

**CITY OF MODESTO-
PURCHASING DIVISION**

**INDEPENDENT ACCOUNTANTS' REPORT
ON
AGREED UPON PROCEDURES**

**FOR THE YEAR ENDED
JUNE 30, 2017**



INDEPENDENT ACCOUNTANTS' REPORT

To the City Council of the City of Modesto
Modesto, California

We have performed the procedures enumerated below, which were agreed to by the City of Modesto, (the City), solely to assist you with respect to the policies and procedures of the City of Modesto Purchasing Division (Purchasing Division) for the year ended June 30, 2017. The City's management is responsible for the Purchasing Division's policies and procedures. The sufficiency of these procedures is solely the responsibility of those parties specified in the report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

Our procedures and findings are as follows:

1. For the year ending June 30, 2017, performed a sample review of 75 invoices related to the Garrett Thompson Construction (the Contractor) agreement as it relates to the Hot Patch Roadwork Project:
 - A) Obtain supporting documentation, and verify that the expenditures are supported, including supporting documentation and properly executed contracts.
 - B) Verify the contract is properly initiated, approved, and executed per the City's Purchasing Policies and Procedures.
 - C) Review the internal controls over the contract, and ensure controls are properly designed and implemented so that expenditures are properly approved and executed via the City's approved contract.

Findings: Hudson Henderson & Company, Inc. (HHC), while performing onsite testing in early November 2017, found that eight of the seventy-five expenditures selected for testing were assigned to a fund or project that was not part of the City Council's resolution awarding the contract or subsequent increase to the contract total. One of the expenditures was assigned to Fund 4210 and seven expenditures were assigned to Project #100665 totaling \$3,475.34.

HHC also found that the City's purchasing software included contract limits and actual expenditures that exceeded the City Council approved limits. On September 25, 2012, the City Council approved a grand total of \$3,886,000 amongst three different contractors for the Hot Patch Roadwork Project. This is a normal practice of the City that is done when the workload is more than the primary contractor can perform. When the initial board resolution was approved by the Council, the Senior Buyer entered, and the Purchasing Manager approved, an amount different from the board resolution. The Senior Buyer entered \$3,866,000 for each of the three contractors over a period of nine months for a total of \$11,598,000. On December 9, 2014 city management returned to the Council with a request for additional funding of \$3,100,000 and to extend the expiration date of the contract to September 24, 2017.

This was reflected in the purchasing software correctly as the increase to the Contractor's approved limit increased by \$3,100,000.

In December 2015, the Senior Buyer and the Purchasing Manager increased the Contractor's limit in the purchasing software by an additional \$1,784,000. The only approval found was by the Purchasing Manager, and there is no evidence that this increase was taken to the City Council for approval. The final amounts authorized for approval in the purchasing software for each contractor were as follows: The Contractor- \$8,750,000, United Pavement- \$3,866,000, and Patch Crew Modesto- \$3,866,000, for a total of \$16,482,000. This total authorized amount input in the City's purchasing software exceeded the City Council approved amount of \$6,986,000 by \$9,496,000. Through Council Resolutions 2012-386 and 2014-538, the City Council approved \$6,986,000 for the Hot Patch Roadwork Project. However, as a result of the Senior Buyer and the Purchasing Manager inputting \$16,482,000 as the maximum limit of the agreements associated with the project, the City incurred actual expenditures as spread across all three contractors approved in the contract of \$9,070,164.99. The total amount of expenditures spent in excess of the City Council's approved limits was \$2,084,164.99.

Lastly, HHC found that because of price increases exceeding the annual consumer price indexes (CPI) from 2014 through 2017, it appears the City may have overpaid the Contractor by approximately \$623,984.03. The agreement between the City and the Contractor states that the Contractor may request rate increases annually after two years, but that increase cannot exceed the CPI for the West Urban Area in any one contract year. The Purchasing Division may negotiate the increase; however, it appears as though the Purchasing Division did not review the agreement to determine what the standard annual increase should be for the services being provided, which resulted in the apparent overpayment due to percent increases in excess of the annual CPI index. Excess increases over the annual CPI index ranged from 4.69% to 16.00% over the annual CPI index. It is noted that the increase could be arguable as allowable per exceptions and ordinances as listed in the City Code of Ordinances.

On July 5, 2016, Council adopted the 100 Days Committee Recommendations and directed City staff to prepare a plan to implement these Recommendations. One of the action plans identified for the City was to review all existing vendor contracts and negotiate fee/rate reductions. As part of this review during the summer of 2017, City finance staff discovered that amounts were incorrectly entered into the purchasing system when the original agreements were established in 2012 and again in 2015. City finance staff also discovered that no proper authorization was taken by City Council authorizing these transactions and changes to the contracts. Management has not been able to determine the reason for these actions. On July 27, 2017, the City finance staff expired the three agreements in the Oracle Purchasing system to ensure \$7,410,617 would not be allowed to be spent due to the incorrect amounts that were entered into the system and in order to allow a thorough review of this matter. No other findings were noted.

2. Perform an evaluation review of the City's vendor contracts and provide a risk assessment on how the City processes these contracts in the Oracle Procurement System and identify any process flows that need to be improved to establish better internal controls and provide any recommendations to improve the process.

Findings: As part of our evaluation review of the City's vendor contracts during the November 2017 onsite fieldwork, performed an overall review of an additional 24 Oracle agreements, spread over 19 City Council approved annual agreements, that were effective as of October 31, 2017. Excluded from our population for the additional Oracle agreement testing was the Garrett Thompson Construction agreement, as tested and the results noted in the findings section above. For our selection of 24 agreements, 14 were selected as high risk per our initial planning and AUP preparation procedures.

The agreements were noted as high risk per discussion with management, per review of the annual agreement list and review for certain factors including usage, age, volume and cross resolution identification, obtaining an understanding of the City, and other procedures deemed necessary to understand the operating environment of the City and the Contract Procedures.

After the initial section of 14 high risk agreements, an additional 10 agreements were selected at random. See the list of agreements tested and results of testing in Appendix I following this report. In our review of the 24 Oracle agreements, we noted the following issues and deficiencies in the performance and effectiveness of the internal controls over the procurement and purchasing transaction class of the City:

- Of the 24 Oracle agreements reviewed, we noted that 14 of the agreements had at one point during the course of the agreement an approved purchasing amount in the City's purchasing accounting software that exceeded either the purchasing limit for the type of agreement per the City's policies and procedures or amounts that exceeded City Council's approved resolution amounts. Of the \$18,414,133 in total contracts reviewed, the 14 agreements that were found to exceed approval limits totaled \$4,475,103 in excess of approved limits. Of these 14 agreements, 13 of the agreements were electronically approved by the previous Purchasing Manager and were initiated by the former Senior Buyer. The 14th Oracle agreement that exceeded approved limits was electronically approved by the previous Director of Finance.
- Of the 24 Oracle agreements reviewed, we noted a total of 11 agreements that had total expenditures as of October 23, 2017 that were in excess of either the purchasing limit for the type of agreement per the City's policies and procedures or amounts that exceeded City Council's approved resolution amounts. In total, \$2,319,376 were expended in excess of the approved limits from City Council per the City's purchasing policies and procedures.
- Of the 24 Oracle agreements reviewed, we noted a total of 3 agreements that had exceeded their properly authorized effective through date, and were improperly authorized to continue past their effective date, thus operating as expired contracts without proper City Council approval. The annual agreements, once expired, should have either been put through the full procurement process or extensions granted via City Council approval.

As part of our evaluation of the City's vendor contracts, performed an overall review of blanket agreements for the year ended June 30, 2017. In our review of the blanket agreements, we noted the following issues and deficiencies in the performance and effectiveness of the internal controls over the procurement and purchasing transaction class of the City:

- We noted that 14 of the blanket agreements had amounts authorized in excess of the City's purchasing policy amount of \$50,000 without proper authorization by City Council, as required per the City's purchasing policy (see list of Blanket Purchase Agreements tested in Appendix I). The agreements have varying amounts of increases throughout the year, ranging from 1 to 6 total revisions in the approved agreement amount, all electronically approved in the City's purchasing system by the previous Director of Finance. In total, the approved amount in excess of City approved limits for the year ended June 30, 2017 totaled \$670,000.
- We noted that 14 of the blanket agreements had expenditures in excess of the City's purchasing policy amount of \$50,000 without proper authorization by City Council, as required per the City's purchasing policy. The total expenditures released in excess of City Council approved limits for the year ended June 30, 2017 totaled \$611,127.

In our review of the overall procurement process of the City and how the City processes contracts in the Oracle Procurement System, we identified the follow process flows that need to be improved to better internal controls:

- We noted an overall environment in the purchasing department where work flow seemed in excess of staff resources and man power. While controls were in place, they were circumvented to ensure the operations of the City continued and to ensure bills were being paid for the work being performed. The purchasing department was under constant pressure from other City departments, vendors, and management to maintain status quo and keep the operations of the City functioning.
- We noted that certain contracts were kept as blanket purchase agreements, but should have been moved to annual agreements due to the volume of transactions based on need and were habitually increased year after year in excess of the City approved \$50,000 limit. The blanket agreements never went out to bid or to City Council for approval due to the time required to take an agreement through the full procurement process and approval of the City Council. Added to the environment was the stigma of following what was previously done in prior years, as accepted practice, even when it did not follow the formal written procurement policies and procedures.
- We found that the department's estimates of contract expenditures were low, and that actual expenditures were much higher than estimated, causing the need for contracts to be expanded and increased, but weren't fully approved by City Council due to the time required and the pressure to ensure payments for work performed were being completed in a somewhat timely manner. Often annual agreements approved for a five-year period were maxed out and in excess of approved limits starting 2 to 3 years after execution.
- We noted for multi-award contracts, each vendor was approved in the system for the full award amount, and not a proportionate percentage of the contract. This led to the risk of expenditures being incurred in excess of the City Council's approved contract amount.
- During our review and testing, most of the errors noted were from contracts using commodity pricing and an agreement of price per commodity, with an 'estimated' annual approved amount. The approved contracts were mainly focused on the approved price per commodity, and not on the total amount to be allowed over the course of the contract as approved by City Council.

We noted during our review and procedures, that once management became aware of some of the issues as noted previously in the report, they have made a strong effort to start remediating the issues. Stop payments have been established on contracts which were noted to be in excess of City approved limits until formal approval of extension or amendment is made by City Council.

Management is also working on implementing new policies and internal controls with the purchasing department staff to aid and assist in the monitoring of contracts, and to ensure that limits are not being exceeded. Management has hired a new Purchasing Manager to assist in the implementation of stronger controls and documentation within the purchasing department to assist staff in understanding the breakdown of contracts, and to ensure supporting documentation is present for decisions and approvals made by the purchasing department.

3. Provide recommendations of best practices for assisting the City with updating their current Purchasing Policies and Procedures based on the review and procedures performed in #1 and #2 above.

Findings: Based on our findings as noted above in procedures #1 and #2, we recommend the following Purchasing Policies and Procedures be reviewed and implemented to improve the overall purchasing and approval process:

- We recommend a strong dollar threshold cap be established and documented by vendor when awarding the contract for commodity pricing. This will allow the purchasing department to establish strong thresholds for commodity pricing contracts to prevent total contract expenditures to be in excess of approved limits.
- For the purchasing department to better manage the total cost expended under multi-vendor contracts, we recommend that the award of contracts to multi-vendors be given estimated specific proportionate amounts of the contract.
- We recommend that management, the departments and purchasing create a new process for amending contracts, to help expedite increase approvals for workflow and to avoid staff increasing agreements without proper authorization.
- We recommend putting board resolutions and contract documentation into the purchasing system, to allow staff easy access to source documents when reviewing and approving contract adjustments in the Oracle Purchasing System.
- We recommend purchasing staff use the tickler system to assist in monitoring contracts set to expire and those that are nearing their total contract value to avoid last minute extensions or increases. This will assist in the prevention of issues with contracts exceeding limits or dates expiring.
- We also recommend that departments also assist in the monitoring of contracts and expenditures against said contracts, to assist in the prevention of invoices and payment requests in excess of the currently approved contract. Departments are the first level of approval on contract payments, with direct access to the vendors and knowledge of projects and where they stand. This will assist in avoiding putting pressure on the City Finance and Purchasing departments to approve increases without going through the proper channels.
- Lastly, we recommend reviewing the current policy over blanket purchase order limits, and determine if they are still applicable for the current time and pricing. For those agreements that are consistently exceeding the annual threshold, consider moving them to annual agreements with realistic expenditure thresholds.

This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. We were not engaged to, and did not, conduct an examination, or review, the objective of which would be the expression of an opinion on the policies and procedures of the City of Modesto Purchasing Division. Accordingly, we do not express such an opinion or conclusion. Had we performed additional procedures, other matters might have come to our attention that would have been reported.

This report is intended solely for the information and use of the City Council and management of the City and is not intended to be, and should not be, used by anyone other than these specified parties. However, this report is a matter of public record, and its distribution is not limited.

HUDSON HENDERSON & COMPANY, INC.

Hudson Henderson & Company, Inc.

Fresno, California
February 21, 2018

**CITY OF MODESTO
PURCHASING DIVISION
APPENDIX I
LIST OF AGREEMENTS TESTED**

ANNUAL AGREEMENTS

| # | Agreement # | Supplier | Agreements | | | Agreement in excess of City Council & Policy Approved Limits | Expenses in excess of City Council Approved or Purchasing Policy (Total Contract) |
|---------------------------------|-------------|--|-----------------------------------|--------------------------------|-------------------------------|--|---|
| | | | Highest Value per City Purchasing | City Council's Approval Amount | Released Amount thru 10/23/17 | | |
| 1 | 31528 | SAN DIEGO POLICE EQUIPMENT CO | 625,000.00 | 461,535.00 | 619,340.21 | 163,465.00 | 157,805.21 |
| 2 | 69834 | BURTON'S FIRE INC | 64,620.66 | 50,000.00 | 64,620.66 | 14,620.66 | 14,620.66 |
| 3 | 69833 | L N CURTIS & SONS | 15,330.39 | - | 15,330.39 | 15,330.39 | 15,330.39 |
| 4 | 25953 | PACE SUPPLY CORPORATION | 391,267.00 | 475,000.00 | 393,915.68 | - | - |
| 5 | 25950 | GROENIGER/FERGUSON | 2,398,080.65 | 475,000.00 | 2,398,080.65 | 1,923,080.65 | 1,923,080.65 |
| 6 | 25952 | MODESTO WINDUSTRIAL COMPANY | 45,000.00 | 475,000.00 | 16,514.58 | - | - |
| 7 | 36077 | MCPRINT DIRECT | 193,951.05 | 121,765.00 | 193,951.05 | 72,186.05 | 72,186.05 |
| 8 | 47600 | AQUATIC BIOASSAY & CONSULTING LABS INC | 250,000.00 | 250,000.00 | 116,960.00 | - | - |
| 9 | 1432 | DELTA WIRELESS INC | 275,000.00 | 840,000.00 | 196,497.15 | - | - |
| 10 | 55717 | ZAP MANUFACTURING INC | 70,000.00 | 50,000.00 | 59,295.15 | 20,000.00 | 9,295.15 |
| 11 | 68596 | SIMPSON INVESTIGATIVE SERVICES GROUP | 500,000.00 | 125,000.00 | 229,652.35 | 375,000.00 | 104,652.35 |
| 12 | 67751 | RANK INVESTIGATIONS AND | 39,271.85 | 125,000.00 | 38,292.45 | - | 86,707.55 |
| 13 | 72942 | NOONAN AND HART INVESTIGATIVE SERVICES | 345,000.00 | - | 88,435.64 | 345,000.00 | 88,435.64 |
| 14 | 79675 | STI Investigations | 45,000.00 | - | 20,677.00 | 45,000.00 | 20,677.00 |
| 15 | 25177 | FERGUSON/GROENIGER | 1,250,000.00 | 687,500.00 | 4,582.26 | 562,500.00 | - |
| 16 | 25176 | American AVK Co | 700,000.00 | 687,500.00 | 147,688.02 | 12,500.00 | - |
| 17 | 37271 | ALPHA ANALYTICAL LABORATORIES | 1,095,800.00 | 1,665,800.00 | 694,301.00 | - | - |
| 18 | 123943 | THE MODESTO BEE- ADVERTISING | 50,000.00 | 50,000.00 | 4,852.42 | - | - |
| 19 | 52791 | PRIDESTAFF | 1,015,000.00 | 4,633,860.00 | 257,557.45 | - | - |
| 20 | 59392 | MYERS TOWING | 49,000.00 | 50,000.00 | 20,263.00 | - | - |
| 21 | 84247 | BRANNON TIRE CORP | 318,455.00 | 318,455.00 | 167,722.41 | - | - |
| 22 | 99391 | NATIONAL METER & AUTOMATION | 3,640,006.40 | 3,646,665.00 | 725,859.90 | - | - |
| 23 | 14844 | ABS Direct, Inc. | 1,743,498.00 | 731,350.00 | 618,622.08 | 1,012,148.00 | - |
| 24 | 2342 | Pacific Storage Company | 320,000.00 | 50,000.00 | 222,176.00 | 270,000.00 | 172,176.00 |
| Total Annual Agreements- | | | 15,439,281.00 | 15,969,430.00 | 7,315,187.50 | 4,745,102.60 | 2,319,375.55 |

**CITY OF MODESTO
PURCHASING DIVISION
APPENDIX I (CONTINUED)
LIST OF AGREEMENTS TESTED**

BLANKET AGREEMENTS

| | | | | | | Agreement in excess of City Council & Policy Approved Limits | Expenses in excess of City Council Approved or Purchasing Policy (Total Contract) |
|----------------------------------|----------|-----------------------------------|-----------------------------------|---------------------------------|---------------------|---|---|
| Blanket Agreement # | Supplier | Blanket Agreement Amount | City Council's Approval Amount | Released Amount thru 6/30/17 | | | |
| 1 | 100566 | GILLIG CORP | 177,000.00 | 50,000.00 | 169,741.24 | 127,000.00 | 119,741.24 |
| 2 | 100365 | SAFE-T-LITE OF MODESTO INC | 157,000.00 | 50,000.00 | 156,388.87 | 107,000.00 | 106,388.87 |
| 3 | 100334 | CLASS C SOLUTIONS/MSC | 135,000.00 | 50,000.00 | 129,405.86 | 85,000.00 | 79,405.86 |
| 4 | 100219 | PLATT ELECTRIC | 118,000.00 | 50,000.00 | 117,123.82 | 68,000.00 | 67,123.82 |
| 5 | 100183 | MOTOR PARTS DISTRIBUTORS INC | 103,000.00 | 50,000.00 | 100,313.80 | 53,000.00 | 50,313.80 |
| 6 | 100649 | WILLE ELECTRIC SUPPLY CO INC | 95,000.00 | 50,000.00 | 83,513.18 | 45,000.00 | 33,513.18 |
| 7 | 100575 | GRAINGER INC | 85,000.00 | 50,000.00 | 81,583.54 | 35,000.00 | 31,583.54 |
| 8 | 100609 | HOME DEPOT | 80,000.00 | 50,000.00 | 72,052.16 | 30,000.00 | 22,052.16 |
| 9 | 100591 | GROENIGER/FERGUSON | 80,000.00 | 50,000.00 | 78,501.81 | 30,000.00 | 28,501.81 |
| 10 | 100478 | FLEETPRIDE INC | 80,000.00 | 50,000.00 | 76,879.64 | 30,000.00 | 26,879.64 |
| 11 | 100345 | RAYCO INDUSTRIAL SUPPLY | 71,000.00 | 50,000.00 | 70,093.90 | 21,000.00 | 20,093.90 |
| 12 | 100472 | FERGUSON/GROENIGER | 65,000.00 | 50,000.00 | 60,588.24 | 15,000.00 | 10,588.24 |
| 13 | 100199 | NORMAC | 64,000.00 | 50,000.00 | 62,074.59 | 14,000.00 | 12,074.59 |
| 14 | 100456 | DITTOS | 60,000.00 | 50,000.00 | 52,866.65 | 10,000.00 | 2,866.65 |
| 15 | 105005 | K & D ENTERPRISES INC. | 50,000.00 | 50,000.00 | 2,037.09 | - | - |
| 16 | 100602 | HERC/HERTZ EQUIPMENT RENTAL CORP | 50,000.00 | 50,000.00 | 45,723.43 | - | - |
| 17 | 100467 | FAR-GO DISTRIBUTING | 50,000.00 | 50,000.00 | 31,250.28 | - | - |
| 18 | 100340 | LAZER BROADCASTING | 50,000.00 | 50,000.00 | 20,845.00 | - | - |
| 19 | 100190 | NAPA MODESTO AUTO AND TRUCK PARTS | 50,000.00 | 50,000.00 | 40,794.26 | - | - |
| 20 | 100093 | INTERSTATE TRUCK CENTER | 50,000.00 | 50,000.00 | 42,896.40 | - | - |
| Total Blanket Agreements- | | | 1,670,000.00 | 1,000,000.00 | 1,494,673.76 | 670,000.00 | 611,127.30 |