



City of Phoenix

Mission Statement

To improve the quality of life in Phoenix through efficient delivery of outstanding public services.

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1230038

This report can be made available in alternate format upon request.

Public Works Department Contract Monitoring

November 3, 2023

Report Highlights

Oversight

We found that overall, Public Works was tracking its numerous contracts. However, the Department did not have a structured contract monitoring program; thus, there was no uniformity among its divisions' processes and procedures.

Contract Monitoring

Overall, most of the tested contracts had an assigned contract monitor and did not exceed their payment authorities.

Invoice Testing

All tested invoices were mathematically accurate. However, some invoices were missing required notations, or billed fees did not correlate to fee schedules. Other invoices were so complex that divisions had issues confirming the accuracy of specific rates and charges.

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Executive Summary

Purpose

Our purpose was to determine that the Public Works Department (PW) has adequate processes to ensure that contracts are monitored.

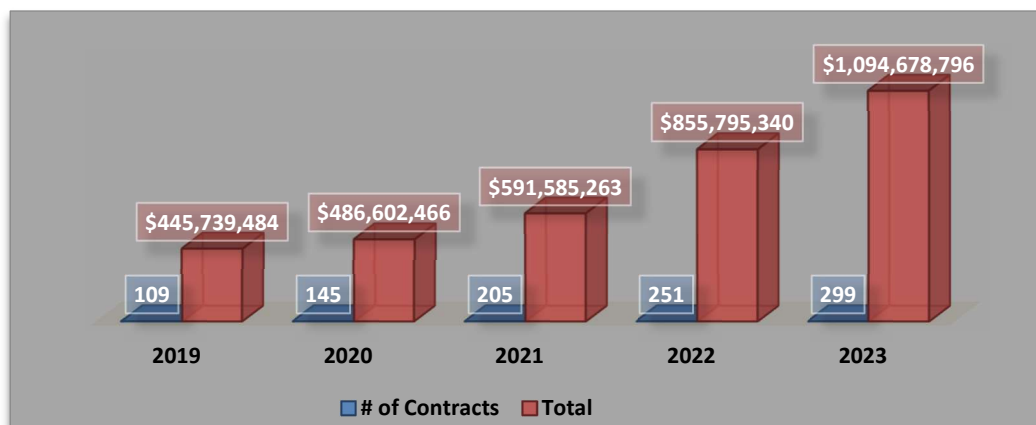
Background

Contract monitoring ensures that vendors meet all the requirements outlined in a contract and are held accountable for their performance. *Administrative Regulation (AR) 3.10 - General Procurement Procedures* outlines steps departments should follow when obtaining contracted goods and services from vendors. The AR's purpose is to provide an efficient process that ensures uniformity. It states that once contracts are signed, departments should monitor them for changes and performance issues to ensure fiscal and programmatic accountability.

PW is a self-support department, which means it has its own procurement staff and requires limited assistance from Finance's Central Procurement Division. The Department has four divisions (Administration, Facilities, Fleet, and Solid Waste) that employ contract specialists, shoppers, aides, and multiple end-users who administer and monitor contracts as needed.

As of April 20, 2023, PW had 327 active contracts across its four divisions valued at over \$1B. The total number of contracts and their corresponding dollar values has increased since CY19.

Public Works Contracts CYs 19-23



The Department's number of contracts and their values have increased significantly since CY19.

We wanted to ensure PW had an adequate monitoring process for its multiple contracts. Therefore, we interviewed staff, reviewed contract monitoring policies and procedures, studied best practices, read contracts, and tested invoices for mathematical accuracy and compliance with contract terms.

Results in Brief

We found that, overall, PW divisions were tracking their numerous contracts. However, the Department did not have a structured contract monitoring program; thus, there was no uniformity of processes and procedures among the divisions.

We met with and interviewed PW staff across its four divisions to review contract monitoring processes. While most divisions reviewed their contracts consistently, there was no uniformity in risk ranking of contracts or performance evaluations because the Department lacked a structured contract monitoring program.

Most of the tested contracts had an assigned contract monitor and did not exceed their payment authorities.

We tested a sample of 16 contracts across the four divisions to ensure they were assigned to a contract monitor and had not exceeded contracted amounts. We found that all the contracts were assigned to a monitor and were under their payment authorities.

All tested invoices were mathematically accurate. However, some invoices were missing required notations, or fees did not correlate to published schedules. Others were so complex that divisions had issues confirming the accuracy of specific rates and charges.

We selected a sample of 8 contracts and reviewed 42 invoices for accuracy. All the invoices were mathematically accurate. However, many divisions had issues explaining some of the invoice fees and rates. Further, we found incorrect fees on invoices and incomplete supporting documentation, that divisions subsequently had the vendors correct; these issues were not materially significant.

Department Responses to Recommendations

Rec. #1.1: Administrative Services – Create a documented departmental contract monitoring program that includes: 1) a contract risk ranking process that follows a tiered structure, 2) contract monitoring plans based on the risk ranking tier, 3) a contract monitor training program, 4) documented annual (minimum) performance evaluations, and 5) vendor escalation guidelines.

Response: Public Works Administrative Services will create a documented departmental contract monitoring program that includes: 1) a contract risk ranking process that follows a tiered structure, 2) contract monitoring plans based on the risk ranking tier, 3) a contract monitor training program, 4) documented annual (minimum) performance evaluations, and 5) vendor escalation guidelines.

Target Date:
June 14, 2024

Explanation, Target Date > 90 Days: The Procurement Manager position that will lead the execution of this new program became vacant on 10/30/23. The extended timeline will allow for the recruitment process to be completed followed by the development and implementation of the new contract monitoring program.

Rec. #2.1: Administrative Services – Develop a process to ensure that vendor evaluations are completed annually and are submitted to Administrative Services for review and retention.

Response: Public Works Administrative Services developed and implemented a process to ensure that vendor evaluations are completed annually and submitted to Administrative Services for review and retention on July 1, 2023.

<https://cityofphoenix.sharepoint.com/sites/pwd/directorsoffice/administration-fleet-management/administrativeservices/procurement-services/contract-service>

Target Date:
July 1, 2023

Rec. #3.1: As part of the recommended contract monitoring procedures (1.1), include a process for divisions to perform additional internal reviews on high-risk vendor contracts and invoices to ensure billing is accurate and complies with contract terms

Response: As part of the recommended contract monitoring procedures (1.1), Public Works Administrative Services will include a process for divisions to perform additional internal reviews on high-risk vendor contracts and invoices to ensure billing is accurate and complies with contract terms.

Target Date:
June 14, 2024

Explanation, Target Date > 90 Days: The Procurement Manager position that will lead the execution of this new program became vacant on 10/30/23. The extended timeline will allow for the recruitment process to be completed followed by the development and implementation of the new contract monitoring program.

1 – Governance and Oversight

Background

AR 3.10 stipulates that departments are responsible for monitoring their contracts. Ideally, self-support departments such as PW have procurement staff who assist with such topics as formal procurements, contract management, policy, and procedural support, as needed. Finance's Central Procurement provides additional support for items such as: strategic procurement, cooperative agreements, policy support, Citywide training, and procurement resources.

Finance's Central Procurement uses the *Guidelines: Contract Tiers and Risk Factors* worksheet to monitor and assess contracts and to assign a contract to one of three risk tiers: High, Medium, and Low. Which assignment a contract receives directly impacts its level of evaluation and its review schedule. According to the documentation, high-risk contracts should be monitored every three months (or more), medium-risk contracts bi-annually, and low-risk contracts annually.

Outside of this documentation, there is no Citywide policy on contract monitoring. AR 3.10 does not specify what departments should focus on in their contract monitoring plans. The AR does state that departments are responsible for implementing sufficient internal controls and review procedures to ensure compliance with the Procurement Code. PW's Administrative Services Procurement Services provides support on contract services including monitoring.

The Office of Federal Procurement Policy (OFPP) published a guidebook on best practices for contract administration. Some of its recommendations include the following:

- Risk assessments should determine a contract's monitoring plan.
- Contract monitoring plans should outline the performance metrics.
- Training should be provided for individuals responsible for contract monitoring.
- Criteria for vendor escalations should be standardized.

We used the standards outlined by the OFPP to establish criteria to test how adequately PW monitored its contracts. Therefore, we interviewed contract staff about the Department's contract monitoring process. We also reviewed documentation on contract monitoring processes, procedures, templates, and training objectives. Finally, we tested a sample of contracts to confirm they had assigned monitors and, at minimum, annual evaluations.

Results

We found that overall, PW divisions were tracking its numerous contracts. However, the lack of documentation on critical contract monitoring processes has resulted in inconsistencies among the divisions.

We met with PW contract monitoring staff across all divisions and discussed the Central Procurement and OFPP contract monitoring guidance on risk assessments, training, vendor performance, and escalations.

Risk Assessments

PW Procurement staff stated that divisions conduct risk assessments on their contracts; these assessments were then used to set up contract monitoring plans. However, in interviews with the divisions, we found that most were unaware of any ranking system. They were only doing risk assessments on contracts for vendors that needed background checks for badge access to City buildings. Divisions stated that they were constantly monitoring contracts, but there was neither a formal, written process to establish how often contracts should be evaluated, nor a standardized checklist that outlined specific performance metrics to assess.

Training

The OFPP suggests that organizations conduct training for contract monitors based on the complexity and criticality of the contracts they oversee. In addition, it recommends that contract monitors who are assigned to more complex or critical contracts receive more training hours than their counterparts. The OFPP also advocates a structured training program for contract monitors and continuing professional education.

During our interview with PW staff, we found that training for contract monitor was largely ad hoc, with divisions responsible for outlining their specific agendas. Some divisions had training for contract monitors only when they were newly hired. Other divisions, however, had a more structured approach to training their contract monitors. During our interviews, we found that the Fleet division was in the process of creating a dedicated contract monitoring team. They provided us with manuals and documentation used for training monitors. Further, the division conducted routine refresher courses for their monitors on recurring issues and tracked participation with attendance sheets.

However, this was not the standard practice across the Department. The lack of a formal training program for the department suggests there may be no uniformity in contract monitoring knowledge. As PW's contract monitors retire, promote, or leave the Department, the probability increases that valuable knowledge will be lost. A comprehensive, structured training program reduces the likelihood of this scenario.

Performance Evaluations

Performance evaluations are essential to gauge how well vendors conform to contract requirements. However, during our testing, we found that most divisions were not performing vendor evaluations, not even annually. We selected a sample of 16 active

contracts across multiple PW divisions and requested copies of the most recent evaluations. None of the divisions could provide this document for the selected sample. PW divisions only conduct evaluations on vendors when there are issues, or when a contract is ready to expire or is eligible for renewal.

PW has no criteria that its divisions conduct annual evaluations to ensure vendors meet performance requirements. The large volume of contracts makes this task inherently difficult. However, the lack of a formal, uniform process to monitor all contracts (especially those that are critical or more complex), at least annually, increases the probability that important vendor issues could get overlooked. PW's procurement staff confirmed that the Department was in the process of creating an annual evaluation process using MS Forms. While the webpage was active and operational, there was no documentation yet to support the program.

Vendor Escalations

We found no Departmental guidelines on when to report or escalate vendor issues. Since divisions were considered subject matter experts on their contracts, how and when they handled escalated contract issues was a subjective determination. Most division staff we interviewed often stated they rarely or never had vendor issues, but in subsequent meetings, we were informed of some vendor issues.

Fleet division did provide us with a link to a new form they use that stipulated an evaluation was necessary after five or more complaints about a vendor. Still, we could not confirm that other divisions used the same criteria to escalate issues. A vendor evaluation form was available to the department, but during our conversations with PW staff, we confirmed that it was mainly used when it was time to rebid contracts. Most issues were resolved personally by contract monitors who had relationships with the vendors; however, issues were not always formally tracked or documented by the divisions. All PW staff confirmed that they escalated known issues to Procurement staff for further involvement if they became critical.

Recommendation

- 1.1 Administrative Services – Create a documented departmental contract monitoring program that includes: 1) a contract risk ranking process that follows a tiered structure, 2) contract monitoring plans based on the risk ranking tier, 3) a contract monitor training program, 4) documented annual (minimum) performance evaluations, and 5) vendor escalation guidelines.

2 – Contract Monitoring and Utilization

Background

The OFPP recommends organizations create a well-documented, structured process to monitor their contracts. Within the process, some steps should include the assignment of contract monitors, annual vendor performance evaluations, and an automated system that tracks contracts from the procurement to closeout stages.

We wanted to ensure that PW divisions were monitoring their contracts based on the criteria outlined by the OFPP. Therefore, we interviewed PW staff on their contract monitoring processes. We obtained and read the provided documentation. We also selected a sample of contracts and conducted tests to ensure they were being monitored.

Of the tested vendors, we found that most of the contracts had specific monitors assigned to track the contracts. The divisions stated they were conducting annual evaluations on each vendor; however, they could not provide any supporting documentation to support this statement.

We tested a sample of 16 contracts that were valid from 2016 with maximum extension dates through 2027; the total target value of all the contracts was nearly \$44M. Our results showed that all the tested contracts had specific monitors assigned. All divisions stated they conducted annual evaluations; however, they could not provide documentation of the most current contractor evaluation form for the sample selected. Although the divisions advised that the vendors did not have any performance issues, documented annual evaluations provides a historical reference if issues do occur and if the assigned contract monitor changes.

All the tested contracts had remained within the payment authority. Further testing on five high-utilization contracts confirmed they were being adequately tracked, rebid early, or supplemented by other vendors to ensure they stayed within budget.

SAP Supplier Relationship Management (SRM) is the software system used by the City for contract procurement and vendor monitoring. The system provides a reporting tool that allows users to monitor the budget utilization or payment authority on contracts. Contract owners in Procurement can assign parameters, so the system notifies them when a contract's utilization is approaching a specific threshold to avoid overspending.

We wanted to confirm that PW adequately managed the payment authority on its contracts. Therefore, we selected a sample of 299 contracts to review. Our tests found that the majority of contracts had utilization rates that were less than 39%. Two contracts were at 100% utilization, but all had remained within that threshold.

Utilization of PW Contracts

Contract Budget Utilization	39% or less	40% to 59%	60% or higher	Total
# of Contracts	195	23	81	299
Percentage	65%	8%	27%	100%

Most of PW's contracts had used only 39% or less of their allocated budgets; none had gone over its contract limit.

Further, we selected five vendors with a year or less remaining on their contracts, and budget utilization rates at 85% or higher. We deemed these contracts as having a higher risk of exceeding their payment authorities. Procurement staff confirmed that out of the five vendors in this sample, two had contracts rebid early due to increased utilization and vendor costs; another contract went to Council at the end of August 2023 to request additional payment authority.

The two remaining contracts were up for rebid in April 2024. One vendor's contract was a subscription and was on track to not exceed its limit based on historical trends, despite SRM reports. The last vendor provided services that were supplemented by other vendors, and the Department staff advised that they would be using these alternates to not exceed the contract's payment authority.

PW staff procured and tracked all contracts using SAP SRM, the City's procurement application. During our interviews with PW staff, most stated they relied on SRM for their daily contract monitoring activities but confirmed the system had limitations that they have learned to work around. PW personnel explained that SRM provided basic aggregate spending information on contracts, but nothing more substantial. Procurement staff did confirm that the City is in the process of rolling out modules with OpenGov that will include contract development and vendor performance ratings. However, at the time of this audit, there was no further documentation on this topic or definitive launch dates for the various modules.

Recommendation

- 2.1 Administrative Services – Develop a process to ensure that vendor evaluations are completed annually and are submitted to Administrative Services for review and retention.

3 – Payment Testing

Background

PW currently has 327 contracts that provide goods and services for its various divisions and other City departments. Further, some cooperative contracts are shared with other governmental entities within Arizona including other cities and/or organizations. PW's Procurement Services provides an invoice review document for its divisions. It states that purchase orders (PO) and invoices should be reviewed when conducting internal quality checks.

Invoices are considered sufficient if they have the following information: date, invoice number, quantities, and unit prices (extended and totaled). A contract number or PO must be on the invoice, and correct payment terms and discounts for early payment. Further, charges on the contract should match contract rates, and should only include contracted services. Additionally, the OFPP recommends that invoices only be approved and paid when vendors perform according to contract terms and conditions.

We wanted to confirm that payments to vendors were compliant with contract terms and conditions; we also wanted to ensure PW staff was reviewing and paying only accurately billed invoices. Therefore, we selected 42 invoices from eight PW contracts for testing. We reviewed all the selected invoices for mathematical accuracy, completeness, expenditures that fit contract scopes, and for additional specific contract requirements, such as logs or supporting documentation provided by vendors.

Results

We found that all the tested invoices were mathematically accurate.

For our testing, we selected eight vendors and 42 invoices from FY22-24 that totaled over \$1M in spending. We recalculated the charges, fees, and taxes on each invoice and found that all were mathematically accurate. In our review of the accuracy of contract rates and fees, we confirmed they were correct. All expenditures fit contract scopes.

Verifying the accuracy of the invoices in our sample took a great deal of work. Out of the eight vendors chosen for our sample, nearly all required additional support to determine accuracy since some fees on the invoices were not reflected in the supporting documentation included in the contracts. In most instances, divisions could provide supporting documentation to explain the charges, but some invoices previously paid had incorrect data or supporting documentation.

In our testing, we found that a few invoices were missing important information required by the contract. Some of these issues were resolved in more current invoices. We also found that staff accepted some invoice fees at face value due to billing complexity or the low dollar value of items being charged.

Using the criteria listed above, we tested 42 invoices for compliance. We found that 93% of the invoices were complete per Procurement guidelines. We found one vendor whose FY22 invoices were missing required PO or contract numbers. However, the FY23-24 invoices we reviewed did not have similar issues. Fleet division confirmed that this vendor had initial issues accurately completing its invoices, but after additional support and training, the problem was rectified.

We found multiple invoices that required additional support and explanation to comprehend due to fee schedules that failed to correspond to what was listed in the contract. Some invoices, especially those associated with compressed natural gas (CNG) services, were based on hedge pricing. For these services, the City purchased CNG on a rolling basis; therefore, invoices could include prices from multiple years. We reviewed one invoice from July 2021 and confirmed that the market price for CNG at that time was less than what the City was billed.

We could not account for other fees on the invoices, and Departmental staff confirmed that they were not able to fully explain all the charges. Since the vendor acted as the broker for the City, the vendor was responsible for making sure the City was charged correctly and handled any billing disputes. PW staff was only ensuring the invoices were mathematically accurate and reasonable. This same procedure was used for a vendor that provided locksmith services for the Fleet divisions. Due to the different kinds of keys provided, and multiple corresponding unit prices, the division only confirmed that labor fees were accurate, not the individual price for each key type.

Recommendation

- 3.1 As part of the recommended contract monitoring procedures (1.1), include a process for divisions to perform additional internal reviews on high-risk vendor contracts and invoices to ensure billing is accurate and complies with contract terms.

Scope, Methods, and Standards

Scope

We reviewed PW's contract monitoring policy and procedures across its four divisions. We also tested invoice payments for mathematical accuracy and compliance with contract terms between FY22-24.

The internal control components and underlying principles that are significant to the audit objectives are:

- Control Environment
 - Management should establish an organizational structure, assign responsibility, and delegate authority to achieve the entity's objectives.
- Control Activities
 - Management should design the entity's information system and related control activities to achieve objectives and respond to risk.
 - Management should demonstrate a commitment to recruit, develop, and retain competent individuals.
 - Management should design control activities to achieve objectives and respond to risk.
- Monitoring Activities
 - Management should establish and operate monitoring activities to monitor the internal control system and evaluate the results.
 - Management should implement control activities through policies.

Methods

We used the following methods to complete this audit:

- Met with and interviewed Procurement and PW staff.
- Retrieved internal documents on contract monitoring process and procedures.
- Researched other cities and entities for best practices on contract monitoring.
- Reviewed SRM and SAP reports on contract status, utilizations, and spend amounts.
- Selected sample of vendor contracts for review and testing.
- Reviewed paid invoices for mathematical accuracy and compliance with contract terms.
- Met with SAP SRM support team for assistance on how to run and read reports.

- Conducted survey of external agencies and cities to review the contract monitoring system they use.

Unless otherwise stated in the report, all sampling in this audit was conducted using a judgmental methodology to maximize efficiency based on auditor knowledge of the population being tested. As such, sample results cannot be extrapolated to the entire population and are limited to a discussion of only those items reviewed.

Data Reliability

We assessed the reliability of SRM Contract Utilization data by (1) performing electronic testing, (2) reviewing existing information about the data and the system that produced them, and (3) interviewing agency officials knowledgeable about the data. We determined that the data were sufficiently reliable for the purposes of this audit.

The reliability of the SAP Accounts Receivable Revenue Report and the SRM Purchase Orders by Contract Report, were previously determined to be reliable through an independent audit review.

Standards

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Any deficiencies in internal controls deemed to be insignificant to the audit objectives but that warranted the attention of those charged with governance were delivered in a separate memo. We are independent per the generally accepted government auditing requirements for internal auditors.