

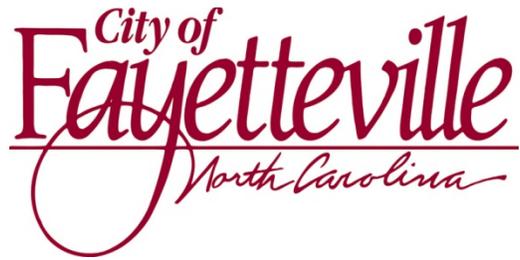
**Compliance Audit 2016-06
Contracting Practices and
Procedures**

October 2017

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Provide independent, objective assurance and consulting services designed to add value and improve the City of Fayetteville’s operations.

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EXECUTIVE SUMMARY

Due to the establishment of contract signature delegation authority and a new electronic contract routing system, an audit of Contracting Practices and Procedures was included in the Fiscal Year 2016-2017 Audit Plan. The Office of Internal Audit assessed compliance with relevant policies, procedures, laws, rules and regulations for contracts/change orders. In order to meet the objectives, Internal Audit examined contract and accounting documents; interviewed personnel; and tested records.

This report addresses a number of areas where management actions could further reduce the risks associated with contracts/change orders. Those areas are discussed below:

1. Oversight and management of *Policy # 120 City of Fayetteville Contracting Practices and Procedures* were lacking.
2. Purchase orders and contracts were not always issued in compliance with applicable policies.
3. Contracts are a part of the internal control system but were not always utilized and timely executed.

BACKGROUND

On September 28, 2015, an Ordinance Amendment for the City's *Part II Code of Ordinances Chapter 2 Article III Section 2-61* for contracts was taken to City Council for approval under consent agenda item number 6.14. The update included language allowing designees to execute contracts on behalf of the City Manager.

Additionally, on November 5, 2015, *Policy # 120 City of Fayetteville Contracting Practices and Procedures* was approved by the City Manager which not only provided guidelines related to contracting practices and procedures, but also set delegation thresholds for which designees would be permitted to sign City contracts on the City Manager's behalf. Accordingly, Deputy/Assistant City Managers, and Department Directors were authorized to approve contracts, agreements and other legal obligations based on thresholds or document type. However, in some instances, City Council must approve contracts and cannot delegate this authority.

Furthermore, a new electronic contract routing system was implemented and training was provided in December 2015 and January 2016 to City personnel involved in the contracting process. Once a contract is uploaded into the electronic contract routing system, the contract is electronically routed to obtain all required approvals and signatures, and is maintained within Laserfiche, a document imaging and management software.

AUDIT OBJECTIVES

The objective of this audit was to reasonably ensure contracts/change orders were prepared and executed in compliance with relevant policies, procedures, laws, rules and regulations.

AUDIT SCOPE

The scope of the audit included PRM contracts with transactions incurred from July 1, 2016 to January 20, 2017. The scope did not include a review for monitoring and implementation of contract compliance. In addition, only two contracts sampled required bids, and therefore, provided insufficient evidence to determine overall compliance related to bid requirements.

AUDIT METHODOLOGY

In order to meet the objectives, Internal Audit examined contract and accounting documents; interviewed personnel; and tested records. Additionally, the following specific audit steps were performed:

- Reviewed applicable policy and procedures and relevant laws and regulations;
- Obtained and reviewed Parks, Recreation and Maintenance (PRM) transactions incurred from July 1, 2016 to January 20, 2017;
- Selected a sample of transactions and tested for adequate internal controls and against procedural requirements; and
- Interviewed employees involved in the PRM Department contracting process.

The Parks, Recreation and Maintenance Department was selected for this audit due to the volume of City contracts the department processes. The City did not have a central repository for all City contracts, whereas; there was no cumulative record to obtain a complete and accurate listing of all City contracts. Therefore, in order to reasonably ensure a complete contract population was captured, Internal Audit prepared a listing of all transactions from JD Edwards, the City's Financial System, that were charged to PRM as of January 20, 2017 for the current fiscal year which started on July 1, 2016. After reviewing this listing, Internal Audit determined 930 transactions out of 8,957 should have been paid under a contractual agreement. For purposes of this audit, contractual agreements refer to a separate, written agreement that has terms above and beyond those stated in a purchase order. Internal Audit tested 60 contracts from the 930 transactions.

NOTEWORTHY OBSERVATION

The Parks, Recreation and Maintenance Department appeared to be promoting local spending. During the audit of contracting practices and procedures, Internal Audit noted 107 (76%) of the 141 PRM vendors within the audited sample were Fayetteville or Cumberland County based vendors, according to records obtained from JD Edwards. In addition, of the remaining 34 vendors that were not reflected as Fayetteville or Cumberland County, nine were from counties surrounding Cumberland County.

FINDINGS, RECOMMENDATIONS, AND MANAGEMENT RESPONSES

Finding 1

Oversight and management of Policy # 120 City of Fayetteville Contracting Practices and Procedures were lacking.

Policies are established to ensure City personnel are consistently adhering to federal, state and local laws and regulations while mitigating risks that may prevent the City from achieving its objectives. Additionally, to ensure policies stay compliant with applicable laws and regulations, they must be reviewed and updated periodically. Therefore, if policies are established without being managed or proper oversight, then it cannot be assured policies remain compliant and are being followed.

Based on Internal Audit inquiry, the following provisions related to oversight and management of *Policy #120 City of Fayetteville General Contracting Practices and Procedures* were not performed as required by the policy:

1. The Signature Authority Designee Matrix, Appendix B to the policy was not reviewed and updated at least once a year by the City's Managers Office;
2. A "Committee", comprised of the City Finance Director, City Purchasing Manager, a Deputy or Assistant City Manager, an Assistant City Attorney and a contracting expert nominated by and selected from one of the City Departments, which was to be established by the City Manager's

office to conduct at least on an annual basis a review of the policy and recommend appropriate revisions was not created; and

3. Written departmental contracting procedures, which were to be established by all Department Directors and reviewed and approved by the City Attorney's Office, the Chief Financial Officer and the City Manager within six months of policy implementation, were not established.

Based on Internal Audit inquiry, management indicated personnel who were responsible to implement and provide policy management and oversight separated from the City in July 2016. However, prior to this turnover in personnel, the City of Fayetteville's Purchasing and Thresholds and Procedures, Appendix A of the policy was updated effective March 21, 2016. In addition, since Internal Audit's original inquiry, the "Committee" was established, with the first meeting being conducted on March 22, 2017. Currently, the "Committee" is reviewing and updating the policy and its appendices.

Recommendation

The Office of Internal Audit recommends management determine if the City Manager's Office is the most appropriate department to be responsible for *Policy #120 City of Fayetteville General Contracting Practices and Procedure* based on the ability to provide oversight and management of all policy provisions and appendices. Once determined, management should designate personnel/positions responsible for the oversight and management of the policy and ensure the personnel/positions responsible have the ability to enforce contract policy provisions. This recommendation is applicable for all findings within this report and will have a direct impact on the management responses for oversight and monitoring of compliance with the policy.

Management's Response

We concur. Management is in full agreement with the recommendation.

The approvals required and the procedures within Policy #120 City of Fayetteville General Contracting Practices and Procedure were initially assigned to the City Manager's Office; however, after further review and evaluation, the oversight and management of the policy to include the appendices is being assigned to the Finance department. Currently, the Finance department is responsible for the Purchasing function along with playing a major role with citywide contracting. Furthermore, Policy #120 City of Fayetteville General Contracting Practices and Procedure will continue to require the City Manager to approve all delegation of contract signature authority as authorized by the City's Code of Ordinances Chapter 2 Article III Section 2-61.

Responsible Party: Chief Financial Officer or designee

Implementation Date: 01/31/2018

Finding 2

Purchase orders and contracts were not always issued in compliance with applicable policies.

A strong system of internal control requires policies and procedures written by management to ensure proper controls, safeguards and segregation of duties. The development and use of policies and procedures are an integral part of a successful quality system as it provides personnel with the information and guidance to perform a job properly.

Internal Audit reviewed applicable federal, state and local policies, procedures, laws, rules and regulations relevant to contracts. This included *Policy #120 City of Fayetteville General Contracting Practices and Procedures*; City of Fayetteville Code of Ordinances; and *North Carolina General Statutes*. Upon review of these guidelines and the sampled contracts, the following observations were made:

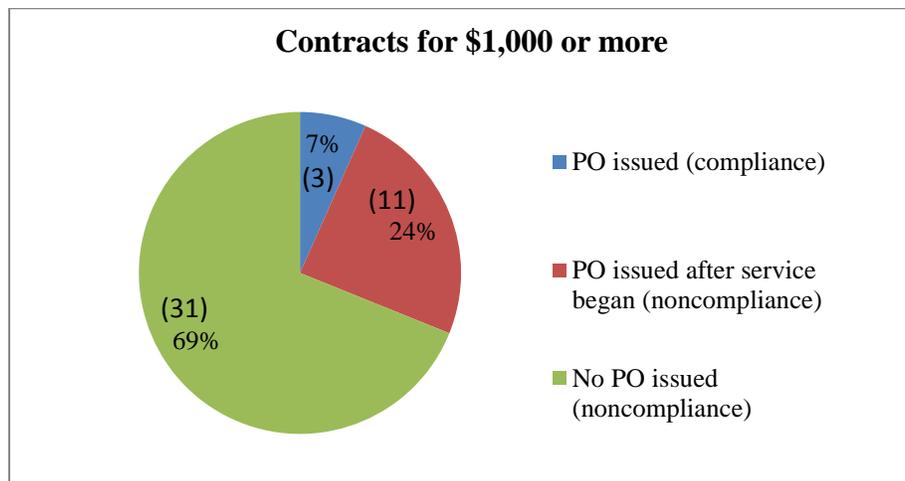
1. *Policy #120 City of Fayetteville General Contracting Practices and Procedures* required an approved purchase order prior to committing on all purchases, services and construction/repair project contracts \$1,000 and above. Internal Audit tested the sample to determine that purchase orders were issued in compliance with this requirement and noted the following:

- Fifteen (25%) of the 60 contracts did not require a purchase order, whereas, the contract amount was less than \$1,000.

The remaining 45 contracts either met the threshold of \$1,000 which required an approved purchase order or Internal Audit could not determine the contract amount due to wording within the terms of the contract. Of these remaining contracts, Internal Audit noted the following:

- Thirty-one (69%) of the contracts did not have approved purchase orders issued;
- Eleven (24%) of the contracts had purchase orders approved after service began; and
- Three (7%) of the contracts had purchase orders approved in compliance with established policies.

Based on Internal Audit inquiry, PRM personnel stated purchase orders were not obtained because the individual payments made to the vendors did not exceed \$1,000. The Department did not consider whether the amount paid to the vendor over the life of the contract would exceed \$1,000. Since written policies and procedures did not clearly state when purchase orders were required, it was left to the reader's interpretation.



In addition, purchase orders were not requested in advance to ensure a purchase order was obtained prior to the purchase or start of services. Generally, there was a lack of oversight and accountability related to ensuring approved purchase orders were obtained for all services and purchases \$1,000 and above; and approved purchase orders were obtained prior to a purchase or the start of services. Contract oversight processes should include adequate procedures and sufficient reviews to ensure purchase orders are appropriately established, consistent with contract spending authority and are capturing all related invoices.

2. *Policy #120 City of Fayetteville General Contracting Practices and Procedures* required the City Manager or his designee's signature based on delegation thresholds, City Clerk or Deputy City Clerk's signature, and the City Seal. The sample was tested to determine if authorized signatures and City Seal were present on the contracts. Internal Audit noted five (8%) of the 60 contracts sampled did not have all authorized signatures nor the City Seal. For three of the five contracts, internal controls were not in place to ensure contracts have all the authorized signatures and the City Seal affixed. However, once Internal Audit notified City personnel, the contracts were corrected. The remaining two contracts were related to the authorized signature based on delegation thresholds:

- One contract in the amount of \$220,000 could not be determined if the signature was authorized for execution, whereas, Laserfiche did not capture the date the contract was executed nor did the signor add the date to the contract; and
- One contract, not routed through the electronic routing system, was lacking all required approvals, authorized signatures and the City Seal.

Recommendation

1. Clarification should be added to *Policy #120 City of Fayetteville General Contracting Practices and Procedures* to:
 - a. Define the conditions under which a purchase order is required; and
 - b. Require all signatures on contracts in Laserfiche be dated.
2. Training and monitoring practices to ensure procedures are being followed by all user departments should be improved.
3. A quality control program should be developed to help ensure purchase orders are obtained prior to purchase or start of service, and all contracts are fully executed with all required approvals, signatures and the City Seal.

Management's Response

1. We concur. Management is in full agreement with the recommendation.

To ensure full implementation and compliance, the City Manager will assign the Chief Financial Officer the responsibility to define the conditions under which a **purchase order** is required and to require that all signatures on contracts in LaserFiche be dated.

2. We concur. Management is in full agreement with the recommendation.

To ensure full implementation and compliance, the City Manager will assign the Chief Financial Officer the responsibility of providing training and monitoring practices to ensure **purchase order** procedures are being followed by all user departments.

3. We concur. Management is in full agreement with the recommendation.

To ensure full implementation and compliance, the City Manager will assign the Chief Financial Officer the responsibility to develop a quality control program to help ensure **purchase orders** obtained prior to purchase or start of service, and all contracts are fully executed with all required approvals, signatures and the City Seal.

Responsible Party: Chief Financial Officer or designee

Implementation Date: 03/31/2018

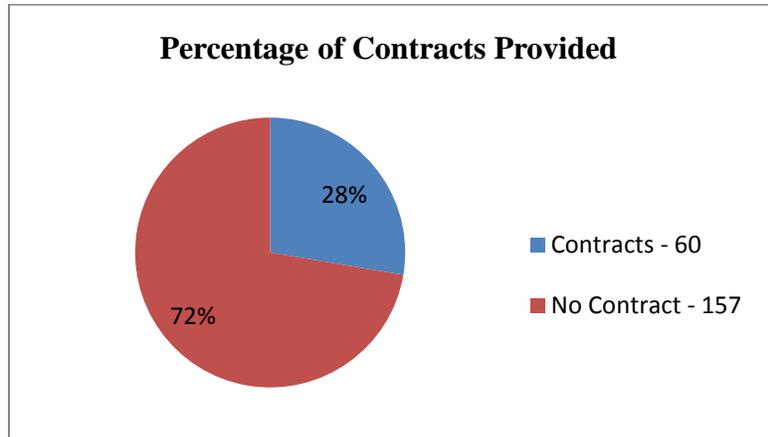
Finding 3

Contracts are a part of the internal control system but were not always utilized or timely executed.

The PRM Department makes purchases and accomplishes much of its work through many kinds of contracts. Poor contracting practices can leave the City vulnerable to paying more than it should, not getting the value expected and potential fraud. Internal control is the integration of the activities, plans, attitudes, policies, and efforts of City personnel working together to provide reasonable assurance that the City will achieve its mission. An effective internal control system helps the City with:

- Efficiency and effectiveness of operations;
- Safeguarding resources against loss due to waste, abuse, mismanagement, errors and fraud;
- Promoting adherence to statutes, regulations, policies and procedures; and
- Developing and maintaining reliable data, and accurately reporting that data in a timely manner.

Policy #120 City of Fayetteville General Contracting Practices and Procedures defines a City contract but does not state when a contract is required. In order for Internal Audit to achieve the desired sample of 60 contracts, 217 transactions which required a contract were reviewed. Therefore, a contract was not executed for 157 (72%) transactions. Additionally, services were started prior to contract execution for 30 (50%) of the 60 contracts tested, whereas; work was performed without a contract in place, limiting the City's control over the vendor or protection in case of a dispute.



When a contractor completes work without a contract or starts work prior to the contract being executed, it may result in:

- Delayed payment to the contractor;
- Possible unforeseen problems, such as violations of contract terms, scope, and conditions;
- Increased risk of liability to the City due to lack of or inadequate insurance;
- Possible litigation; and
- An inappropriately awarded contract, for example, without a competitive bid process, it would be too late to stop the process and put the contract out to bid.

Since written policies and procedures did not clearly state when contracts were required, it was left to the reader's interpretation. In addition, contracts were not routed far enough in advance to ensure execution prior to the start of services. Generally, there was a lack of oversight and accountability related to ensuring: contracts were obtained whenever applicable; and contracts were obtained far enough in advance to ensure contracts were executed prior to the start of services. Contract oversight processes should include clear organizational roles and responsibilities to enable accountability.

Recommendation

1. Clarification should be added to *Policy #120 City of Fayetteville General Contracting Practices and Procedures* defining the conditions under which a contract is required;
2. Training and monitoring practices to ensure procedures are being followed by all user departments should be improved;
3. A quality control program should be developed to help ensure contracts are obtained prior to purchase or start of service; and
4. Management should establish a central repository for all City contracts.

Management's Response

1. We concur. Management is in full agreement with the recommendation.

To ensure full implementation and compliance, the City Manager will assign the CFO the responsibility of providing clarification to Policy #120, City of Fayetteville General Contracting Processes and Procedures in an effort to define the conditions under which a **contract** is required.

2. We concur. Management is in full agreement with the recommendation.

To ensure full implementation and compliance, the City Manager will assign the CFO the responsibility of providing training and monitoring practices to ensure **contract** procedures are being followed by all user departments.

3. We concur. Management is in full agreement with the recommendation.

To ensure full implementation and compliance, the City Manager will assign the CFO the responsibility to develop a quality control program to help ensure all **contracts** are fully executed with all required approvals, signatures and the City Seal.

4. We concur. Management is in full agreement with the recommendation.

All contracts will go through contract routing and **LaserFiche** will serve as the contract repository.

Responsible Party: Chief Financial Officer or designee

Implementation Date: 03/31/2018

CONCLUSION

Oversight and management of contracts and purchase orders needs improvement to ensure compliance. In addition to the violations of existing City policy noted during this audit, there were instances in which existing City policy on contracts and purchase orders could provide better guidance, not only to ensure a better understanding of the policy, but also to assist in reducing the City's risk.

Internal Audit recommends updating existing policy to improve oversight; strengthen internal controls; provide clear guidance; and ensure employees are properly trained on all policies related to contracts and purchase orders.

Internal Audit wishes to thank the City Manager's Office and other City departments for their assistance and numerous courtesies extended during the completion of this audit.

Signature on File

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