

**CITY OF MODESTO-
CONTRACT COMPLIANCE**

**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), on specified accounts, transactions and internal control procedures in relation to contract compliance for the year ended June 30, 2017. The City's management is responsible for the transactions, internal control procedures and contract compliance 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, obtained the list of annual contract agreements and selected a random representative sample for review of compliance with City purchasing policies and procedures (30 agreements) by performing the following procedures:
 - A) Obtain copies of contract agreements and the City Council's Board Resolutions, and test for proper recording, processing, and set-up in the purchasing module in accordance with City of Modesto purchasing policies.
 - B) Verify that contract approval amounts, the set-up of the contract, and all City of Modesto purchasing policies are being followed as appropriate for the size of the contract.
 - C) Verify the amount as expended doesn't exceed the contract value or the approved amount as per City Council Board Resolutions.
 - D) Verify that all changes/amendments to the contracts selected were approved and properly followed policies and procedures per the City of Modesto's purchasing policies.

Findings: Hudson Henderson & Company, Inc. (HHC) first removed all contracts tested and reviewed as part of our initial agreed upon procedures with respect to the City's Purchasing division, as noted in our report dated February 21, 2018. From the modified population of annual contract agreements as of June 30, 2017, selected using a random number generator thirty (30) annual agreements for testing (see list of agreements tested in Appendix I). In our review of the 30 annual agreements during our onsite fieldwork conducted in early January 2018, we noted the following issues and deficiencies in the performance and effectiveness of the internal controls over contract compliance for the City:

- Of the 30 annual agreements reviewed, we noted that the (10) 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 \$15,312,281 in total contracts reviewed, the 10 agreements that were found to exceed approval limits totaled \$1,934,340 in excess of approved limits.

Of these 10 agreements, eight (8) of the agreements were electronically approved by the previous Purchasing Manager and were initiated by the former Senior Buyer. The remaining two (2) annual agreements that exceeded approved limits were electronically approved by the previous Director of Finance.

- Of the 30 annual agreements reviewed, we noted one (1) agreement that had total expenditures as of January 3, 2018 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, \$331,115 were expended in excess of the approved limits from City Council per the City's purchasing policies and procedures.

We noted during our review and procedures, that once management became aware of some of the issues as noted, 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. All contracts were properly adjusted back down to approved limits from City Council to avoid any further expenditures exceeding approved limits.

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.

2. For the fiscal year ended June 30, 2017, obtain the list of annual contract agreements that had contract amendments. From this population, selected three contracts previously tested by Hudson Henderson & Company, Inc. and found to be in compliance with the City's purchasing policies. Also from this population, selected three contracts previously tested by Hudson Henderson & Company, Inc. and found not to be in compliance with the City's purchasing policies. For each of the selected contract agreements, perform the following:
 - A) Test all invoices for the two months before and two months after the selected contract amendment increase date for proper recording, processing, and set-up in accordance with the City of Modesto's purchasing policies.
 - B) For all invoices selected in item 2a, review the volume of items/quantities purchased along with the purchase price for any significant fluctuations between contract agreements and the reasonableness of activity. Identify any patterns or changes in activity of purchase volume and/or pricing related to the contract amendment for any indications of possible misuse, abuse or improper spending associated with the contract amendments.

Findings: From our onsite visit and tests completed in early January 2018 did not identify any significant variation, patterns or changes in activity directly related to the contract amendments. All variations and changes from before and after the contract amendments were easily explained due to the noted activity per the invoices, and all appeared normal in the course of business. Nothing of abuse, or improper spending was noted as associated with the contract amendments. No significant changes in prices were noted around the time of contract adjustment. However, as part of our review, we did note a few items and areas deemed worth of reporting, see below.

As part of our review of the contract limit increases, we needed to determine the point in time that the increases were processed to obtain the invoices needed for the testing before and after the change. Of the six contract adjustments tested, we noted that four of those contract adjustments occurred on December 22, 2015, before a City holiday closure.

Because this appeared to be abnormal, we inquired with management who was able to determine that a total of fifty two (52) contract increases were performed on this date by the previous senior buyer and purchasing manager. No further testing was performed on the 52 contract adjustments noted as all changed on the same day. It is however noted, that of the 52 contract adjustments, a total of nine (9) were previously tested by HHC during the current AUP procedures and the previous AUP procedures as completed and reported on February 21, 2018, with all 9 being improperly adjusted. HHC was informed the list and information was given by the City to its hired outside forensic investigator for further review and analysis.

Also, while reviewing invoices for Garrett Thompson Construction, we discovered nine (9) invoices that appeared to be duplicate invoices. These invoices were split over two days and referenced the same project, work order number, and in five (5) instances the same quantity. Upon inquiry of management, it was determined that the invoices were not duplicates, but instead were requested to be processed this way by the City. Per management, that department requested that the vendor split the invoice into smaller invoices in order to get the invoices processed and paid more quickly and avoid large invoices. It was quoted that the larger invoices would require additional approvals and take longer to process as such. Despite the department having proper authorization via board resolution, it could be conceived that the department was trying to circumvent purchasing and payment controls of the City by requesting that one service be billed in multiple smaller invoices under a certain determined threshold to avoid multiple required approvals.

Furthermore, while reviewing Aramark Uniform Services invoices, we found a large amount of services being charged by the vendor at multiple rates. Of the fifty-four different service types reviewed as part of our testing we noted the following:

- Only Eighteen services had one consistent billing rate
- Fourteen services had two different billing rates
- Nine services had three different billing rates
- Three services had four different billing rates
- Four services had five different billing rates
- Two services had six different billing rates
- One service had seven different billing rates
- One service had eight different billing rates
- One service had ten different billing rates
- One service had thirty-eight different billing rates

Although the rates may have been in accordance with the contract, we were unable to determine the appropriateness based on review of the contract alone. The contract does state that the rates are subject to consumer price index (CPI) increases that must be negotiated between the vendor and the City's purchasing manager, however, it shouldn't account for the changes above as they were over a period of four months. In addition, HHC was unable to locate any documentation in the purchasing or payment files to substantiate or document the various billing rates in the testing performed.

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
CONTRACT COMPLIANCE
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 1/3/18		
1	52790	EXACT STAFF	4,000,000.00	4,633,860.00	26,574.62	-	-
2	65944	EAST BAY MUNICIPAL UTILITY	135,000.00	135,000.00	102,576.00	-	-
3	1336	JORGENSEN AND CO	10,000.00	50,000.00	6,021.56	-	-
4	99052	MALLORY SAFETY AND SUPPLY	20,000.00	50,000.00	6,229.95	-	-
5	33631	CAPITAL RUBBER	47,500.00	50,000.00	579.41	-	-
6	100422	ZEN FIRE & SAFETY	585,045.00	550,000.00	171,164.00	35,045.00	-
7	28349	DILLINGHAM TICKET CO. LLC	90,000.00	86,055.00	83,973.09	3,945.00	-
8	109718	SCOTT'S PPE RECON INC	327,000.00	327,000.00	46,975.75	-	-
9	93338	PYRO COMBUSTION OF CALIFORNIA	45,000.00	50,000.00	5,792.33	-	-
10	124366	PUMPING EFFICIENCY TESTING SERVICES	150,000.00	150,000.00	24,800.00	-	-
11	46961	SYNAGRO-WWT	550,000.00	500,250.00	384,626.08	49,750.00	-
12	75924	MAXWELL PRODUCTS	687,295.00	687,295.00	66,211.87	-	-
13	87574	GREATER SAN JOAQUIN	50,000.00	50,000.00	45,724.00	-	-
14	30462	GALLAGHER BENEFIT SERVICES	250,000.00	215,000.00	184,899.83	35,000.00	-
15	50356	CARLSON SCALE SHOP	45,000.00	50,000.00	17,950.50	-	-
16	67074	MERCED PEST CONTROL	86,900.00	86,900.00	65,150.00	-	-
17	71290	DITTOS	45,000.00	50,000.00	11,729.21	-	-
18	26064	MODESTO WINDUSTRIAL COMPANY	2,105,000.00	1,250,000.00	18,936.94	855,000.00	-
19	47846	SIERRA CHEMICAL CO	375,025.00	375,025.00	52,584.39	-	-
20	75942	PACE SUPPLY CORPORATION	1,000,000.00	941,720.00	169,921.57	58,280.00	-
21	34889	HSQ TECHNOLOGY	375,000.00	375,000.00	195,098.54	-	-
22	85095	ANDREWS ELECTRIC	885,460.00	442,740.00	84,990.88	442,720.00	-
23	47006	ZIM INDUSTRIES INC	567,000.00	515,500.00	-	51,500.00	-
24	52881	GROVER LANDSCAPING SERVICES	290,000.00	236,400.00	149,489.76	53,600.00	-
25	125249	JIM BRISCO ENTERPRISES	728,000.00	728,000.00	86,346.62	-	-
26	30753 & 124214	ARAMARK UNIFORM SERVICE	849,500.00	500,000.00	831,114.57	349,500.00	331,114.57
27	118446	CENTRAL CALIFORNIA GENERATOR	575,000.00	575,000.00	14,528.18	-	-
28	74892	SCOTO FARMING	210,000.00	210,000.00	80,550.00	-	-
29	94991	SITEONE LANDSCAPE SUPPLY	30,000.00	50,000.00	9,455.41	-	-
30	122593	XYLEM WATER SOLUTIONS	198,556.00	198,556.00	34,560.53	-	-
Total Annual Agreements-			15,312,281.00	14,119,301.00	2,978,555.59	1,934,340.00	331,114.57