records in the SAP accounting system. According to the General Accounting Division manager, which includes the Claims Unit, attachment of documents to travel payments began as of July 2012, near the end of the period reviewed for this report.

Code H13

Code H13 is defined as "Mandatory payments to other government agencies." However, this definition provides no further explanation as to what makes a payment mandatory, and therefore we found some confusion as to the use of this Code among different County departments.

Appropriate uses of this code we identified included these examples:

- Remittance of sales taxes by the Controller's Office to the California Board of Equalization for use taxes on items purchased by the County, where sales tax was not collected by the selling vendor. Valley Medical Center also makes such payments, estimating the amount owed monthly and filing a sales and use tax return with payment quarterly.
- Remittance of sales taxes by the Department of Correction, for correctional industries items it sells to other governmental agencies.
- Pass-through to other counties of a portion of a U.S. Environmental Protection Agency grant to reduce and prevent childhood lead poisoning, where Santa Clara County is managing the grant for itself and other participating counties.
- Payments by the Probation Department to the California Department of Corrections and Rehabilitation for the cost of minors sent by the Department to State juvenile facilities for housing.

- Payments by the Sheriff's Office to other law enforcement agencies for cost of investigative staff that work on the Regional Auto Theft Task Force, and payments to the Superior Court for bail and fines collected by the Sheriff'.

Other uses of this Code were more problematic, as follows:

- The County Executive's Office used the code to reimburse other public safety agencies for cost of their staff to attend training paid for by a Homeland Security grant administered by the County. We believe these reimbursements should have used Code H62, training and seminar registration fees, since that what was being paid for.
- Commercial driver's license payment for Roads Department employee. Roads concurred this should have been Coded H64, as the license application costs are reimbursable under a labor agreement.
- Payment to Metropolitan Transportation Commission for Streetsaver software. The Roads department concurred that this should have used a field purchase order to buy what is a good, rather than being a government fee that is mandatory.
- Long-term disability insurance payments for County physicians to an insurance company by the Employee Services Agency. Should have used Code H18, as these are payroll-related costs for an employee benefit. Code H8, which is for insurance premiums, also could have been used, except that its use is limited to the Employee Services Agency, as pointed out by Valley Medical Center, which also used Code H13 for these payments.
- Membership in the California Association of Health Plans, which hospital accounting staff agree should have been paid using Code H9 for memberships, which would have required Legislative Committee and Board approval for the \$16,853 cost.
- Payments by the County's Emergency Medical Services program to various fire agencies for EMS-related improvements to those agencies' computer aided dispatch systems. Although Procurement staff authorized the use of this code, we believe it would have been more appropriate to use a field purchase order to each agency.

To address what we view as the confusion over use of this Code, its definition should be expanded or supplemental information should be provided by the Controller's Office and Procurement Department as to what constitutes a "mandatory" payment to a government agency. We suggest the definition should include payments required by State or federal law, such as the sales tax payments described above, and payments that result from ongoing intergovernmental agreements, such as grants managed by the County that also benefit other governmental entities, or multi-agency law enforcement task forces where the County is the lead agency.

One-time payments should be made using other mechanisms than a Direct Pay Code when possible, and codes that more directly relate to the purpose of the expenditure, rather than the fact that payment is made to another governmental entity, should also be used when possible, to more directly tie the mode of payment to its purpose.

Code H15

This Code was defined as "Non-mandatory payments to other government agencies that do not exceed \$2,500 per occurrence," but was changed in 2013 to state that it is for ". . . goods or services provided directly to the County. . ."

This definition is very broad, and would allow a wide variety of expenditures to be paid using the Code, rather than using a field purchase order that has greater documentation as to the purpose of the transaction. There is also confusion over using this Code. Examples include:

- Facility rental in City of Cupertino for Moscow Sister County Commission. This should have been paid via a field purchase order.
- Payments by the District Attorney's Office to various non-governmental organizations, including the Southwestern Association of Forensic Document Examiners, the Exchange Club of San Jose, the American Red Cross and the Friends of the Human Relations Commission of San Jose. Department accounting staff agreed that Code H9 for memberships, or a non-Direct Pay Code payment method should have been used for these items.

- Fingerprint charges by the California Department of Justice to the Probation Department as part of background checks for prospective employees. We believe this is an appropriate use of this Code.

We recommend further definition be provided by the Controller's Office and Procurement as to when this Code should be used, versus other payment methods.

Code H22

This Code is defined as "Revenue Refunds," prior to 2013, when it was expanded to include "Revenue refunds, reimbursements of deposits from third parties that do not require appropriations, and disbursements of funds of a County commission managed by a County department." The latter language regarding commissions permits the Code to be used, for example, for costs of sister County commissions discussed previously in this section.

We found one instance where this Code was used, and another should have been. This Code is used by the Department of Revenue to remit to the Superior Court on a monthly basis fines and fees collected from clients on the Court's behalf. The Code also was used to remit to the Franchise Tax Board quarterly payments received from DOR clients that the State agency collects related to criminal offenses. Finally, DOR also remits funds to San Jose State University for pay and benefits of college students that work for County departments as part of the University's work-study program. According to DOR accounting staff, other departments participate by making advance quarterly payments to a specific fund earmarked for this program. DOR then transfers the funds to San Jose State to pay the costs of the student employees. We believe, and DOR staff concurred, that Code H13, mandatory payments to other government agencies, should have been used for all these payments instead.

Code H29

This Code is defined as Valley Health Plan payment to providers for medical services. However, the database included payments that appeared to be to Valley Health Plan clients, rather than to medical professionals or firms. Valley Health Plan staff reported that these payments were to VHP members who received medical services out of the area, paid for them out of pocket, and sought reimbursement, based on proof of payment and information on the services that were provided. VHP staff said to their

knowledge, there is no other applicable Direct Pay Code for this purpose, but they would like to have one established, to avoid confusion regarding payments.

We recommend that Ordinance NS-300.389 be amended to provide a Direct Pay Code for this purpose, or that the existing language of Code H22, which provides for refunds and reimbursements, be amended to include this among the types of payments for which that Code can be used.

Code H61

Code H61, which was created in 2011, shortly before the period of transactions reviewed for this report, is defined as: "Purchase of books, magazines, periodicals, and subscriptions in paper, online or electronic format with suppliers and publishers who do not accept a Procurement Card. (Not to be used for Software license subscription purchase)." In 2013, the definition was expanded to require approval by a department head or designee for purchases exceeding \$5,000.

This Code was one where there was significant confusion as to its use, versus other Codes or other payment methods. Examples included:

- A Department of Agriculture and Environmental Management employee used to code to pay for two advertisements. The Department reported that the employee was "new to the process," and has since been shown how those items should have been paid for.
- The Registrar of Voters used this code to pay for Direct TV access. We believe that should have been paid for using Code E1, utilities, because at this point cable service is similar to telephone, electricity, gas, garbage disposal and other services that are normally viewed that way. The Department indicated it would use this code going forward.
- The Department of Planning and Development used the Code to pay for accessing the Internet from surveying equipment, which it agreed might be more appropriately paid for using Code E, and for a maintenance subscription for a computer-assisted-design software license, which it acknowledged should not have been paid that way, and subsequently was purchased through a Countywide vendor contract.

- The Santa Clara Valley Health and Hospital System used the Code to purchase books from Amazon, even though Amazon clearly accepts procurement cards, because not all System departments have access to procurement cards. Because of the superior documentation, field purchase orders should have been used for these purchases, when procurement cards are not available, as Procurement Department policy states. Similarly, a SCVHHS department used the Code to buy nearly \$18,000 worth of training manuals, in four transactions, after its procurement card was terminated due to misuse and policy issues. It makes no sense for a procurement card, which is supposed to have documentation of the purpose of purchases, at least on an after-the-fact basis, to be removed and replaced by Direct Pay Code purchasing, which has less documentation and auditing. A field purchase order, or a regular purchase order processed through the Procurement Department, should have been used instead.
- SCVHHS reported that two other transactions, for bereavement brochures and a video, should have been bought with field purchase orders, because this Code was not available for those types of purchases, and a series of training services and materials received from a consultant, which were recurring services, should have been paid using a formal service contract, not using the Direct Pay Code process. SCVHHS accounting staff noted that the agency had decided not to provide procurement cards to individual physicians, “due to control issues.”

Based on these problems, we recommend that additional guidance regarding use of Code H61 be provided, either by further amendments to the description in Ordinance NS-300.389, or by supplemental information. The additional information should specify that this code should be used only when both a procurement card and a field purchase order will not be accepted by the vendor. It also should provide additional language describing the difference between a software license subscription purchase, and an acceptable purchase of subscription access to an electronic database, for example.

Code H62

The Code is defined as: “Registration fees and seminar (e.g. webinars) when travel is not involved.” In the 2013 revision and codification of Direct Pay Codes, the definition was expanded to apply “if (1) the County Procurement Card cannot be used, and (2) the fee is approved by the Department Head or his or her designee.”

While we interpreted the definition to apply only in situations where a County employee is not physically traveling to training, such as training occurring at a County facility, or on-line or correspondence course training, several departments, responding to questions about transactions, used an additional interpretation, using this code when registration fees for training or conferences were required far in advance of the event. For example, Agriculture and Environmental Management reported five instances where this code was used for registration, and transportation, lodging and other travel-related expenses used other methods, either procurement cards or Direct Pay Code F.

This use of Code H62 creates a potential difficulty in matching the travel costs paid by other methods to the event registration paid via this Code, in order to properly monitor the appropriateness of the travel expenses.

In order to avoid that problem, we recommend this Code only be used for the purposes identified on its face by the definition, registration and seminar fees for events and training where no travel is involved. Registrations for events where lodging or other travel-related expenses are expected to be incurred should be paid using Code F, to ensure the ability to properly monitor the expenditures. Since Code F use is now limited to the Controller's Office and the Social Services Agency, other departments should process these requests through the Controller, which would presumably assign a Travel Authorization number under the County's travel policy to track all expenses related to a particular event. The Controller's Office concurs with this recommendation.

Code H63

This Code is defined as: "Employee reimbursement not exceeding \$250 per transaction (exclude travel, mileage and services) and petty cash replenishment." The limit has since been expanded to \$300 in 2013, with larger reimbursements permitted on approval of a department head or designee and the County's Chief Operating Officer.

We identified separate instances in the County Executive's Office and the Department of Parks and Recreation, where either the \$250 limit was exceeded, or where what appeared to be multiple reimbursement transactions of less than \$250 were processed for what appeared to the same expense by an employee, in effect splitting the reimbursements to stay within the limit.

Both departments acknowledged these errors, but said there was no other way to reimburse the employees for money they had spent. In one case the reimbursements

were for bus passes and books purchased by staff in the Skills to Succeed Program, a program funded by 2011 Realignment funds to serve female ex-offenders. Because the purchaser was an individual staff member, not a vendor, a procurement card could not be used for reimbursement, nor could a field purchase order. Therefore, the choice was either not to reimburse the employee, break up the reimbursement into smaller amounts to avoid the limit, or issue reimbursement that exceeded the limit.

Accounting staff in the Department of Parks and Recreation responded similarly, stating that when the previous \$250 limit on reimbursements was proposed by the Controller's Office, they expressed concern, because reimbursements in that department to staff had often been higher amounts. Even though Department staff were informed of the new limit, they continued in some cases to make purchases with their own funds and sought reimbursement. A Parks and Recreation accounting staff member stated:

"But since it's for true County business needs (a lot of times it's for professional exam, membership and licensing purposes) we still need to reimburse the employee who paid the fee out of their own pockets. At the time we came across transactions that were over \$250 we actually brought it up with the Controller's Office, and were instructed to process the balance with another payment document. So we did not purposely circumvent the system. We did also reiterate the personal reimbursement limit to Parks staff afterwards."

We believe the 2013 changes should address these issues, but also recommend that additional language be added to the definition of this Code in ordinance, or supplemental instructions be provided, clarifying that this Code, permitting purchases by employees to be reimbursed, is only permitted when either a procurement card or a field purchase order cannot be used for the purchase, and that planning purchases to use those methods, rather than this one, is preferred.

An Ongoing Review of the Direct Pay Codes is Needed

A wide variety of issues and concerns by departments using Direct Pay Codes have been identified in this section. Even with the amendments to the Codes made through 2011, as a result of the 2009 Internal Audit Division report, and again in 2013, when the Codes were formally made part of the County Ordinance Code, departments continue to have questions about when a particular code may be used or difficulties in effectively using Direct Pay Codes because of dollar limits or other restrictions on particular codes.

There needs to be the ability to modify Codes, to delete Codes or to add Codes as patterns of goods and services purchases change in County departments.

To address this need, we recommend that the Controller's Office designate a staff person, most appropriately the current Senior Accountant in charge of the Claims Unit, to receive questions about when a particular Code should be used, or concerns about difficulty using a particular Code, or questions about creating a new Code. These inquiries should be retained by the Controller's Office, and used to make periodic revisions to Ordinance NS-300.389 as necessary, perhaps every two years, so that the ordinance remains of maximum utility for County departments.

CONCLUSION

Review of a judgmental sample of 7,629 Direct Pay Coded transactions, which included 25 different codes, identified instances involving 13 codes where the wrong code was used, a Direct Pay Code was used where a different purchasing method should have been used, and other problems indicating some uncertainty by County staff as to the proper application of the codes.

RECOMMENDATIONS

It is recommended that:

- 3.1 Departments electronically attach documentation to Direct Pay Code transactions that are for purchase of physical goods, or services, showing the purpose of the purchase and the process used to select the supplier or service provider, including whether any competitive/comparison processes were used. The intent of this recommendation is to exempt revenue pass-throughs or distributions, or payroll-related payments, from this requirement, and to focus on situations where there's a choice of vendors, or a choice as to whether or not the purchase should be made. (Priority 1)
- 3.2 The Controller's Office revise the language of selected codes, provide supplemental information on their use for County departments, or create new codes as recommended in this section. This includes providing language for some codes specifying that they are to be used only in situations where neither a procurement card nor a field purchase order can be used. (Priority 2)

- 3.3 Credit cards independently maintained by the Office of the District Attorney or other departments be identified and replaced by County-issued procurement cards. If this is not feasible, the same independent training and monitoring provided for procurement cards should be provided for department-based credit cards. (Priority 1)
- 3.4 The Social Services Agency and Procurement Department jointly develop a Countywide contract awarded by competitive bid for purchase of furniture and miscellaneous supplies needed for foster children, in place of the previous vendor selection process conducted only within SSA. (Priority 1)
- 3.5 The Finance and Government Operations Committee of the Board of Supervisors review implementation of procurement-related recommendations in the 2005 audit of the County Fire District, and that the Board make a policy determination whether to permit blanket use of a Direct Pay Code by the District for all its purchases. The current practices are inconsistent with County policy as applied to General Fund departments. (Priority 1)
- 3.6 The Controller's Office and Social Services Agency standardize the text descriptions provided for payments under Code F, for county travel, to provide more information about the purpose of the travel, such as the acronym of an organization sponsoring a conference. (Priority 2)
- 3.7 The Controller's Office should assign a specific staff member, most logically the Senior Accountant in charge of the Claims Unit, to respond to questions from departments about application of Direct Pay Codes. Based on the inquiries received, the Controller's Office should periodically, perhaps every two years, proposed updates to Ordinance NS-300.389, updating, adding and eliminating codes as needed to adapt to changing procurement patterns in the County. (Priority 1)

SAVINGS AND BENEFITS

Recommendations 3.1, 3.2, and 3.7 would assist departments in properly using Direct Pay Codes and reduce inappropriate uses, while ensuring the Codes remain useful as County purchasing patterns change, and permitting independent review of the reasons for and processes used in purchases of goods and services. Recommendation 3.3 would standardize use of procurement cards across all County departments, or require

department-based credit cards to follow the same standards as for procurement cards. Recommendations 3.4 and 3.5 would ensure that County purchasing practices are followed in order to maximize cost savings in procurement. Recommendation 3.6 would make it easier to track travel to ensure it is for legitimate County purposes, by providing clearer information on the purpose of trips.

County of Santa Clara

Office of the County Executive

County Government Center, East Wing
San Jose, CA 95110
408-491-5105



March 7, 2014

TO: Roger Mialocq
Board of Supervisors Management Audit Division

FROM: Gary Graves
Chief Operating Officer

SUBJECT: Response to the Review of Direct Pay Purchasing Methods in the County of Santa Clara

The Harvey M. Rose Accountancy Corporation Management Audit Review of Direct Pay Purchasing Methods in the County of Santa Clara is organized into three sections:

- Section 1: Improving the P-Card Program
- Section 2: Evaluating the Field Purchase Order Process
- Section 3: Adding Clarity to Use of Direct Pay Codes

The Administration's responses to the audit recommendations are provided in the attached matrix. Additional comments provided by the Procurement Department are attached as well.

Attachments:

1. Memo from Jenti Vandertuig, Procurement Director, to Gary Graves, Chief Operating Officer, dated March 4, 2014.
2. Matrix of responses to audit recommendations.

cc: Emily Harrison, Director, Finance Agency
Jenti Vandertuig, Director of Procurement, Procurement Department
David Snow, Deputy Director, Facilities and Fleet Department
Danny Chou, Assistant County Counsel, Office of the County Counsel
Sandra Dalida, Chief Fiscal Officer, Social Services Agency
Peter Jensen, Administrative Services Manager, Office of the District Attorney
Tom McClung, Director of Resource Management, Health and Hospital Systems
Alex Gallego, Director of Facilities, Health and Hospital Systems

Board of Supervisors: Mike Wasserman, Cindy Chavez, Dave Cortese, Ken Yeager, S. Joseph Simitian,
County Executive: Jeffrey V. Smith



County of Santa Clara

Office of the County Executive
Procurement Department

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March 4, 2014

TO: Gary Graves
Chief Operating Officer

FROM: Jenti Vandertuig
Director of Procurement

SUBJECT: Response from the Procurement Department Related to the Review of Direct Pay Purchasing Methods in the County of Santa Clara

The Procurement Department appreciates the opportunity to provide a response to the Review of Direct Pay Purchasing Methods in County of Santa Clara. The department has provided an overall narrative and a response to each of the recommendations applicable to the Procurement Department.

Overall Response

The Board of Supervisors is the only body that has authority to enter into contracts and issue solicitations on behalf of the County. The Board of Supervisors may, however, delegate authority to enter into contracts on behalf of the County pursuant to state law, County Ordinance Code, resolution, or express action of the Board.

The Board has delegated authority to the Director of Procurement and also in limited circumstances, to agencies and departments.

The Director of Procurement may designate purchasing authority. Under such a designation, the Director of Procurement still retains the authority and is ultimately accountable to the Board. All contracting conducted pursuant to the authority designated by the Director of Procurement must conform to the procedures established by the Director of Procurement and consistent with Board Policy.

The Director of Procurement has designated authority to County Departments to make small dollar purchases using the P-Card and the Field Purchase Order. In their Board-mandated

audit, the Management Audit Division reviewed the policies, procedures and transactions of direct pay purchasing processes, including the P-Card and Field Purchase Order.

The Audit recommendations for Field Purchase Orders which Procurement will address are: 1) Training in the use of competitive practices; 2) Providing better documentation for purchases by attaching relevant documentation for field purchase orders in the SAP system; and 3) Identifying opportunities for Countywide contracting by analyzing P-Card and Field Purchase Order data.

While the expansion of the P-Card and introduction of the Field Purchase Order in 2011 improved operational efficiencies in the delivery of County services to the public, the Audit identified shortcomings which could produce benefits and savings to the County.

The Procurement Department fully supports providing departments with increased authority via the P-Card and Field Purchase Order; however, it is imperative that ethical and best business practices be followed consistently by all who have been entrusted with the designated authority in order to safeguard tax payer dollars and to maintain integrity and the public trust.

A primary concern raised by the Audit which will be addressed by the Procurement Department, with assistance from County Counsel, is a revision in the Field Purchase Order procedures to require consistent and proper use of the competitive bidding process to capture potential cost savings and to insure an open and fair process to the vendor community. In addition to establishing requirements and procedures for competitive bidding, the revised procedures will include guidelines on the rotation of vendors, to insure that the vendor community receives opportunities to do business with the County and to minimize the use of favored suppliers.

In addition, revised Field Purchase Order procedures will include standardized step-by-step instructions for the administrative processing of Field Purchase Orders. This will include processing of documentation related to a purchase order such as attaching competitive quotes and all pertinent correspondence to the purchase order in SAP.

The Procurement Department will provide training on the updated Field Purchase Order process, which will also include an overview of the ethics and discipline of the procurement process. A review of history shows that departments not only bypass the competitive quote process, but they often place the order first, then follow with generating a Field Purchase Order just to pay the invoices.

The audit also found the need for data mining of P-Card and Field Purchase Orders to identify contracting opportunities for cost savings and improved efficiencies. Although Procurement recognizes this need, Procurement does not currently have the staffing to perform the extensive analysis, data mining and sourcing needed to maximize the opportunities for the high volume of newly identified potential cost savings. Additional staffing is needed to perform this critical function.

In addition, the eProcurement automation, which is being requested in the FY 2015 budget, would facilitate the sourcing and data mining for identification of contracting opportunities and is crucial to solving our current issues of program compliance and would maximize cost savings in small dollar purchases.

To cover emergency situations, Procurement will develop a form to be completed in the event of sudden and unexpected occurrences, so that the proper documentation can be recorded to explain why no competitive quotes were obtained.

The Procurement Department agrees with the weaknesses mentioned above found in the P-Card and Field Purchase Order processes and will implement the recommended improvements in procedures and training toward improving the identified problems to improve program compliance. The authority delegated to departments to make small dollar purchases is crucial to County operations as it provides departments with an efficient and cost-effective method of handling the transactional, small dollar purchases, which in turn allows the Procurement Department to focus more strategically on the complex, high-dollar purchasing with greater savings potential for the County.

The Audit also reflects a large number of transactions in facilities-related commodities and services that have high aggregate spend by vendor. Our records show that there are transactions from specific departments like Facilities and Fleet, Roads, Parks, Office of the Sheriff and Department of Corrections. Since 2003, based on the County's budget constraints, the number of buyers in Procurement handling the Facilities and Institutional Contracting in support of these departments has been reduced from 7 to 3. As part of the FY 2015 Budget Submittal to the County Executive, Procurement has submitted a recommendation to augment resources in the Procurement Department to effectively assist County clients.

Response to Recommendations in the Audit Report:

Section 1 - Improving the P-Card Program

1.1 The Employee Services Agency, Controller's Office and Procurement Department ensure that procurement card termination forms are included in the packet of

documents for employees who separate from County service or change positions, so that the forms are filled out and the accounts terminated as part of that process.

The Procurement Department agrees with this recommendation. While we have instituted a provision to ensure that the P-Card Program Administrator sends reminders to the Agency Program Coordinators to follow the P-Card Policy related to cancelling cards of employees who are no longer with the County, the County must have a method to cancel the P-Card when the employee is separated from County service or changes positions without any delay. Procurement will work with Employee Services Agency and the Controller's Office to incorporate this requirement.

- 1.2 **The Procurement Department utilize procurement card information to identify additional opportunities for Countywide contracting, both for individual vendors and across categories of goods purchased, as described in this section.**

The Procurement Department agrees with this recommendation. The P-Card Program Administrator is required to utilize the transaction reports to complete the vendor data analysis. The challenge to date in undertaking the additional contracting opportunities are multifold as follows:

- The bank report does not provide sufficient level 3 data as to what type of goods and services the client is procuring requiring the P-Card Administrator to manually review the transactions making it difficult and cumbersome. Procurement has reached out to the bank for further assistance;
- The comingling of purchase of items on established contracts with the use of the P-Card in certain departments like Facilities and Fleet for building operations and fleet, as approved by the Procurement Department, requires full collaboration and coordination between the users and the P-Card Program Administrator to make the determination of what items are not on contract;
- Procurement should be sufficiently staffed to manage both transactional and strategic contracting efforts to support the entire County.

- 1.3 **The Procurement Department request Departments using procurement cards to comparisons shop against Countywide contracts, require departments to give contracted vendors the opportunity to match prices identified elsewhere, and have departments report instances where non-contract prices are less, so contracts can be renegotiated or elimination of such non-competitive items can be eliminated from contracts.**

The Procurement Department partially agrees with this recommendation. Public procurement functions continue to face a momentous change in strategic functioning.

The movement is from a concentration of a “buy transaction” to supply chain management which includes the requirement definition and disciplines such as supplier development and strategic sourcing. The Harvey Rose Audit Introduction section provides information on how the then Purchasing Department was functional in 1995. The report has cited that 72 percent of the requisitions processed by the Procurement Department at that time were for less than \$1,000 and the cost of staff time to process each requisition averaged \$98. Eighteen years later the current Procurement Department functions very differently. Less than 1% is transactional buying.

Over the last decade, the Procurement Department has transformed from a transactional “low bid” model to supply chain management via strategic sourcing, best value procurement with appropriate risk mitigation. Through this model, when the client departments know their requirements, the Procurement Department can solicit and obtain the best cost given the volume of projected spend for established standards. However, if the client departments need a portfolio of products and services such as in our software and peripherals agreements, building supplies and equipment agreements to name a few, we are assured an optimum pricing with a percentage off the list price or a percentage markup as there is no guarantee of spend. Additionally, depending on the commodity, we do know that certain cost of goods go down such as information technology hardware and software while other products go up in costs.

For such commodities where we know that cost of goods go down and in other special circumstances where a cheaper price can be found on the internet, we have provided provisions in the P-Card Policy allowing departments to request the contracted vendor to match the price of the product if the departments find it cheaper from a different source. If the contracted vendors are not able to match the price, departments have been given direction to document the written communication and utilize the P-Card to make the purchase from the non-contracted vendor, thereby saving the County money. This is common for software and peripherals contracts.

It is important for clients to focus on their operational needs and work on their specifications and requirements so that Procurement can effectively source and establish term contract with appropriate pricing, instead of the common practice where departments do not invest the time to properly specify their requirements, resulting in higher pricing for requirement items, and then they later comparison shop the vendor pricing to the County contracts. Where and when feasible, Procurement will utilize the data to negotiate with suppliers.

- 1.4 **The Procurement Department and Controller's Office request US Bank to randomize the credit card numbers issued on the County's accounts.**

The Procurement Department agrees with this recommendation. In calendar 2013 there were multiple instances of fraud activity on County P-Cards both nationally and internationally. In communication with the bank, the County P-Card Administrator learned that there were instances where the credit card theft was occurring more often due to the sequence in credit card numbers. The bank is taking steps to randomize the credit card numbers and the Procurement Department has escalated this matter to the US Bank.

Section 2 - Evaluation the Field Purchase Order Process

- 2.1 **Existing training for procurement card use can be expanded to include use of field purchase orders, or additional training to be provided by the Procurement Department and Controller's Office, focusing on the need to properly document the purpose of purchases and use of competitive purchasing methods.**

The Procurement Department agrees with this recommendation. Since the Procurement Department rolled out the Field Purchase Order Policy and training to County staff, we have not provided on-going training like the P-Card Program due to lack of sufficient resources in the Procurement Department. Prior to the Field Purchase Order method introduced to the County, agencies and departments utilized the Direct Payment method utilizing the specific codes H2A, H2B and H2C. These transactions were completed without a contract with the vendor for the purchase of goods and services. With the lack of training and oversight due to resource issues, departments have not done their due diligence in maintaining appropriate purchasing records like they do with the P-Card Program. The Procurement Department has reviewed the staff who are able to issue Field Purchase Orders in the respective departments and will narrow down the number of users authorized to make such designated transactions and ensure that they are adequately trained to complete this function.

- 2.3 **Policies should be developed by the Facilities Department and the facilities unit of the Santa Clara Valley Health and Hospital System to guide when contracts with crafts vendors are used for maintenance and repairs, rather than County staff, along with a process to consolidate the number of current contracts and select vendors through a competitive process. These policies should be included in Chapter 5 of the Board of Supervisors Policy Manual, which governs County contracting policies.**

The Procurement Department agrees with this recommendation. The volume of transactions both on P-Cards and Field Purchase Orders are excessive and against the Policies that are for small dollar purchases. In order to comply with Section 5.1 of the Board Policy Chapter 5, vendors should be given an opportunity to earn our business and the County must competitively solicit to ensure we establish contracts for recurring use. There have been instances where service calls are placed and at times the charges are over the \$5,000 transaction limit requiring Procurement to issue Purchase Orders after the fact. Request for staffing in Procurement has been recommended in the FY 2015 budget to address this workload.

- 2.4 **The Procurement Department should regularly analyze field purchase order data, in conjunction with end-user departments, as occurred in this section, to identify opportunities for cost savings by negotiating Countywide agreements using competitive bidding process.**

The Procurement Department agrees with this recommendation. The data mining and analysis utilizing SAP is very labor intensive and we have to look into every Field Purchase Order to determine what is being procured. With the staff resources we will be able to address the analysis and take steps to issue solicitations and establish term contracts where applicable. Additionally, the eProcurement automation will greatly assist in this area by having department s provide limited competition for their immediate needs by sourcing from a minimum of three vendors and Procurement subsequently utilizing that data to establish term contracts via full and open competition when the spend is high.

- 2.5 **The Santa Clara Valley Health and Hospital System should be required to shift from the current Pathways Materials Management software system to the purchasing module of SAP to process purchases, as all other departments have, or to develop some method to make its purchasing activity more transparent for third party review than the PMM system provides.**

The Procurement Department agrees with this recommendation. While the Procurement department agrees with the recommendation, we believe a holistic approach that optimizes the relationship between people, process and technology needs to be taken to address the non-compliance and system issues.

- **Technology:** Procurement recommends an eProcurement automation of the procure to pay process with a link to SAP accounting system based on a comprehensive evaluation of the system issues of SAP and PMM. The proposed eProcurement automation will:

- Maintain catalogs of contracted items while allowing for using PMM for auto replenishment of products and consumables for VMC operations;
- Establish a single, centralized contract repository for all County-recognized contracts (i.e. local contracts, Group Purchasing Organization (GPO) contracts approved by Procurement);
- Enable all contract items to be searchable;
- Allow for electronic invoicing and matching in PMM before it is fed into SAP; and
- Offer electronic sourcing capability for small dollar purchases.
- **People:** A significant volume of spot buying happens at VMC and is co-mingled with the orders placed against contracts established by the Procurement Department. This is a violation of the Purchasing Agent's designated authority. In order to remedy this non-compliance, the spot buying via Field Purchase Orders needs to happen by the buying team under the direct management of the Procurement Manager in charge of the Medical Contracting Division. Neither VMC, Procurement nor the auditors are able to delineate the spend between the contracted versus non-contracted items.
- **Process:** Process efficiencies will be achieved along with the deployment of the proposed eProcurement automation. They include:
 - Reducing the overdependence on manual processes from procure to pay;
 - Establishing limited competition for small dollar purchases for non-contracted items;
 - Maintaining the data integrity of Field Purchase Order transactions; and
 - Ensuring negotiated savings through contracts be realized.

Section 3 – Adding Clarity to Use of Direct Pay Codes

- 3.4 **The Social Services Agency and Procurement Department jointly develop a Countywide contract awarded by competitive bid for purchase of furniture and miscellaneous supplies needed for foster children, in place of the previous vendor selection process conducted only within SSA.**

The Procurement Department agrees with this recommendation. We will do what is necessary to solicit and establish contracts with favorable pricing and terms for furniture and miscellaneous office supplies as needed for foster children.

FOLLOW UP REVIEW OF Direct Pay Purchasing Methods in the County of Santa Clara

SECTION	AUDIT RECOMMENDATION	COUNTY RESPONSE
Section 1. Improving the Procurement Card Program		
1.1	The Employee Services Agency, Controller's Office and Procurement Department ensure that procurement card termination forms are included in the packet of documents for employees who separate from County service or change positions, so that the forms are filled out and the accounts terminated as part of that process.	Agree. As mentioned in the report, the Procurement Department already has a mechanism to identify employees who separate from County service or change positions. In addition, the Controller's Office will work with Employee Services Agency to review the feasibility of real time identification of such changes and termination of P-Card holders who separate from the County or leave their departments.
1.2	The Procurement Department utilize procurement card information to identify additional opportunities for Countywide contracting, both with individual vendors and across categories of goods purchased, as described in this section.	Agree. The P-Card Administrator is required to utilize transaction reports to complete vendor data analysis. However, undertaking additional contracting opportunities is affected by the lack of information captured in the P-Card system, using P-Cards to purchase contract items from non-contract vendors, and lack of staff within the Procurement Department to manage both transaction and strategic contracting efforts.
1.3	The Procurement Department request Departments using procurement cards to comparison shop against Countywide contracts, require departments to give contracted vendors the opportunity to match prices identified elsewhere, and have departments report instances where non-contract prices are less, so contracts can be renegotiated or elimination of such non-competitive items can be eliminated from contracts.	Partially agree. The Procurement Department partially agrees with the recommendation. It is important for clients to focus on their operational needs and work on their specifications and requirements so that the Procurement Department can effectively source and establish term contract with appropriate pricing, instead of the common practice where departments do not invest the time to properly specify their requirements, resulting in higher pricing for requirement items, and then they later comparison shop the vendor pricing to the County contracts. Where and when feasible, the Procurement Department will utilize the data to negotiate with suppliers.
1.4	The Procurement Department and Controller's Office request U.S. Bank to randomize the credit card numbers issued on the County's accounts.	Agree. The Procurement Department has already contacted U.S. Bank who is taking steps to randomize the credit card numbers.

Section 2. Evaluating the Field Purchase Order Process

FOLLOW UP REVIEW OF Direct Pay Purchasing Methods in the County of Santa Clara

SECTION	AUDIT RECOMMENDATION	COUNTY RESPONSE
2.1	Existing training for procurement card use be expanded to include use of field purchase orders, or additional training be provided by the Procurement Department and Controller's Office, focusing on the need to properly document the purpose of purchases and use of competitive purchasing methods.	Agree. The Procurement Department agrees with this recommendation. Department staff who issue Field Purchase Orders have been identified by the Procurement Department and these users will be adequately trained in documenting purpose of the purchase and competitive purchasing methods used.
2.2	The County Executive remind departments in writing of the Comprehensive Vehicle Policy requirement that the Facilities and Fleet Department be used for all vehicle maintenance and repair services on County vehicles, and that other enforcement methods be developed to address any continued non-compliance.	Agree. The Facilities and Fleet Department already performs a semi-annual desk review of department's compliance to the Comprehensive Vehicle Policy and reports findings to the Finance and Government Committee.
2.3	Policies should be developed by the Facilities Department and the facilities unit of the Santa Clara Valley Health and Hospital System to guide when contracts with crafts vendors are used for maintenance and repairs, rather than County staff, along with a process to consolidate the number of current contracts and select vendors through competitive processes. These policies should be included in Chapter 5 of the Board of Supervisors Policy Manual, which governs County contracting policies.	Agree. The Procurement Department, Facilities and Fleet department and Santa Clara Valley Health and Hospital System agree that policies should be developed to be a guide when contracts with vendors are to be used for maintenance and repairs. However, staffing needs most be addressed to completely deal with workload in this area.
2.4	The Procurement Department should regularly analyze field purchase order data, in conjunction with end-user departments, as occurred in this section, to identify opportunities for cost savings by negotiating Countywide agreements using competitive bidding processes.	Agree. The Procurement Department agrees with this recommendation. The data mining and analysis of SAP information is very labor intensive, requiring each Field Purchase Order to be reviewed to determine what is being procured obtaining additional staff will assist in this analysis as well as the use of proposed automation, which will assist departments with identifying appropriate vendors to purchase from and providing data for the Procurement Department to establish term contracts in openly competitive environment.
2.5	The Santa Clara Valley Health and Hospital System should be required to shift from the current Pathways Materials Management software system to the purchasing module of SAP to process purchases, as all other departments have, or to develop some other method to make its purchasing activity more transparent for third-party review than the PMM system provides.	Agree. The Santa Clara Valley Health and Hospital System has already shifted some of its purchases from the Pathways Materials Management System to SAP. Further areas to be shifted will be explored by the Procurement Department and Santa Clara Valley Health and Hospital System.

**FOLLOW UP REVIEW OF
Direct Pay Purchasing Methods in the County of Santa Clara**

SECTION	AUDIT RECOMMENDATION	COUNTY RESPONSE
3.1	<p>Departments electronically attach documentation to Direct Pay Code transactions that are for purchase of physical goods, or services, showing the purpose of the purchase and the process used to select the supplier or service provider, including whether any competitive/comparison processes were used. The intent of this recommendation is to exempt revenue passthroughs or distributions, or payroll-related payments, from this requirement, and to focus on situations where there's a choice of vendors, or a choice as to whether or not the purchase should be made.</p>	<p>Section 3. Adding Clarity to Use of Direct Pay Codes Agree. The Controller's Office will work with departments to implement the attachment requirement for the applicable Direct Pay Code payments showing procurement information or will assist departments with developing alternative solutions.</p>
3.2	<p>The Controller's Office revise the language of selected codes, provide supplemental information on their use for County departments, or create new codes as recommended in this section. This includes providing language for some codes specifying that they are to be used only in situations where neither a procurement card nor a field purchase order can be used.</p>	<p>Agree. The Controller's Office and County Counsel will review the Direct Pay codes identified in the report to develop practical means of resolving the issues that were mentioned. With the changes made to the May 2013 revised Direct Pay Ordinance, we believe that better guidance together with implementation changes will solve most of the problems.</p>
3.3	<p>Credit cards independently maintained by the Office of the District Attorney or other departments be identified and replaced by County-issued procurement cards. If this is not feasible, the same independent training and monitoring provided for procurement cards should be provided for department-based credit cards.</p>	<p>Agree. The Office of the District Attorney agrees with this recommendation.</p>
3.4	<p>The Social Services Agency and Procurement Department jointly develop a Countywide contract awarded by competitive bid for purchase of furniture and miscellaneous supplies needed for foster children, in place of the previous vendor selection process conducted only within SSA.</p>	<p>Agree. The Procurement Department and Social Services Agency agree with this recommendation.</p>
3.5	<p>The Finance and Government Operations Committee of the Board of Supervisors review implementation of procurement-related recommendations in the 2005 audit of the County Fire District, and that the Board makes a policy determination whether to permit blanket use of a Direct Pay Code by the District for all its purchases. The current practices are inconsistent with County policy as applied to General Fund departments.</p>	<p>Agree. The Controller's Office and Procurement Department will meet with the County Fire District to develop a recommended plan and will return to the Board of Supervisors.</p>

**FOLLOW UP REVIEW OF
Direct Pay Purchasing Methods in the County of Santa Clara**

SECTION	AUDIT RECOMMENDATION	COUNTY RESPONSE
3.6	The Controller's Office and Social Services Agency standardize the text descriptions provided for payments under Code F, for county travel, to provide more information about the purpose of the travel, such as the acronym of an organization sponsoring a conference.	Agree. The text line for Direct Pay Code F already includes standardized information for both the Controller's Office and the Social Services Agency and more information cannot be included on this line. Instead the Controller's Office has identified an additional field that can be used to capture the desired information.
3.7	The Controller's Office should assign a specific staff member, most logically the Senior Accountant in charge of the Claims Unit, to respond to questions from departments about application of Direct Pay Codes. Based on the inquiries received, the Controller's Office should periodically, perhaps every two years, proposed updates to Ordinance NS-300.389, updating, adding and eliminating codes as needed to adapt to changing procurement patterns in the County.	Agree. We believe that we are already compliant in this area. The Senior Accountant in the Claims Unit and Unit staff members respond to questions from department staff regarding the Direct Pay Code list. Also the Direct Pay Code list is revised when appropriate, which may be sooner or later than the proposed two year period.