



CITY OF PALO ALTO OFFICE OF THE CITY AUDITOR

January 22, 2013

The Honorable City Council
Palo Alto, California

Policy and Services Committee Recommendation to Accept the Contract Oversight Audit

The Office of the City Auditor recommends acceptance of the Contract Oversight Audit. At its meeting on November 20, 2012, the Policy and Services Committee approved and unanimously recommended the City Council accept the report. The Policy and Services Committee minutes are included in this packet.

Recommended Action: Accept the Contract Oversight Audit.

Respectfully submitted,

Jim Pelletier
City Auditor

ATTACHMENTS:

- Attachment A: Contract Oversight Audit (PDF)
- Attachment B: Policy and Services Committee Meeting Minutes Excerpt (November 20, 2012) (PDF)

Department Head: Jim Pelletier, City Auditor



CITY OF PALO ALTO OFFICE OF THE CITY AUDITOR

November 20, 2012

The Honorable City Council
Attention: Policy & Services Committee
Palo Alto, California

Contract Oversight Audit

In accordance with the Fiscal Year (FY) 2012 Annual Audit Work Plan, the Office of the City Auditor has completed the Contract Oversight Audit. The audit contains six findings with a total of ten recommendations. The Office of the City Auditor recommends the Policy and Services Committee review and recommend to the City Council acceptance of the Contract Oversight Audit.

We thank the staff of the Administrative Services Department (ASD) for their time, information, and cooperation during the audit process.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Jim Pelletier".

Jim Pelletier
City Auditor

ATTACHMENTS:

- Attachment A: Contract Oversight Audit (PDF)

Department Head: Jim Pelletier, City Auditor



CITY OF
**PALO
ALTO**

AUDIT OF CONTRACT OVERSIGHT: OFFICE SUPPLIES

November 2012



Office of the City Auditor

Jim Pelletier, City Auditor
Houman Boussina, Senior Performance Auditor



Office of the City Auditor

EXECUTIVE SUMMARY – CONTRACT OVERSIGHT AUDIT: OFFICE SUPPLIES



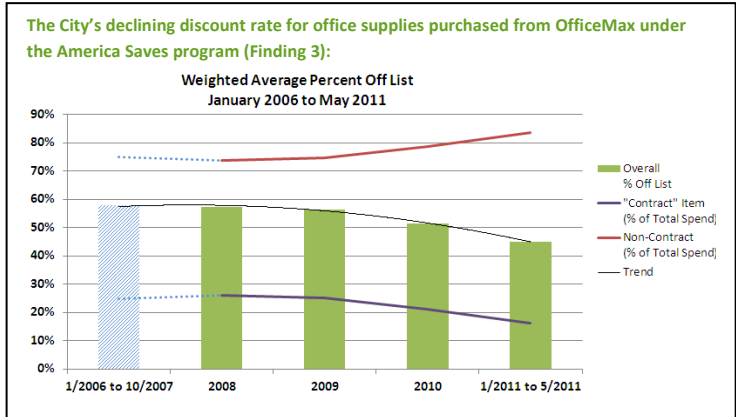
Audit Objective: To assess whether internal controls are effective and adequate to ensure that City contracts are administered in accordance with the City of Palo Alto Municipal Code and relevant policies and procedures. The audit focused on the City’s office supplies contract with OfficeMax Incorporated.

SUMMARY OF RESULTS

Internal controls within the Purchasing and Contract Administration Division (Purchasing) of the Administrative Services Department (ASD) require improvement to ensure that contracts are administered in accordance with the Municipal Code and relevant policies and procedures.

In regard to the City’s contract with OfficeMax, the City could have saved between \$196,484 and \$389,426 if the contract had been appropriately administered to ensure the City was receiving reasonably expected discounts at authorized prices. This includes:

- \$47,563 in overcharges from unauthorized price increases (Finding 1).
- \$148,921 to \$341,863 in additional discounts (Finding 2).

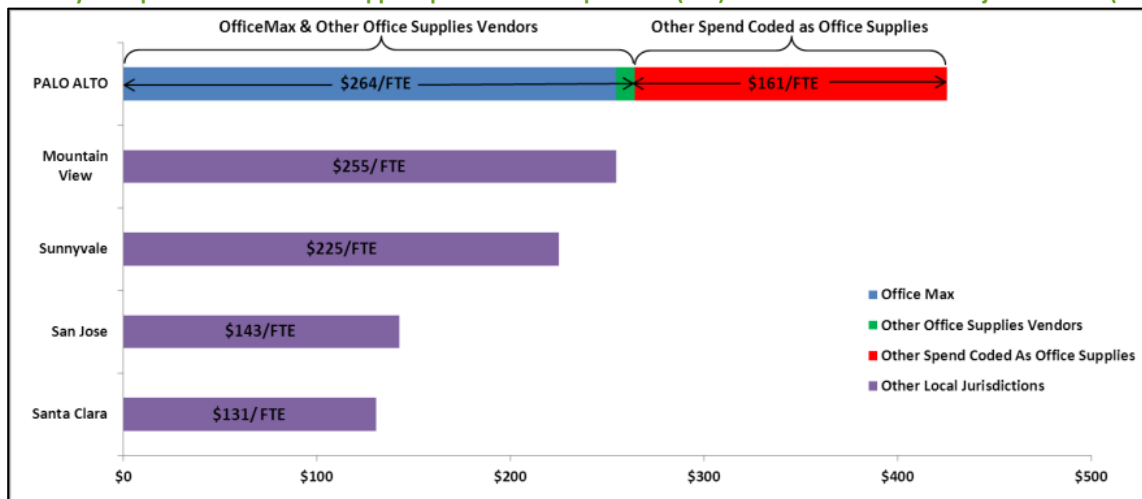


Source: OfficeMax billing records for the City

In this report, the Office of the City Auditor (OCA) provides 10 recommendations to improve contract oversight practices within the City and to support the City in recovering additional discounts from OfficeMax.

We encourage other City departments with contract administration roles and responsibilities to review this report and implement the recommendations where applicable. Page two of this executive summary presents highlights of findings and recommendations presented in this report.

The City has spent more on office supplies per Full Time Equivalent (FTE) than other selected local jurisdictions (Finding 3)



Source: Cities

REPORT HIGHLIGHTS

OfficeMax overcharged the City at least \$47,563 by applying unauthorized changes to pricing—

OfficeMax changed the prices on items purchased by the City under contract and could not provide supporting evidence showing price changes were approved as required by the contract. [Page 9]

The City could have received additional discounts for non-contract office supplies—

Our analysis indicates the City could have saved between \$148,921 and \$341,863. [Page 10]

ASD has not effectively administered the City's office supplies contract—

ASD has not established effective processes and procedures to ensure the City receives contracted discounts and other key benefits, and that the office supplies contract meets the City's business needs. [Page 13]

ASD should ensure the City's financial records accurately identify office supplies and should properly budget for and control office supplies expenditures—

While City records indicate the City has spent considerably more for office supplies than other local jurisdictions sampled, we could not reasonably associate a significant portion of office supplies expenditures with office supplies vendors. [Page 19]

Strategic contracting practices may provide savings opportunities—

The City did not have authorized contracts for several vendors selected for review and did not have a process to document and approve all exemptions from competitive procurement. [Page 20]

The City has not sufficiently defined contract administration roles and responsibilities—

We did not find sufficient guidance regarding contract administration roles, responsibilities, and business practices to ensure compliance with the City's contract terms and also to ensure the City receives contracted benefits. [Page 25]

RECOMMENDATION HIGHLIGHTS

OCA recommends that ASD consider the following actions:

- Request reimbursement of \$47,563 from OfficeMax for contract item overcharges.
- Consult with the City Attorney's Office to determine if the City can recover additional discounts ranging from \$148,921 to \$341,863 from OfficeMax for non-contract items.
- Develop formal procedures to effectively administer the City's office supplies contract.
- Implement controls to ensure that office supplies are accurately recorded in the City's accounting records.
- Clarify the City's procurement policies and procedures to specify when Purchasing should negotiate contracts, based on dollar amount thresholds applicable to total citywide expenditures for goods and/or services regardless of payment method.
- Monitor expiring contracts to ensure they are re-established in a timely manner.
- Comply with Municipal Code requirements for applying and documenting exemptions from competitive solicitation in the procurement of goods and services.
- Monitor total citywide expenditures on categories of goods and/or services to ensure the City has properly approved contracts in order to maximize cost savings.
- Ensure contract administration roles and responsibilities are defined and appropriately communicated.

This document represents a limited summary of the audit report and does not include all of the information available in the full report. The full report can be found on the Office of the City Auditor website at: <http://www.cityofpaloalto.org/gov/depts/aud/reports/performance.asp>

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In accordance with the Fiscal Year 2012 Annual Audit Work Plan, the Office of the City Auditor has completed this Audit of Contract Oversight. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We would like to thank the staff of the Administrative Services Department for their time, information, and cooperation during the audit process.

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INTRODUCTION

Audit Objective

The objective of this audit was to assess whether internal controls are effective and adequate to ensure that City contracts are administered in accordance with the City of Palo Alto Municipal Code (Municipal Code) and relevant policies and procedures. The audit focused on the City's office supplies contract with OfficeMax Incorporated (OfficeMax).

Background

The Office of the City Auditor (OCA) presents its contract oversight audit, which is included in the OCA Fiscal Year (FY) 2012 workplan approved by City Council. This audit provides an initial assessment of contract oversight, with a focus on the City's office supplies contract, which was selected for detailed review.

According to an OfficeMax representative, the City entered the OfficeMax America Saves program on November 1, 2007. Under its America Saves program, OfficeMax extended to other government agencies the terms of a master purchasing agreement (the America Saves contract) it held with Oakland County, Michigan, the lead agency. This contract covered the period from June 1, 2006 through June 30, 2011. OfficeMax extended the America Saves program under the terms of a new agreement with Oakland County. According to an OfficeMax representative, the City continued to participate in the America Saves program under the terms of the new agreement. Staff has purchased office supplies using purchasing documents and also the City's purchasing card (CAL-Card) system. Exhibit 1 summarizes the City's records of payments to OfficeMax for office supplies from 2005 through 2011.

Exhibit 1: City expenditures on office supplies from OfficeMax

Year	Purchasing Documents	CAL-Card	Total
2005	\$ 43,137	\$ 32,271	\$ 75,407
2006	\$ 129,753	\$ 154,809	\$ 284,562
2007	\$ 82,577	\$ 177,652	\$ 260,229
2008	\$ 106,670	\$ 174,790	\$ 281,461
2009	\$ 96,484	\$ 185,899	\$ 282,383
2010	\$ 85,999	\$ 201,878	\$ 287,877
2011	\$ 53,270	\$ 220,645	\$ 273,915
Total:	\$ 597,890	\$ 1,147,945	\$ 1,745,834

Source: City of Palo Alto financial records

Audit Scope and Limitations

The period covered was the assumed term of the City's contract with OfficeMax under the America Saves program, from November 1, 2007 through May 31, 2011. The City did not retain all contract documentation, and we relied on information from OfficeMax to determine the contract commencement date for the City. Subsequent to issuance of the draft audit report, OfficeMax provided documentation supporting that the agreement had been extended through June 30, 2011 due to a delay in signing a new agreement dated June 1, 2011. We did not extend our testing to cover the month of June 2011.

The audit focused on the following areas:

- OfficeMax compliance with the key America Saves contract terms, with an emphasis on pricing accuracy.

- Enforcement of contract terms and monitoring of contractor performance by the City.
- Usage of the OfficeMax America Saves contract by the City.

Scope Limitation—OfficeMax sales tax and service charge data was unreliable and incomplete

As illustrated in Exhibit 2a, sales tax was unusually high in 2006, 2007, and 2008. The exhibit also shows service charges paid by the City totaling approximately \$25,092.

Exhibit 2a: Summary of office supplies charges for the City – data reliability concerns highlighted

Year	Amount Billed	Sales Tax	Service Charge
2006	\$ 260,481	\$ 134,370	\$ 29
2007	\$ 242,801	\$ 145,759	\$ 236
2008	\$ 256,422	\$ 125,478	\$ -
2009	\$ 246,788	\$ 21,610	\$ 581
2010	\$ 256,674	\$ 23,700	\$ 23,700
2011	\$ 240,857	\$ 21,120	\$ 546
Total:	\$ 1,504,023	\$ 472,036	\$ 25,092

Source: OfficeMax records originally provided for this audit

Section 7.17 of the America Saves contract required OfficeMax to maintain and provide access to accurate books and records in connection with the services provided. In response to our concerns regarding data reliability and completeness, OfficeMax provided a new data file that did not include complete sales tax and service charge data. When asked, the OfficeMax representative stated service charge data was included “where applicable,” but that sales tax was not standard data provided in response to an audit request. Because of this limitation:

- We could not quantify service charges. We were unable to find any contractual basis for these charges.
- We could not verify accuracy of tax charges.
- We could not perform a direct comparison of OfficeMax records with the City’s accounting records, which include tax charges, in order to verify OfficeMax records we tested were complete. OfficeMax data we used may understate total City purchases by approximately \$25,000 for the period from November 1, 2007 to May 31, 2011.

Subsequent to issuance of the draft audit report, OfficeMax provided a new data file showing sales tax and service charges for each invoice. The data appeared more consistent; however, we did not perform any testing or verification on the new data, which is summarized in Exhibit 2b. OfficeMax stated that service charges were delivery charges for special order items that were applied by the vendor and passed on by OfficeMax. However, our analysis indicates OfficeMax only applied the “service charges” in some instances when the City placed an order totaling less than \$50. This practice appears consistent with printed language in invoices submitted to the City stating a specified “small order fee” was applicable to orders under \$50. We were unable to find any contractual basis for these service charges or small order fees.

Exhibit 2b: Summary of office supplies charges for the City (restated)

Year	Amount Billed	Sales Tax	Service Charge
2006	\$ 260,481	\$ 21,483	\$ 215
2007	\$ 242,801	\$ 20,005	\$ 379
2008	\$ 256,422	\$ 21,148	\$ 424
2009	\$ 246,788	\$ 22,243	\$ 312
2010	\$ 256,674	\$ 23,777	\$ 240
2011	\$ 240,857	\$ 21,265	\$ 534
Total:	\$ 1,504,023	\$ 129,920	\$ 2,104

Source: OfficeMax records provided subsequent to issuance of the draft audit report

Scope Limitation—OfficeMax unit of measure data field is not reliable

We also noted discrepancies between the unit of measure data field in OfficeMax billing data for the City and the City's contract. As a result, \$72,099, or about 8 percent of the City's net purchases during the period from November 1, 2007 through May 31, 2011 was excluded from our analysis. For example, the contract price list identified a ream of Aspen paper with the numeric identification number 322344, product code P154901, and the contracted unit cost of \$2.52. OfficeMax billing data for the City shows Aspen paper, identified by the same numeric identification number and product code, was also sold using different units of measure, such as "CT" or "PL," with the unit cost ranging from \$35.70 to \$1,460. Due to differences of this type, which prevent a valid comparison of charges with the contract terms, we limited the scope of our audit to records without unit of measure discrepancies.

Subsequent to issuance of the draft audit report, OfficeMax explained that the unit of measure data listed in the billing file represents the unit of measure that the City of Palo Alto end-user utilized when placing orders and that a conversion is required to match the unit of measure with the unit of measure associated with the numeric identification number. OfficeMax did not provide formal guidance to convert the information, and we did not assess whether such conversion is feasible or practical.

Scope Limitation—Additional discounts offered by OfficeMax outside the America Saves program were not clearly defined

During the audit, OfficeMax provided quarterly price lists of items that it stated were discounted specifically for the City of Palo Alto. OfficeMax representatives did not have any formal documentation regarding how these discounts were derived, but explained these items were "competitively bid in the marketplace and discounts arrived from that competitive bid."

In taking a conservative approach in our testing methodology, which is based on contract terms, we did not use price lists not specifically defined and authorized in the contract and assumed all items not matching the valid contract item list were non-contract items.

Exhibit 3 summarizes the City's office supplies purchases under the America Saves program, shown by the contract categories that are consistent with contract terms, which we refer to in our audit findings.

Audit Methodology

To conduct this audit, we analyzed reports from the City's SAP Enterprise Resource Planning system on payments to vendors through purchasing cards and purchasing documents in order to select a contract for detailed review. We

interviewed Administrative Services Department (ASD) staff and assessed the City's overall procurement policies and procedures to determine if contract administration roles and responsibilities have been defined and if contract administration practices were reasonable.

In order to assess OfficeMax's compliance with the office supplies contract terms, we identified key contract terms and conditions, including discounts and incentives to the City. We also interviewed OfficeMax representatives and staff in the Oakland County, Michigan Purchasing Division, who had responsibilities in administration of the America Saves program. We used data analysis software (ACL) to perform a complete analysis of the City's office supplies purchases from November 1, 2007 through May 31, 2011, to determine if the City received expected discounts and incentives.

City Auditor's Conclusion

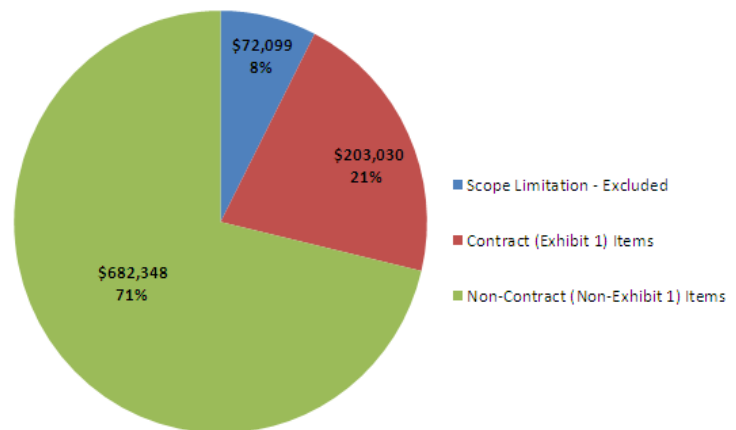
Government auditing standards require us to report our conclusion based on the sufficiency and appropriateness of the evidence supporting the findings in this report. These findings indicate that internal controls within the Purchasing and Contract Administration Division of ASD require improvement to ensure that contracts are administered in accordance with the Municipal Code and relevant policies and procedures.

In our detailed review of the City's contract with OfficeMax, we found that the City could have saved between \$196,484 and \$389,426 during the audit period if the contract had been appropriately monitored to ensure the City was receiving reasonably expected discounts at authorized prices. This includes:

- \$47,563 in overcharges from unauthorized price increases (Finding 1).
- \$148,921 to \$341,863 in additional discounts (Finding 2).

In this report, the Office of the City Auditor provides 10 recommendations to improve contract oversight practices within the City and to support the City in recovering additional discounts from OfficeMax.

Exhibit 3: City's office supplies purchases totaling \$957,477 under the America Saves program—November 1, 2007 to May 31, 2011



Source: Auditor's analysis of OfficeMax records

The audit recommendations in the report are addressed to ASD; however, in an effort to strengthen controls over contract oversight throughout the City, we encourage other City departments with contract administration roles and responsibilities to review this report and implement the recommendations where applicable.

Finding 1: OfficeMax overcharged the City at least \$47,563 by applying unauthorized changes to pricing

From November 1, 2007 through May 31, 2011, OfficeMax changed the prices on items purchased by the City under the contract. Neither OfficeMax nor Oakland County, Michigan (the lead agency under the contract) could provide supporting evidence showing price changes were approved as required by the contract. Our analysis indicates OfficeMax charged the City at least \$47,563 more than the amount calculated using the price list included in the contract. Most of the overcharges (\$38,045) were due to discrepancies between the contracted price of \$2.52 per ream for a commonly purchased package of "Aspen" paper and prices actually charged per ream, which ranged from \$3.19 per ream in 2007 (a 27 percent increase from the contracted price) to \$3.92 per ream in 2010 (a 56 percent increase).

The America Saves contract states that any changes, substitutions, additions, deletions, and/or pricing revisions must be reviewed and approved by Oakland County and OfficeMax in writing. The contract goes on to state that the contractor will be responsible for furnishing and delivering approved price lists to participating agencies. Without any documentation showing price changes were appropriately authorized, our analysis was limited to the original price list provided as an attachment to the contract.

Subsequent to issuance of the draft audit report, OfficeMax stated that although it does not have records of the communications, it did follow the process of providing price change information to Oakland County and only made changes with their approval. In addition, OfficeMax stated representatives met with the City of Palo Alto purchasing agents and communicated any changes in writing and that City representatives accepted price changes and at no time questioned prices. We did not find evidence that contract price list changes were appropriately authorized or communicated. The original contract price list was incorporated and made a part of the contract, which required the signature of an authorized OfficeMax employee and an Oakland County agent for any contract modifications or amendments. In addition, Oakland County was contractually required to place a copy of the America Saves contract on the County's website. We did not find evidence that Oakland County systematically authorized contract price list changes or that it disclosed the amended contract price lists on its website. In fact, when we initially requested the contract price list(s) and information regarding how Oakland County managed the contract, Oakland County provided a single price list and claimed it was the only one available. Subsequently, OfficeMax provided, for our audit, 21 contract price lists associated with each quarter during the term of the contract. In comparing the single Oakland County price list to the OfficeMax price lists, we found it did not match the original contract price list provided by OfficeMax. In response to our repeated

Finding 1 Recommendation to City Management:

1. ASD should consult with the City Attorney's Office to pursue recovery of unauthorized charges from OfficeMax, including at least \$47,563 for contract item overcharges under the America Saves program during the period November 1, 2007 through May 31, 2011.

requests for price lists, Oakland County did provide some additional price lists; however, there was no evidence these price lists were approved as required by the contract or that there had been a systematic process to authorize and/or communicate contract price list amendments to participating jurisdictions.

Considering the scope and magnitude of the America Saves program, OfficeMax and Oakland County should have established processes and controls to ensure any modifications to the contract were appropriately documented, communicated, and available to participating jurisdictions during and after the term of the contract and also for audit purposes. According to OfficeMax, as of April 2012, the sales volume of the (renewed) America Saves program was approximately \$30 million annually. A 4th quarter 2011 report on the America Saves program shows 1,128 “customers,” total spend of about \$9.38 million, and administrative fees totaling \$46,918 due to Oakland County, based on a percentage of total net purchases made by participating agencies during the quarter. We note that under the America Saves contract that was in effect during the audit period, Oakland County was awarded in addition to administrative fees, a “long term contract incentive” of approximately \$250,000 paid in three equal installments “in consideration of the length of this contract and the benefits that OfficeMax will derive as a result.”

Finding 2: The City could have received additional discounts for non-contract office supplies

About 71 percent of the City’s office supplies expenditures were for non-contract items discounted on average 40 percent, as opposed to contract items discounted on average 75 percent. The America Saves contract states non-contract items would be discounted at “up to 85 percent.”

Since the contract terms were unclear as to the level of discount the City should have received, our analysis considered other sources or reference points in assessing the reasonableness of discounts provided to the City. The two main sources we analyzed included records of bids received from other jurisdictions during the competitive solicitation process Oakland County, Michigan conducted in awarding the office supplies contract in 2006 and other local government audits of office supplies contracts. Overall, while the City received about \$452,604 in total discounts from OfficeMax for non-contract items, our analysis of the two sources, summarized below, finds the City could have reasonably anticipated additional discounts between \$148,921 and \$341,863.

Source #1—Competing bids received by Oakland County, Michigan, indicate the City could have received between \$148,921 and \$341,863 in additional discounts for non-contract items.

In assessing other competing bids Oakland County, Michigan, considered when it awarded its office supplies contract to OfficeMax in 2006, we found the other vendors offered clearer terms and calculated additional discounts the City could have received during the contract period:

- \$341,863 in additional discounts if the Staples bid terms were in effect, assuming the 70 percent discount rate would not have resulted in items sold below cost.
- \$194,319 in additional discounts if the Corporate Express bid terms were in effect.

Finding 2 Recommendation to City Management:

2. ASD should consult with the City Attorney’s Office to determine if the City can recover additional discounts ranging from \$148,921 to \$341,863 for non-contract items it purchased under the America Saves program terms from November 1, 2007 through May 31, 2011.

- \$148,921 in additional discounts if the Kamar bid terms were in effect.

Source #2—Other local government audits of office supplies contracts indicate the City could have received between \$228,367 and \$341,863 in additional discounts. We also reviewed office supplies contract audits conducted by other jurisdictions to assess the reasonableness of the overall discount provided to the City for non-contract items:

- A City of San Jose January 2012 audit report on its office supply purchases under the terms of the same OfficeMax America Saves program found the City’s understanding was that it could expect to save approximately 60 percent for “fluctuating price” items (i.e., non-contract items) when it first signed on to the America Saves program, but that the City actually received only an average discount of 35 percent off list for these items. The report states OfficeMax agreed to pay the City \$166,000 to correct the problem in the current fiscal year. If the City of Palo Alto had received an average discount of 60 percent for the non-contract items it purchased under the America Saves program, it would have saved an additional \$228,367.
- A City and County of San Francisco December 2009 audit report on its office supplies contract with Office Depot found its contract terms indicated it should have received an average discount of 70 percent for items not listed in the contract’s fixed price list. If the City of Palo Alto had received an average discount of 70 percent for non-contract items under the America Saves program, it would have saved an additional \$341,863.

Exhibit 4 summarizes our comparison of overall discounts for non-contract items OfficeMax provided to the City and total discounts the City could have received using other sources or reference points.

Exhibit 4: Analysis of discount levels for non-contract office supplies

Source:	Actual Discount %:	Total Discount:
OfficeMax Actual	40%	\$452,604

Source:	Proposed Discount Percentage:	Total Discount If Applied to City’s Non-contract Expenditures:	Additional Discounts the City Could Have Received:
OfficeMax contract	Up to 85%	Not Auditable	Not Auditable
Staples Bid	70% down to Cost	Up to \$794,466	Up to \$341,863
Kamar Bid	Generally 53%	About \$601,525	About \$148,921
Corporate Express Bid	57%	\$646,923	\$194,319
City of San Jose Audit	60%	\$680,971	\$228,367
City of San Francisco Audit	70%	\$794,466	\$341,863

The results of a separate analysis of the City’s office supplies expenditures conducted by ASD are consistent with this finding. OfficeMax stated that many of the bids presented in this report as reference points are either no longer in effect and are therefore inaccurate reference points, or have been proven to have inaccurate information pertaining to their discount structures. Further, OfficeMax stated that each reference point also represents an average, or general prices, not stated exact discounts across the board for every item. During the audit, the City’s Purchasing and Contract Administration Division (Purchasing) requested three office supplies vendors, including OfficeMax, to provide pricing from the most advantageous currently available agreements

the City of Palo Alto could use. According to the Manager of Purchasing and Contract Administration (Purchasing Manager), vendors applied current pricing to the City's record of purchases for the top 20 percent of line items that account for approximately 80 percent of the City's annual office supplies expenditures. The Purchasing Manager stated OfficeMax based its pricing on the current America Saves agreement. Our assessment of the Purchasing Manager's analysis suggests the City could save approximately \$56,000 annually if the City contracts with a different vendor. This is overall consistent with the results of our audit.

In response to the draft audit report, OfficeMax explained that the discount term "up to 85 percent" covers all merchandise classes and product categories. OfficeMax provided for our review a spreadsheet titled "America Saves Non Core Price Ranges" to show the basis for the non-contract item discount term of "up to 85 percent." The document, included as Attachment 2 in this report, shows merchandise classes (e.g., "Envelopes"), the minimum discount from list, maximum discount from list, and average discount from list. In our review of this document, which is not part of the actual contract, we noted the following:

- There are a total of 80 merchandise classes, with only 3 of the 80 with a stated "average discount from list" over 50 percent. There is not even one merchandise class with an "average discount from list" approaching 85 percent.
- Only 1 of the 80 merchandise classes (i.e., "RIBBONS") has a "maximum discount from list" that meets or exceeds the 85 percent discount level; however, the range of discount from list for this merchandise class is reported to be from 4 percent to 86 percent, with a stated average discount from list of about 39 percent. We found the City purchased about \$2,635 worth of ribbons during the audit period, and that the City received an average discount of only 26 percent for this merchandise class.

We did not perform further testing or analysis using the provided "America Saves Non Core Price Ranges" spreadsheet because it was not part of the contract and also because the information does not provide a reasonable basis for audit purposes.

OfficeMax further stated that there is no basis for comparing the City of San Jose audit report to our report findings because San Jose restricted purchases of specific items and negotiated terms beyond the America Saves contract through a purchase order process (specifically in writing). This position is not consistent with the OfficeMax written response to the City of San Jose audit report which states, "Also, it's stated in the P.O., that the *estimated* average discount will be 60% off of the manufacturers' price list. Please note, this was an estimate only of the general mix of non-core products under the America Saves Master Agreement. Since 2008, the City changed its purchasing patterns by adding many different types of products to their spend mix including toner products, which by industry standards carry lesser discounts than general office products." OfficeMax reiterated to the City of San Jose that the America Saves contract terms provided for discounts on non-core items of "up to 85 percent off manufacturers suggested list prices," and further stated, "All local government customers that are tied to the America Saves Agreement receive the same discounts and pricing for 'non-core' pricing [sic]." OfficeMax offered a one-time payment of \$166,000 to the City of San Jose "in an effort of goodwill to clear up any misunderstandings in how the P.O. was interpreted and issues coming from the City audit." This amount covered the fiscal year 2011 overpayments for the "fluctuating price" or "non-core" items discussed in the audit report.

Finding 3: ASD has not effectively administered the City’s office supplies contract

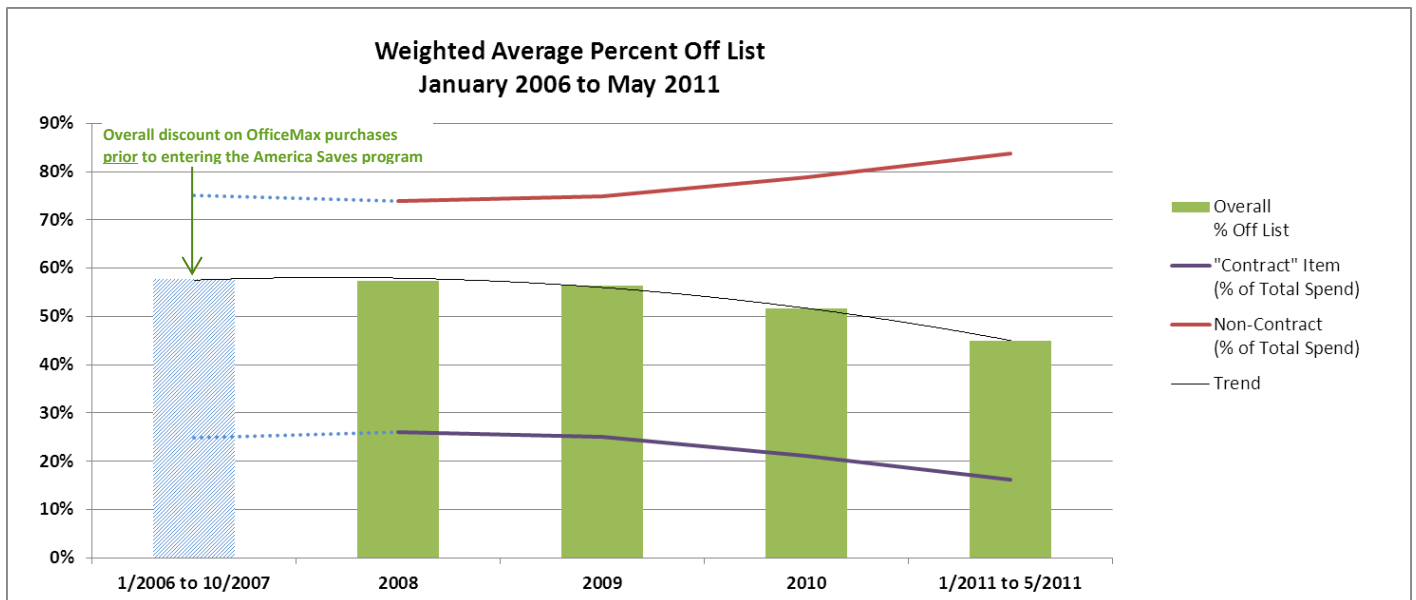
ASD has not established effective processes and procedures to ensure the City receives contracted discounts and other key benefits, and that the office supplies contract meets the City’s business needs. As a result, the City missed savings opportunities and did not maximize contracted benefits consistent with the City’s goals and policies.

ASD did not ensure the office supplies contract met the City’s business needs, resulting in lost savings opportunities

Contract items under the America Saves program that were discounted at about 75 percent accounted overall for only about 21 percent (\$203,030) of the City’s OfficeMax office supplies purchases, suggesting the City’s office supplies needs were not adequately addressed in the contract. The City only received a discount of about 40 percent for the majority (71 percent) of its office supplies expenditures on non-contract items. ASD did not have a process to monitor discounts provided to the City or the City’s purchasing patterns.

Exhibit 5 shows the City received an overall discount of about 58 percent from OfficeMax for purchases prior to entering the America Saves program, from January 2006 to October 2007. The City’s overall discount dropped each subsequent year, under the America Saves program, to about 45 percent off of list in 2011. The decline appears to be due to a decrease in purchases of highly discounted contract items and an increase in purchases of non-contract items. If the City had continued to receive an average discount of about 58 percent for all its purchases subsequent to entering the America Saves program, it would have saved at least an additional \$67,302 from November 1, 2007 through May 31, 2011.

Exhibit 5: City of Palo Alto’s declining discount rate for office supplies purchased from OfficeMax



Source: OfficeMax billing records for the City

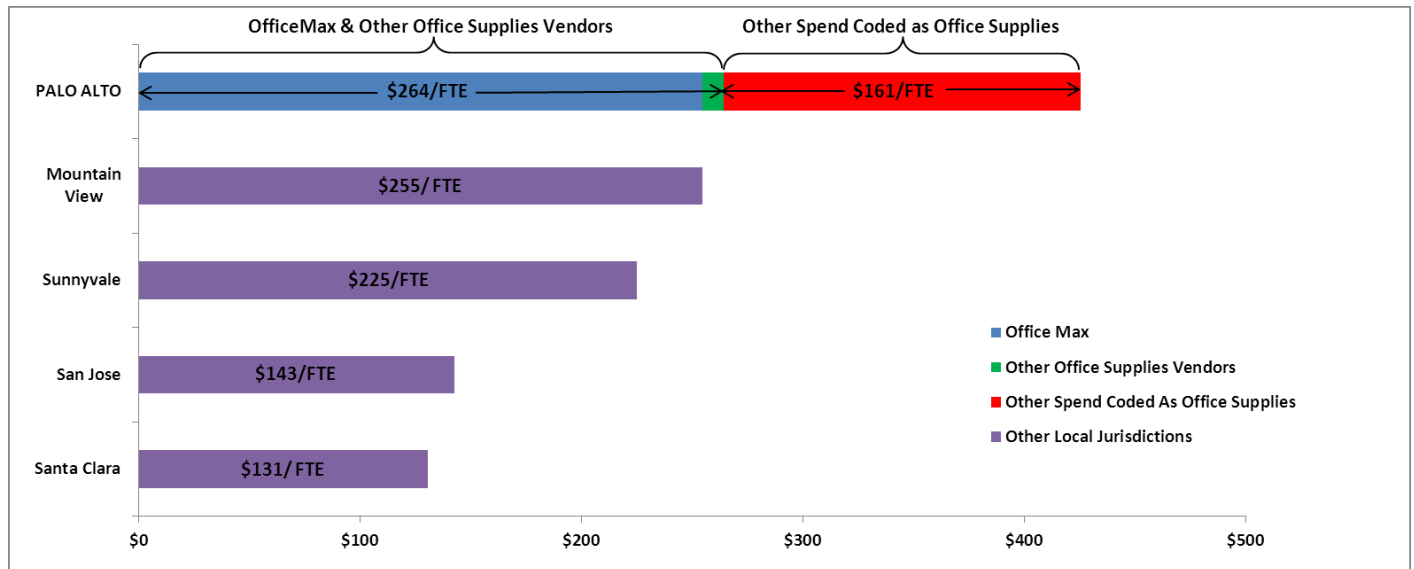
We found ASD does not have procedures to ensure:

- OfficeMax has made all contract items available for purchase.
- Contract terms and highly discounted contract items continue to meet the City’s business needs.
- OfficeMax provides correct discounts for both contract and non-contract items.

The City has spent more than other jurisdictions for office supplies and has not fully utilized its office supplies contract

In FY 2011, the City budgeted \$562,784 for office supplies and spent about \$473,790, or about \$425 per authorized full time equivalent (FTE), indicating the City has spent more on office supplies than other local jurisdictions. While the majority of the City’s expenditures coded as office supplies could be associated with OfficeMax or other commonly known office supplies vendors (the blue and green bars in Exhibits 6a and 6b), we also identified expenditures coded as office supplies that we could not necessarily identify with office supplies vendors. These are labeled “Other Spend Coded as Office Supplies” (the red bar in Exhibits 6a and 6b).

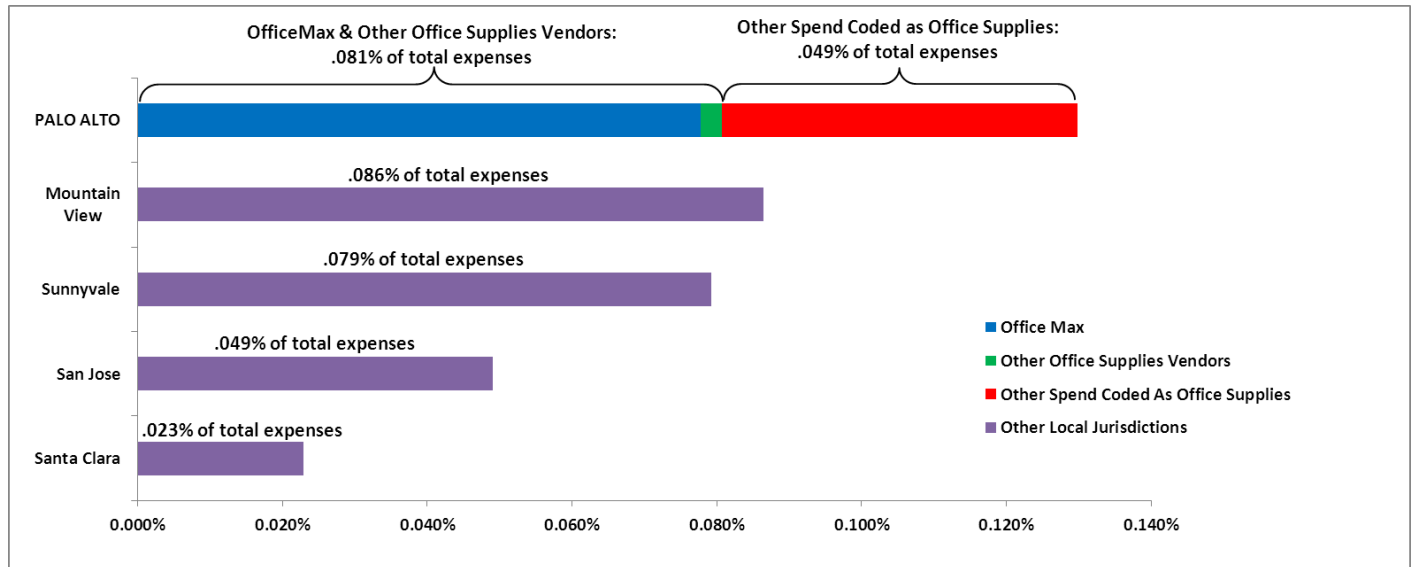
Exhibit 6a: FY 2011 office supplies expenditures per Full Time Equivalent (FTE)



Source: Cities

As shown in Exhibit 6b, office supplies expenditures as a percentage of total expenses were similarly higher than other local jurisdictions in FY 2011.

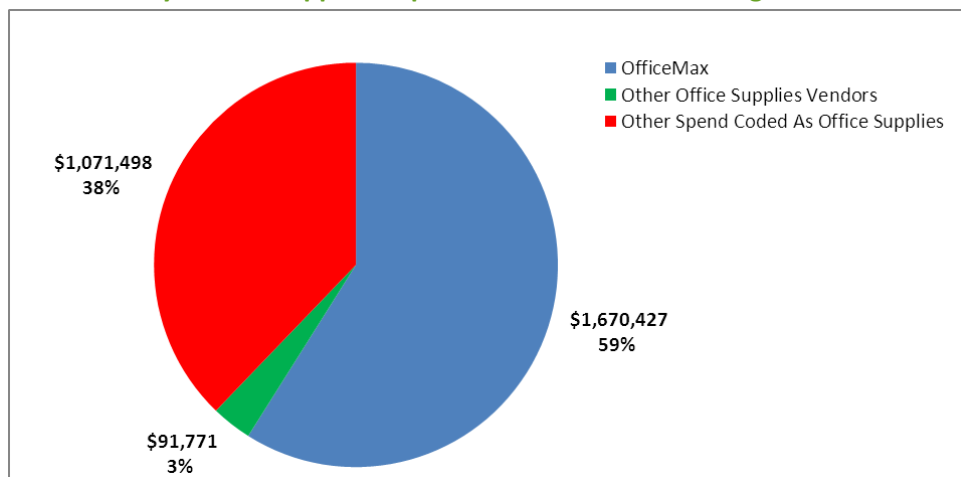
Exhibit 6b: FY 2011 office supplies expenditures as a percentage of total expenses



Source: Cities

From 2006 through 2011, the City only purchased approximately 59 percent (about \$1.67 million) of its office supplies (about \$2.8 million in total) from OfficeMax, as shown in Exhibit 7. This raises concerns regarding the nature of expenditures identified in the City’s financial records as office supplies, and whether the City has fully utilized its office supplies contract to realize benefits from the presumed discounts and other favorable terms. We identified other office supplies vendors the City paid, such as Office Depot and Staples, which accounted for about 3 percent of the City’s total office supplies purchases. We also concluded that about 38 percent of the expenditures coded as office supplies in the City’s financial systems could not necessarily be associated with office supplies vendors. This is further discussed in Finding 5.

Exhibit 7: City’s office supplies expenditures from 2006 through 2011



Source: City of Palo Alto financial records

The City does not have procedures to maximize the use of its office supplies contract. According to the City's Purchasing Manager, the City's goal is to provide maximum flexibility to staff in purchasing supplies.

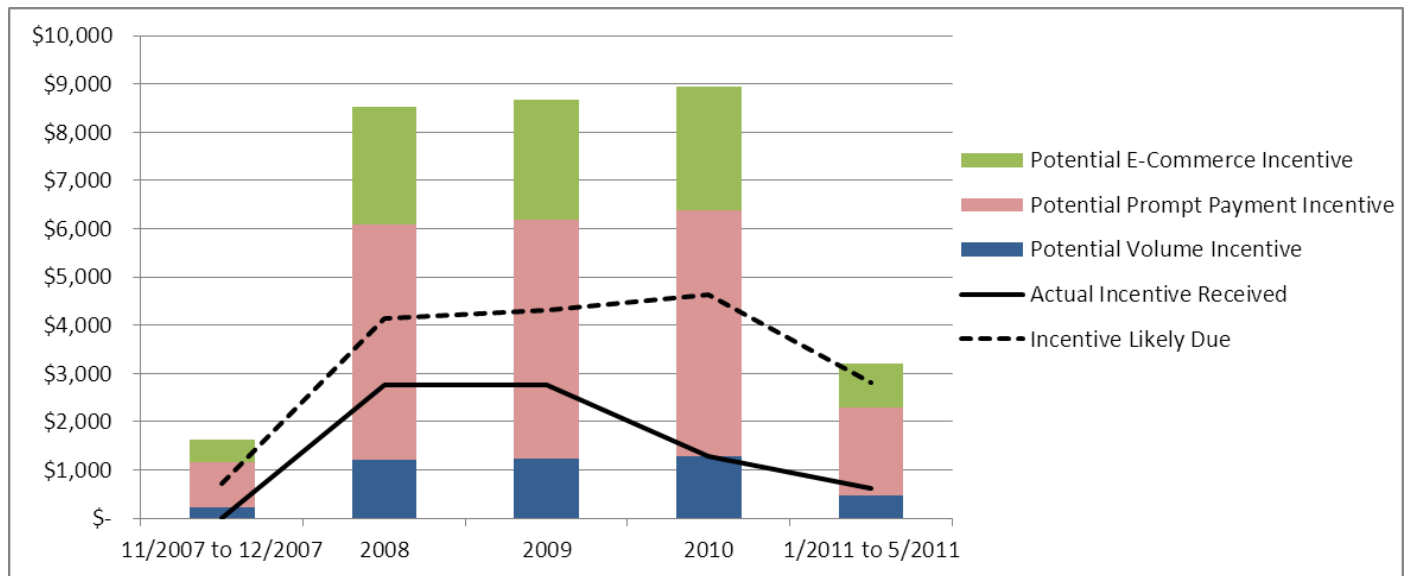
ASD has not managed or monitored contract incentives owed to the City and/or available to the City

The City does not have a process to monitor or account for all contract incentives paid to the City or to ensure the City maximizes its eligibility for contract incentives. The contract required OfficeMax to pay various incentives, including:

- Volume incentives from 0.5 percent to 2 percent, based upon total annual net purchases.
- A prompt payment incentive of 2 percent, provided payment was made within 10 days via "EFT" (electronic funds transfer). The contract does not further define what qualifies as EFT.
- An electronic commerce (ecommerce) incentive of 1 percent of total net purchase volume, provided greater than 75 percent of net purchases were placed electronically.

Because Purchasing does not have complete records of incentives received, we relied on OfficeMax to provide the records for our review. As shown in Exhibit 8, OfficeMax likely paid the City volume incentives the City was eligible for; however, the City did not receive all available ecommerce or prompt payment incentives. Considering that staff purchased most office supplies using purchasing cards, a payment method that appears to qualify as a form of electronic funds transfer, the City should at least have received most prompt payment incentives. However, except for in 2011, the City did not qualify for the ecommerce incentive because less than 75 percent of net purchases were placed electronically, using purchasing cards.

Exhibit 8: Analysis of incentives

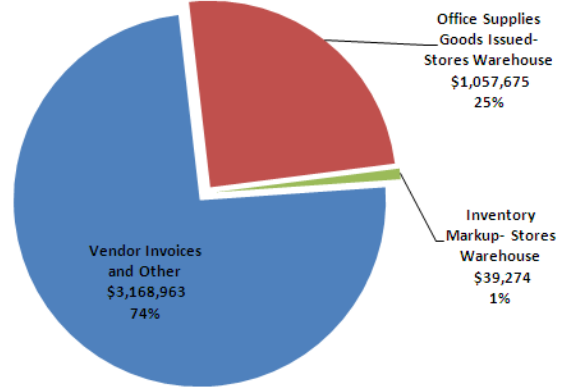


Source: OfficeMax billing records for the City

City warehouse purchase and storage of office supplies results in additional costs to City Departments

The City maintains an inventory of office supplies at its warehouse at the Municipal Services Center despite the contract with OfficeMax which ensures a 98.5 percent fill rate and provides for next-day delivery. The warehouse charges City departments for the cost of office supplies plus a 2 percent markup. As shown in Exhibit 9, approximately \$1.06 million (about 25 percent) of the City's total office supplies purchases of \$4.26 million were issued through the City's warehouse from July 2003 through February 2012. City departments were charged a markup of about \$40,000 during this period, or about 3.7 percent.¹

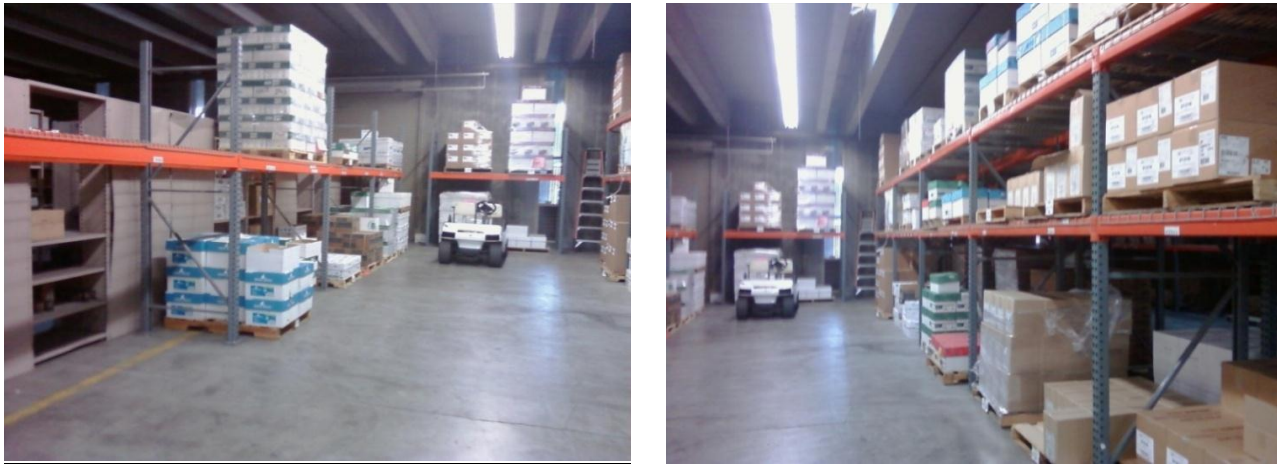
Exhibit 9: City's office supplies purchases – July 2003 to February 2012



Source: City of Palo Alto financial records

The City incurs avoidable costs for maintaining and distributing office supplies, some of which is passed on to City departments in the form of the 2 percent markup. We did not perform a detailed analysis of potential cost savings as part of this audit; however, there is a cost associated with warehouse space used for storing the supplies, as well as the cost for staff time to manage and deliver office supplies.

Exhibit 10: The City's inventory of office supplies at the warehouse



According to the City's warehouse supervisor, office supplies occupy about 2 to 4 percent of warehouse space.

¹ An analysis of the difference between the 2 percent markup rate stated in a City procedure and the actual inventory markup was beyond the scope of this audit. We have brought this to the attention of the ASD Director.

ASD has not ensured the City's office supplies purchases support the City's environmental policies and goals

The City spent \$229,420 plus tax on ASPEN 30% Post-Consumer paper, from December 23, 2005 to June 29, 2012. This product was mostly purchased by the warehouse, and according to staff, delivered to City departments. The City's policy on the procurement of recycled paper products requires the City to purchase paper products consisting of at least 50% secondary and postconsumer waste, whenever the recycled alternative meets the City's requirements and specifications for paper products, and within the constraints of staff time and cost factors. The policy provides for a price preference of up to 5 percent for recycled products calculated based on the lowest responsible bid or price quoted by suppliers offering non-recycled paper products.

We also found the City's June 2007 Zero Waste Operational Plan raised concerns about compliance with the City's policy on recycled content. The report recommended the City establish and incorporate environmental standards into applicable bid solicitations and purchasing opportunities. The plan stated: "The recycled product procurement process in the City has not achieved the goals set out by the policy. For example, although the City's Purchasing Department [sic] had arranged for the purchase of 100 percent recycled paper, but [sic] after nine months of implementation, this program was discontinued." ASD does not have procedures to ensure the City's office supplies contract supports the City's environmental goals and policies. Staff reported during the audit that the City has initiated efforts to address the City's environmental policies in the future procurement of office supplies.

Exhibit 11: The City's most commonly purchased item: BOISE ASPEN 30 (30% post-consumer content paper)



Source: BOISE Inc.

Finding 3 Recommendation to City Management:

3. ASD should develop formal procedures to effectively administer the City's office supplies contract in order to ensure:
- The contract supports the City's business needs, policies, and goals, including the City's environmental policies.
 - Purchasing monitors discounts provided to the City in order to timely detect any negative trends, such as a decline in the purchase of highly discounted contract items, and to ensure the City receives all contracted discounts and other key benefits.
 - Use of the contract is maximized and purchases of office supplies from other vendors or suppliers the City has not contracted with is restricted or minimized.
 - The City identifies and maximizes its eligibility for available contract incentives.
 - The City discontinues storing and delivering office supplies, unless staff can provide a cost/benefit analysis justifying the current practice.
 - Responsibility for contract administration is formally assigned, documentation of contract administration activities is retained, and contract administration is minimally impacted by staff turnover.

Finding 4: ASD should ensure the City's financial records accurately identify office supplies and should properly budget for and control office supplies expenditures

As discussed in Finding 3, while City records indicate the City has spent considerably more for office supplies than other local jurisdictions sampled, we could not reasonably associate a significant portion of office supplies expenditures with office supplies vendors. For example, we found instances where purchases from the following vendors were recorded as office supplies:

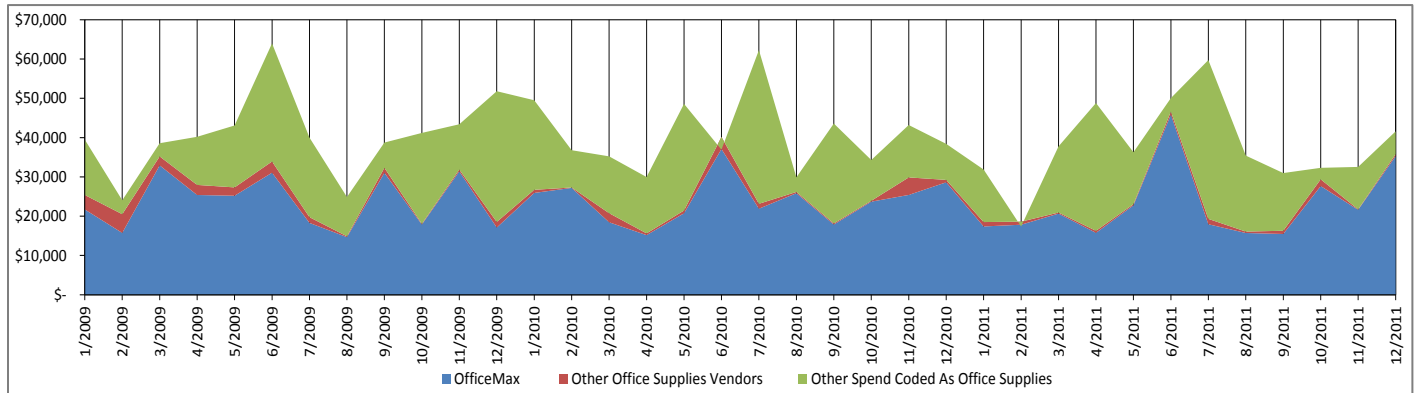
- Golden Gate Systems
- Creative Data Products
- Monterey Mechanical
- Palo Alto Hardware Inc.
- Hub International Inc.
- Tax Collector
- Advance Recruitment Solutions

ASD has not ensured the use of the office supplies code is limited to office supplies purchased from OfficeMax or other office supplies vendors. In addition, the City's office supplies budget is nearly double what the City purchases from OfficeMax under its office supplies contract. In FY 2011, the City budgeted \$562,784 for office supplies, or approximately double the average total annual purchase amount of \$281,409 from OfficeMax.

The City's office supplies spending patterns, as shown in Exhibit 12, raise further concerns regarding what the City has coded as office supplies and the nature and timing of "office supplies" purchases. Exhibit 12 shows, on a monthly basis, the difference between expenditures we could associate with OfficeMax or other commonly known office supplies vendors, and "Other Office Supplies Spend." It also shows spikes in the purchase of office

supplies near the end or beginning of fiscal years. Our analysis in this area was limited because the City's financial records and systems do not provide the necessary detail and functionality to assess the nature of all expenditures coded as office supplies. For example, the City's SAP Enterprise Resource Planning system does not have a report or the data required to assess the use of the office supplies code for purchasing card (CAL-Card) transactions.

Exhibit 12: City of Palo Alto's monthly office supplies expenditures



Source: City's financial records

Finding 4 Recommendation to City Management:

- ASD should develop and communicate to staff policies and procedures to ensure the office supplies accounting code is clearly defined, its use is monitored, and that office supplies are accurately recorded in the City's accounting records.

Finding 5: Strategic Contracting Practices May Provide Savings Opportunities

In order to assess contract oversight practices in light of concerns raised during our review of the OfficeMax contract and considering the City's expenditure trends showing increased use of purchasing cards, we judgmentally selected 13 vendors for review. The sample was selected to ensure coverage of vendors we classified into three groups:

- Vendors paid using purchasing cards.
- Vendors paid using purchasing documents.
- Vendors awarded contracts exempted from the City's competitive solicitation requirements.

The scope of our review included determining whether the City had an authorized and competitively solicited contract in place for each vendor. Exhibit 13 summarizes our selection of vendors and the results of our review.

Exhibit 13: Summary of testing results for 13 selected vendors

Number	Vendor	Total (Purchasing Documents plus Purchasing Card Payments)		Purchasing Card (% of Calendar Year 2011)	Authorized Contract Exists?	Solicitation Conducted or Properly Exempted?
		Total (Historical in SAP)	Calendar Year 2011			
1	Granite Rock Company	\$ 4,831,371	\$ 249,000	0%	Yes	Yes
2	Palo Alto Community Child Care	\$ 4,011,623	\$ 407,491	0%	Yes	Yes
3	Hydromax USA, LLC	\$ 3,800,000	\$ 3,800,000	0%	Yes	Yes
4	Ecology Action of Santa Cruz	\$ 3,759,190	\$ 817,397	0%	Yes	Yes
5	OfficeMax, Inc.	\$ 1,897,830	\$ 266,039	83%	No	No
6	W.W. Grainger, Inc.	\$ 833,039	\$ 64,754	69%	No	No
7	Canopy Trees For Palo Alto	\$ 646,993	\$ 62,408	0%	No*	No*
8	Wingfoot Commercial Tire Systems, LLC	\$ 518,977	\$ 122,331	100%	No	No
9	G&K Services, Inc.	\$ 414,391	\$ 154,593	1%	Yes	Yes
10	The Home Depot, Inc.	\$ 374,552	\$ 63,629	100%	No	No
11	Renne Sloan Holtzman Sakai LLP	\$ 85,000	\$ 85,000	0%	Yes	No
12	Stone and Youngberg LLC	\$ 91,285	\$ -	N/A	No	No
13	Quint & Thimmig LLP	\$ 60,002	\$ -	N/A	No	No

Source: City's financial reports and Auditor's analysis of ASD Purchasing files for the period May 2003 through February 2012.

*Although there was a current properly authorized and exempted contract on file in the amount of \$83,210 for each of three years starting April 1, 2011, contracts were not available to cover all prior payments made to Canopy Trees For Palo Alto.

The City did not have authorized contracts for several vendors selected for review

As shown in Exhibit 13, the City did not have evidence of properly authorized contracts for 7 of 13 vendors we selected for review, as listed below:

- OfficeMax, Inc.
- W.W. Grainger, Inc.
- Wingfoot Commercial Tire Systems, LLC
- The Home Depot, Inc.
- Stone and Youngberg LLC
- Quint & Thimmig LLP
- Canopy Trees For Palo Alto

While the City had a valid contract with Canopy Trees For Palo Alto dated April 1, 2011 at the time of our review, we found purchasing documents dating back to July 2003 without any record of a valid contract. In response to our concerns regarding the lack of contracts for Canopy Trees For Palo Alto, ASD staff stated that Canopy Trees For Palo Alto is a non-profit organization. We are not aware of Municipal Code provisions that exempt non-profit organizations from the City's contracting requirements. Moreover, we found a collection of staff emails dating back to 2004 that taken together suggest the City has had ongoing problems in making payments to Canopy Trees For Palo Alto because contracts had not been in place when payments were due.

The City does not have a properly authorized office supplies contract

The City's financial records indicate approximately \$1.9 million in purchasing documents and purchasing card transactions for supplies from OfficeMax from May 2003 through February 2012. From 2006 through 2011, the City purchased the majority of its office supplies from OfficeMax, with annual expenditures excluding tax and

service charges ranging from approximately \$243,000 to \$260,000. Municipal Code Chapter 2.30 (Part 3 - Contracting Authority) requires City Council approval and the mayor or vice-mayor's signature, if annual expenditures on goods from a vendor surpass the \$85,000 limit on the Purchasing Manager's contract award authority and the \$250,000 limit on the City Manager's contract award authority. In addition, Municipal Code section 2.30.070 requires approval "as to form" from the City Attorney. We did not find any evidence the City Council authorized the City's OfficeMax contract or that ASD requested the City Attorney's Office approve the contract as to form. Staff initially reported the City had an agreement with OfficeMax for office supplies dating back to 2006; however, staff provided an April 13, 2010 "supplier agreement" with the printed names of the City's Purchasing Manager and an OfficeMax Business Development Manager indicating the City had entered the OfficeMax America Saves program approximately four years after the period initially reported. Staff subsequently found an August 1, 2008 letter from an OfficeMax District Sales Manager stating the City was "tied to the OfficeMax Nationwide Co-operative Purchasing Agreement with non-profit agency Public Sourcing Solutions." However, an OfficeMax representative stated OfficeMax records indicate the City had actually entered the America Saves program on November 1, 2007.

Although the America Saves program master purchasing agreement expired on June 30, 2011, we found no evidence the City subsequently took steps to appropriately contract for office supplies. Staff provided a "Supplier Agreement" dated March 1, 2012, indicating the City re-entered the America Saves program, under a new Oakland County, Michigan master agreement dated June 1, 2011, or eight months after the prior master agreement expired. OfficeMax representatives stated, however, that the City's account had been rolled over into the new agreement terms when the prior terms had expired in 2011.

ASD could maximize savings opportunities for the City through strategic contracting practices

The City's procurement policies and procedures do not clearly identify and communicate requirements for establishing negotiated contracts for goods and/or services the City purchases mainly using purchasing cards, which likely results in lost savings opportunities. Exhibit 13 identifies several vendors (OfficeMax, Inc., W.W. Grainger, Inc., The Home Depot, Inc., and Wingfoot Commercial Tire Systems, LLC) the City purchased goods and/or services from in 2011 primarily using purchasing cards, without having negotiated contracts. ASD staff was not aware of any contracting or competitive solicitation requirements for the purchase of goods and services using purchasing cards, and we did not find any evidence ASD has monitored the City's aggregate spend for categories of goods and/or services (or total spend by vendor) in order to determine whether cost savings opportunities could be maximized by entering negotiated contracts.

The Purchasing Manager stated the role of the ASD Purchasing and Contract Administration Division (Purchasing) is "reactive" to the procurement needs of City departments. Purchasing does not monitor expenditures for goods and/or services from vendors through the use of the City's SAP Enterprise Resource Planning system reports and generally relies on City departments to contact Purchasing staff regarding contracting needs. Also, according to the Purchasing Manager, Purchasing does not have a process to ensure staff is alerted as contracts approach expiration.

In our review of the City's policies and procedures, we noted the Municipal Code and key policies and procedures suggest the use of procurement cards should not preclude efforts to establish negotiated agreements and to maximize cost savings:

- The Municipal Code states that all petty cash or purchasing card purchases shall be in accordance with the contract procedures and requirements contained in the purchasing manual, which implements the requirements of the Municipal Code. The Municipal Code states that while Purchasing is centralized and all purchases shall be made through the Purchasing Manager, designated employees authorized by their department head may award and sign contracts for goods and services where the contract price does not exceed \$5,000 and the terms is one year or less.
- The City's current purchasing card guidebook states that the purchasing card program is designed as an alternative to a variety of processes including petty cash, check requests, and low dollar purchase orders. The guidebook states the purchasing card program is not intended to avoid or bypass appropriate procurement or payment procedures. Although the guidebook establishes a \$5,000 daily transaction limit and a \$15,000 monthly spending limit, it provides minimal guidance to ensure the City maximizes savings opportunities where there are repetitive or significant annual purchases of particular categories of goods and/or services.
- The purchasing card guidebook makes reference to the Municipal Code prohibition on splitting of purchases for the purpose of evading the City's competitive solicitation requirements or contract authority limitations. The guidebook presents as an example a situation where a cardholder purchases the same \$1,500 dollars in chemicals from one vendor each month, suggesting that while this is not considered a "split," the commodity should be bid and set up on a blanket purchase order.

We found purchasing card payments totaling more than \$20,000 in 2011 to each of 19 different vendors. We also noted significant expenditure levels for vendors that sell similar products and/or services without negotiated contracts available for any of the vendors. For example, City records show the City purchases goods and/or services from hardware vendors including W.W. Grainger, Inc., The Home Depot, Inc., and Orchard Supply Hardware Stores Corporation without negotiated contracts to ensure the City maximizes discounts and other benefits for the City. The Purchasing Manager stated the City does not have a "strategic sourcing" strategy implemented, which could facilitate the City's ability to consolidate expenditures for commonly purchased goods and/or services under a contract with a selected vendor. A detailed analysis of cost savings to the City through contracting with these vendors is beyond the scope of this audit. However, during the course of the audit, we found examples of contracts available to governmental agencies that provide discounts the City could potentially take advantage of for some of the goods and/or services purchased with purchasing cards:

- A Home Depot U.S.A., Inc. (Home Depot) contract providing rebates ranging from 1 to 3 percent. We also found potential opportunities for greater savings from a contract with Lowe's HIW, Inc., which provides discounts of 5 percent off of retail in addition to a 2 percent prompt pay discount. Subsequent to issuance of the draft audit report, the City's Purchasing Manager stated the City does have a contract with Home Depot, however, the documentation was not provided during the audit. Moreover, according to a Home Depot representative, Home Depot has record of only \$13,623 in City of Palo Alto expenditures in 2011. As shown in Exhibit 13, we found the City purchased goods and/or services totaling \$63,629 from Home Depot in 2011.
- A W.W. Grainger, Inc. contract provides category discounts ranging from 15 percent to 45 percent off of list price, in addition to negotiated pricing on selected items.
- A Western States Contracting Alliance contract for tires, tubes, and services provides for discounts ranging from 15 percent to 30 percent.

ASD does not have a process to document and approve all exemptions from competitive procurement

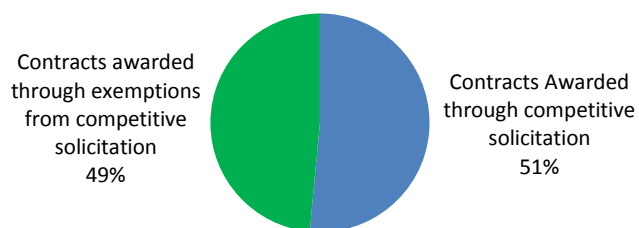
As shown in Exhibit 13, there was no evidence that contracts for 8 of 13 vendors sampled were awarded competitively or properly exempted from competitive solicitation requirements. Municipal Code Section 2.30.360 allows for narrowly applied exemptions from competitive solicitation requirements and provides details on 18 different circumstances that may qualify for an exemption. Departments are required to request an exemption by providing all relevant information supporting the application of the exemption to the Purchasing Manager. Based on this information, the Purchasing Manager must make a recommendation to the City Manager who will determine whether an exemption from competitive solicitation requirements applies.

ASD staff stated that Municipal Code section 2.30.360 only requires Departments to submit a “Sole Source Justification Form” for 2 of the 18 exemption categories listed and that no additional step is required from the requesting Department or from Purchasing for the other categories. We disagree with this interpretation.

Nearly half of City contracts listed in the City’s biannual report to Council are exempted from competitive solicitation requirements.

Staff submits a biannual report to Council on selected contracts, which indicates use of exemptions in awarding these contracts. The reports include sections on contracts awarded in the following categories: service contracts (\$25,000 to \$85,000), goods contracts (\$65,000 to \$250,000), and blanket orders for goods and services. We did not audit or verify the information contained in the reports. Two recent examples covering the period January 1, 2011 through December 31, 2011 indicate a significant number of City contracts are awarded using bidding exemptions, as shown in Exhibit 14. However, because the City’s SAP Enterprise Resource Planning system does not currently have the reporting capability to effectively identify contracts awarded using exemptions, we could not quantify and assess the use of various types of exemptions.

Exhibit 14: City contracts awarded



Source: ASD reports on contracts awarded by the City Manager between January 1, 2011 and December 31, 2011

ASD Purchasing does not have any documentation to support it was authorized to participate in the OfficeMax America Saves program through use of the Oakland County, Michigan master purchasing agreement with OfficeMax. Although the Municipal Code provides that the City may, in certain instances, use another governmental or public agency’s contract (i.e., piggyback on another entity’s contract), provided the contract resulted from solicitation methods similar to those required by the Municipal Code, we did not find evidence the Purchasing Manager made a recommendation to the City Manager regarding applying the exemption or that the City Manager determined the exemption was applicable.

Finding 5 Recommendations to City Management:

5. ASD should clarify the City's procurement policies and procedures, while ensuring consistency with the Municipal Code, to specify when Purchasing should negotiate contracts, based on dollar amount thresholds applicable to total citywide expenditures for goods and/or services (or payments to vendors) in aggregate, regardless of payment method.

ASD should develop policies and procedures to ensure:

6. ASD monitors total citywide expenditures on categories of goods and/or services (or expenditures by vendor) and periodically assesses whether the total volume of the transactions and expenditures, regardless of payment method, may require the City to contract for the goods and/or services either through the City's competitive solicitation methods or by using another agency's contract, in order to maximize cost savings.
7. The City has properly approved contracts, when required by the Municipal Code, prior to conducting business. Specifically, the City should ensure it establishes a process to prevent and/or detect issuance of purchasing documents or purchasing card payments to vendors without a properly approved contract, if required.
8. ASD Purchasing staff monitors expiring contracts and ensures contracts are re-established in a timely manner.
9. ASD complies with Municipal Code requirements for applying and documenting exemptions from competitive solicitation in the procurement of goods and services (A City working group that promotes efficient and effective purchasing methods has drafted a new "City of Palo Alto Sole Source Justification Form" which includes all 18 exemptions listed in the Municipal Code).

Finding 6: The City has not sufficiently defined contract administration roles and responsibilities

In reviewing the Municipal Code and the City's Purchasing Manual, we did not find sufficient guidance regarding contract administration roles, responsibilities, and business practices to ensure compliance with the City's contract terms and also to ensure the City receives contracted benefits. The Purchasing Manager stated ASD's Purchasing and Contract Administration Division (Purchasing) only administers two contracts:

- The office supplies contract with OfficeMax, Inc.
- A uniform rental services contract with G&K Services, Inc.

However, we did not find any evidence of a defined, documented, or effective process to administer either of these contracts. Specifically, we did not find evidence that staff had identified and monitored key contract terms, such as pricing and incentive terms, contract amendment terms, and various milestone dates. In addition, Purchasing does not monitor purchasing data to detect and follow up on unexplained variances and/or expenditure trends. The Municipal Code states purchasing is to be centralized, and that all purchases shall be made through the Manager of Purchasing and Contract Administration (Purchasing Manager), with certain exceptions. The Purchasing Manual section on “Contractor Performance Documentation” indicates Purchasing is responsible for documenting significant vendor performance issues for purchases of goods and that Department project managers are responsible for documenting contractor performance issues for professional services, but that the project manager should consult with the Purchasing and/or the City Attorney’s office, as needed, to resolve significant performance issues.

According to the Purchasing Manager, contract administration practices are inherently defined by each contract and contract administration is the responsibility of the departmental project manager. The Purchasing Manager stated the City’s procurement process requires City departments to identify departmental procurement needs, to manage the pre-solicitation process in order to identify and assess qualified vendors, and to administer each contract to ensure compliance. He stated the role of Purchasing is to manage the competitive solicitation process, address any contract non-compliance issues, and to manage the contract close-out process. In our opinion, the City needs additional controls to ensure contracts are appropriately administered. Finding 3 discusses the results of ineffective contract administration of the City’s office supplies contract.

Finding 6 Recommendations to City Management:

10. ASD should ensure contract administration roles and responsibilities are defined and appropriately communicated. At a minimum, ASD should broadly define contract administration and develop a process to:

- Formally identify the contract administrator and assign contract administration responsibilities.
- Identify and document key contract terms.
- Identify and provide the necessary training to ensure the contract administrator has the required expertise.
- Identify or develop specific methodology, reports, and/or tools required to administer the contract.
- Establish and monitor timelines and milestones in administering the contract.

Glossary of Acronyms and Terms

- America Saves Program – An OfficeMax program that extends the terms of the Oakland County Michigan master purchasing agreement with OfficeMax for office supplies to other government agencies.
- ASD – Administrative Services Department. The Purchasing and Contract Administration Division is part of this department.
- Contract – A mutually binding, legal relationship obligating the seller to furnish supplies or services, and the buyer to pay for them.
- Contract Administration – Government actions taken to obtain compliance with such contract requirements as timely delivery of supplies or services, acceptance, payment, and closing of the contract. These actions include technical, financial, audit, legal, administrative, and managerial services in support of the contracting officer.
- Contract items (also referred to as “core” items) – A list of office supplies with contracted prices specifically identified in Exhibit 1 of the Oakland County Master Purchasing Agreement with OfficeMax, which is the basis for the OfficeMax “America Saves” program.
- List Price – The price which the manufacturer recommends that the retailer sell the product. According to an OfficeMax representative, office supplies list prices are standardized across the industry and across all OfficeMax contracts.
- Non-Contract items (also referred to as “non-core” items) – Office supplies not specifically listed with contracted prices in Exhibit 1 of the Oakland County master purchasing agreement with OfficeMax. The America Saves program states these items are at discounts “up to 85%.”
- Numeric ID (NID) – According to OfficeMax records, this is a unique, 6-digit identification number, assigned to each product in an item file.
- Product Code – A variable length alphanumeric identification number for office supplies. According to OfficeMax guidance, the Product Code should correspond to an item’s unique NID.
- Purchase order – A request or instruction from a purchasing organization to a vendor to deliver a quantity of material or to perform services at a certain point in time.
- Purchasing document – In the City’s SAP enterprise Resource Planning system, an instrument used by Purchasing to procure materials or services. SAP purchasing documents may include purchase orders and contracts.
- Unit of Measure (UOM) – Identifies the quantity included in a uniquely identified office supplies item.
- Unit Price – The price charged for each uniquely identified item with its unit of measure.

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ATTACHMENT 1: City of Palo Alto Municipal Code—Chapter 2.30 Contracts and Purchasing Procedures

Palo Alto Municipal Code

Chapter 2.30 CONTRACTS AND PURCHASING PROCEDURES*

* Editor's Note: Ordinance 4827 amended Chapter 2.30 in its entirety. Certain ordinances or parts of ordinances previously codified herein remain in effect, though superseded. Those ordinances are: Ords. 3927, 3992, 4009, 4059, 4095, 4453, 4462, 4589 and 4740.

Sections:

PART 1 -- GENERAL

- 2.30.010 Purposes.
- 2.30.020 Scope.
- 2.30.030 Council contract policies adopted by resolution.
- 2.30.040 Centralized purchasing.
- 2.30.050 Purchasing manual.
- 2.30.060 Validity of contracts and purchase orders.
- 2.30.070 Approval as to form by the city attorney.
- 2.30.080 Interpretive authority.
- 2.30.090 No conflicting policies or procedures.

PART 2 -- CONTRACT TYPES

- 2.30.100 Public works contract.
- 2.30.110 Contract for goods.
- 2.30.120 General services contract.
- 2.30.130 Professional services contract.
- 2.30.140 Contracts for wholesale utility commodities.
- 2.30.150 Contracts for dark fiber optics licensing services.

PART 3 -- CONTRACTING AUTHORITY

- 2.30.200 Purchasing manager contract award authority.
- 2.30.210 City manager contract award authority.
- 2.30.220 City attorney contract award authority.
- 2.30.225 Wholesale utility commodity transactions.

Note: This was the current version of the Palo Alto Municipal Code chapter on contracts and purchasing procedures during audit field work (as of February 8, 2012). A more current version is available at: <http://www.amlegal.com/library/ca/paloalto.shtml>

- 2.30.230 Designated employee purchases of \$5,000.00 or less.
- 2.30.240 Designated employees use of petty cash and city credit card.
- 2.30.250 Council approval/award of contracts.
- 2.30.260 Contracts with terms exceeding one year -- Appropriation.
- 2.30.270 Delegations of authority to contract.
- 2.30.280 Authority to modify and terminate contracts not approved or awarded by the council.
- 2.30.290 Authority to modify contracts awarded by the council.
- 2.30.295 Limitations on contract authority; authority otherwise conferred.

PART 4 -- COMPETITIVE SOLICITATION REQUIREMENTS

- 2.30.300 Public works contracts.
- 2.30.310 Contracts for goods.
- 2.30.320 General services contracts.
- 2.30.330 Professional services contracts.
- 2.30.340 Contracts for wholesale utility commodities.
- 2.30.350 Contract splitting prohibited.
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PART 7 -- ETHICS IN CONTRACTING

- 2.30.600 Ethics.
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PART 8 -- RECORDS AND REPORTS

- 2.30.700 Records, public inspection.
- 2.30.710 City manager report.

PART 9 -- REWARDS

- 2.30.800 Rewards.

PART 10 -- STANDARDIZATION

- 2.30.900 Standardization.

PART 1 -- GENERAL**2.30.010 Purposes.**

This chapter defines the contract procurement procedures and requirements for public works construction, general services, professional services, wholesale utility commodities and goods. This chapter establishes the contracting authority of the manager of purchasing and contract administration ("purchasing manager"), designated employees, the city manager, the city attorney and the council. The purpose of this chapter is to foster and encourage the use of best management practices in contracting, to ensure quality and efficiency while obtaining goods, services, equipment, materials and supplies at the lowest cost commensurate with the quality needed; to provide for a fair and equitable procurement process utilizing standardized solicitation procedures; and to maintain honesty and integrity within the procurement process.

(Ord. 4827 § 1 (part), 2004)

2.30.020 Scope.

(a) Contracting Authority. Part three of this chapter establishes the authority of certain officers and employees of the city to award and sign contracts.

(1) The city manager, purchasing manager, and their authorized delegates and certain designated employees may award and sign contracts within the limits of their authority for: public works construction, general services, professional services, wholesale utility commodities and other energy and energy-related contracts, and contracts or purchase orders for goods, materials, equipment and supplies.

(2) The city attorney and authorized delegates may enter into and sign contracts with the limits of their authority for legal services.

(3) The city manager may also award or approve, and sign, contracts within the limits of his or her authority to: rent, lease, license, acquire or purchase interests in real property from other parties; rent, lease or license city property;

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provide municipal services to other public entities; provide for indemnity or risk of loss; and any other contract involving city expenditure of an amount of \$85,000.00 or less.

(b) Solicitation and Award Procedures and Requirements. Contracts for public works construction, general services and professional services, wholesale utility commodities and other energy and energy-related contracts, and contracts or purchase orders for goods, materials, equipment and supplies shall be awarded pursuant to the procedures contained in this chapter. The solicitation and award procedures and requirements contained in this chapter shall not apply to the following:

(1) Subdivision agreements, improvement agreements, deferred parking agreements, development agreements and other land use contracts entered into between the city and property owners or developers pursuant to other parts of this code;

(2) Franchises and franchise agreements;

(3) Contracts between the city and other public entities for city provision of services to the other entities;

(4) Transactions involving the acquisition and disposal of real property; and

(5) Agreements to provide funds pursuant to the human services resource allocation process or community development block grant program.

(Ord. 4827 § 1 (part), 2004)

2.30.030 Council contract policies adopted by resolution.

The council may from time to time adopt by resolution policies related to contract solicitation and award procedures and requirements. The policies may include, but shall not be limited to, policies addressing local boycotts, protest procedures, and price preferences for use of recycled or sustainable goods and for local businesses. The policies shall not conflict with, but may be in addition to, any provisions of this chapter. All council policies shall be considered and implemented in the solicitation and award of contracts.

(Ord. 4827 § 1 (part), 2004)

2.30.040 Centralized purchasing.

Purchasing is to be centralized. All purchases shall be made through the purchasing manager, except:

(a) Purchases made from petty cash funds pursuant to control procedures approved by the city manager and contained in the administrative policies and procedures manual maintained by the city manager;

(b) Emergency purchases made in conformance with control procedures approved by the city manager and contained in the purchasing manual;

(c) Contracts for legal services;

(d) Purchases by city credit card, made in conformance with control procedures approved by the city manager and contained in the purchasing manual;

(e) Purchases, where the total expenditure by the city does not exceed \$5,000.00, made in conformance with control procedures approved by the city manager and contained in the purchasing manual; and

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(f) Transactions under master contracts for wholesale utility commodities as defined in Section 2.30.140 made in conformance with Section 2.30.340.

(Ord. 4827 § 1 (part), 2004)

2.30.050 Purchasing manual.

The purchasing manager shall prepare a written purchasing manual that implements the requirements of this chapter. The purchasing manual shall establish and describe in detail the contract solicitation and award procedures and requirements that must be followed in making purchases on behalf of the city. The purchasing manual shall include, among other things, control procedures established under the authority of this chapter. The city manager shall approve the purchasing manual and any modifications made to the manual from time to time.

(Ord. 4827 § 1 (part), 2004)

2.30.060 Validity of contracts and purchase orders.

The city shall not be and is not bound by any contract, purchase order, document, or any other agreement unless it is in a writing which is both:

(a) Approved by the council and signed by the mayor, vice mayor or other duly authorized officer or employee on behalf of the city as provided in this chapter; and

(b) Approved as to form by the city attorney as provided in Section 2.30.070.

The foregoing requirements shall not apply to authorized purchases with a city credit card.

(Ord. 4827 § 1 (part), 2004)

2.30.070 Approval as to form by the city attorney.

The city attorney shall approve as to form all contracts, purchase orders, documents and other agreements. The city attorney approval as to form may be performed on a general basis (standardized form contract) or on an individual basis. No city office or department other than the city attorney is authorized to create, modify or approve for use standardized form contracts.

Each contract, purchase order, document or other agreement that is subject to individual review and approval shall be signed by the city attorney to signify that it is approved as to form. A standardized form contract that has been approved by the city attorney for general use may be used without further approval or signature by the city attorney so long as the form is not modified.

The purchasing manager in consultation with the city attorney and the city auditor shall be responsible for creating a control system for the creation and use of standard form contracts, purchase orders, documents and other agreements to be included in the purchasing manual.

(Ord. 4827 § 1 (part), 2004)

2.30.080 Interpretive authority.

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The city attorney shall have the sole authority to interpret the provisions of this chapter and to issue rulings or opinions concerning the meaning and application of the provisions of this chapter.

(Ord. 4827 § 1 (part), 2004)

2.30.090 No conflicting policies or procedures.

No city department, commission or other division or body may adopt or create an internal policy or procedure that conflicts with or is not consistent with any provision of this chapter.

(Ord. 4827 § 1 (part), 2004)

PART 2 -- CONTRACT TYPES

2.30.100 Public works contract.

A public works contract is a contract paid for in whole or in part out of public funds for the construction, alteration, repair, improvement, reconstruction or demolition of any public building, street, sidewalk, utility, park or open space improvement, or other public improvement.

(Ord. 4827 § 1 (part), 2004)

2.30.110 Contract for goods.

A contract for goods is a contract for the purchase of supplies, materials or equipment including, but not limited to, office supplies, janitorial supplies, furnishings, machinery, tools, vehicles, computer hardware and other personal property, materials or goods. A contract for goods includes blanket purchase order contracts where no particular quantity of units to be purchased is established at the time the contract is executed. A blanket purchase order contract must establish a maximum dollar amount for the contract and set forth pricing terms for the items to be purchased. A contract for goods may include labor incidental to the purchase of goods, such as set-up, installation, and testing.

(Ord. 4827 § 1 (part), 2004)

2.30.120 General services contract.

A general services contract is a contract, with or without the furnishing of supplies or equipment, for work, labor or services including, but not limited to:

- (a) Maintenance of public buildings, streets, parks and playgrounds and other public improvements;
- (b) Repair, modification and maintenance of equipment;
- (c) Licensing, installation and maintenance of computer software;
- (d) Janitorial services, uniform cleaning, tree trimming, street sweeping, power washing and landscape

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maintenance; and

- (e) Leasing of personal property for use by the city.

(Ord. 4827 § 1 (part), 2004)

2.30.130 Professional services contract.

A professional services contract is a contract for services which involve the exercise of professional discretion and independent judgment based on specialized knowledge, expertise or training. These services may include, but are not limited to, those provided by accountants, auditors, appraisers, architects, attorneys, engineers, financial advisors, information technology experts, instructors, and planners.

(Ord. 4827 § 1 (part), 2004)

2.30.140 Contracts for wholesale utility commodities.

A contract for wholesale utility commodities is a contract with a private or public supplier or counterparty (in the case of gas or electricity) for the purchase or sale-incidental-to-purchase of water, gas or electricity and all related supplemental or ancillary services and any other energy or energy-related contract. A contract for wholesale utility commodities includes, but is not limited to, a master agreement containing general terms and conditions that provide for the execution of one or more purchase or sale-incidental-to-purchase transactions under the terms of a standard form contract and any exhibit or addendum thereto.

(Ord. 4827 § 1 (part), 2004)

2.30.150 Contracts for dark fiber optics licensing services.

A contract for dark fiber optics licensing services is a contract with a telecommunications or non-telecommunications carrier for the licensing of city-owned, city-installed and city-maintained dark fiber optics and related facilities, if any, located in the public right-of-way and public utility easements. A telecommunications carrier includes any person subject to the Telecommunications Act of 1996, as amended. A non-telecommunications carrier includes any person that is not a telecommunications carrier.

(Ord. 4827 § 1 (part), 2004)

PART 3 -- CONTRACTING AUTHORITY

2.30.200 Purchasing manager contract award authority.

The purchasing manager may award and sign the following contracts:

- (a) Public Works Contracts. Public works contracts where the contract price, plus any contingency established for change orders, does not exceed \$85,000.00.
- (b) Contracts for Goods. Contracts to purchase goods where the term does not exceed three years, and the

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contract price, plus any contingency established for change orders or additional services, but excluding sales or use tax, does not exceed \$85,000.00 in the first year, and does not exceed \$85,000.00, plus any unexpended monies carried forward from a prior fiscal year, in any subsequent contract year.

(c) **General Services Contracts.** General services contracts where the term does not exceed three years, and the contract price, plus any contingency established for change orders or additional services, but excluding sales or use tax, does not exceed \$85,000.00 in the first year, and does not exceed \$85,000.00 plus any unexpended monies carried forward from a prior year, in any subsequent contract year.

(d) **Professional Services Contracts.** Professional services contracts where the term does not exceed three years, and the contract price, plus any contingency established for change orders or additional services, but excluding sales or use tax, does not exceed \$85,000.00 in the first year, and does not exceed \$85,000.00, plus any unexpended monies carried forward from a prior year, in any subsequent contract year.

(e) **Software Maintenance Contracts.** Notwithstanding subsection (c) of Section 2.30.200, the purchasing manager may award and sign contracts for maintenance of licensed computer software for any period of time during which the city maintains licenses for the software, where the contract price, excluding sales or use tax, does not exceed \$85,000.00 per year in the first year and does not exceed \$85,000.00, plus any unexpended monies carried forward from a prior year, in any subsequent contract year.

(Ord. 4827 § 1 (part), 2004)

2.30.210 City manager contract award authority.

The city manager may award and sign the following contracts:

(a) **Public Works Contracts.** Public works contracts where the contract price, plus any contingency established for change orders, is greater than \$85,000.00, but does not exceed \$250,000.00.

(b) **Contracts for Goods.** Contracts to purchase goods where the term does not exceed three years and the contract price, plus any contingency established for change orders or additional services, but excluding sales or use tax, is greater than \$85,000.00 but does not exceed \$250,000.00 in the first year, and does not exceed \$250,000.00 plus any unexpended monies carried forward from a prior year, in any subsequent contract year.

(c) **General Services Contracts.** Contracts to lease personal property where the term is greater than three years but not more than seven years, and the contract price does not exceed \$85,000.00 in the first year, and does not exceed \$85,000.00 plus any unexpended monies carried forward from a prior year, in any subsequent contract year.

(d) **Contracts for Studies and Services Related to Private Development.** Professional services contracts for: (1) the preparation of environmental assessments or other studies deemed necessary by the director of planning and community environment for the processing of applications for private development projects, or (2) inspection and plan review services deemed necessary by the director of planning and community environment to evaluate conformity of private development projects with applicable building codes, regardless of the cost or term thereof, provided the applicant for the private development project agrees to bear responsibility for the entire contract cost, and the contract does not require the expenditure of city funds in any amount.

(e) **Rewards.** The city manager may offer and pay rewards where the amount of the reward does not exceed \$25,000.00, in accordance with the procedures of Section 2.30.800.

(f) **Emergency Contracts.** An emergency is an urgent unforeseen situation that threatens life, property, or the general public health, safety and welfare. In emergency situations the city manager is authorized to expend city funds without limitation on amount and without following the contract solicitation and award procedures otherwise required by this chapter. The city manager is authorized to conclude that an emergency exists without further declaration by the

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council. Expenditures made during an emergency must be reported to the council at the next regular meeting if approval for such expenditures would otherwise have been made by the council.

(g) **Contracts to Rent, Lease, License, Acquire or Purchase Interests in Real Property from Other Parties.** Contracts to rent, lease, license, or purchase by installment interests in real property from other parties for a term of seven years or less, where the contract price does not exceed \$85,000.00 per year. The city manager may enter into and sign contracts to acquire or purchases interests in real property where the contract price does not exceed \$85,000.00.

(h) **Contracts to rent, lease, or license city property to other parties.** The authority granted under this section is distinct from the authority of the director of community services to grant individuals and groups permits for the exclusive use of buildings, facilities and areas of city parks and open spaces described in Title 22 of this code. The city manager may award and sign contracts to rent, lease or license city property to other parties regardless of the price for a term not exceeding three years. Notwithstanding the preceding sentence, the city manager may enter into and sign contracts to rent, lease or license property at the Cubberley site for terms up to five years.

(i) **Contracts to Provide Municipal Services to Other Public Entities.** Contracts to provide municipal services and functions to any other local public agency in any amount for a term not exceeding three years; provided the contract is in compliance with the city council adopted policy covering such contracts. The authority granted herein does not include the authority to add permanent employee positions.

(j) **Contracts Providing for Indemnity or Risk of Loss.** The city manager, with the concurrence and approval of the city attorney and the risk manager, may enter into and sign contracts, otherwise within the limits of his or her authority, that provide for the city or its officers or employees to defend, indemnify, or assume the risk of loss or liability for, any other contracting party respecting claims, demands, actions, losses or liabilities arising from the city's performance under the contract.

(k) **Other Contracts.** All other types of contracts for which the contract term does not exceed three years and the total expenditure by the city does not exceed \$85,000.00 in the first year, and does not exceed \$85,000.00, plus any unexpended monies carried forward from a prior year, in any subsequent contract year.

(l) **Wholesale Utility Commodity Contracts.** Wholesale utility commodity contracts where the term does not exceed three years and the contract price does not exceed \$250,000.00 in any year, including but not limited to gas transportation contracts and power transmission contracts with Pacific Gas and Electric Company and any public agency contract as defined in Section 2.30.340(d).

(Ord. 4827 § 1 (part), 2004)

2.30.220 City attorney contract award authority.

The city attorney may award and sign contracts for legal services including outside counsel and experts for litigation or other administrative and legal proceedings, to be provided to the city for any time period, where the contract price, plus any contingency established for change orders or additional services, but excluding sales or use tax, does not exceed \$65,000.00 in the first year, and does not exceed \$65,000.00, plus any unexpended monies carried forward from a prior year, in any subsequent contract year. The city attorney may sign contracts where the contract price exceeds the amounts set forth above, provided the council has first approved the use of such services.

(Ord. 4827 § 1 (part), 2004)

2.30.225 Wholesale utility commodity transactions.

The city manager, director of utilities and designated employees may enter into and execute transactions for

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wholesale utilities commodities in accordance with the authority, limits and procedures set forth in the Energy Risk Management Policies Guidelines and Procedures Manual.

(Ord. 4827 § 1 (part), 2004)

2.30.230 Designated employee purchases of \$5,000.00 or less.

Employees authorized in writing by their department head may award and sign contracts for goods and contracts for general services where the contract price does not exceed \$5,000.00 and the term is one year or less. All such purchases shall be in accordance with the contract procedures and requirements contained in the purchasing manual. All department head written authorizations shall be kept on file in the office of the purchasing manager.

(Ord. 4827 § 1 (part), 2004)

2.30.240 Designated employees use of petty cash and city credit card.

Employees authorized in writing by their department head may make purchases using petty cash or a city credit card. All such purchases shall be in accordance with the contract procedures and requirements contained in the purchasing manual. All department head written authorizations shall be kept on file in the office of the purchasing manager.

(Ord. 4827 § 1 (part), 2004)

2.30.250 Council approval/award of contracts.

The council shall approve and/or award and the mayor or vice-mayor shall sign all contracts for which no contracting or signature authority has been established under this chapter, except to the extent the council has previously authorized a city officer or employee to negotiate and execute a contract on the city's behalf without the further approval of the council.

(Ord. 4827 § 1 (part), 2004)

2.30.260 Contracts with terms exceeding one year -- Appropriation.

Contracts with a term exceeding one year shall not be approved by any person with contracting authority under this chapter or the council, unless the total amount due and payable by the city over the life of the contract is appropriated at the time the city assumes the obligation to pay, or the total amount due and payable during the first full or partial fiscal year of a multi-fiscal year contract is appropriated and the contract is subject to appropriation by the council of amounts to become due and payable in subsequent fiscal years. The requirements of this section do not apply to contracts not subject to the debt limit requirements of Article XVI, section 18 of the California Constitution as determined by the city attorney.

(Ord. 4827 § 1 (part), 2004)

2.30.270 Delegations of authority to contract.

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This section establishes the exclusive source of authority to delegate any authority to contract granted by this chapter. The authority to delegate contracting authority shall not be implied from any other provision in this code.

(a) **Purchasing Manager Delegations.** The purchasing manager may delegate the authority granted under Section 2.30.200 as follows: Persons holding the position of contract manager may be authorized to award and sign contracts in an amount of \$25,000.00 or less per year with a term not to exceed three years; persons holding the position of buyer may be authorized to award and sign contracts in an amount of \$10,000.00 or less per year with a term not to exceed three years.

(b) **City Manager Delegations.** The city manager may delegate any authority to contract granted to the city manager by this chapter to the assistant city manager and to the director of administrative services, and, as to wholesale utility commodities contracts and transactions issued thereto and other utility related transaction, to the director of utilities. If the assistant city manager, the director of administrative services, or the director of utilities is unable to exercise the authority delegated to him or her due to legal or physical incapacity, constraint or unavailability, the city manager may, with the prior concurrence of the city attorney, delegate authority to another person.

(c) **City Attorney Delegations.** The city attorney may delegate any authority to contract granted to the city attorney by this chapter to a person holding the position of senior assistant city attorney.

(d) **Delegations to be Written.** All delegations of authority shall be in writing, dated and describe the limits of the authority delegated, including but not limited to the type, dollar amount, quantity of goods or services, and duration of the contracts that may be executed under the delegation. All delegations of authority shall be kept on file in the office of the purchasing manager.

(Ord. 4827 § 1 (part), 2004)

2.30.280 Authority to modify and terminate contracts not approved or awarded by the council.

Each person with contracting authority under this chapter may authorize and sign amendments or change orders to contracts they have awarded under the authority granted in this chapter subject to the following:

(a) All modifications to contracts, including, but not limited to, changes to the scope of work, quantity of goods, price or term shall be made in writing, and accomplished in accordance with the terms of the original contract; and

(b) The amendment or change orders to a contract shall not cause the contract as modified to exceed the monetary or term limits of that person's authority as defined in this chapter.

Each person with authority granted under this chapter to award and sign a contract also has the authority to terminate the contract in accordance with the contract terms and conditions.

(Ord. 4827 § 1 (part), 2004)

2.30.290 Authority to modify contracts awarded by the council.

(a) The council, at the time it awards a contract or authorizes a city official or employee to award a contract, may also authorize the city official or employee to execute an amendment or change order to a contract in an amount exceeding the monetary and/or term limits of the official's or employee's contract authority set forth in this chapter. Amendments or change orders made under authority granted by the council shall be in writing, accomplished in accordance with the terms of the original contract and shall not cause the contract as modified to exceed the limits of the authority granted by the council

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(b) The city manager is authorized to enter into and execute for and on behalf of the city, without the prior approval of the council, any amendment or change order to a contract previously approved by the council that does not increase the compensation for the contract to accomplish the following:

- (1) To extend the term of the contract for a period not to exceed six consecutive months from the last council-approved expiration date; or
- (2) To make minor revisions to the scope of services or schedule; or
- (3) To make clerical corrections.

In addition, the city manager may approve and sign assignments of contracts previously approved by the council when he or she has determined that the proposed assignee has the ability, capacity, experience and skill and is otherwise qualified to perform the contract.

(Ord. 4827 § 1 (part), 2004)

2.30.295 Limitations on contract authority; authority otherwise conferred.

(a) This chapter does not authorize a city officer or employee to award or sign any contract which such officer or employee is otherwise prohibited from awarding or signing under the provisions of the City Charter, this municipal code, or any other applicable law, or by any ordinance, resolution, minute order or other official action of the council.

(b) Nothing in this chapter shall limit any authority conferred by the city council through a resolution delegating authority to a city officer or employee to negotiate and execute contracts on the city council's behalf without the further approval of the city council.

(Ord. 4827 § 1 (part), 2004)

PART 4 -- COMPETITIVE SOLICITATION REQUIREMENTS

2.30.300 Public works contracts.

Public works contracts not exempt from these competitive solicitation requirements under Section 2.30.360 or by resolution of the city council shall be solicited as follows:

(a) Public works contracts providing for an estimated expenditure of \$65,000.00 or less, and not otherwise required to be formally bid by the Charter, shall be solicited by informal bid in accordance with the provisions of Section 2.30.400.

(b) Public works contracts providing for an estimated expenditure exceeding \$65,000.00 shall be solicited by formal bid in accordance with the provisions of Section 2.30.420.

(c) Article VII, Section 6 of the City Charter requires formal bidding only for public works contracts funded by bonded indebtedness of the city or by assessment against particular property in the city. However, the intent of this Section 2.30.300 is to require formal bidding for all public works contracts exceeding \$65,000.00, unless exempt as provided in Section 2.30.360 or by resolution of the council as provided in this Section 2.30.300. The council may determine by resolution that a particular public works project may be solicited and contracted for using alternate project delivery methods, including but not limited to design build, construction manager at risk, or competitive negotiation. Any such resolution shall set forth the reasons supporting the use of the alternate project delivery method

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for the project and describe the solicitation method to be used and the criteria for determining the party to whom the contract should be awarded.

(Ord. 4827 § 1 (part), 2004)

2.30.310 Contracts for goods.

Contracts for goods not exempt from competitive solicitation requirements under Section 2.30.360 shall be solicited as follows:

(a) Contracts for goods providing for an estimated expenditure by the city of \$25,000.00 or less shall be solicited by informal bid in accordance with the provisions of Section 2.30.400; and

(b) Contracts for goods providing for an estimated expenditure by the city exceeding \$25,000.00 shall be solicited by formal bid in accordance with the provision of Section 2.30.420.

(Ord. 4827 § 1 (part), 2004)

2.30.320 General services contracts.

General services contracts not exempt from competitive solicitation requirements under Section 2.30.360 shall be solicited as follows:

(a) General services contracts providing for an estimated expenditure by the city of \$25,000.00 or less shall be solicited by informal bid or informal proposal in accordance with the provisions of Section 2.30.400.

(b) General services contracts providing for an estimated expenditure by the city exceeding \$25,000.00 shall be solicited by formal bid in accordance with the provisions of Section 2.30.420 or by formal request for proposal in accordance with the provisions of Section 2.30.410.

(c) It is expected that most general services contracts will be solicited using the informal or formal bid procedures. However, where the city has defined a situation for which it seeks a solution, or the circumstances require that a contract award be based on significant factors in addition to price, the purchasing manager may determine that a request for formal or informal proposals shall be used to solicit the contract.

(Ord. 4827 § 1 (part), 2004)

2.30.330 Professional services contracts.

Professional services contracts not exempt from competitive solicitation requirements under Section 2.30.360 shall be solicited as follows:

(a) Professional services contracts providing for an estimated expenditure by the city greater than \$25,000.00 and up to and including \$65,000.00 shall be solicited by informal request for proposal in accordance with Section 2.30.400.

(b) Professional services contracts providing for an estimated expenditure by the city exceeding \$65,000.00 shall be solicited by formal request for proposal in accordance with the provisions of Section 2.30.410.

(c) In lieu of the solicitation requirements set forth in subsections (a) and (b), professional services contracts in any amount may be awarded from a list of qualified professionals to be created and maintained by the purchasing

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manager, so long as the list is created and the award of contract to an entity on the list is in compliance with procedures contained in the purchasing manual.

(Ord. 4827 § 1 (part), 2004)

2.30.340 Contracts for wholesale utility commodities.

(a) Solicitation of Contracts.

(1) Contracts for purchase or sale-incidental-to-purchase of wholesale utility commodities providing for an estimated expenditure of \$65,000.00 or less shall be solicited by informal bid or informal request for proposal in accordance with the provisions of Section 2.30.400. Contracts for a purchase or sale-incidental-to-purchase of wholesale utility commodities providing for an estimated expenditure of \$65,000.00 or more shall be solicited by formal bid, formal request for proposal or combination thereof, in accordance with the provisions of Sections 2.30.410, 2.30.420 or 2.30.430.

(2) Master contracts containing general terms and conditions for wholesale utility commodities that provide for the execution of one or more individual water, gas or electricity purchase and sale-incidental-to-purchase transactions under the terms of the master contract, shall be solicited by formal bid, formal request for proposals, or combination thereof, in accordance with the provisions of Sections 2.30.420, 2.30.430 or 2.30.440.

It is expected that the city will enter into several master contracts with different counterparties for the purchase and sale-incidental-to-purchase of gas and electricity utility commodities at wholesale. Whenever the city desires to execute an individual purchase or sale incidental to purchase transaction for gas or electricity commodities at wholesale, any counter party who executes a master contract with the city and who is otherwise eligible to bid for or propose in regard to the particular transaction in accordance with the city's Energy Risk Management Policies Guidelines and Procedures Manual shall be solicited, in writing (by mail, facsimile or electronic mail), and shall be eligible to tender a bid or proposal on the transaction. The counterparty offering the price for wholesale utility commodities deemed to be the most advantageous to the city shall be eligible for award of a contract for the transaction.

(b) **Basic Terms and Conditions.** For contracts not otherwise within the city manager's authority to award, the council may by resolution authorize the city manager to award and sign a contract with a qualified, eligible counter party for the purchase and incidental sale of wholesale utility commodities. The resolution shall specify the limits of the authority delegated, including the maximum dollar amount of the authority and the duration of the contracts and/or transactions that may be executed under the delegation of authority.

Any resolution delegating authority to the city manager to contract for electricity shall specify generally at least the following terms and conditions: quantity and the description of energy and energy services to be procured, including, but not limited to, on-peak and off-peak energy and ancillary services; term, specifying a not-to-exceed period of time; period of delivery denoted in years or months or years and months; and point of delivery or the locus on the interstate transmission system at which transfer of title is made.

Any resolution delegating authority to contract for gas shall specify generally at least the following terms and conditions: quantity and the description of gas services to be procured, including, but not limited to, scheduled gas and gas transportation services; term, specifying a not-to-exceed period of time; period of delivery denoted in years or months or years and months; and point of delivery of the locus on the interstate transmission system at which transfer of title is made.

(c) **Required Contract Terms for Gas and Electric Procurement Contracts.** The city shall use standardized form contracts for the procurement of gas and electricity, as practicable, including, but not limited to, form contracts created and copyrighted by the Edison Electric Institute, the Western States Power Pool, and the North American Energy Standards Board, Inc. Unless waived by resolution of the city council, a contract for procurement of gas or electricity

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and any amendment to the contract shall not be awarded by the city and executed by the duly authorized representatives of the city, unless the following terms and conditions are required: (1) governing law shall be the laws of the state of California; (2) choice of venue shall be the county of Santa Clara; and (3) a counterparty shall obtain and maintain during the term of the contract the minimum credit rating established as of the date of award of contract of not less than a BBB- credit rating established by Standard & Poors and a Baa3 credit rating established by Moody's Investors Services.

(d) **Public Agency Contracts.** The city may procure and make sales-incidental-to-purchase of wholesale utility commodities from energy counter parties through public agencies, including but not limited to the Northern California Power Agency and the federal Western Area Power Administration. The city may engage the public agency to act as the agent of the city to procure wholesale utility commodities, provided that the public agency conducts a competitive selection process and awards one or more contracts in substantial compliance with the contract procurement procedures and requirements of this chapter. The city attorney shall determine whether the contract procurement process substantially complies with the provisions of this chapter. For the purposes of this Section 2.30.340, the public agency process shall be deemed to substantially comply if the public agency (1) conducts a formal or an informal bidding or proposal process to solicit bids or proposals for the provision of wholesale utility commodities, (2) executes a standardized form contract, including a form contract created and copyrighted by the Edison Electric Institute and the Western States Power Pool, or equivalent, as determined by the city attorney, and (3) unless waived by resolution of the city council, the standardized form contract requires or specifies (a) the governing law shall be the laws of the state of California, (b) the choice of venue shall be identified according to either the county in which such public agency does business or the preference for federal or state court jurisdiction over the public agency and the energy counter party and the contract, and (c) the energy counter party shall obtain and maintain during the term of the contract the minimum credit rating established as of the date of award of contract of not less than a BBB- credit rating established by Standard & Poors and a Baa3 credit rating established by Moody's Investors Services.

(e) **Risk Management Policies, Guidelines and Procedures Manual.** All procurement of gas and electricity by contract for wholesale utility commodities, shall conform to the requirements of the Energy Risk Management Policies, Guidelines and Procedures Manual.

(Ord. 4827 § 1 (part), 2004)

2.30.350 Contract splitting prohibited.

It is unlawful to split or separate into smaller portions, work orders, projects, purchases, contracts, or public works projects for the purpose of evading the competitive solicitation requirements or contract authority limitations of this chapter, including the splitting of work or services between or among departments or divisions or other organizational units of the city.

(Ord. 4827 § 1 (part), 2004)

2.30.360 Exemptions from competitive solicitation requirements.

The following are exemptions from the informal and formal competitive solicitation requirements of this chapter. It is expected that the exemptions will be narrowly applied. The department requesting an exemption shall provide all relevant information supporting the application of the exemption to the purchasing manager. Based on this information, the purchasing manager shall make a recommendation to the city manager and the city manager shall determine whether an exemption from competitive solicitation requirements applies. Nothing herein is intended to preclude use of competitive solicitations where possible.

(a) **Emergency contracts** as defined in Section 2.30.210(f).

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(b) Situations where solicitations of bids or proposals would for any reason be impractical, unavailing or impossible provided that in the case of a public works project, the project is not otherwise required by the Charter to be formally bid. These situations are those where solicitations of bids or proposals would not be useful or produce any advantage for the city. Situations where solicitations of bids or proposals would be impractical, unavailing or impossible, include, but are not limited to, the following:

- (1) Specifications cannot be drawn in a way that would enable more than one vendor or contractor to meet them;
- (2) Due to circumstances beyond the control of the city, the time necessary to use the competitive solicitation process procedures and requirements would result in a substantial economic loss to the city, or the substantial interference with a required city operation; and
- (3) Special conditions attached to a grant, donation or gift requires the use of particular goods and/or services.

All requests for exemptions under this subsection shall be supported by written documentation (facsimile or electronic mail may be used), approved by the department head and forwarded to purchasing.

(c) Where competitive bids or requests for proposals have been solicited and no bid or proposal has been received or no bid or proposal meeting the requirements of the invitation to bid or request for proposal has been received, provided that, in the case of a public works project, the project is not otherwise required by the Charter to be formally bid.

(d) Contracts for goods, wholesale commodities and related services, general services or professional services available from only one source where there is no adequate substitute or equivalent provider. Examples of acceptable sole source purchases are: equipment for which there is no comparable competitive product, proprietary products sold directly from the manufacturer, a component or replacement part for which there is no commercially available substitute and which can be obtained only from the manufacturer, items where there is only one authorized distributor in the area, and items where compatibility with items in use by the city is an overriding consideration. All requests for sole source purchases shall be supported by written documentation (facsimile or electronic mail may be used), approved by the office or department head and forwarded to purchasing.

(e) Contracts for goods where, pursuant to Section 2.30.900, the city manager has determined that standardization of the supplies, materials or equipment is permissible.

(f) Placement of insurance coverage and bonds.

(g) Legal services contracts, including outside counsel and experts for litigation or other legal proceedings.

(h) Professional services contracts for private development related studies and services when funded wholly by private developers.

(i) Professional services contracts where the estimated total expenditure by the city, regardless of term, does not exceed \$25,000.00.

(j) Cooperative purchases where the city participates with one or more other governmental or public agencies in a cooperative agreement, provided the solicitation process used is substantially similar to the process required by this chapter; or

(k) The use of another governmental or public agency's contract provided: (i) the agency used a solicitation method substantially similar to the method required by this chapter; (ii) the contract allows other agencies to utilize or the vendor authorizes the city to utilize; (iii) the contract is consistent with requirements specified in this code; and (iv) there is an overall value to the city's utilizing the contract versus the city performing it's own solicitation.

(l) Contracts with Northern California Power Agency, Transmission Agency of Northern California, and Western Area Power Administration to procure wholesale utility commodities and related services that meet the requirements of

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Section 2.30.340(d).

(m) Contracts with Pacific Gas and Electric Company and the California Independent Service Operator Corporation for energy transmission services to the extent necessary and expedient to provide for the general health, safety and welfare of its citizens.

(n) Contracts with any public agency or governmental body to construct a public work where the public agency or governmental body has used methods similar to those required by this chapter to contract for the work.

(o) Contracts with any public utility holding a certificate of public convenience and necessity or any entity holding a cable communications system franchise pursuant to Chapter 2.10 to construct a public work where such work involves property of such public utility or cable communications system franchisee and is otherwise of direct concern to both the city and such public utility or cable communications system franchisee, provided that the project is not otherwise required by the Charter to be formally bid.

(p) Contracts with private developers to construct public improvements in connection with their development project even if the city contributes funds to the improvement project, provided that the project is not otherwise required by the Charter to be formally bid.

(q) Projects where the public work is performed by the city with its own employees.

(r) Contracts where the estimated total expenditure by the city does not exceed \$5,000.00.

(Ord. 5081 § 1, 2010; Ord. 4827 § 1 (part), 2004)

PART 5 -- COMPETITIVE SOLICITATION PROCEDURES

2.30.400 Informal bids or proposals.

(a) Informal bids or proposals may be solicited by any reasonable means including, but not limited to, mail, telephone, fax, e-mail or posting to the city's web site. Quotations shall be solicited from a minimum of three bidders or proposers; however, if quotations from three bidders or proposers cannot be obtained, quotations shall be solicited from as many under three as can be obtained. The purchasing manager shall maintain a record of all informal bids and informal proposals received by the city for a period of time in compliance with state law and the city's records retention schedule.

(b) Informal bids shall be awarded to the lowest responsive and responsible bidder as defined in Section 2.30.440.

(c) Informal proposals shall be awarded on the basis of proposal deemed most advantageous to the city. The proposal deemed most advantageous to the city shall be determined based on the factors set forth in Section 2.30.410(e).

(d) If a contract or purchase order is made or awarded to other than the contractor submitting the lowest price in its quotation or proposal, written reasons for the award decision shall be prepared and shall be kept as part of the record of the transaction.

(Ord. 4827 § 1 (part), 2004)

2.30.410 Formal request for proposals.

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(a) Advertising. Contracts, that may be solicited by formal request for proposals shall be solicited by posting at the civic center or by advertising at least once in a daily newspaper of general circulation in the city, not less than five days prior to the date set for receiving proposals. In addition to posting or advertising, contracts may be solicited by posting on the city web site. Where practicable, proposals shall be solicited from a minimum of three proposers.

(b) The request for proposals shall specify the date, time and place for submitting proposals and describe the scope and time frame for the delivery of what is requested, the information to be submitted by the proposer, and the criteria for evaluating the proposal.

(c) Proposals received after the specified date and time shall not be accepted and shall be returned unopened unless opening is necessary for identification purposes.

(d) The contract shall be made or awarded on the basis of the proposal deemed most advantageous to the city.

(e) The following factors shall be considered in determining the proposal deemed most advantageous to the city:

(1) Quality of the proposal;

(2) Quality, performance and effectiveness of the solution, goods and/or services to be provided by the contractor;

(3) Contractor's experience, including the experience of staff to be assigned to the project, with engagements of similar scope and complexity;

(4) Cost to the city;

(5) Contractor's financial stability;

(6) Contractor's ability to perform the contract within the time specified;

(7) Contractor's prior record of performance with city or others;

(8) Contractor's ability to provide future maintenance, repairs parts and/or services;

(9) Contractor's compliance with applicable laws, regulations, policies (including city council policies), guidelines and orders governing prior or existing contracts performed by the contractor; and

(10) Any other factor the city deems relevant as specified in the request for proposals.

(Ord. 4827 § 1 (part), 2004)

2.30.420 Formal bids -- Notice, submittal, opening.

(a) Advertisement. Contracts required to be solicited by formal bid shall be solicited by posting notices inviting bids at the civic center or by advertising notices inviting bids at least once in a daily newspaper of general circulation in the city, not less than five days prior to the date set for receiving bids. In addition to posting or advertising, contracts may be solicited by posting on the city web site. Where practicable, bids shall be solicited from a minimum of three bidders.

(b) Notice. The notices inviting bids shall generally describe the things or services to be purchased or the public work to be constructed, identify the place where the bid proposal form, specifications and other contract documents may be obtained and specify the date and time when and place where bids will be opened.

(c) Bid Submittal. All bids shall be sealed. All bids shall be submitted at the place and at or before the date and

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time specified in the notice inviting bids. Bids received after the specified date and time shall not be accepted and shall be returned to the bidder unopened unless opening is necessary for identification purposes.

(d) Bid Opening. Bids timely received shall be opened in public, at the time and place specified in the notice inviting bids, and the aggregate bid of each bidder declared.

(Ord. 4827 § 1 (part), 2004)

2.30.430 Combined proposals and bids.

(a) Nothing in Part 5 of this chapter shall prohibit the city from conducting a competitive solicitation process which combines the elements of the request for proposals and invitation for bids processes in a single process in order to award a contract for wholesale utility commodities purchases and sales.

(Ord. 4827 § 1 (part), 2004)

2.30.440 Determination of lowest responsive/responsible bidder.

The awarding authority shall award contracts required to be formally bid to the lowest responsive and responsible bidder. As used in this chapter "awarding authority" means the city officer or employee with authority to award and sign the particular contract, as provided in part three of this chapter, or the council.

(a) Low Bid. The low bid shall be the bid offering the lowest total cost to the city.

(1) The determination of lowest total cost shall be made after applying relevant policies adopted by resolution of the council that may provide for a price preference.

(2) Where add alternates or deduct alternate items are included in the specifications the determination of lowest total cost shall be made in accordance with the procedure for considering the add alternate and deduct alternate items as set forth in the bid specifications.

(3) The determination of lowest total cost may include the effect of factors such as trade discounts, delivery costs and life cycle costs when included in the specifications.

(b) Responsive Bidder. A responsive bidder is a bidder determined by the awarding authority to have submitted a bid that conforms in all material respects to the requirements of the bid documents.

(c) Responsible Bidder. A responsible bidder is a bidder determined by the awarding authority:

(1) To have the ability, capacity, experience and skill to perform the work, or provide the goods and/or services in accordance with the bid specifications;

(2) To have the ability to perform the contract within the time specified;

(3) To have the equipment, facilities and resources of such capacity and location to enable the bidder to perform the contract;

(4) To have the ability to provide, as required, future maintenance, repair, parts and service for the use of goods purchased;

(5) To have a record of satisfactory or better performance under prior contracts with the city or others; and

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(6) To have complied with applicable laws, regulations, policies (including city council policies), guidelines and orders governing prior or existing contracts performed by the bidder.

(Ord. 4827 § 1 (part), 2004)

2.30.450 Tie bids.

If an identical price is received from two or more responsive and responsible bidders, the awarding authority may determine the successful bidder by the casting of lots with the tie bidders in public on and at a date, time and place set by the awarding authority. The awarding authority shall notify the tie bidders of the date, time and place for casting lots by e-mail, phone or facsimile.

(Ord. 4827 § 1 (part), 2004)

2.30.460 Correction or withdrawal of bids or proposals.

(a) Before date and time for receipt of bids or proposals. Bids or proposals that contain mistakes discovered by a bidder or proposer before the date and time for receipt of bids or proposals may be modified or withdrawn by written notice to the person designated for receipt of bids or proposals received prior to the deadline for receipt of bids or proposals. Any modification shall be submitted under seal.

(b) After date and time for receipt of bids or proposals. A bidder or proposer may not change its bid or proposal after the date and time set for receipt of bids or proposals, except that the bidder or proposer may seek the city's consent to the substitution of a subcontractor where the bidder can demonstrate in accordance with applicable provisions of state law, that the name of the a substituted subcontractor was listed as a result of an inadvertent clerical error.

(c) Withdrawal of Bids or Proposals. A bidder or proposer alleging a mistake in a bid may be permitted to withdraw its bid or proposal only in conformance with applicable state law.

(Ord. 4827 § 1 (part), 2004)

2.30.470 Cancellation of solicitations -- Rejections of bids/proposals.

(a) Cancellation of Solicitations. The purchasing manager may cancel solicitations for proposals or bids before the date and time set for receipt of proposals or bids upon a written determination that such action is in the city's best interest for reasons, including, but not limited to, any of the following:

- (1) The city no longer requires the public works project, goods and/or services;
- (2) The city no longer can reasonably expect to fund the public works project, goods and/or services; or
- (3) Proposed amendments to the solicitation would be of such magnitude that a new solicitation is desirable.

(b) Rejection of Bids. The awarding authority may reject any or all bids or proposals. If all bids or proposals are rejected, the awarding authority has the discretion to resolicit for bids or proposals. In the case of a bid, if the awarding body is the city council and all bids are to be rejected due to excessive cost, the purchasing manager shall have the discretion to reject all bids and to resolicit bids.

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(Ord. 4827 § 1 (part), 2004)

2.30.480 Waiver of minor irregularities, defects and informalities.

The awarding authority may exercise its discretion to waive, minor irregularities, defects or informalities in the bids or proposals, so long as the waiver would not affect the amount of the bid or proposal or give the bidder or proposer an advantage over others.

(Ord. 4827 § 1 (part), 2004)

PART 6 -- CONTRACT TERMS AND CONDITIONS

2.30.500 Bid security, bonds and insurance.

(a) **When Required.** The purchasing manager shall have the authority to require bid security, payment (labor and materials) and performance bonds as well as specific types and amounts of insurance coverage in connection with contracts for public works, goods, general services, professional services, and wholesale utility commodities to the extent required by state or federal law, or this chapter, or upon a determination that it is in the best interest of the city to do so.

(b) **Bid Security.** Bid security shall be submitted with the bid and shall be in the form of a certified check, cashier's check or surety bond. Any surety bond shall be issued by an admitted surety authorized to conduct business in the state of California and shall be in a form acceptable to the city attorney and as specified in the solicitation for bids. If a bidder fails to submit the required bid security with the bid, the bid shall be deemed nonresponsive. After bids are opened, bid security is irrevocable for the period specified in the invitation for bids. If the successful bidder fails to execute the contract within the time specified, the total amount of the bid security shall be forfeited to the city. The bid security of an unsuccessful bidder shall be returned to the bidder no later than sixty calendar days from the date of contract award. Bids for public works projects greater than \$65,000.00 shall require the submission of bid security in an amount equal to at least ten percent of the bid. On public works projects less than or equal to \$65,000.00, and all other procurements of goods and services the purchasing officer is authorized to determine if bid security is needed on a project-by-project basis.

(c) **Payment and Performance Security.** Payment and performance security shall be in the form of bonds acceptable to the city attorney and issued by an admitted surety authorized to conduct business in the state of California. Invitations for bids for public works projects greater than \$25,000.00 shall require the submission of payment and performance bonds, each in an amount equal to one hundred percent of the contract price at the time the contract is executed. Where the contract is with a governmental agency or a public utility the requirement for performance and payment security may be waived in writing by the purchasing manager if the contracting governmental agency or public utility agrees that, to the extent all work is not to be done by its own employees, it will require any and all contractors it awards contracts for the performance of any of the work to provide, before commencement of the work, payment and performance bonds, satisfactory to the city and complying with the provisions of the California Civil Code. Payment and performance bonds for public works projects shall be extended in the full amount of the contract for a one-year warranty period beyond the date of acceptance of the work by the city. On public work projects less than or equal to \$25,000.00, and on all acquisitions of goods and services the purchasing manager is authorized to determine if payment and performance security is needed on a case-by-case basis.

(d) **Form of Bonds.** The only bonds acceptable to the city shall be those executed on forms approved by the city attorney and as specified in the solicitation for bids or proposals.

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(e) Insurance. The risk manager shall determine insurance requirements. The successful bidder or proposer shall submit certificates of insurance and endorsement forms, as applicable, as evidence that it has the type and amount of insurance coverage required by the bid or proposal documents. Such evidence shall be submitted to the purchasing manager promptly upon request and shall be issued by an admitted insurer authorized to operate in the state of California and acceptable to the city. The risk manager may waive the insurance requirement when the contract is an intergovernmental contract or a city-public utility contract, and the governmental, public or quasi-public agency or the public utility to whom the contract is awarded agrees that it will have all the work obtain and provide evidence of the required insurance before commencement of the work naming the city, its officers, agents and employees as additional insureds to such policy.

(Ord. 4827 § 1 (part), 2004)

2.30.510 Nondiscrimination.

All contracts in excess of \$5,000.00 shall include a certification that in the performance of the contract, the contractor will not discriminate in the employment of any person because of race, skin color, gender, age, religion, disability, national origin, ancestry, sexual orientation, housing status, marital status, familial status, weight or height of such person.

Any contractor who is found in violation of the nondiscrimination provisions of the State of California Fair Employment Practices Act or similar provisions of federal law or executive order in the performance of any contract with the city, thereby shall be found in material breach of such contract and thereupon the city shall have the power to cancel or suspend the contract, in whole or in part, or to deduct from the amount payable to such contractor the sum of \$25.00 for each person for each calendar day during which such person was discriminated against, as damages for said breach of contract, or both. Only a finding of the State of California Fair Employment Practices Commission or the equivalent federal agency or officer shall constitute evidence of a violation of contract under this section.

(Ord. 4827 § 1 (part), 2004)

PART 7 -- ETHICS IN CONTRACTING

2.30.600 Ethics.

(a) Statement of Policy. City employees shall discharge their duties impartially so as to assure fair competitive access to city contracting opportunities by responsible contractors. Moreover, they shall conduct themselves in a manner as will foster public confidence in the integrity of city contracting activities.

(b) Conflict of Interest. No city employee shall participate directly or indirectly in a city contract when the employee knows that:

(1) The employee or any member of the employee's immediate family has a financial interest pertaining to the contract; or

(2) The employee or any member of the employee's immediate family is negotiating or has an employment arrangement which is contingent upon or will be affected by the contract.

(c) Withdrawal from Participation. Upon discovery of an actual or potential conflict of interest, an employee shall promptly withdraw from further participation in the contract procurement process.

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(d) **Gratuities.** No person shall offer, give or agree to give any city employee any gratuity, discount or offer of employment in connection with the award of a contract by the city. No city employee shall solicit, demand, accept or agree to accept from any other person a gratuity, discount or an offer of employment in connection with a city contract.

(Ord. 4827 § 1 (part), 2004)

2.30.610 Preparation of bid or proposal documents.

Any person or entity with whom the city has contracted to prepare or assist in the preparation of plans and specifications that will be included as contract terms and conditions in bid or proposal documents, is ineligible to submit a bid or proposal for that contract. This shall not preclude the award of a contract calling for design and construction of a public works project.

(Ord. 4827 § 1 (part), 2004)

PART 8 -- RECORDS AND REPORTS

2.30.700 Records, public inspection.

(a) **Records Maintenance.** The purchasing manager shall maintain records (in hard copy or electronic format) for each contract, purchase order, document or other agreement awarded or entered into by the city, which shall include, at a minimum: the request from the department; the bid or proposal documents received for the contract, if any; all bids or proposals received; the basis on which the contract award was made; and a copy of any and all contracts awarded. The purchasing manager shall maintain written records of his or her determination to cancel solicitations and of an awarding authority's decision to reject bids or proposals. Such records shall be maintained for a period of time in compliance with state law and the city's records retention schedule and shall be available for public inspection during normal city business hours. The foregoing shall not apply to records of wholesale utility commodity transactions under a master contract which shall be maintained by the department of utilities.

(b) **Public Inspection.** Bids shall be available for public inspection following the date and time set for receipt of bids. Proposals shall be available for public inspection following public announcement of the selection of a proposer for award of contract award. This section shall not be construed to require disclosure of records not otherwise required by law to be disclosed.

(Ord. 4827 § 1 (part), 2004)

2.30.710 City manager report.

Report to Council. The city manager shall make a biannual report to the council of all contracts awarded by the purchasing manager or the city manager for general services and professional services, the cost of which exceed \$25,000.00, and of all contracts awarded by the city manager for public works and goods the cost of which exceed \$65,000.00. The city manager shall also make an annual report to the council of all leases and rentals of city property with third parties approved by the city manager.

(Ord. 4827 § 1 (part), 2004)

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PART 9 -- REWARDS

2.30.800 Rewards.

Rewards for information leading to the arrest and conviction of criminals. Although the payment of rewards is not a purchase in the strict sense of the definition, the authority to offer and pay rewards is contained in this chapter because it involves the expenditure of city funds in return for information.

(a) The city manager is authorized to offer and pay a reward of up to \$25,000.00 for information leading to the arrest and conviction of any person or persons whose willful conduct causes unlawful injury or death to another person, or whose willful misconduct results in unlawful damage or destruction of personal property. The city manager shall cause the reward offer to be publicized and reported to the city council.

(b) A reward shall not be paid unless the information is received by the Palo Alto Police Department within 90 days of publication of the reward offer.

(c) Conviction of the person or persons responsible for the crime shall be required for payment of a reward unless the city manager makes a written finding that the conviction was impossible due to the death of the criminal.

(d) Reward claims shall be in writing and shall provide the name, address and telephone number of the claimant. Unless disclosure is authorized by the claimant, this information shall be deemed confidential and protected from public disclosure to the maximum extent permitted by law.

(e) Each reward offer shall be in writing and shall be valid only if approved in advance as to form and compliance with this section by the city attorney.

(Ord. 4827 § 1 (part), 2004)

PART 10 -- STANDARDIZATION

2.30.900 Standardization.

Where the city manager has determined that it is required by the health, safety or welfare of the people or employees of the city, or that significant costs savings have been demonstrated, standardization of supplies, materials or equipment, including information and communication technology, for purchase or to be used in a public works project is permitted and the specifications may specify a single brand or trade name. Among the factors that may be considered in determining to standardize on a single brand or trade name are that:

- (a) Repair and maintenance costs would be minimized;
- (b) User personnel training would be facilitated thereby;
- (c) Supplies or spare parts would be minimized;
- (d) Modifications to existing equipment would not be necessary;
- (e) Training of repair and maintenance personnel would be minimized; and
- (f) Matching existing supplies, materials or equipment is required for proper operation of a function or program.

Note: This was the current version of the Palo Alto Municipal Code chapter on contracts and purchasing procedures during audit field work (as of February 8, 2012). A more current version is available at: <http://www.amlegal.com/library/ca/paloalto.shtml>

ATTACHMENT 2: OfficeMax list of “America Saves Non Core Price Ranges”

America Saves Non Core Price Ranges					
Merchandise Class	Merchandise Class Description	# of in Category	Min DFL	Max DFL	Ave DFL
A1	ADHESIVES,CEMENTS,GLUE	25	9.00%	66.00%	41.60%
A2	SELF-ADHESIVE NOTES,TAPE FLAGS	85	12.00%	50.00%	36.86%
A3	SIGNS	1	12.00%	12.00%	12.00%
A4	COIN BOXES, BANKING SUPPLIES	9	13.00%	48.00%	32.78%
A5	LABELS,LABELMAKERS,TAGS,BADGES	203	4.00%	63.00%	37.54%
A6	RUBBERBANDS	30	13.00%	81.00%	57.43%
A7	LUNCHROOM SUPPLIES, FOOD	55	4.00%	51.00%	21.24%
A8	TAPES, DISPENSERS	87	4.00%	70.00%	39.70%
A9	CORRECTION FLUID,RUBBER FINGER	40	10.00%	75.00%	41.08%
B1	CALENDARS - DATED	175	4.00%	66.00%	35.17%
B2	CALENDARS - NON DATED	21	5.00%	48.00%	26.24%
B3	CALENDARS - ORGANIZERS	35	4.00%	48.00%	36.46%
B4	CALENDARS - ACADEMIC	6	30.00%	53.00%	45.17%
B5	REFERENCE BOOKS & DICTIONARIES	9	32.00%	32.00%	32.00%
E3	COMPUTER & LAN FURNITURE	6	26.00%	48.00%	32.33%
E4	SEATING	3	39.00%	48.00%	42.00%
E5	STORAGE,SHELVING,BOOKCASES	13	24.00%	39.00%	33.31%
E6	ERGONOMIC ACCESSORIES	100	10.00%	52.00%	30.11%
E7	MAILROOM FURNITURE, LIT RACKS	13	24.00%	33.00%	27.85%
E8	CONFERENCE & TRAINING ROOM	5	29.00%	48.00%	36.20%
E9	FURNITURE ACCESSORIES	66	4.00%	48.00%	30.39%
F1	FILE FOLDERS (TOP TAB)	182	4.00%	76.00%	43.93%
F2	FILING GUIDES, FILING SORTERS	53	4.00%	64.00%	34.81%
F3	INDEX CARDS, PRINTABLE CARDS	35	4.00%	71.00%	33.63%
F4	BUSINESS CARD FILES, ADDRESS BK	44	4.00%	42.00%	30.77%
F5	HANGING FOLDERS,FILE ORGANIZER	159	6.00%	81.00%	45.13%
F7	BOX/ARCH FILES, CLIPBOARDS	16	21.00%	57.00%	47.38%
F8	FILE FOLDERS (END TAB)	33	4.00%	58.00%	41.73%
G8	ATTACHES,PORTFOLIOS,CASES	11	4.00%	48.00%	33.09%
H1	STAPLERS,STAPLES,TACKERS	68	9.00%	80.00%	49.46%
H2	PUNCHES	34	10.00%	71.00%	41.85%
H3	SCISSORS,XACTO KNIVES,LTR OPNR	42	4.00%	84.00%	36.38%
H4	CLIPS,CLAMPS,TACKS,FASTENERS	77	4.00%	68.00%	43.51%
J1	DRAFTING,ART SUPPLIES, RULERS	16	4.00%	53.00%	28.88%
J4	BOARDS, EASELS	67	26.00%	42.00%	29.96%
K1	DESK PADS, MOTIVATIONAL ITEMS	29	4.00%	50.00%	29.59%
K3	DESK ACCESSORIES, KEY CONTROL	226	4.00%	65.00%	35.17%
K4	LAMPS	10	43.00%	48.00%	45.00%
K5	CLOCKS	14	7.00%	61.00%	36.14%
K6	WASTE BINS,LINERS	25	4.00%	70.00%	28.12%
K7	SHREDDERS	15	33.00%	45.00%	36.27%
L1	PRESENTATION PRODUCTS	8	9.00%	61.00%	38.50%
L2	BINDRS,REPORT COV, LAMINATING	434	4.00%	70.00%	40.61%
L3	INDEXES AND TABS	103	11.00%	81.00%	39.51%
L5	CATALOG/REFERENCE RACKS	3	29.00%	36.00%	33.67%
L6	DATA BINDERS & SUPPLIES	15	16.00%	74.00%	44.93%
L8	TELEPHONE & ACCESSORIES	15	4.00%	68.00%	40.80%
L9	BATTERIES	48	4.00%	45.00%	22.88%
M1	CALCULATORS	44	4.00%	48.00%	22.52%
M2	TYPEWRITERS & WORD PROCESSORS	2	12.00%	41.00%	26.50%
M3	FAX & MULTIFUNCTION MACHINES	2	31.00%	38.00%	34.50%
M5	AIRCLEANERS,FANS,HEATERS	6	12.00%	48.00%	31.50%
M6	DICTATION, RECORDERS, FILM	39	4.00%	47.00%	11.15%
M8	ELECTRONIC ORGANIZERS, & PDA'S	1	4.00%	4.00%	4.00%
N1	BALLPOINT,ROLLING,STYLUS PENS	339	4.00%	68.00%	40.11%
N2	MARKERS, HIGHLIGHTERS	227	4.00%	64.00%	38.49%
N3	PENCIL SHARPENERS	13	9.00%	48.00%	31.69%
N4	PENCILS-AUTOMATIC	76	7.00%	54.00%	38.54%
N5	PENCILS-WOODCASE	12	32.00%	68.00%	50.67%
N6	ERASERS-PENCIL & CHALKBOARD	10	17.00%	48.00%	41.60%
P1	PAPER, COPY, LASER, INKJET	128	4.00%	80.00%	46.90%
P2	ENVELOPES	131	4.00%	66.00%	47.57%
P3	PADS,NOTEBOOKS,FORM,ACCT BKS	144	4.00%	80.00%	39.66%
P4	ADD,CALCULATOR,FAX PFR ROLLS	18	19.00%	79.00%	48.56%
P5	STORAGE BOXES	19	27.00%	61.00%	43.84%
P6	COMPUTER PAPER	4	63.00%	69.00%	65.50%
P7	SHIPPING & MAILROOM SUPPLIES	6	41.00%	48.00%	46.17%
P8	WIDE FORMAT PAPER	4	48.00%	48.00%	48.00%
Q8	PRINTERS & SCANNERS	5	29.00%	37.00%	34.60%
R1	STAMPS,DATESTERS,NUMBER MACH	68	4.00%	48.00%	36.22%
R2	STAMP PADS, RACKS, INKS	10	12.00%	53.00%	38.10%
S1	PRINTER SUPPLIES	175	4.00%	65.00%	13.98%
S2	RIBBONS	35	4.00%	86.00%	38.54%
S5	COPIER & FAX SUPPLIES	39	4.00%	49.00%	22.90%
S6	COMPUTER ACCESSORIES	77	4.00%	48.00%	34.52%
S7	DISKETTES, DATA MEDIA/STORAGE	129	4.00%	51.00%	34.63%
S9	SURGE, MICE, KEYBOARDS	46	4.00%	72.00%	33.39%
W1	CUTTING BOARD,CTN OPENERS	9	39.00%	48.00%	42.11%
W3	MAINTENANCE SUPPLIES,FIRST AID	43	4.00%	52.00%	27.40%
W5	RESTROOM SUPPLIES	2	22.00%	30.00%	26.00%

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ATTACHMENT 3: City Manager’s Action Summary

In response to the Audit Recommendations in this report, the City Manager has agreed to take the following actions. The full response from the City Manager is included in Attachment 4.

Finding #	Summary of Finding	Recommendation	City Manager’s Action Plan	Target Date
1	OfficeMax overcharged the City at least \$47,563 by applying unauthorized changes to pricing for items with specified contract prices.	1. ASD should consult with the City Attorney’s Office to pursue recovery of unauthorized charges from OfficeMax, including at least \$47,563 for contract item overcharges under the America Saves program during the period November 1, 2007 through May 31, 2011.	<ul style="list-style-type: none"> ASD will work with the City Attorney’s Office to request reimbursement. 	
2	<p>The City could have received additional discounts for non-contract office supplies.</p> <p>The City could have reasonably anticipated additional discounts between \$148,921 and \$341,863 for non-contract office supplies.</p>	2. ASD should consult with the City Attorney’s Office to determine if the City can recover additional discounts ranging from \$148,921 to \$341,863 for non-contract items it purchased under the America Saves program terms from November 1, 2007 through May 31, 2011.	<ul style="list-style-type: none"> ASD will work with the City Attorney’s Office to consider options for recovering additional discounts. 	
3	<p>ASD has not effectively administered the City’s office supplies contract.</p> <p>ASD has not established effective processes and procedures to ensure the City receives contracted</p>	<p>3. ASD should develop formal procedures to effectively administer the City’s office supplies contract in order to ensure:</p> <ul style="list-style-type: none"> The contract supports the City’s business needs, policies, and goals, including the City’s environmental policies. 	<ul style="list-style-type: none"> ASD has completed a request for proposal process for a new office supply contract with the involvement of department stakeholders and members of the City’s environmental team. Collectively, this review panel selected a new office supply provider that meets the City’s needs, policies and goals. A contract with the new office supply provider is estimated to save the City \$40,000 compared to the current contract. This 	Q4 2012 – Q1 2013

Finding #	Summary of Finding	Recommendation	City Manager's Action Plan	Target Date
	<p>discounts and other key benefits, and that the office supplies contract meets the City's business needs.</p>	<ul style="list-style-type: none"> • Purchasing monitors discounts provided to the City in order to timely detect any negative trends, such as a decline in the purchase of highly discounted contract items, and to ensure the City receives all contracted discounts and other key benefits. • Use of the contract is maximized and purchases of office supplies from other vendors or suppliers the City has not contracted with is restricted or minimized. • The City identifies and maximizes its eligibility for available contract incentives. • The City discontinues storing and delivering office supplies, unless staff can provide a cost/benefit analysis justifying the current practice. • Responsibility for contract administration is formally assigned, documentation of contract administration activities is retained, and contract administration is minimally impacted by staff turnover. 	<p>estimated savings figure may be reduced if: new costs are realized for compliance with environmental policies, incentives are not achieved, purchases from non contract vendors is not prevented, purchases of non discounted items is not prevented.</p> <ul style="list-style-type: none"> • ASD has formally assigned and documented contract administration duties and transitions those duties when there is staff transition. • Using tools offered by the new contract, ASD will monitor and ensure that discounts and incentives offered are realized. New tools will enable staff to prevent the purchase of non-discount items. • ASD will require departments to purchase office supplies via the new contract and will consider ways to restrict the purchase of office supplies outside of the contract via restrictions in the PCard system. • ASD will review the practice of storing office supplies to see if it is the best approach given the benefits of the new contract. 	
4	ASD should ensure the City's financial records	4. ASD should develop and communicate to staff policies and procedures to	<ul style="list-style-type: none"> • City departments handle the classification of expenses at the point of purchase. ASD will make clear to 	Q4 2012

Finding #	Summary of Finding	Recommendation	City Manager's Action Plan	Target Date
	<p>accurately identify office supplies and should properly budget for and control office supplies expenditures.</p> <p>City records indicate the City has spent considerably more for office supplies than other local jurisdictions sampled, however, we could not reasonably associate a significant portion of office supplies expenditures with office supplies vendors.</p>	<p>ensure the office supplies accounting code is clearly defined, its use is monitored, and that office supplies are accurately recorded in the City's accounting records.</p>	<p>departments via policy and training and periodic review to ensure compliance to properly classify office supply expenses in the accounting system. As result of staffing reductions and increased work volume ASD does not have the person power to monitor how accurately departments classify all expenses.</p>	
5	<p>Strategic contracting practices may provide savings opportunities.</p> <p>The City's procurement policies and procedures do not clearly identify and communicate requirements for establishing negotiated contracts for goods and/or services the City purchases mainly using purchasing cards, which likely results in lost savings opportunities.</p>	<p>5. ASD should clarify the City's procurement policies and procedures, while ensuring consistency with the Municipal Code, to specify when Purchasing should negotiate contracts, based on dollar amount thresholds applicable to total citywide expenditures for goods and/or services (or payments to vendors) in aggregate, regardless of payment method.</p>	<ul style="list-style-type: none"> As staffing levels allow, ASD periodically reviews spending activity, services used and commodities to determine if a contract with a vendor would be advantageous. Due to staffing reductions and increased work volume, this level of review is time consuming for staff and staff may not always be available to perform this type of analysis. Staff will continue to perform this review as time permits and will also look into automated tools to flag this activity. In addition, staff will consider hiring temporary help to accomplish this review, which could offset savings. When ASD conducts this review a threshold will be set to flag purchasing activity with vendors when aggregate spend meets the level of \$5,000. Where spending levels are met, Purchasing staff will take action to ensure competitive pricing agreements are put in place and are consistent with the muni code. 	Q4 2012 – Q1 2013

Finding #	Summary of Finding	Recommendation	City Manager's Action Plan	Target Date
5	<p>Strategic contracting practices may provide savings opportunities.</p> <p>The City did not have authorized contracts for several vendors selected for review.</p> <p>OCA did not find evidence ASD Purchasing monitors expenditures for goods and/or services from vendors through the use of the City's SAP Enterprise Resource Planning system reports in order to determine whether cost savings opportunities could be maximized by entering negotiated contracts.</p>	<p>6. ASD should develop policies and procedures to ensure it monitors total citywide expenditures on categories of goods and/or services (or expenditures by vendor) and periodically assesses whether the total volume of the transactions and expenditures, regardless of payment method, may require the City to contract for the goods and/or services either through the City's competitive solicitation methods or by using another agency's contract, in order to maximize cost savings.</p>	<ul style="list-style-type: none"> As staffing levels allow, ASD periodically reviews spending activity, services used and commodities to determine if a contract with a vendor would be advantageous. Due to staffing reductions and increased work volume, this level of review is time consuming for staff and staff may not always be available to perform this type of analysis. Staff will continue to perform this review as time permits and will also look into automated tools to flag this activity. In addition, staff will consider hiring temporary help to accomplish this review, which could offset savings. When ASD conducts this review a threshold will be set to flag purchasing activity with vendors when aggregate spend meets the level of \$5,000. Where spending levels are met, Purchasing staff will take action to ensure competitive pricing agreements are put in place and are consistent with the muni code. 	<p>Q4 2012 – Q1 2013</p>
5	<p>Strategic contracting practices may provide savings opportunities.</p> <p>OCA found that the City did not have authorized contracts for several vendors selected for review, despite significant aggregate purchases in 2011 and/or historical total</p>	<p>7. ASD should develop policies and procedures to ensure the City has properly approved contracts, when required by the Municipal Code, prior to conducting business. Specifically, the City should ensure it establishes a process to prevent and/or detect issuance of purchasing documents or purchasing card payments to vendors without a properly approved contract, if required.</p>	<ul style="list-style-type: none"> ASD has in place a Purchasing Manual that outlines the process for contract approval. ASD will continue to work with other departments to ensure that contracts are approved consistent with the process outlined in the Purchasing Manual prior to work commencing. ASD will implement additional review steps in the contract process to ensure contracts are executed properly. 	<p>Q4 2012 – Ongoing</p>

Finding #	Summary of Finding	Recommendation	City Manager's Action Plan	Target Date
	purchases from the vendor.			
5	<p>Strategic contracting practices may provide savings opportunities.</p> <p>The City does not have a properly authorized office supplies contract. Although the America Saves program master purchasing agreement expired on June 30, 2011, we found no evidence the City subsequently took steps to appropriately contract for office supplies.</p>	<p>8. ASD should develop policies and procedures to ensure ASD Purchasing staff monitors expiring contracts and ensures contracts are re-established in a timely manner.</p>	<ul style="list-style-type: none"> ASD will work with departments to help develop a process for highlighting contracts that are due to expire. There are reports available that departments can use to review upcoming expiration dates. Purchasing staff will be assigned to review SAP reports on a quarterly basis to flag contracts that are due to expire. 	Q4 2012 – Q1 2013
5	<p>Strategic contracting practices may provide savings opportunities.</p> <p>ASD does not have a process to document and approve all exemptions from competitive procurement. As shown in Exhibit 13, there was no evidence to support that contracts for 8 of 13 vendors sampled were awarded competitively or properly exempted from</p>	<p>9. ASD should develop policies and procedures to ensure it complies with Municipal Code requirements for applying and documenting exemptions from competitive solicitation in the procurement of goods and services (A City working group that promotes efficient and effective purchasing methods has drafted a new "City of Palo Alto Sole Source Justification Form" which includes all 18 exemptions listed in the Municipal Code).</p>	<ul style="list-style-type: none"> ASD prepares a report that goes to the City Council documenting contracts that were approved with exemptions. This has been established process for many years and offers efficiency and approvals at the appropriate staff level while satisfying accountability. Staff will review the municipal code and current practice to ensure they are both in sync and recommend revisions to the municipal code where needed. Should Staff, in collaboration with the City Attorney's Office, consider streamlining the municipal code requirements for exemptions then staff will make the appropriate recommendation to the City Council. 	2013

Finding #	Summary of Finding	Recommendation	City Manager's Action Plan	Target Date
	competitive solicitation requirements.			
6	<p>The City has not sufficiently defined contract administration roles and responsibilities.</p> <p>In reviewing the Municipal Code and the City's Purchasing Manual, we did not find sufficient guidance regarding contract administration roles, responsibilities, and business practices to ensure compliance with the City's contract terms and also to ensure the City receives contracted benefits.</p>	<p>10. ASD should ensure contract administration roles and responsibilities are defined and appropriately communicated. At a minimum, ASD should broadly define contract administration and develop a process to:</p> <ul style="list-style-type: none"> • Formally identify the contract administrator and assign contract administration responsibilities. • Identify and document key contract terms. • Identify and provide the necessary training to ensure the contract administrator has the required expertise. • Identify or develop specific methodology, reports, and/or tools required to administer the contract. • Establish and monitor timelines and milestones in administering the contract. 	<ul style="list-style-type: none"> • ASD roles and responsibilities are defined and communicated (e.g., the Contract Administrator or Buyer who handled the solicitation is listed). • ASD will implement a checklist of minimum requirements for project managers and contract administrators and hold departments accountable for satisfying their responsibilities. • Contractor Administrator and or Buyer are formally identified and assigned administration responsibilities pursuant to their respective job description. • ASD Purchasing staff is trained to understand specific terms and conditions of a contract, and is knowledgeable pursuant to the qualifications required to hold the position as described within the job description. Additionally, Team training is held on selected topics (e.g., Risk Management) as needed. • ASD will look to determine if it would serve the organization for Purchasing and Contract Administration to take over the overall contract administration of contracts for the City. Current process is Purchasing and Contracts Administration Division performs the activities required to award a contract. Contract Administration duties are managed by the individual Departments who the contract was issued for. Improved training, to address turnover, and easy access to information will be important. • The role of departments in the contract administration process must be clearly defined. 	2013

ATTACHMENT 4: City Manager's Response

Date: November 14, 2012

To: City Auditor

From: James Keene, City Manager

Prepared by: Lalo Perez, Director of Administrative Services (ASD)

The Administrative Services Department (ASD) staff acknowledges and appreciates the detailed work of the City's Auditor Office (Auditor's Office) and is pleased to respond to the Contract Oversight Audit. Listed below after the summary is the staff response to the auditor's recommendations. This memo supplements the responses provided in the City Manager's Action Summary, the format for responses requested by the City Auditor.

The Administrative Services Department Purchasing Division oversees procurement activities for the City. In 2012, the division established 2232 purchasing orders with a value of \$137,003,000. Since 2005, the department has gone from ten to nine full-time equivalent employees. In addition, the Accounting Division in ASD has shrunk by three full-time equivalent positions since 2005. Also, during this period the Purchasing Division has experienced turnover in three long-term positions. In terms of volume, the division is handling \$152,000,000 in purchase order, contract and purchase card activity, up from \$60,000,000 in 2005. As a result of this increase in dollar volume, the average contract value is up from \$22,000 in 2005 to \$65,000 presently. The dollar amount of the contract is usually a good indicator of the complexity of the procurement process. More complex procurements generally require more staff time. In recent years there has been an increase in infrastructure-related contracts, often complex construction contracts, such as the contracts related to library improvements.

The Administrative Services Department Purchasing Division is charged with maintaining an open and fair process for interested parties to do business with the City, while ensuring that the City obtains competitive pricing for the goods and services it seeks. The Purchasing Division works in collaboration with all City departments to facilitate the contracts needed by various departments. Departments serve in the role of project manager for the contracts needed to satisfy their mission. In this role departments are responsible for overseeing contract deliverables and overall contract compliance.

The Administrative Services Department has worked to implement improvements to the overall procurement process to provide better-coordinated service to departments. Upcoming improvements include reviewing the municipal code procurement requirements for options to simplify steps, moving documents to electronic storage and retrieval, and enhancing training to address the knowledge gap as experienced employees leave the City.

RECOMMENDATION #1

ASD should consult with the City Attorney's Office to pursue recovery of unauthorized charges from OfficeMax, including at least \$47,563 for contract item overcharges under the America Saves program during the period November 1, 2007 through May 31, 2011.

Response:

- ASD will work with the City Attorney's Office to request reimbursement.

RECOMMENDATION #2

ASD should consult with the City Attorney's Office to determine if the City can recover additional discounts ranging from \$148,921 to \$341,863 for non-contract items it purchased under the America Saves program terms from November 1, 2007 through May 31, 2011.

Response:

- ASD will work with the City Attorney's Office to consider options for recovering additional discounts.

RECOMMENDATION #3

ASD should develop formal procedures to effectively administer the City's office supplies contract in order to ensure:

- The contract supports the City's business needs, policies, and goals, including the City's environmental policies.
- Purchasing monitors discounts provided to the City in order to timely detect any negative trends, such as a decline in the purchase of highly discounted contract items, and to ensure the City receives all contracted discounts and other key benefits.
- Use of the contract is maximized and purchases of office supplies from other vendors or suppliers the City has not contracted with is restricted or minimized.
- The City identifies and maximizes its eligibility for available contract incentives.
- The City discontinues storing and delivering office supplies, unless staff can provide a cost/benefit analysis justifying the current practice.
- Responsibility for contract administration is formally assigned, documentation of contract administration activities is retained, and contract administration is minimally impacted by staff turnover.

Response:

- ASD has completed a request for proposal process for a new office supply contract with the involvement of department stakeholders and members of the City's environmental team. Collectively this review panel selected a new office supply provider that meets the City's needs, policies and goals. A contract with the new office supply provider is estimated to save the City \$40,000 compared to the current contract. This estimated savings figure may be reduced if: new costs are realized for compliance with environmental policies, incentives are not achieved, purchases from non contract vendors is not prevented, purchases of non discounted items is not prevented.
- ASD has formally assigned and documented contract administration duties and transitions those duties when there is staff transition.
- Using tools offered by the new contract, ASD will monitor and ensure that discounts and incentives offered are realized. New tools will enable staff to prevent the purchase of non-discount items.

- ASD will require departments to purchase office supplies via the new contract and will consider ways to restrict the purchase of office supplies outside of the contract via restrictions in the PCard system.
- ASD will review the practice of storing office supplies to see if it is the best approach given the benefits of the new contract.

RECOMMENDATION #4

ASD should develop and communicate to staff policies and procedures to ensure the office supplies accounting code is clearly defined, its use is monitored, and that office supplies are accurately recorded in the City's accounting records.

Response:

- City departments handle the classification of expenses at the point of purchase. ASD will make clear to departments via policy and training and periodic review to ensure compliance to properly classify office supply expenses in the accounting system. As result of staffing reductions and increased work volume ASD does not have the person power to monitor how accurately departments classify all expenses.

RECOMMENDATION #5

ASD should clarify the City's procurement policies and procedures, while ensuring consistency with the Municipal Code, to specify when Purchasing should negotiate contracts, based on dollar amount thresholds applicable to total citywide expenditures for goods and/or services (or payments to vendors) in aggregate, regardless of payment method.

Response:

- As staffing levels allow, ASD periodically reviews spending activity, services used and commodities to determine if a contract with a vendor would be advantageous. Due to staffing reductions and increased work volume, this level of review is time consuming for staff and staff may not always be available to perform this type of analysis. Staff will continue to perform this review as time permits and will also look into automated tools to flag this activity. In addition, staff will consider hiring temporary help to accomplish this review, which could offset savings. When ASD conducts this review a threshold will be set to flag purchasing activity with vendors when aggregate spend meets the level of \$5,000. Where spending levels are met Purchasing staff will take action to ensure competitive pricing agreements are put in place and are consistent with the muni code.

RECOMMENDATION #6

ASD should develop policies and procedures to ensure it monitors total citywide expenditures on categories of goods and/or services (or expenditures by vendor) and periodically assesses whether the total volume of the transactions and expenditures, regardless of payment method, may require the City

to contract for the goods and/or services either through the City's competitive solicitation methods or by using another agency's contract, in order to maximize cost savings.

Response:

- As staffing levels allow, ASD periodically reviews spending activity, services used and commodities to determine if a contract with a vendor would be advantageous. Due to staffing reductions and increased work volume, this level of review is time consuming for staff and staff may not always be available to perform this type of analysis. Staff will continue to perform this review as time permits and will also look into automated tools to flag this activity. In addition, staff will consider hiring temporary help to accomplish this review, which could offset savings. When ASD conducts this review a threshold will be set to flag purchasing activity with vendors when aggregate spend meets the level of \$5,000. Where spending levels are met Purchasing staff will take action to ensure competitive pricing agreements are put in place and are consistent with the muni code.

RECOMMENDATION #7

ASD should develop policies and procedures to ensure the City has properly approved contracts, when required by the Municipal Code, prior to conducting business. Specifically, the City should ensure it establishes a process to prevent and/or detect issuance of purchasing documents or purchasing card payments to vendors without a properly approved contract, if required.

Response:

- ASD has in place a Purchasing Manual that outlines the process for contract approval. ASD will continue to work with other departments to ensure that contracts are approved consistent with the process outlined in the Purchasing Manual prior to work commencing.
- ASD will implement additional review steps in the contract process to ensure contracts are executed properly.

RECOMMENDATION #8

ASD should develop policies and procedures to ensure ASD Purchasing staff monitors expiring contracts and ensures contracts are re-established in a timely manner.

Response:

- ASD will work with departments to help develop a process for highlighting contracts that are due to expire. There are reports available that departments can use to review upcoming expiration dates.
- Purchasing staff will be assigned to review SAP reports on a quarterly basis to flag contracts that are due to expire.

RECOMMENDATION #9

ASD should develop policies and procedures to ensure it complies with Municipal Code requirements for applying and documenting exemptions from competitive solicitation in the procurement of goods and services.

Response:

- ASD prepares a report that goes to the City Council documenting contracts that were approved with exemptions. This has been established process for many years and offers efficiency and approvals at the appropriate staff level while satisfying accountability. Staff will review the municipal code and current practice to ensure they are both in sync and recommend revisions to the municipal code where needed. Should Staff, in collaboration with the City Attorney's Office, consider streamlining the municipal code requirements for exemptions then staff will make the appropriate recommendation to the City Council.

RECOMMENDATION #10:

ASD should ensure contract administration roles and responsibilities are defined and appropriately communicated. At a minimum, ASD should broadly define contract administration and develop a process to:

- Formally identify the contract administrator and assign contract administration responsibilities.
- Identify and document key contract terms.
- Identify and provide the necessary training to ensure the contract administrator has the required expertise.
- Identify or develop specific methodology, reports, and/or tools required to administer the contract.
- Establish and monitor timelines and milestones in administering the contract.

Response:

- ASD roles and responsibilities are defined and communicated (e.g., the Contract Administrator or Buyer who handled the solicitation is listed).
- ASD will implement a checklist of minimum requirements for project managers and contract administrators and hold departments accountable for satisfying their responsibilities.
- Contractor Administrator and or Buyer are formally identified and assigned administration responsibilities pursuant to their respective job description.
- ASD Purchasing staff is trained to understand specific terms and conditions of a contract, and is knowledgeable pursuant to the qualifications required to hold the position as described within the job description. Additionally, Team training is held on selected topics (e.g., Risk Management) as needed.

- ASD will look to determine if it would serve the organization for Purchasing and Contract Administration to take over the overall contract administration of contracts for the City. Current process is Purchasing and Contracts Administration Division performs the activities required to award a contract. Contract Administration duties are managed by the individual Departments who the contract was issued for. Improved training, to address turnover, and easy access to information will be important.
- The role of departments in the contract administration process must be clearly defined.



POLICY AND SERVICES COMMITTEE DRAFT EXCERPT

Special Meeting
November 20, 2012

Contract Oversight Audit

Jim Pelletier, City Auditor reported the Contract Oversight Audit (Audit) focused on the City's office supplies contract with Office Max. The objective of the Audit was to assess the effectiveness and adequacy of internal controls to ensure contracts were administered in accordance with the Municipal Code and relevant policies and procedures. The City Auditor's Office Staff focused on the office supplies contract, because they felt it would be a simple and straightforward contract and it would allow them to review broader contract administration practices. The office supplies contract was one of the two main contracts administered directly by the Purchasing and Contracting Division of the Administrative Services Department (ASD).

Houman Boussina, Senior Performance Auditor stated the Audit report provided six findings and ten recommendations. The audit included selected key points from Office Max's responses and management's perspective. The report concluded with the City Manager's action summary and response. Under the America Saves Program, Office Max extended to governmental agencies a contract it held with Oakland County, Michigan. The term of the Master Purchasing Agreement was June 1, 2006 through June 30, 2011. The City's purchases from Office Max from 2005 through 2011 totaled approximately \$1.75 million. Staff did not have all contract documentation; therefore, the City Auditor's Office relied on Office Max to provide the commencement date for the contract. Staff reported the commencement date of the contract as 2006, while Office Max reported the City entered the agreement on November 1, 2007. The Audit focused on Office Max's compliance with key contract terms, the City's enforcement of contract terms, and the City's usage of the contract. Finding 1 indicated Office Max overcharged the City at least \$47,563 by applying unauthorized changes to pricing. The contract required formal amendments or authorized price list changes for contract items. The City Auditor's Office recommended ASD Staff consult with the City Attorney's Office to pursue recovery of \$47,563. Finding 2 indicated the City could have received additional discounts of approximately \$149,342 for non-contract office supplies covered under the terms of the contract. In order to provide this analysis, the City Auditor's

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Office reviewed various reference points, such as the original bids of Oakland County and other audit reports. During the audit, ASD Staff performed an analysis of pricing from another available contract, and found that the City could save \$40,000 annually compared to the current contracts. The City Auditor's Office recommended ASD Staff consult with the City Attorney's Office to determine if the City could recover additional discounts for non-contract items. Finding 3 indicated ASD did not effectively administer the City's office supplies contract. The City Auditor's Office did not find effective procedures to ensure the City received the contracted discounts and other key benefits. The City Auditor's Office found an overall decline in the discount rate on office supplies. The City increasingly purchased non-contract items discounted approximately 40 percent as opposed to contract items discounted approximately 75 percent on average. The decrease in the discount percentage resulted from the City's increased purchase of non-contract items. The City spent more than other jurisdictions for office supplies per Full Time Equivalent (FTE). Staff did not fully utilize the office supplies contract to realize benefits. From 2006 through 2011, the City purchased approximately 59 percent of its supplies from Office Max. The City did not manage or monitor contract incentives. The contract provided a 98.5 percent fill rate and next-day delivery; therefore, The City Auditor's Office did not agree with the necessity for storing office supplies at the City warehouse. ASD Staff did not ensure purchased office supplies supported the City's environmental goals. The City spent approximately \$230,000 on 30 percent recycled paper. City policy required the purchase of paper products containing at least 50 percent recycled materials. The City Auditor's Office recommended ASD Staff develop formal procedures to effectively administer the contract. ASD Staff should ensure the City's financial records accurately identified office supplies. The City Auditor's Office could not reasonably associate a significant portion of office supply expenditures with office supply vendors. In Fiscal Year 2011, the City budgeted approximately \$563,000 for office supplies, approximately twice the actual purchase amount of office supplies from Office Max. The City Auditor's Office questioned the nature of expenditures for office supplies that were coded as office supplies. The City Auditor's Office recommended ASD Staff develop and communicate policies and procedures to ensure the office supplies accounting code was properly utilized. Strategic contracting practices could provide savings opportunities. The City did not have authorized contracts for several vendors selected for review in the Audit. In addition, the City did not have a properly authorized office supplies contract. The City Auditor's Office found the policies and procedures did not clearly identify contracting requirements for goods and services purchased with purchase cards (P-Card). Purchasing did not monitor expenditures for goods and services using reports, relied on departments to communicate information, and did not have a process to ensure Staff was alerted to

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approaching contract expirations. ASD Staff did not have a process to document and approve all exemptions from competitive solicitation. The City Auditor's Office found a large number of the City's contracts were exempted. Staff reported that in practice approval was required for only 2 of 18 exemption categories specified in the Municipal Code. The Municipal Code provided some details regarding the process for documenting exemptions that were not followed in all cases. The City Auditor's Office recommended that ASD Staff clarify the City's procurement policies in this area, develop policies and procedures to have approved contracts in place prior to conducting business, monitor expiring contracts, and follow Municipal Code requirements when documenting exemptions from competitive solicitation. Finding 6 indicated Staff did not sufficiently define contract administration rules and responsibilities. The City Auditor's Office did not find sufficient guidance regarding contract administration, specifically, no evidence that two contracts administered by Purchasing were properly administered. The City Auditor's Office recommended ASD Staff ensure contract administration rules and responsibilities were defined and communicated.

Lalo Perez, Chief Financial Officer stated the recommendations were reasonable, and Staff wished to provide responses. The America Saves Program had more than 1,100 participants nationwide. Staff trusted that Oakland County, Michigan performed a thorough analysis and selected the lowest responsible bidder. As a result of the Audit and Staff's experience, Staff determined the City could have saved more funds than it did. Staff experienced numerous challenges during the period under review, including a reduction in resources and various significant initiatives. He would report the result of the new Request for Proposal (RFP) process and provide an estimate of savings. Losses were reported, but savings and efficiencies were not. The City was a large organization and some areas needed improvement. The City Manager asked him to review the resource allocation to this program. Rather than adding permanent staff, seasonal support could assist with analysis, issue RFPs, and award contracts. Another option was utilizing the Office of Management and Budget (OMB) to review various areas. The City Manager tasked him with continuing to improve opportunities for efficiency and savings. The Palo Alto process required more expenditures than the process in other cities. The level of process added to costs. In reviewing the audit findings, he determined Staff coded various items as office supplies if there were no funds in the appropriate category to fund the purchase. In July 2012, Staff elevated budget controls to a group level. With more training and retraining, Staff could log the proper codes.

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David Ramberg, Assistant Director of Administrative Services reported the Purchasing Group was comprised of three contract administrators, two buyers, and one purchasing manager. Three of those employees retired and the positions had to be filled. The number of purchasing orders processed during the term of the audit (approximately 3 1/2 years) was 8,589. The number of contracts and contract amendments sent to the City Council was 336. The dollar value of purchase orders and contracts processed was approximately \$512 million. The number of bids completed was approximately 1,200. The number of bid protests was six. Staff resolved all six protests at Staff level, clearing the City of any inaccuracies in the bid process. Two of the bid protests reached Council level, and the Council supported Staff in not approving the bid protest. The City's purchasing process provided a cost reduction when existing contracts were issued for renewal. Cost reductions were achieved when compared to the estimates Staff expected to receive for some key contracts. The total of cost reductions over 3 1/2 years was approximately \$5 million. A better and more accountable P-Card system was installed in 2011. The issuer of the P-Cards, JPMorgan Chase, provided a more favorable contract by offering a competitive rebate based on spending. Staff anticipated a rebate of approximately \$40,000 per year. That rebate amount should increase year-to-year as purchasing activity increased. Through the competitive process, the City would have a new contract with Staples for office supplies. The contract would provide savings, better reporting, and controls to ensure Staff purchased only discounted items. In addition, the contract offered remanufactured toner cartridges at a significant price advantage and the largest suite of green products available. The City was moving in a positive direction with the new contract with Staples.

Council Member Espinosa was interested in Staff responses to the Audit Recommendations. Staff's responses to Recommendations 4 and 5 noted staffing reductions. Staff's response to Recommendation 9 essentially stated policy and procedures were in place. He inquired whether the City Auditor felt Staff's responses would lead to change and compliance.

Mr. Pelletier worked closely with ASD Staff in the development of responses. He was confident ASD Staff would make the necessary changes to correct issues. The City Auditor's Office follow-up would ensure ASD Staff met the recommendations.

Council Member Espinosa asked if there were any areas Mr. Pelletier felt would not change.

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Mr. Pelletier answered no. The City Auditor's Office and ASD Staff generally agreed with the issues noted and the actions to be taken.

Council Member Espinosa asked Mr. Perez if the results of the Audit surprised him.

Mr. Perez was surprised by the extent of the amount. As Staff decreased, he had to determine priorities based on the highest return of time. He chose the implementation of the new P-Card as the top priority in order to provide a new revenue stream for the City. The City's program for infrastructure had increased dramatically, which impacted procurement. Contracts and transactions were complex and required a great deal of time, which was impacted by the decrease in staffing. Increased staffing could provide a return that was larger than expenses. Reduced staffing levels increased risk for the City. Other areas of the City organization would also have problems. OMB Staff and additional software could assist with analysis. He would return to the Council with a request for additional funding to address these issues.

Mr. Pelletier noted Findings 1 and 2 were specific to Office Max. Other findings concerned general contracting practices across the City. The City Auditor's Office encouraged ASD Staff to develop procedures and policies that would impact all contracting across the City.

Council Member Espinosa expressed concern about Staff's responses regarding the lack of Staff to perform the recommendations. The key purchasing statistics alarmed him. He inquired about the level of risk for the City based on the Audit.

Mr. Perez could only guess about the level of risk. This audit raised areas of concern which Staff could review. When purchasing contracts were not in place, Staff was performing some checks and balances to reassure the Council. He could pursue other contracts and savings opportunities if Staff was available. The larger contracts had a rigorous process and project managers to provide checks and balances. One initiative under discussion was decentralization of some purchasing. Staff planned to present Municipal Code changes and levels of authority to the Council.

Council Member Schmid inquired whether the Audit could inform processes for service-oriented contracts.

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Mr. Pelletier indicated the Audit considered broader processes regarding all contracts within the City. The larger contracts received more attention; however, the core processes for large and small contracts were similar.

Council Member Schmid believed much of the judgment for service contracts was qualitative rather than quantitative.

Mr. Pelletier agreed. The City had expectations of what it planned to receive from those contracts, and had a responsibility to monitor contracts to ensure it received what it paid for.

Council Member Schmid noted a transition from measuring pieces of paper to determining the quality of contract fulfillment.

Mr. Pelletier hoped service contracts contained specific requirements for levels of service and ensured those services were actually provided.

Council Member Schmid noted in the Audit Report the number of times information had to be obtained from Office Max, because SAP software did not retain the records. He inquired whether SAP was providing accurate coding.

Mr. Pelletier explained that Staff was coding items incorrectly in the SAP system. It was not an issue with the SAP software.

Council Member Schmid believed the goal of SAP software was to coordinate definitions across departments. He asked why Staff had to obtain information from Office Max.

Mr. Pelletier stated City Staff had not maintained a copy of the contract.

Council Member Schmid inquired if Staff had obtained data from Office Max in addition to the contract.

Mr. Pelletier explained Staff would request records from a vendor to compare with City records as part of the audit process.

Council Member Schmid noted statements in the Audit Report indicating the City did not have data and the reliance on Office Max information.

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Mr. Pelletier felt those statements referred to the City not having a copy of the contract.

Mr. Boussina believed those statements concerned the contract initiation date.

Mr. Pelletier recalled instances of SAP not being able to provide needed reports.

Mr. Boussina indicated SAP could not generate a list of vendors coded as office supplies providers.

Council Member Schmid inquired if there were limitations to the data SAP could provide.

Mr. Perez stated the data depended on the configuration of the report. A report could be configured to generate almost any data.

Council Member Schmid was disappointed SAP could not provide the needed information.

Council Member Klein inquired whether other major contracts should be audited given the data obtained from auditing the Office Max contract.

Mr. Pelletier stated it was important to review contracts on a regular basis. Regardless of this Audit, he would feel the need to audit different contracts.

Council Member Klein asked if the Auditor's work plan included audits of other contracts.

Mr. Pelletier reported the work plan contained an audit related to construction practices. It had not been determined which specific contract would be reviewed. Rather than auditing a contract, he could review the processes for managing construction projects contracted to outside vendors. Future audit plans should include one or two important contracts each year.

Council Member Klein asked if the ASD Audit had been presented to the Finance Committee.

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Mr. Pelletier answered no. All audits except for utilities-related audits were presented to the Policy and Services Committee (Committee). Utilities-related audits were presented to the Finance Committee.

Council Member Klein suggested the Finance Committee should focus on whether the City had a sufficient number of Staff before beginning the budget process. If the purchasing section had an additional employee, the City could have saved \$500,000.

Mr. Perez believed an additional employee would pay for itself. The position could begin as a temporary trial. If the employee found savings of \$500,000, then it would be logical to have a permanent, benefited person.

Council Member Klein felt that would be a worthy discussion.

Mr. Perez stated hiring an additional person need not necessarily wait for the budget process, because he could work within the City Manager's authority for funding. The Council would not regret an expenditure for an additional Staff position.

Council Member Klein said there was a limit to the number of positions that could be reduced before performance suffered.

Mr. Perez agreed. The City Manager and he had been reviewing that issue, including the wear and tear on Staff, the capacity, and the level of risk. Further discussions were needed.

Council Member Klein noted incorrectly coded purchases would result in other categories being underreported, and inquired whether Staff knew what those other categories were.

Mr. Pelletier reported the analysis only considered purchases coded to office supplies. The incorrect coding led him to believe that other categories were not properly stated.

Council Member Klein was not persuaded by Mr. Perez's response that Palo Alto was different from other cities regarding spending per FTE. Mr. Perez's response implied that Utility Workers consumed more office supplies than General Fund employees.

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Mr. Perez said Palo Alto had multiple needs for different parts of the process. If miscoding were removed from the equation, Palo Alto's spending per FTE was not that far from Mountain View's spending per FTE.

Council Member Klein stated the amount of miscoding was unknown.

Mr. Perez suggested ASD needed further analysis. It was tempting for employees to code purchases to categories with sufficient funding due to lack of training. ASD stopped analyzing those issues when the number of Staff was reduced.

Council Member Klein noted 59 percent of office supplies were purchased from Office Max and the City Auditor's surprise that such a large percentage was purchased from other vendors.

Mr. Pelletier explained that the chart on Packet Page 89 included purchases incorrectly coded to office supplies. Inclusion of the incorrectly coded purchases made it difficult to analyze the numbers.

Council Member Klein asked why office supplies were purchased from vendors other than Office Max.

Mr. Pelletier reported the Audit found 3 percent or \$91,000 was spent for office supplies from other vendors.

Council Member Klein reiterated his question.

Mr. Perez indicated the new bid provided more control. Staff may have purchased office supplies from other vendors because of convenience or unique needs. That was difficult to control, but Staff would provide messaging.

Council Member Klein felt it was a training problem.

Council Member Schmid referenced the first full sentence at the top of page 94 regarding the City's financial records and systems not providing the necessary detail and functionality. That implied that the basic system had a problem.

Mr. Boussina stated that was a reasonable interpretation. He had no difficulty determining purchases coded as office supplies when purchase

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orders were utilized. However, there was no visibility when P-Cards were used for purchases.

Mr. Pelletier believed the root cause was the bank's lack of detail for transactions. Under the new JPMorgan Chase system, those details would be available.

Mr. Perez indicated the problem was the prior vendor, rather than the SAP system. Staff was now scanning receipts and submitting a detailed receipt in electronic format.

Mike Ramseck, Office Max Representative welcomed the opportunity to participate in the Audit. It afforded the ability to provide the City with third-party validation of the accuracy of processes. Office Max worked with the City to provide significant amounts of information pertinent to the contract. Office Max reviewed the draft Audit Findings in August 2012, and provided additional information that he believed addressed all concerns. Office Max was disappointed that the final report appeared to conclude there were additional issues to address. Office Max intended to work directly with the City and would continue to share all relevant information. They were confident the process would deliver a resolution acceptable to both parties. Regarding overcharges, Office Max provided the requested price lists, which were validated and updated by a letter of certification from Oakland County. Oakland County accepted all price changes over the audit period; therefore, the price changes were passed on to the City of Palo Alto. Office Max was concerned that it was not asked to participate in the competitive bid process for future purchases. He requested documentation of the bid process to determine why Office Max was not included.

Chair Holman inquired about the process to be used to determine additional staffing.

Mr. Perez explained audit recommendations required more control, and more control required more time across the organization. Training had to be implemented; however, there was not an appropriate training plan for the organization. Procedures, processes, and checks and balances required a great deal of intervention and Staff time. Staff eliminated controls and accepted risk, because of the lack of resources. Additional efficiencies would not outweigh the requirements of the recommendations. Two concerns were retaining employees on a temporary basis and the tremendous amount of turnover in City Staff. Time and resources were needed to implement processes and training.

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Chair Holman referenced ASD's response to warehousing office supplies, and suggested it could have been more qualitative.

Mr. Perez explained Staff could not provide a better response prior to the report being published. Currently, the vendor delivered orders to a central point, and then Staff distributed individual orders to each department. ASD reviewed the issue three to five years ago, and determined vendor delivery to departments was not cost effective. They would review it again.

Chair Holman suggested fewer employees having P-Cards could decrease the number of miscoded transactions.

Mr. Perez was willing to take the risk. Issuing P-Cards created more efficiencies and more opportunity for risk. In the alternative, increased use of P-Cards would provide higher rebates. If abuse occurred, then P-Cards would be withdrawn.

Chair Holman inquired whether systems were in place for Staff to suggest improvements and efficiencies such that problems identified in the Audit could have been identified and halted earlier.

Mr. Perez indicated Staff could not implement suggestions quickly enough. Speed teams worked with ASD Staff to make changes in the procurement process. Those changes could include decentralization of some procurement and reconsideration of authority and accountability for specific individuals.

Mr. Ramberg said the Audit offered good recommendations. The prior audit of the P-Card system prompted Staff to replace the Cal Card system. In doing so, Staff eliminated a manual process that had been in place for quite some time. The new P-Card system delivered statements electronically, and Staff uploaded paper receipts to the vendor's system. Staff searched for opportunities to utilize new tools and to revise processes.

Chair Holman did not wish to convey the impression that the only goals were speed and efficiency. The product and employees were important as well.

MOTION: Council Member Schmid moved, seconded by Council Member Espinosa to recommend the City Council accept the Contract Oversight Audit.

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Chair Holman hoped savings from audits would reinforce efficiencies and support audit activities.

Mr. Pelletier recognized that audits demanded Staff time and resources, and thanked ASD Staff for their cooperation and efforts.

Mr. Perez stated ASD Staff would address audit recommendations as quickly as possible.

MOTION PASSED: 4-0