Seattle Public Schools
The Office of Internal Audit

Internal Audit Report
Procurement

September 1, 2014 through Current

Issue Date: June 21, 2016

Executive Summary

Background Information

The Procurement function is centralized under the District's Business and Finance Division. The District has adopted the 6200 series of Board Policies and Superintendent Procedures to govern the procurement process of the District, and ensure compliance with the Revised Code of Washington. This includes a Districtwide Procurement Authority Matrix that identifies required approvals based on dollar thresholds. All transactions are initiated at the department level and must follow the approval process based on their dollar threshold.

The District's procurement process is divided into two main functions:

- **Purchasing**: The District uses a variety of processes for the purchase of materials and goods. The term "purchased goods" refers to all items except for curriculum materials, personal services, public works/construction, and client services.

  Purchase Orders: There are two kinds of purchase orders prevalent in the District:

  - o *One-Time Purchase Orders*: These are one time purchases that are normally executed through the B2B system. Employees can initiate a purchase requisition in the B2B system, which will automatically route the purchase to the responsible budget manager for approval. The B2B system is aligned with the approval matrix so that only authorized employees can approve a one-time purchase order initiated in the B2B system.

  - o *Open Purchase Orders:* These purchase orders are open for a definite period of time and allow for multiple purchases from a single vendor. Their purpose is to create efficiency with the purchase of numerous small-dollar-value items from a single vendor. District employees need to show a copy of the open purchase order in order to execute the purchase with the vendor. The District is billed directly by the vendor on a regular basis for such orders.

  Small works roster: This process applies to construction work, up to $200,000. Contracts under this amount may be competed under the Small Works Roster, or bid according to the regular construction procedures. In order to encourage contracts with small businesses, the District has established a small works roster. Depending on the nature of project, an invitation email is sent to all the eligible vendors providing services. During our initial risk assessment we noted that most small works projects were specific to capital projects. Thus, this process is not covered in this audit as all capital related audits are reviewed and conducted separately.

- **Contracting Services**: This function assists departments with the competitive selection of vendors. The methods of competitive procurement that the District uses include:

- o *Bidding Contracts*: The majority of the bidding contracts at the District are construction related. These contracts were not covered in this audit as all capital related audits are reviewed and conducted separately.

- o *Request for Proposal*: This type of competitive contracting is the primary means of obtaining consulting services over $50,000. Vendors are requested to submit proposals for the specific services desired, showing qualifications and content for their proposal. The proposals are evaluated by District staff, and a contract is awarded to the vendor deemed best suited for the District.

- o *Personal Services Contracts*: This type of contract provides an agreement between the District and the vendor and relies on the unique skills and experience of the contractor. Personal services contracts are often used to execute Request for Proposal contracts.

- o *Other Agreements*: The agreements that do not fall under a specific category addressed in the Superintendent procedures are considered other agreements.

The focus of this audit did not include public works related procurement. Public works as categorized by RCW 39.04.010 means all work, construction, alteration, repair, or improvement other than ordinary maintenance, executed at the cost of the state or of any municipality, or which is by law a lien or charge on any property therein. Public works audits are conducted by the Office of Internal Audit's capital audit function. This audit also excluded federal procurement requirements, which are reviewed annually by the Washington State Auditor's Office.

Roles and Responsibilities

This audit was completed as part of the *Annual Risk Assessment and Audit Plan* approved by the Audit and Finance Committee on September 16, 2014. District management has the primary responsibility to establish, implement, and monitor internal controls. Internal Audit's function is to assess and test those controls in order to provide reasonable assurance that the controls are adequate and operating effectively. We conducted the audit using due professional care, and we believe that the evidence obtained provides a reasonable basis for our findings and conclusions.

Audit Objectives

The primary objectives of this audit were to determine if the District's procurement function:

- Has adequate internal controls over the procurement of goods and services.

- Has adequate policies and procedures over the procurement process.

Scope of the Audit

September 1, 2014 through current

Audit Approach and Methodology

To achieve the audit objectives, we performed the following procedures:

- Planned the audit in cooperation with the Business and Finance Division to ensure that we had a strong understanding of the District's procurement process

- Interviewed Procurement staff knowledgeable of the various processes that were covered during the course of the audit.

- Analyzed available data to corroborate the information obtained during our walkthroughs.

- Reviewed all applicable RCW's, WAC's, and OSPI reference material for state compliance requirements.

- Planned the audit in accordance with the Committee of Sponsoring Organizations of the Treadway Commission. The focus of this methodology is to determine if a framework of internal controls exists, and if those controls are executed in an efficient and effective manner.

- Performed tests and analysis of the objective areas to support our conclusions.

Conclusion

Based on the results of the audit procedures performed, the District appears to have adequate internal controls, policies, and procedures over the procurement function, except for the items noted in this report. This report identifies several recommendations that are intended to improve the overall accountability and transparency of the procurement function.

We extend our appreciation to the staff within the Business and Finance Division for their assistance and cooperation during the course of the audit.

Andrew Medina

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Findings and Recommendations

1) Unapproved Contracts and Other Agreements

A personal services contract represents an agreement between the District and a contractor that relies on the unique skills and experience of the contractor to provide professional or technical expertise that otherwise cannot be supplemented by current District staff. In order for these contracts to be effective, review and approval from the Accounting Department is necessary. We noted that there are instances when schools or departments commit to contracts on behalf of the District, without creating a Personal services contract. The payments to such contracts are occasionally requested through the general requisition process. The Accounting Department does not become aware of such contracts until after the services have been initiated. In these instances a personal services contract is completed after the fact, and the Accounting Department will initiate training procedures for the staff members that did not follow proper contracting procedures.

Another type of contract noted in the Superintendent Procedures is Other Agreements. Per the Superintendent Procedures, Other Agreements are subject to the normal contracting procedures for the District. We noted that there is an inherent limitation associated with Other Agreements because there is no central repository for such agreements. As the result, the District cannot identify all the agreements it has entered into. The lack of a central repository increases the risk that District staff will enter into an agreement on the District's behalf without proper approval.

A lack of adequate controls around the approval of District of contracts exposes the District to following risks:

- Risk of noncompliance with the competitive procurement procedures of the District.

- Risk of not obtaining the best value for the services requested.

- Risk of potential unknown liabilities that the District is not currently aware of.

Recommendation

We recommend that the District:

- Provide adequate training and education to District staff on the proper approval process for District contracts.

- Implement additional controls to identify unauthorized contracts.

- Create a central repository of Other Agreements so they can be monitored for compliance purposes.

2) Segregation of Duties

To establish proper segregation of duties, District management has chosen to separate the purchasing and receiving functions at an operational level. However, when we reviewed employee access rights in the SAP system, we noted multiple people with access to both the purchasing and receiving functions. Although we are not aware of any misuse of these roles, having people with access to both the purchasing and receiving functions increases the risk of inappropriate or unapproved purchases.

We also noted that both the Purchasing and Accounts Payable Departments have the ability to create a vendor in the system. Allowing the accounts payable function to create vendors in the system is incompatible with their duty to pay vendors. Although we are not aware of any inappropriate vendors created by the Accounts Payable Department, the function of creating vendors should be separate from the function for paying vendors in order to reduce the risk of fraudulent payments.

Recommendation

We recommend that the District properly segregate the purchasing and receiving functions in the SAP system by limiting user access to only the role specifically related to their job function. We also recommend that the District segregate the duties of creating and paying vendors.

3) Request for Proposal Process

A Request for Proposal (RFP) is the primary means of obtaining professional services exceeding $50,000 that cannot be provided by District staff. A Request for Proposal is a competitive solicitation, which is done via advertisement in an effort to ensure the District receives the best service for the best price. Contracts awarded from the Request for Proposal process are executed via personal services contracts.

We reviewed the RFP process from the scope gathering phase to the post-awarding phase. During our review we noted the following opportunities for improvement:

- When the scope of an RFP needs be changed after it has already been advertised, the District does not have adequate controls to ensure that the changes are re-advertised and properly communicated to any potential vendors. Properly advertising and communicating the scope of an RFP will help to ensure a transparent and fair procurement process.

- On occasion, the District must apply specific criteria to determine whether to use an RFP or another form of procurement. In these instances, the District does not adequately document why a particular procurement method is selected. In addition, the District does not create and maintain a checklist documenting compliance with required procedures. Such a checklist will help ensure that the District has complied with all of the required procedures.

- There is no requirement that budget capacity be established prior to initiating a Request for Proposal. The District has controls in place to ensure that there is adequate budget capacity before it will finalize a contract, but there are no procedures in place to ensure that budget capacity exists before the District commits significant resources into preparing and evaluating RFPs. Without confirming budget capacity early in the RFP process, the District could be investing unnecessary resources into RFPs that will never be finalized.

- The District does not require staff responsible for evaluating RFPs to certify that they do not have any conflicts of interests with any of the potential vendors.

Recommendation

We recommend that the District:

- Implement controls to ensure that any significant changes to the scope of an RFP are re-advertised and properly communicated to all potential vendors.

- Establish an end-to-end checklist documenting compliance will all of the procedure requirements during the RFP process.

- Establish procedures to verify budget capacity prior to investing significant resources in the RFP process.

- Require each team member responsible for evaluating RFPs to certify that they do not have a conflict of interest, or the appearance of a conflict of interest, with any of the potential vendors.

4) Open Purchase Orders

An open purchase order is intended to attack the small-order problem and make the acquisition of numerous small-dollar-value goods and/or services more convenient for employees. An open purchase order is a means for the District to increase efficiency for employees who regularly purchase items from the same vendor of a similar nature.

We noted that payments against an open purchase order occasionally exceed the established dollar value of the open purchase order. Open purchase orders are given a dollar value when they are created by the District's Purchasing Department. They are routinely established with low dollar amounts, even if the District has advance knowledge that the total payments will be greater than the initial amount that is established. When the Accounts Payable Department receives an invoice that will cause an open purchase order to exceed its value, they inform the budget owner of the situation and will pay the invoice with the budget owner's approval, so long as there is capacity in that department's budget. The Purchasing Department is not required to approve an increase to the value of an open purchase before an invoice is paid, and there is no monitoring performed to ensure that the open purchase is being used as intended prior to exceeding its value. The District's current procedures also put the District at risk of not obtaining the appropriate approval signatures when open purchases orders exceed a threshold requiring an additional level of approval. We also noted that there are no written procedures or guidance supporting the course of action required when an open purchase order exceeds its threshold.

Recommendation

We recommend that:

- The District create a process to alert the budget owners and the Purchasing Department to initiate an increase in the value of the open purchase order anytime an open purchase order exceeds its established dollar value.

- Prior to approving any increases to an open purchase order, the District ensure that the open purchase order is being used as intended, and that the open purchase order has received the required level of approval.

- The District accurately forecasts and establishes the maximum dollar value of an open purchase orders based on past trends and anticipated purchases.

- The District follow the competitive procurement requirements based on the total anticipated value of the open purchase order.

5) Contract Approval Process

The District conducted an extensive review and enhancement of the Superintendent Procedures related to procurement in 2012. The procedures provide specific instructions on who is responsible for approving individual contracts, based on the type of contract and the dollar value of the contract. However, the District's procedures do not provide adequate guidance on the approval of contracts involving a contractor that has multiple contracts with the District.

Under the current procedures, it is possible for a single vendor to have multiple contracts to provide similar services to different departments or schools. Even though each individual contract may be below the threshold requiring Board approval, the total amount of contracts awarded to the vendor may be significantly higher. As a result, it is possible for a single contractor to receive significant District contracts without receiving Board approval. The District's procedures do not identify when payments to a single vendor require Board approval. This lack of guidance increases the risk that District staff will intentionally split a larger contract into multiple smaller contracts in order to avoid having to obtain Board approval. It also increases the risk that the District will show favoritism to one vendor, and that the District will not receive the best value for the services it seeks.

Recommendation

We recommend that the District update the Superintendent Procedures related to procurement to require Board approval when payments for similar services to a single vendor exceed a specific threshold.

6) Procurement Cards

The District has approximately 200 Procurement Cards assigned to various District employees. The cards were assigned to employees to create efficiency in procuring the goods required to conduct business. In an effort to prevent misuse, the District has imposed spending limits on the Procurement Cards. The limits include an individual transaction limit as well as a monthly total spending limit.

We noted that there is an additional Procurement Card security features available to the District. Procurement Cards can be further limited through the use of Merchant Credit Codes (MCC). Merchant Credit Codes categorize all businesses, and would allow the District to prevent the use of the Procurement Cards for items such as travel, car repairs, and fast food. The use of Merchant Credit Codes is a preventative control that can help prevent unallowable activities from occurring on those cards. Currently the District has not adopted this feature on its Procurement Cards.

Recommendation

We recommend that the District adopt the use of Merchant Credit Codes to limit the ability for staff to purchase unallowable activities with District procurement cards.

7) Creating New Vendors in the SAP System

The method for creating a new vendor entry is completely manual. As invoices are received, Accounts Payable or Procurement must manually enter and commit the necessary vendor information into the database. This process is true for both regular vendors and employee vendors. In the case of employee vendors, the system does not have any integration with the payroll system, and thus personnel information (name, address, etc.) must be manually entered.

In addition, there is no review of the new vendor entry before it is committed to the system. This process can result in clerical errors, duplication, or missing information going unnoticed before being committed to the system. Two percent of the vendors we examined contained some form of error, and the majority of vendor entries do not contain any contact information, such as email, fax, or phone number. These items are not required as part of the vendor entry process, and are only included if they are readily available.

Having a review of vendor information before the vendor is committed to the system helps reduce the risk of errors, fraud, and abuse. In addition, integrating the vendor system and payroll system would provide operational efficiencies and reduce errors. Including contact information for vendors also reduces the risk of fraud and errors, as well as providing operational efficiencies by providing a recognized point of contact in the event of billing errors.

Recommendation

We recommend that the District:

- Establish internal controls to ensure that vendor information is being thoroughly reviewed and approved by management prior to being committed to the database.

- Update its procedures to ensure that contact information (phone, fax, email, etc.) is included during the vendor creation process.

- Explore integrating the vendor and payroll databases, so that the vendor database can pull the required information (name, address, employee number, etc.) directly from the payroll database.

Management Response

The District takes its obligations to federal and state laws and rules, locally determined policies and use of public resources seriously. The District agrees with the findings of the internal audit and will address each in a manner that reflects adherence to best organizational practice coupled with stewardship of public resources.