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Procurement Process Review

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To: Gary Warnberg, Procurement Director
LeaAnn Stagg, Interim Controller

Re: Procurement Process Review

The Internal Audit Department (IA) conducted a review of City's procurement processes. The 2011 Internal Audit Plan included the Purchasing and Accounts Payable Functions Review; however, due to the complexity and size of the audit, IA divided the review into two phases. Phase I, the Procurement Process, is contained within this report. Phase II, the Accounts Payable Review, will take place later in 2011.

Background
The City Procurement processes include the City's bid processes (requests for high dollar products or services), the Request for Proposal (RFP) process, the requisitioning process (request for a product or service), and purchase approvals and authorizations.

The total cost and nature of purchase for a product or service dictates which procedure must be followed:

- Requests for Proposals (for professional services over $50,000);
- Informal bids (purchase $1,000 to $50,000 in one year): Procurement collaborates with department management to select the lowest overall total cost from at least two proposals; and
- Formal bids - Official Publication (purchase over $50,000 in one year): sealed bids are submitted to Procurement then the lowest qualified bidder is recommended to the Permanent Review Committee.

The Procurement process results in establishing active contracts with the City's vendors. In 2010 there were approximately 4,400 active contracts. Total City payments in 2010 related to contractual services, operational expenses and capital expenditures were approximately $416 million.

Scope
The Procurement Process Review included gaining an understanding of internal controls, including policies and procedures, through observation, inquiry, and limited testing surrounding the Procurement processes. We performed, on a sample basis, testing of procurement processes and transactions within the period of January 2010 through March 2011.

Objectives
The review was performed to assess whether controls over the following processes are efficient and effective:
- Purchasing approval and authorization;
- Formal and informal bid processes;
- Requisitioning process, purchasing approval, and authorization;

- Change management (monitoring any system post-approval changes made to purchases or receipts; and changes to authorization levels in PeopleSoft).

Summary of Findings *and Management Action Plans:*
- Department and purchasing management do not monitor some purchasing system user roles.
  On a quarterly basis Compass support, on behalf of Procurement Management and Central Requisitions Group (CRG), will provide a list of Department Approvers to Department Heads for their review and approval. (Ref # 1 below, Monitoring Compass Roles)

- There is no formal City policy to define expectations regarding processing requisitions properly. Also, there is no procedure in place that defines expectations for various departments to regularly monitor incorrectly processed requisitions.
  Finance Management will develop a formal policy surrounding the Central Requisitions process. Also, Finance Management will develop a Compass public query, made available to City departments, to identify invoices that did not follow the proper requisition process. (Ref # 2 below, Vendor Invoices)

- Some departments submit purchase requisitions for processing with missing or incorrect coding[1] information.
  CRG will continue training and educating department requesters on the necessity of submitting correct coding with the requisition requests, and to respond in a timely fashion when insufficient or erroneous coding is submitted. (Ref # 3 below, Requisition Coding)

- There is no formal process to monitor post-approval changes made in the purchasing system during the procurement process.
  Due to system limitations, Finance management will need more time to determine the needed enhancements to monitor the post approval increases to purchase order number of units or unit price on a weekly basis over a predetermined threshold. (Ref # 4 below, Monitoring Post-approval Edits)

- Some departments submit requisitions to be processed directly to employees rather than the CRG e-mail address.
  CRG personnel will continue to educate requesters on the importance of using the CRG e-mail address, and re-evaluate the process at year end. (Ref # 5 below, Central Requisitions Group e-mail)

- A sealed bid envelope with insufficient information was opened prior to the formal bid opening process.
  The Procurement Department will review the process for receipt of unmarked bids by mail and in consultation with the City Attorney's Office, will establish additional procedures or include additional language in the bid documents. (Ref # 6 below, Formal Bid Opening)

Conclusion
Based on our review, we believe there are opportunities for improvements that address risk areas identified in this report. Procurement and Finance management worked collaboratively with Internal Audit to develop action plans that effectively address these risk exposures.

IA would like to extend our appreciation to the Procurement and Finance personnel who assisted and cooperated with us during the review.

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[1] Coding refers to the numeric information needed for the City's general ledger accounting system.

Procurement Process Review

Audit Findings and Action Plans

1. Monitoring Compass User Roles

The City uses Compass, which is a software system used to maintain City financial data including procurement processes. The appropriateness of active Compass user roles, assigned in the procurement process, is not periodically monitored. To ensure adequate internal controls are in place surrounding system access, appropriate management should periodically review and monitor Compass roles related to the procurement process. Not monitoring Compass user roles regularly in the Procurement process may increase risk of errors or fraud to the City.

Recommendation

IA recommends CRG and Procurement management work with Compass Support to periodically extract data from Compass, assess validity of procurement user access, and establish a process to periodically monitor City-wide Compass user roles to ensure proper access authorization.

Management Action Plan

Compass support can only change the status of a Department Approver with a request form that is signed by a Finance manager. At the time of a request for a change, a review is initiated of all department managers and their alternates.

On a quarterly basis Compass Support, on behalf of Procurement and CRG management, will provide to Department Heads a list of assigned individuals to approve requisitions on behalf of the Department for their review and validation.

Responsible Parties
Lynn Gustafson, Finance Manager

Expected Completion Date
June 1, 2011

2. Vendor Invoices

To improve efficiencies in processing invoices, the City established a CRG, as of February 2011; however, there is no City policy to mandate that all purchases should follow the centralized requisitions process. Bypassing the centralized requisition process and purchasing directly from vendors with no formal purchase order creates inefficiencies and delays in paying an invoice, creates potential for duplicate payments, and bypasses the pre-purchase authorization controls designed to protect the City's assets.

According to Results Minneapolis, published on the City website September 7, 2010, the City has established a target goal of processing 95% of invoices properly by 2013. Per the Controller's Division, as of December 31, 2010, 70% of invoices were not processed in accordance to City procedures. A properly processed invoice requires pre-purchase vendor verification, verification of available funds, and approval of the expenditure. Then, prior to payment, the invoice should be matched to the purchase order and receiving documentation for goods and/or services ordered. Payment should be made within the discount period if a vendor discount is offered, or within 30 days of receiving the vendor invoice, assuming goods or services have been satisfactorily received.

Delays in paying vendors could violate state regulation 471.425 that requires the City to pay vendors within 35 days of receipt.[2] Furthermore, delays in making payments may result in lost opportunity for the City to receive cash discounts from vendors, and may negatively impact the City's reputation amongst vendors.

Strong internal controls include prior authorization of purchases. When purchase requests are not reviewed and approved before processing, the City is at increased risk of fraud, error, misappropriation, and potential understatement of liabilities in financial reporting. In addition, a contract related to a purchase may be expired or out of funding which would be detected in the proper review and approval stage of the centralized requisitions process.

Recommendation
IA supports the CRG in continuing their efforts through training and continuous follow-up with departments to ensure the purchasing requests are processed through the CRG to ensure efficient processing and proper authorization.

IA recommends establishing a formal City policy which mandates all departments to follow the central requisitions process, defining exceptions (such as utility bills), and establishing parameters for handling emergency orders (e.g., submitting requests to the CRG within one business day after the order was placed).

IA also recommends the CRG management work with Compass Support to generate and distribute monthly department level reports containing invoice detail and identification of invoices that did not follow the proper requisitions process. The reports will facilitate department oversight of expenditures.

> **Management Action Plan**
> Finance and CRG management will develop a formal policy surrounding the central requisition process, clearly defining the types of invoices that may bypass the process, and establishing how emergency orders will be handled.
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> Finance management staff will develop a public query in Compass and make it available to all City departments. The query will contain invoice detail and identification of invoices that did not follow the proper requisition process. This will improve department oversight of expenditures and the procurement process.
> *Responsible Parties*
> LeaAnn Stagg, Interim Controller;
> Lynn Gustafson, Finance Manager;
> Skip Hyvare, Accounts Payable Supervisor
>
> *Expected Completion Date*
> Quarterly, beginning September 30, 2011 for the query;
> September 30, 2011 for the policy

3. Requisition Coding
Some departments submit requests for purchases with incorrect coding information, resulting in unnecessary efforts spent by CRG researching the proper coding. Submitting requests with

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[2] MN State Statute 471.425(b) "Date of receipt" means the completed delivery of the goods or services or the satisfactory installation, assembly or specified portion thereof, or the receipt of the invoice for the delivery of the goods or services, whichever is later. https://www.revisor.mn.gov/statutes/?id=471.425

insufficient information to the CRG creates inefficiencies and can result in delayed payments to vendors. Department and project managers are in the best position to provide accurate and current contract and coding information for purchasing requests.

Recommendation
IA recommends CRG management continue training and educating department and project managers on the necessity of submitting correct coding with requisition requests, and responding timely when insufficient or erroneous information is submitted to Central Requisitions.

Management Action Plan
CRG personnel will continue training and educating department requesters on the necessity of submitting correct coding with the requisition requests, and to respond in a timely fashion when insufficient or erroneous coding is submitted. A reference to the proper coding will be included in the formal procedures related to the central requisition process.

Responsible Party
Skip Hyvare, Accounts Payable Supervisor

Expected Completion Date
Ongoing; re-evaluate on December 31, 2011

4. **Monitoring Post-approval Edits**
In some cases, there are valid reasons to edit purchase orders after approval (post-approval) in the Compass system. There are no controls in place to monitor Compass post-approval edits made to purchase orders. Strong internal controls require processes to monitor post-approval electronic changes made to purchase orders to ensure validity of such changes. By not monitoring post-approval system edits during the purchasing process, there is a potential for unauthorized changes that may put the City at increased risk of error or asset misappropriation.

Recommendation
IA recommends formal procedures be established to mandate creating post-approval edit reports for purchase orders in Compass. These reports should be reviewed by appropriate management. CRG and Procurement Department management should obtain post-approval system generated edit reports, to be generated periodically for management review.

Management Action Plan
Due to the system limitations, management will need more time to determine the best procedures to adequately monitor changes to purchase orders after they have been approved. The procedures will include developing weekly reports that include post-approval increases to purchase order units or unit price. CRG, Purchasing, Compass Support and Finance will jointly develop a dollar amount threshold for variance for further investigation and management approval prior to payment processing. This team will also determine the most efficient method of communicating these reports to appropriate City management.

Responsible Party
Gary Warnberg, Purchasing Director
LeaAnn Stagg, Interim Controller

Expected Completion Date
October 1, 2011

5. **Central Requisitions Group e-mail**
   The CRG has an e-mail address that should be used when authorized City personnel submit a requisition. Occasionally various requestors submit requisitions directly to a Central Requisition Clerk's personal work e-mail rather than to the CRG e-mail.

   The CRG e-mail was established to encourage various departments to submit requests electronically and to improve response time, as all CRG personnel can access the requests. Submitting requests directly to a Central Requisition Clerk's personal work e-mail can result in unnecessary delays in processing the requisition and prevents the request from being accessed by other CRG personnel. In addition a duplicate requisition could be created if a requisition request is submitted to both the Central Requisition Clerk's personal work e-mail and the CRG e-mail.

   Recommendation
   IA recommends that all requests submitted electronically should be routed only to the CRG e-mail address (CentralReq@ci.minneapolis.mn.us). Central Requisition staff may need to train and educate requesters on the importance of using the CRG e-mail. In addition, CRG management should establish a formal procedure to disallow CRG personnel from processing requests that are not received through CRG e-mail.

   > **Management Action Plan**
   > CRG personnel will continue to educate requesters on the importance of using the CRG e-mail address to submit their purchasing requests. CRG management will re-evaluate this process at year end to determine if a formal procedure to disallow purchasing requests that are not received through the CRG e-mail address is appropriate.
   > *Responsible Party*
   > Skip Hyvare, Accounts Payable Supervisor
   >
   > *Expected Completion Date*
   > Ongoing; re-evaluate on December 31, 2011

6. **Formal Bid Opening**
   The Procurement Department receives sealed bids by mail or hand delivery. During our observation of the bid opening process, IA noted that 1 of 20 bid envelopes was opened prior to the formal bid opening date because the Official Publication number (bid number) was not placed on the envelope.

   Each Official Publication (call for bids notice) contains necessary information for properly submitting bids, which includes specifying the name and Official Publication number of the bid. However, the City has no formal procedure in place regarding how improperly addressed sealed bid envelopes should be handled. Opening a sealed bid prior to the official bid opening may create negative public perception, unnecessary problems with bidders, and possible perception of bid tampering.

   Recommendation
   IA recommends Procurement management establish a formal procedure for procurement staff to handle sealed bid envelopes which are not labeled with sufficient information as required by the Official Publication. The procedure should clearly define consequences for the bidder, which may include disqualification of the bid, and should be communicated to all potential bidders as a part of the request for proposals and any other bidding documentation, as appropriate. The procedure should be clearly communicated to Procurement Department staff.

In addition, the Procurement Department may want to consider obtaining a unique mailbox to be used only for receiving sealed bids to reduce the likelihood of opening a sealed bid envelope by mistake and enhance physical security over bid envelopes.

Management Action Plan
The Procurement Department will review the process for receipt of unmarked bids by mail. In consultation with the City Attorney's Office, additional procedures will be established or additional language will be included in the bid documents to address this situation.
Responsible Party
Gary Warnberg, Procurement Director

Expected Completion Date
December 31, 2011

Abbreviations Used Throughout the Report	
Compass	Software system used to maintain City financial data
CRG	Central Requisitions Group
IA	Internal Audit
RFP	Request for Proposal