City and County of San Francisco

Office of the Controller – City Services Auditor

OFFICE OF CONTRACT ADMINISTRATION:

Technology Store Vendors Do Not Always Abide by Contract Percentage Markup Limits, Resulting in Overcharges for Goods Purchased

October 20, 2014

OFFICE OF THE CONTROLLER
CITY SERVICES AUDITOR

The City Services Auditor Division (CSA) was created in the Office of the Controller through an amendment to the Charter of the City and County of San Francisco (City) that was approved by voters in November 2003. Charter Appendix F grants CSA broad authority to:

- Report on the level and effectiveness of San Francisco's public services and benchmark the City to other public agencies and jurisdictions.
- Conduct financial and performance audits of city departments, contractors, and functions to assess efficiency and effectiveness of processes and services.
- Operate a whistleblower hotline and website and investigate reports of waste, fraud, and abuse of city resources.
- Ensure the financial integrity and improve the overall performance and efficiency of city government.

CSA may conduct financial audits, attestation engagements, and performance audits. Financial audits address the financial integrity of both city departments and contractors and provide reasonable assurance about whether financial statements are presented fairly in all material aspects in conformity with generally accepted accounting principles. Attestation engagements examine, review, or perform procedures on a broad range of subjects such as internal controls; compliance with requirements of specified laws, regulations, rules, contracts, or grants; and the reliability of performance measures. Performance audits focus primarily on assessment of city services and processes, providing recommendations to improve department operations.

CSA conducts audits in accordance with the Government Auditing Standards published by the U.S. Government Accountability Office. These standards require:

- Independence of audit staff and the audit organization.
- Objectivity of the auditors performing the work.
- Competent staff, including continuing professional education.
- Quality control procedures to provide reasonable assurance of compliance with the auditing standards.

For questions regarding the report, please contact Director of City Audits Tonia Lediju at Tonia.Lediju@sfgov.org or 415-554-5393, or CSA at 415-554-7469.

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City and County of San Francisco

Office of the Controller – City Services Auditor

Office of Contract Administration: Technology Store Vendors Do Not Always Abide by Contract Percentage Markup Limits, Resulting in Overcharges for Goods Purchased

October 20, 2014

Purpose of the Audit

The audit evaluated the adequacy of the administration and monitoring controls of the City and County of San Francisco (City) for the Technology Store contracts (excluding micro-local business enterprise contracts), determined whether vendors comply with their contracts' general provisions, and assessed whether vendors accurately charged selected departments for goods and services purchased and whether the City properly paid the charges.

Highlights

Technology Store vendors did not always abide by contract percentage markup limits, which caused the City to overpay $26,883 in a sample of $1.8 million payments from fiscal year 2011-12 for commodity invoice line items with markups, a markup error rate of 1.46 percent. Projected over the life of the contract, this leads to overcharges estimated to be between $639,741 and $959,611. The overbillings the audit identified were often not detected by the department due to lax monitoring procedures and contract weaknesses. Specifically, the audit found:

- Vendors often include shipping and taxes in the cost basis upon which markups are applied, rather than to the manufacturer's price, contrary to contract requirements.
- Service categories and hourly rates on invoices and purchase orders are often inconsistent with the contracted categories. As a result 56 percent of services tested were broadly categorized as consulting, for which the City pays the highest rates, up to $225 per hour.
- If Technology Store contracts had applied the same markup percentage limits to discounted goods purchased that were applied to all other goods, the City could have avoided an estimated $23,459 based on a sample of $1.1 million of payments made for discounted goods.
- Neither vendors nor OCA maintain the historical manufacturers' prices of discounted goods, which prevent a trail to verify correctness.
- OCA inconsistently reviews prices and does always pursue corrective action on all errors identified.

Recommendations

The report includes 20 recommendations on contract compliance and how the City can improve contract administration and monitoring. Specifically, OCA and the City's chief information officer (CIO) should:

- Recover any overpayments remitted as a result of excessive markups and review invoices submitted before and after fiscal year 2011-12 to determine whether vendors incorrectly billed for markups on certain goods and recover any amounts incorrectly paid.
- Require that vendors abide by contract pricing provisions regarding price-setting within markup limitations.
- Require vendors to include support of their actual costs and/or the manufacturer's list price on invoices submitted to the City.
- Require vendors to detail the manufacturer's list price or the price paid internally.
- Ensure that in its next Technology Store contracts, it clearly states that services invoiced to the City must align with a service category listed in the contract and that invoices must show the hours incurred and rate(s) charged.
- Improve contract language and enforce policies surrounding purchase order approvals and pricing review practices.

Copies of the full report may be obtained at:
Office of the Controller ● City Hall, Room 316 ● 1 Dr. Carlton B. Goodlett Place ● San Francisco, CA 94102 ● 415.554.7500
or on the Internet at http://www.sfgov.org/controller

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CITY AND COUNTY OF SAN FRANCISCO
OFFICE OF THE CONTROLLER

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October 20, 2014

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Dear Ms. Kelly, Ms. Fong, Mr. Gamiño, and Mr. Kelly:

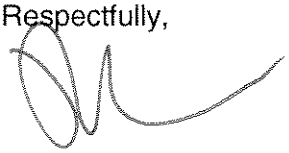
The Office of the Controller's City Services Auditor Division (CSA) presents its audit report of the Technology Store of the City and County of San Francisco (City). The audit objectives were to evaluate controls over the administration and monitoring of Technology Store contracts (excluding micro-local business enterprise contracts), determine whether vendors comply with contract general provisions, and assess whether vendors accurately charge selected departments for goods and services purchased and whether the City properly paid the charges.

The audit concluded that excessive markups may have caused the City to overpay Technology Store vendors between $639,741 and $959,611 in fiscal years 2008-09 through 2011-12. For the three audited departments, net overpayments were estimated to be between $246,327 and $369,490 in fiscal years 2008-09 through 2011-12. A sample that included $1.8 million of payments for commodities with markups showed that the three departments overpaid $26,883 in fiscal year 2011-12, which indicates a markup error rate of 1.46 percent. The overbillings identified were often not detected due to lax monitoring procedures and contract weaknesses. Also, the fact that these contracts do not limit the profits vendors can receive on discounted goods or subcontractor services may not provide the most financial benefit to the City.

The report includes 20 recommendations on Technology Store vendors' contract compliance and how the Office of Contract Administration (OCA) and the City's chief information officer (CIO) can improve their contract administration and monitoring. The responses to the report of the CIO, OCA, Office of the City Administrator and San Francisco Public Utilities Commission are attached as appendices. CSA will work with OCA and the CIO to follow up on the status of the recommendations made in this report.

CSA appreciates the assistance and cooperation of the staffs of the General Services Agency, including the Department of Technology and OCA, and the San Francisco Public Utilities Commission during the audit. For questions about the report, please contact me at Tonia.Lediju@sfgov.org or 415-554-5393 or CSA at 415-554-7469.

Respectfully,



Tonia Lediju
Director of City Audits

cc: Board of Supervisors
Budget Analyst
Citizens Audit Review Board
City Attorney
Civil Grand Jury
Mayor
Public Library

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GLOSSARY OF TERMS

Administrative Code	Administrative Code of the City and County of San Francisco
CIO	chief information officer of the City and County of San Francisco
City	City and County of San Francisco
ComputerLand	CCT Technologies, Inc., dba ComputerLand of Silicon Valley
Cornerstone	Cornerstone Technology Partners, JV
CSA	City Services Auditor Division of the Office of the Controller
DT	General Services Agency - Department of Technology, City and County of San Francisco
En Pointe	En Pointe Technology Sales, Inc.
eWaste	Electronic Waste Recycling
GSA-Admin	General Services Agency - Administrative Services, City and County of San Francisco
HP	Hewlett-Packard
IT	information technology
LBE	Local Business Enterprise (as defined in the Administrative Code)
OCA	Office of Contract Administration, City and County of San Francisco
PO	purchase order
SFPUC	San Francisco Public Utilities Commission
Xtech	Xtech, JV

INTRODUCTION

Audit Authority

This audit was conducted under the authority of the Charter of the City and County of San Francisco (City), which requires that the Office of the Controller's City Services Auditor Division (CSA) conduct periodic, comprehensive financial and performance audits of city departments, services, and activities.

Background

The City spent $57.2 million on purchases through the Technology Store in fiscal year 2011-12.

The City established the Technology Store, formerly known as the Computer Store, in 1998 to serve as the City's method for procuring information technology (IT) commodities and services using a citywide, multiple-award, term contract. The Technology Store is intended to provide a more effective process for city departments to procure technology-related goods and services and offer discounted rates from Technology Store vendors on certain items purchased. In fiscal years 2008-09 through 2011-12 city departments made $172.8 million in IT purchases through Technology Store vendors. In fiscal year 2011-12 city departments spent $57.2 million.[1]

OCA is responsible for managing the Technology Store.

The Technology Store is administered by the Office of Contract Administration (OCA) and is one way for city departments to acquire technology-related goods and services from prequalified vendors without undergoing a separate, independent, competitive process. OCA selected the participating Technology Store vendors through a competitive request for proposal process. At the direction of the mayor in January 2009, the City's chief information officer (CIO) began reviewing and approving all IT-related purchase requests, regardless of the amount, before submittal to OCA for further review and processing.

The San Francisco Administrative Code requires departments to pay an administrative fee of up to 1.9 percent of the total purchase price of commodities and/or services purchased through the Technology Store. The fee revenue is used to pay for the costs of administering the Technology Store contracts for the benefit of city departments. In fiscal year 2011-12 departments

[1] Payments include all purchasing categories made through the Technology Store. The $172.8 million includes $344,735 for Category 3 payments and the $57.2 million includes $17,892 for Category 3 payments.

purchased $57.2 million of goods and services through the Technology Store, yielding an estimated maximum of $1.1 million in administrative fees paid to OCA in the fiscal year.

Steps in the IT purchasing process.

When departments determine a need for IT products or services, they contact a Technology Store vendor of their choice to request a quote. OCA requires that departments seek at least three quotes for orders of more than $100,000. For orders less than $100,000, OCA encourages departments to request quotes from more than one Technology Store vendor, but does not require it.

The Technology Store vendor completes a quote and sends it to the department for review. After an appropriate department representative has signed and dated the quote, the purchase requisition is entered into the City's purchasing system. The signed quote, along with supporting documentation, is submitted to the CIO for review and approval. Once the quote is approved, the CIO will forward all documentation to OCA for secondary review and approval and subsequent processing of the related purchase order.

The Technology Store has three purchasing categories.

The Technology Store has established the following three vendor purchasing categories:

- Category 1 – Services and Products:
  These vendors largely focus on professional and project-related services, which are provided directly or by subcontractors. The vendors may also provide products.

- Category 2 – Products Only:
  These vendors may provide products only.

- Category 3 – Micro Local Business Enterprise (LBE) Set-Aside Program:
  These small businesses were awarded as-needed contracts of less than $100,000 to provide specific products and maintenance services.

The Technology Store uses seven as-needed Category 1 and 2 contracts with four vendors.

On April 8, 2008, OCA issued a request for proposal to prequalify vendors for the City's Technology Store. On December 9, 2008, after the competitive request for proposal process, the Board of Supervisors approved the award of four Category 1 contracts and three Category 2 contracts, with a total not-to-exceed amount of $120 million for all seven contracts awarded.

The following four Category 1 vendors were each awarded a contract with a not-to-exceed amount of $12 million:

- CCT Technologies, Inc., dba ComputerLand of Silicon Valley (ComputerLand)
- Cornerstone Technology Partners, JV (Cornerstone)
- En Pointe Technology Sales, Inc. (En Pointe)
- Xtech, JV (Xtech)

The following three Category 2 vendors were each awarded a contract with a not-to-exceed amount of $24 million:

- ComputerLand
- En Pointe
- Xtech

The contracts were approved for an initial term of three years, calendar years 2009 through 2011, with options to extend the terms by two additional years, or through 2013. All seven contracts were amended to exercise both of the one-year options to extend the contracts through December 2013. Two Category 1 contracts were amended to increase their not-to-exceed amounts, and all three Category 2 contracts were amended to increase their not-to-exceed amounts. The total original not-to-exceed amount of $120 million for all seven contracts has increased by $205.9 million to the current total of $325.9 million.

Exhibits 1 and 2 summarize the contract amendments to increase the not-to-exceed amounts for both Category 1 and 2 vendors.

EXHIBIT 1 Contract Amendments for Category 1 Technology Store Vendors

Agreement	Cornerstone		Xtech	
	Not-to-Exceed Amount	Increase	Not-to-Exceed Amount	Increase
Original	$12,000,000	-	$12,000,000	-
First	N/A[a]	-	12,475,000	$475,000
Second	N/A[a]	-	40,000,000	27,525,000
Third	12,490,000	$490,000	N/A[a]	-
Fourth	22,820,000	10,330,000	60,000,000	20,000,000
Fifth	N/A[b]	N/A[b]	60,490,000	490,000
Sixth	N/A[b]	N/A[b]	N/A[a]	-
Seventh	N/A[b]	N/A[b]	90,580,000	30,090,000
Total		**$10,820,000**		**$78,580,000**

Notes:
[a] N/A with this notation indicates that the vendor had an amendment but the not-to-exceed amount did not change.
[b] N/A with this notation indicates that the vendor did not have an amendment.

Source: Original contract and amendments for Cornerstone and Xtech.

EXHIBIT 2 Contract Amendments for Category 2 Technology Store Vendors

Agreement	ComputerLand		En Pointe		Xtech	
	Not-to-Exceed Amount	Increase	Not-to-Exceed Amount	Increase	Not-to-Exceed Amount	Increase
Original	$24,000,000	-	$24,000,000	-	$24,000,000	-
First	N/A[a]	-	28,000,000	$4,000,000	41,000,000	$17,000,000
Second	24,490,000	$490,000	28,475,000	475,000	N/A[a]	N/A[a]
Third	34,460,000	9,970,000	38,000,000	9,525,000	51,000,000	10,000,000
Fourth	34,950,000	490,000	38,490,000	490,000	51,490,000	490,000
Fifth	43,850,000	8,900,000	54,150,000	15,660,000	67,890,000	16,400,000
Sixth	N/A[b]	N/A[b]	54,640,000	490,000	68,380,000	490,000
Seventh	N/A[b]	N/A[b]	64,810,000	10,170,000	79,830,000	11,450,000
Total		$19,850,000		$40,810,000		$55,830,000

Notes:
[a] The vendor had an amendment but the not-to-exceed amount did not change.
[b] The vendor did not have an amendment.

Source: Original contract and amendments for En Pointe, ComputerLand, and Xtech.

Calculation of charges for commodities and services.

Each contract states:

- The City is to receive a percentage discount off manufacturer's list price for certain IBM, Hewlett-Packard (HP)/Compaq, Dell, and Cisco products.
- If these manufacturers change their pricing structure

during the term of the contract such that it becomes impossible to use the discount off of the list price pricing structure, the City and the Technology Store vendors may negotiate a mutually acceptable alternative.

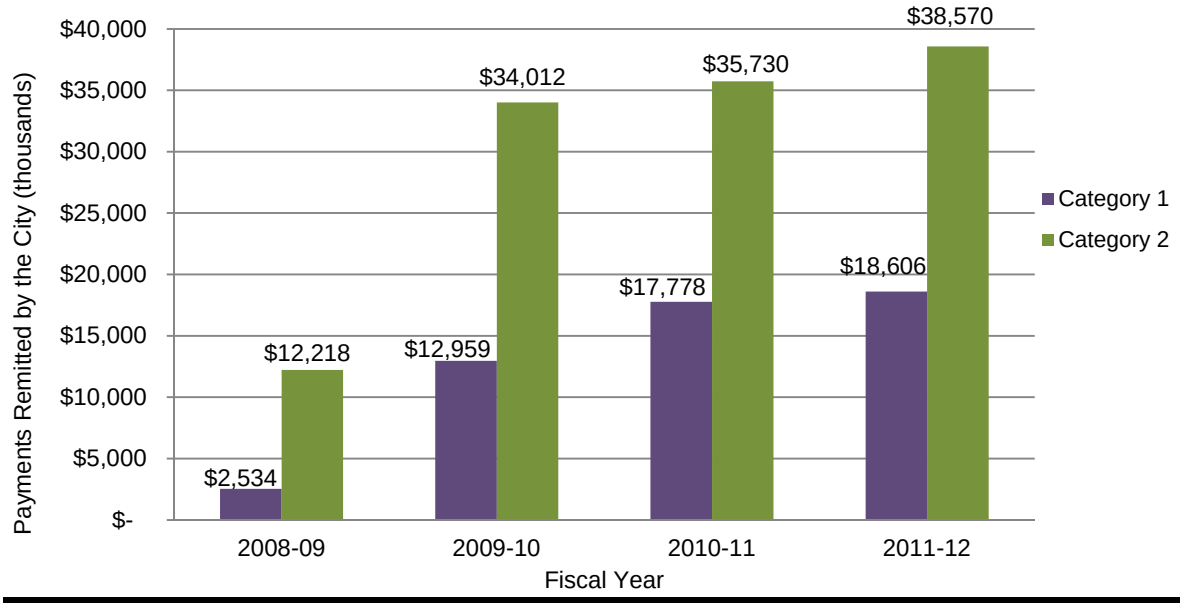
- Prices charged by Technology Store vendors for all other product lines cannot exceed the percentage markups specified by the contracts on all other manufacturers' prices.

- The hourly rates that can be charged by the vendors or the subcontractors for certain job titles and technical services provided.

At the end of fiscal year 2011-12 the City had paid $172.4 million (53 percent) of the current total not-to-exceed amount of $325.9 million for all seven Category 1 and 2 contracts.

Exhibit 3 shows payments made to Category 1 and 2 Technology Store vendors in fiscal years 2008-09 through 2011-12.

EXHIBIT 3 **Payments Remitted to Category 1 and 2 Technology Store Vendors in Fiscal Years 2008-09 Through 2011-12**



Source: Auditor analysis based on data in City's accounting system.

General Services Agency-Administrative Services, General Services Agency-Department of Technology, and San Francisco Public Utilities Commission accounted for 42 percent of payments made to Category 1 and 2 vendors in fiscal year 2011-12.

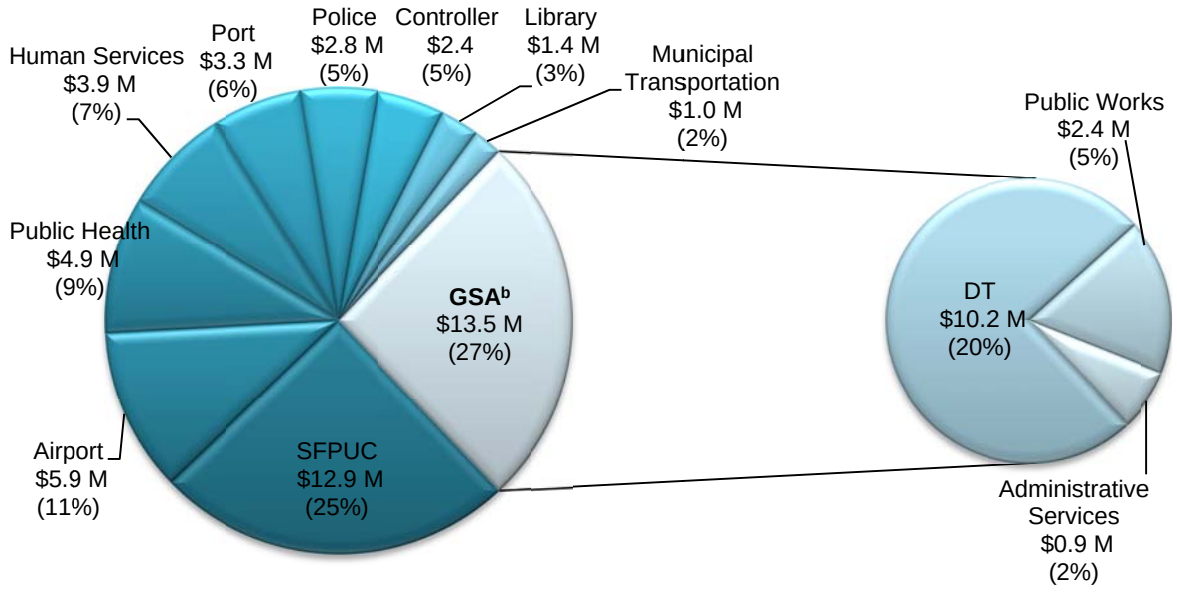
The top ten highest-spending departments represented $52.0 million (91 percent) of the $57.2 million spent under Category 1 and 2 in fiscal year 2011-12. Of these ten departments, the audit focused on payments remitted to Category 1 and 2 Technology Store vendors by the:

- General Services Agency - Administrative Services (GSA-Admin)
- General Services Agency - Department of Technology (DT)
- San Francisco Public Utilities Commission (SFPUC)

Together, these three departments accounted for $24.0 million (42 percent) of total payments remitted by the City to Category 1 and 2 vendors in fiscal year 2011-12.

Exhibit 4 details the amounts paid to Category 1 and 2 Technology Store vendors by the top ten spending departments in fiscal year 2011-12.

EXHIBIT 4 **Top Ten Spending Departments Under Category 1 and 2 Technology Store Contracts[a] Fiscal Year 2011-12**



Notes:
[a] Amounts shown in millions.
[b] General Services is composed of Administrative Services, Technology, and Public Works.

Source: Original contract and amendments for Cornerstone and Xtech.

Objectives

The objectives of the audit were to:

1. Evaluate the adequacy of the City's monitoring procedures and internal controls over the administration of the Category 1 and 2 Technology Store contracts.
2. Determine whether Category 1 and 2 Technology Store vendors comply with the general provisions of their contracts.
3. Assess whether Category 1 and 2 Technology Store vendors accurately charge selected departments for goods and services purchased and whether the amounts were properly paid by the City.

Scope and Methodology

The audit period was July 1, 2011, through June 30, 2012. To conduct the audit, CSA:

- Reviewed and gained an understanding of the Category 1 and 2 contract terms and conditions.
- Interviewed key departmental staff to understand and evaluate the internal controls over the procurement process and contract monitoring procedures.
- Interviewed management of Technology Store vendors to understand the invoice and billing processes.
- Extracted payment information from the City's purchasing system to identify random samples for testing.
- Using a random sample of 106 payments totaling $5,785,203, traced payment data for 272 invoice line items to invoices submitted to the City, obtained evidence of vendors' actual costs for products and services, compared the rates applied to the contracts' calculation of charges rate schedules, and recalculated amounts billed.

Statement of Auditing Standards

This performance audit was conducted in accordance with generally accepted government auditing standards. These standards require planning and performing the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. CSA believes that the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objectives.

CHAPTER 1 – Technology Store Vendors Do Not Always Bill the City in Accordance With Contract Requirements

Summary

Contrary to contract requirements, vendors apply markups to their procurement costs, which include shipping and taxes, rather than to the manufacturer's price. As a result, vendors did not always abide by their contracts' percentage markup limits, which caused the City to overpay for goods purchased through the Technology Store. These deficiencies resulted in net overpayments of $26,883 in a sample of 152 invoice line items tested for markups totaling $1.8 million. The overpayments represent 1.46 percent of the total amount billed for commodities with markups.

Total overpayments by DT, GSA-Admin, and SFPUC are estimated to be as high as $133,558 in fiscal year 2011-12 and up to $369,490 for the term of the Technology Store Category 1 and Category 2 contracts. Furthermore, service categories and hourly rates shown on invoices and purchase orders are often inconsistent with those stipulated by the contracts. Last, one vendor incorrectly billed the City for certain items purchased, resulting in $190 in overpayments made.

Finding 1.1

Technology Store vendors did not always abide by the markup percentage limits set by contracts for certain commodities, causing the City to overpay.

Although their contracts require Technology Store vendors to bill for certain commodities based on the manufacturer's price plus a percentage markup up to a specified amount, all four vendors applied percentage markups based on their actual costs and billed for and received percentage markups that exceeded the amounts permitted by the contracts. This practice, although not permissible by the contracts, is considered acceptable by OCA and has resulted in the City overpaying all four vendors amounts estimated to be in the hundreds of thousands of dollars per year.

Vendors often apply markups to their cost to procure the goods rather than to the manufacturer's price, contrary to contract requirements.

In most instances, while the price charged to the City by Technology Store vendors exceeded the amounts that they were charged, there is no way to determine whether the vendors' prices included a markup or not without first knowing what the manufacturer's price was at the time the purchase order for the item was approved. As further discussed in Chapter 2, neither the purchasing department, OCA, nor the Technology Store vendors could provide evidence to support the product manufacturer's price that was applicable at the time the quote for the product was approved. Because the impact of the vendors' misapplication of markups could not be quantified using the manufacturer's price, the audit used the unit price paid by vendors to evaluate whether or not markup percentages received exceed the amount permitted by the contracts.

Contracts require that vendors provide the City with discounts on certain goods purchased and allow vendors to charge the City a percentage markup on all other goods purchased.

The Technology Store contracts provide that vendors can receive a markup percentage on the manufacturer's price for all goods purchased, up to an amount specified by the contracts, with the exception of certain products manufactured by Cisco, Dell, HP/Compaq, or IBM. The contracts require that the City purchase these specific products at discounted prices. (Discounted goods are further discussed in Chapter 2.)

For the nondiscounted goods tested, Technology Store vendors typically do not apply markups based on the manufacturer's price as required by the contract, but on the cost incurred to procure the goods, which sometimes includes taxes and shipping and handling costs. For example, one vendor applied and was paid for a 19 percent markup and a 9 percent markup on two monitors purchased from Amazon.com and a 41 percent markup on two mounting accessories purchased from another retailer for which shipping was charged. However, the contract limits the maximum markup percentage that the vendor can receive to 8 percent on monitors and 10 percent on accessories and requires that all items be delivered to the City free of charge.

Using the unit price paid by the vendor, in this example the City overpaid $129 in markups and $12 in associated taxes on a $2,179 invoice, or 6.5 percent of the invoice total. The same or similar issues exist with all four of the Technology Store vendors audited.

Although the contracts prohibit vendors from charging for shipping and handling, this prohibition is sometimes ignored.

According to OCA, in general, Technology Store vendors may add a markup percentage to the cost they paid to acquire nondiscounted goods. This normally includes any freight charges less any applicable discounts provided. However, the Technology Store contracts require that markups be applied to the manufacturer's price and do not consider costs imposed by distributors or retailers or additional costs such as those for shipping and handling. Furthermore, the contracts explicitly stipulate that vendors must deliver, free of charge, all products sold through the Technology Store.

The percentage markup applied by Technology Store vendors is a function of their cost and the total purchase order (PO) amount. As a result vendors charged the City a wide range of markup percentages, both negative and positive, ranging from as low as negative 38 percent to as high as 54 percent. In a random sample of invoice payments that included 152 invoice line items that qualified for markups:

- 30 percent of invoice line items had markups that exceeded the maximum allowable percentage markups required by the contracts.
- 57 percent had markups that were below the maximum allowable percentage markups.

Based on the vendor's actual cost (excluding taxes and shipping), the City overpaid $26,883 in markups.

To evaluate the markup received on nondiscounted goods, the audit compared a sample of invoices paid to suppliers by Technology Store vendors to the amounts invoiced to the City, which totaled $5.8 million. Of this amount, $1.8 million (31 percent) was for 152 invoice line items for which a markup was permitted. Based on the vendor's actual cost (excluding taxes and shipping), the City overpaid a net amount of $26,883 in markups on 42 invoice line items for which a markup was permitted, resulting in a 1.46 percent error rate based on the net dollar value of markups below and above contract maximums.

One vendor paid $45,240 to purchase software and the accompanying maintenance support and charged the City $69,600, resulting in a 54 percent markup received on the transaction. According to OCA, the invoiced amount was incorrectly billed and paid by the purchasing department using a Technology Store PO that OCA had

approved only for the purchase of consulting services. Although OCA contends that the payment and the associated markup received by the vendor should be excluded from the audit's sample, the amount paid was ultimately applied against a PO under the Technology Store term contract.

Exhibit 5 summarizes the calculation of overpayments identified in invoice payments for commodities with markups.

EXHIBIT 5 Calculation of Overpayments Identified in Sample Tested

A	Total fiscal year 2011-12 invoice payments tested[a]	$5,785,203
B	Invoice payments for commodities with markups in total sample tested	$1,841,515
C = B÷A	Percentage of total invoice payments that include invoice payments for commodities with markups[b]	**31.83%**
D	Net overpayments[c] identified in invoice payments for commodities with markups tested	$26,883
E = D÷B	Ratio of net overpayments identified to invoice payments for commodities with markups[b]	**1.46%**

Notes:
[a] The sample tested includes payments remitted by DT, GSA-Admin, and SFPUC.
[b] Rounded to the nearest hundredth of a percentage point.
[c] Net overpayments are the difference between invoice payments with markups above and below contract maximums.

Source: Auditor's analysis based on data in City's purchasing system.

Overbillings due to excessive markups may have caused DT, GSA-Admin, and SFPUC to overpay as much as $369,490 during the contracts' terms.

A statistical evaluation of the sample's results indicates that, on a cost basis, estimated overpayments by DT, GSA-Admin, and SFPUC throughout the terms of the Technology Store Category 1 and Category 2 contracts totaled $243,323 to $369,490. If the 1.46 percent error rate extends to payments by all city departments, overpayments during the terms of the Technology Store Category 1 and Category 2 contracts were an estimated $639,741 to $959,611. For fiscal year 2011-12 alone, net overbilling payments by DT, GSA-Admin, and SFPUC were an estimated $89,039 to $133,558 and potentially $212,222 to $318,333 by all city departments.

Using the calculations in Exhibit 5, Exhibit 6 shows the extrapolated potential overpayments made by selected departments and by all city departments from fiscal year

2008-09 through fiscal year 2011-12 and in fiscal year 2011-12 alone.

EXHIBIT 6 Extrapolation of Errors Found in Sample of Commodities With Markups Tested

	Description	Fiscal Year 2008-09 to 2011-12		Fiscal Year 2011-12	
		All City Departments	DT, GSA-Admin, and SFPUC	All City Departments	DT, GSA-Admin, and SFPUC
A	Total payments remitted	$172,410,359	$66,385,128	$57,193,831	$23,995,962
B	Percentage of total invoice payments that include invoice payments for commodities with markups*	31.83%	31.83%	31.83%	31.83%
C=A× B	Potential invoice payments remitted for commodities with markups	**$54,880,733**	**$21,131,355**	**$18,205,631**	**$7,638,265**
D	Ratio of net overpayments identified in invoice payments for commodities with markups*	1.46%	1.46%	1.46%	1.46%
E=C×D	Extrapolated impact of overpayments	**$799,676**	**$307,908**	**$265,277**	**$111,298**
F	Margin of error	20%	20%	20%	20%
G=E-(E×F)	Low range of extrapolated overpayments	**$639,741**	**$246,327**	**$212,222**	**$89,039**
H=E+(E×F)	High range of extrapolated overpayments	**$959,611**	**$369,490**	**$318,333**	**$133,558**

Note: *31.83% and 1.46% calculated in Exhibit 5. Rounded to the nearest hundredth of a percentage point.

Source: Auditor's analysis based on data in City's purchasing system.

DT, GSA-Admin, and SFPUC make a large portion of all city payments to Category 1 and 2 vendors.

Total payments by DT, GSA-Admin, and SFPUC to Technology Store Category 1 and 2 vendors in fiscal year 2011-12 were $24.0 million, or 42 percent of the $57.2 million in payments by all city departments. Throughout the terms of the contracts through June 2012, total payments by these three departments amounted to $66.4 million, or 38.5 percent of the $172.4 million in payments by all departments.

Markups above contract maximums violate contract terms and represent money owed to the City by the vendor.

Markup percentages billed by vendors that are below contract maximums are allowed under the contracts and do not represent money owed to the vendor by the City. In contrast, markup percentages that are above contract maximums violate contract terms and do represent money owed to the City by the vendor. This is because vendors are not required to charge the maximum markups. Vendors may elect to reduce the markup percentage they charge or even apply a negative markup to make their pricing more competitive. Of the 152 invoice line items tested for commodities with markups, 107 (70 percent) had markups that were equal to or below contract maximums, of which 4 invoice line items had negative percentage markups applied.

Contracts do not require that vendors receive the maximum markup allowed, but they often receive markups in excess of the maximums, causing the City to overpay.

According to OCA, the PO amount is the amount that the City is contracted to pay and cannot be exceeded even if the product's price increases or the vendor incurs additional overhead costs in procuring the goods. Establishing a maximum amount the City will pay for a good gives vendors an incentive to procure goods at the lowest possible price to increase profits. The wider the spread between PO amount and vendor's acquisition cost, the bigger the profit. The markup that a vendor can receive when it buys goods for less than the PO amount often results in a vendor receiving markup percentages exceeding the contract maximum.

Also, according to OCA, Technology Store vendors may require lower or higher markups on products depending on the expenses they incur when procuring goods on behalf of the City. However, the contracts only specify the maximum markup percentage that vendors can receive on certain items purchased. Furthermore, contract limits on markups are by item, irrespective of whether an invoice includes markups on items that are both under and over the contract maximums.

OCA must consider whether some Technology Store contracts should be changed to reflect acceptable practices.

It is important to create reasonable contract requirements that establish feasible expectations for vendors. Although the CIO reviews and approves all Technology Store purchase requests before OCA's review, the CIO's responsibility is solely to identify opportunities for standardization and consolidation that could yield savings for the City. In contrast, OCA is ultimately responsible for establishing and administering

Technology Store contracts. Consequently, OCA must assess the appropriateness of contract terms and consider whether some may need modification to reflect current billing practices that are deemed acceptable by the department although they are inconsistent with the contract.

Recommendations

The Office of Contract Administration should:

1. Ensure that Technology Store vendors abide by pricing provisions in future contracts and apply markup percentages based on the manufacturers' prices or declare that compliance with this requirement is infeasible. If the Office of Contract Administration finds this requirement to be infeasible, in the next Technology Store contracts it should revise Appendix B to support the current practice.

2. Ensure that Technology Store vendors abide by the markup percentage limits set by the contracts for the sale of certain commodities.

3. Seek reimbursement from Technology Store vendors for any overbillings related to markups applied on certain commodities that exceeded contract maximums.

4. Review invoices submitted before and after fiscal year 2011-12 to determine whether Technology Store vendors incorrectly billed for markups on certain commodities and recover any amounts found to be incorrectly paid.

5. Ensure that, before approving purchase orders, purchase order amounts comply with the terms of the contract.

6. Ensure that, when a percentage markup is applicable, Technology Store contracts require that invoices submitted to the City clearly state the manufacturer's price and/or vendor's cost basis and the percentage markup for each item purchased and include evidence to support all prices included on the invoice. (As stated in the contracts, evidence may include an actual manufacturer's price list; a

letter provided on the manufacturer's letterhead containing a contact name, signature, and telephone number for the manufacturer's representative; or actual invoices from the manufacturers or distributors.)

7. Ensure that its next Technology Store contracts require Technology Store vendors, when a percentage markup is applicable, to include evidence supporting the manufacturer's price and/or vendor's proposed cost at the time the bid is submitted to the City for review and approval.

8. Ensure that manufacturers' prices and/or vendors' proposed costs are supported and that correct percentage markups are indicated on the bid documentation before approving procurement requests.

Finding 1.2

Service categories and hourly rates on invoices and purchase orders are often inconsistent with the categories and rates in Technology Store contracts.

The service categories and hourly rates shown on Technology Store POs and invoices sometimes disagree with the allowable service categories and rates in the contract and, in some instances, do not align with the services detailed on subcontractors' invoices. Of a sample of 103 services totaling $2,833,099, 65 services (63 percent) described services different from the service category stated on the PO or did not clearly align with one of the contract categories and its associated rates. The City paid a total of $1,991,930 for these services.

56 percent of audited services were categorized as consulting, which comes with high hourly rates.

POs, which are approved and processed by OCA, and vendor invoices broadly categorized the majority of services as some form of consulting. Technical consulting is the only service category listed in the contracts that refers to consulting. The technical consulting service category has some of the highest hourly rates allowed by the contracts, up to $225 per hour. Although each contract lists 32 service categories, each with corresponding hourly rates, many of these categories were not used to categorize the sample of services tested. Of the 103 services audited, 58 (56

percent) included services that were categorized as consulting. The City paid $537,280 for these consulting services.

By categorizing most services as consulting, OCA allows vendors to bill the City more than if the services were in other, lower-paid categories.

For example, the supporting documentation for one invoice showed that a Technology Store vendor's joint venture partner charged the vendor $80 for an hour of technical consulting services and that a subcontractor charged $125 per hour for 39 hours of various services such as design documentation, development environment build services, on-site and remote initial requirements development, and training. However, in accordance with the associated PO, the Technology Store vendor invoiced the City for 40 hours of technical consulting services at an hourly rate of $200. Further, the contract under which this invoice was submitted specifies hourly rates based on service category type. Among these service categories, all but technical consulting have contractual rates lower than the rate charged by the vendor. This lack of consistency with the contract service categories makes it difficult for a reviewer to determine whether the rates charges comply with contract terms.

The number of hours invoiced—regardless of the number actually worked—is often dictated by the purchase order amount.

For the City to be able to determine whether amounts charged by vendors are in accordance with the contract's hourly rates, invoices should show the number of hours incurred and the rate(s) applied to each, given the nature of the service provided. However, some invoices from Technology Store vendors include hours that are simply a function of the total amount approved to be spent and the hourly rates stated on the PO. For example, to be in compliance with the original PO amount for $60,000 of technical consulting services, a Technology Store vendor billed the City $10,000 for 0.16667 hour at a rate of $60,000 per hour, which is clearly not based on real work time or rates. This occurred although the subcontractor had billed the vendor $10,000[2] for 80 hours of application development consulting at an hourly rate of $125.

[2] Also, a 10 percent ($1,000) government discount provided by the subcontractor was not passed on by the Technology Store vendor to the City.

Services are often billed as a lump-sum; many invoices omit the number of hours incurred.

Technology Store vendors often submit service invoices that do not include the number of hours provided or the associated hourly rate charged. For example, a Technology Store vendor billed the City $3,280 for two city employees to take four online courses, each course at a cost of $820. (The number of hours of each course was not indicated). However, the contract states that end-user trainings should be billed at a rate of $80 per hour.

In another example, a Technology Store vendor billed the City a lump sum of $55,260 for services provided and did not indicate the number of hours incurred. While the associated PO summarizes the engagement's final deliverables, the scope of services to be provided and the project's total cost, it does not state the payment structure associated with each deliverable or specify the hourly rates to be charged. Without invoices specifying the number of hours charged, the City cannot be sure that the appropriate hourly rate was charged in accordance with contract terms.

Lack of itemization of charges reduces the City's ability to determine if invoiced items comply with contract terms.

Technology Store contracts do not require that services detailed on invoices submitted to the City align with a service category listed in the contract and do not require invoices to be itemized to show the number of hours incurred and the hourly rate applied based on the service type. Without this level of detail, the City cannot be sure that the items and amounts invoiced comply with contract terms. At a minimum, to ensure that the amounts billed for services are correct and comply with contract terms, services invoiced should align with a service category listed in the contract and invoices submitted should detail the number of hours incurred and the rate applied.

OCA considers the cost of software and hardware support and training to be a cost of the commodity purchased instead of a separate cost, causing lump-sum billing that is not in accordance with contract provisions.

Many of the services that Technology Store vendors billed for in a lump-sum amount, rather than hourly as required by the contract, were training and hardware and software support, such as maintenance, installation, and development. According to an OCA manager, although not specifically stated in the contracts, hardware and software support and training are considered to be costs of the related commodity purchased and are allowed to be billed as a commodity in a lump sum, with either a discount or a markup applied by the vendor.

According to the Technology Store vendors, invoices for hardware and software support services and trainings are billed as lump sums because the corresponding POs were approved by the City as lump sums. Also, vendor management explained that subcontractors typically bill a flat rate for trainings based on the number of students in attendance or by whether a half day or full day of training is required. Although subcontractors billed Technology Store vendors for trainings with lump-sum amounts and the amounts for services agreed to their corresponding POs, this billing practice is not in accordance with contract provisions.

If OCA considers such costs to be commodities, then the percentage markup that vendors can receive is limited by the contracts. However, vendors received markups on trainings and hardware and software support services that exceeded the highest markup allowed by the contracts for any one type of commodity. The markup received for such services was as high as 22 percent although the applicable contract limits commodity markups to no more than 10.5 percent.

Recommendations

The Office of Contract Administration should:

9. Ensure that its next Technology Store contracts require that services invoiced to the City must align with a service category listed in the contract and that invoices submitted to the City clearly state the hours incurred and rate charged and that evidence to support any services provided by subcontractors are included with the invoice. (As stated in the contracts, such evidence may include actual invoices from subcontractors to the Technology Store vendor.)

10. Ensure that its next Technology Store contracts clearly state that training and hardware and software maintenance services may be charged in lump-sum amounts and state how these services should be reimbursed.

Finding 1.3 — One Technology Store vendor overbilled for certain items purchased and owes the City $190.

One Technology Store vendor did not make the discounted pricing it received available to the City.

In two instances, one vendor did not pass on any or all special pricing received on the items purchased. Contracts require Technology Store vendors to provide the City the same pricing that the vendors receive from participating in any government, education, or other special pricing programs.

On one invoice examined, the vendor received two discounts from a subcontractor for the purchase of software and software support. Although a discount of $12,000 for early purchasing was passed on to the City, a partner discount of $24,460 (35 percent) was not. Ultimately, the vendor paid $45,240 for the purchase and charged the City $69,600, resulting in a 54 percent markup received on the transaction. The invoice submitted to the City did not indicate that any special pricing was received by the vendor, although the contracts do not specifically identify partner discounts as allowable discounts. The contract limits the maximum markup on the item to 9 percent of the manufacturer's list price. However, as discussed in Finding 1.1, because the impact of the vendors' misapplication of markups could not be quantified using the manufacturer's price, the audit used the vendor's cost basis and found that a markup of only $4,072 should have been received on the purchase, resulting in an overpayment made by the City of $20,288.[3]

On another invoice, a subcontractor provided $10,000 of consulting services and provided the vendor a 10 percent government discount. However, the vendor did not make the discounted pricing available to the City and charged the City for the full $10,000. Although the vendor did not comply with the clause requiring vendors to pass on any special pricing received to the City, the audit determined that, in this instance, the hourly rate ultimately charged to the City for 80 hours of technical consulting did comply with the contract.

[3] The $20,288 was erroneously received by the vendor as a markup. As such, the amount was included in the audit's markup test discussed in Finding 1.1 and in the amount recommended to be recovered by the City in Recommendation 3. Thus, this amount does not figure into the recommendations for Finding 1.3.

One Technology Store vendor incorrectly charged sales tax on installation services, causing the City to overpay $190.

One Technology Store vendor combined the cost of a battery and its installation cost into one amount and incorrectly applied sales tax to the total amount rather than to the cost of the commodity only. This resulted in the City overpaying $190 in sales tax. According to the vendor's management, the total amount upon which tax was applied was billed based on the lump sum approved on the PO, which did not separately itemize the battery and installation costs. However, California sales tax generally does not apply to charges for installation labor and, as a result, sales tax should have been charged only on the battery cost.

Billing errors were not identified by the purchasing departments or OCA because Technology Store vendors are not required to reflect any special pricing received on invoices submitted to the City and are only required to provide verification of their cost upon the City's request. The billing errors identified by the audit could have been detected by purchasing departments if Technology Store vendors had to provide evidence to verify the amounts they bill to the City.

Recommendations

The Office of Contract Administration should:

11. Ensure that its next Technology Store contracts require Technology Store vendors to a) include evidence supporting their actual costs with the invoice submitted to the City and b) submit invoices that explicitly state when the vendors have taken advantage of special pricing from subcontractors or suppliers to them.

12. Seek reimbursement from one Technology Store vendor for $190 of overbillings as a result of one billing error.

CHAPTER 2 – OCA Needs to Improve the City's Technology Store Contracts

Summary

Although the Technology Store is structured to encourage competitive pricing, vendor contracts have significant weaknesses that may have impeded purchasing departments' ability to properly review invoices and OCA's ability to effectively administer and monitor the contracts.

On September 27, 2013, OCA issued a request for proposal for the procurement of technology products, consulting services, maintenance services, and training services. The multiple contracts that result from the request for proposal will be collectively known as the San Francisco Technology Marketplace, which will replace the City's existing Technology Store contracts. Findings noted in Chapter 2 do not address vendor compliance; rather they address shortcomings identified in the current Technology Store contracts and include recommendations to improve future technology contracts.

Finding 2.1

The City does not know whether it receives the correct discounts because neither Technology Store vendors nor OCA can provide evidence that required discounts were received.

The correct discounts applied to a sample of $1.1 million of goods purchased could not be determined because the manufacturers' list prices could not be substantiated.

Neither Technology Store vendors nor OCA could provide evidence that the City received the discounts required by the contracts on certain goods purchased. Without relevant documentation to support the manufacturers' list prices and the discounts applied, the audit could not verify the accuracy and appropriateness of amounts invoiced for certain items purchased. The audit's random sample included payments totaling $1,110,589 for 73 invoice line items whose manufacturers' list prices could not be verified. Discounts required by the contracts on these items ranged from 2 percent to 39 percent.

Each Technology Store contract includes a schedule that details the percentage discount off of the manufacturer's list price for certain items and quantities purchased from specific manufacturers. Departments can use these schedules to verify that prices charged to the City include the appropriate discounts. However, as discussed in Finding 1.2, invoices submitted by vendors are not required to be itemized to show the manufacturer's list price and the associated discount percentage applied, making it difficult for a reviewer to determine whether amounts were invoiced in accordance with contract requirements.

Other City contracts clearly require that contractor invoices display the list price and the percentage discounted for each item purchased. Requiring this information on invoices allows purchasing departments to ensure that they receive the discount required by the contract.

Incorrect discounts result in incorrect sales tax amounts.

The Technology Store contracts require that vendors provide evidence of the manufacturer's list price within seven days of request from the City. However, neither Technology Store vendors nor OCA could obtain evidence to support the prices charged. It is difficult to obtain historical pricing because major IT manufacturers such as Cisco, HP/Compaq, Dell, and IBM have numerous commodities with continuously fluctuating list prices. Without support for the manufacturers' list price, it is impossible for the audit to verify whether the correct discount was received. Furthermore, because the discounted price is the amount to which sales tax is applied, any underpayment or overpayment related to discounts has a corresponding effect on the associated tax.

The lack of documentation causes the City not to know if it receives the discounts required by the contracts.

The contracts require Technology Store vendors to abide by percentage discounts set by the City for the sale of certain commodities. Vendors found to charge a discount percentage lower than those in the contract must reimburse the City for the excess charges. According to the primary Technology Store users at SFPUC and GSA, department staff traces invoiced amounts back to the related PO, which is required to be reviewed and approved by both the CIO and OCA, and manufacturer's list prices are not obtained to verify whether appropriate

discounts were received on amounts invoiced to the City. Because of the difficulty in obtaining historical published list prices and the fact that contracts do not require vendors to provide evidence of the manufacturer's published list prices to support the amounts invoiced, neither OCA nor the purchasing departments can be sure that the correct discounts were received in accordance with contract provisions.

Recommendations

The Office of Contract Administration should:

13. Ensure that, when a percentage discount is applicable, Technology Store contracts require that invoices submitted to the City clearly state the manufacturer's list price and the percentage discounted for each item purchased and include evidence to support all manufacturer's list prices included on the invoice. (As stated in the contracts, evidence may include an actual manufacturer's price list; a letter provided on the manufacturer's letterhead containing a contact name, signature, and telephone number for the manufacturer's representative; or actual invoices from the manufacturers or distributors.)

14. Ensure that its next Technology Store contracts require Technology Store vendors, when a percentage discount is applicable, to include evidence supporting the manufacturer's list price at the time the bid is submitted to the City for review and approval.

15. Ensure that manufacturers' list prices are supported and that correct discounts off of manufacturers' list prices are indicated on the bid documentation before approving procurement requests.

Finding 2.2

Contracts inadequately define some key requirements and do not capture departments' purchasing needs, costing the City money.

Some terms in the current Category 1 and 2 contracts are inconsistent, missing, or are unclear, which may impede the transparency of the billing process, contract

compliance, and the City's ability to ensure that it receives the appropriate prices and discounts for its technology purchases. The audit identified several contract deficiencies and grouped them into three categories:

1. Inconsistent contract terms
2. Unclear contract terms
3. Terms not addressed in the contract

In one instance, the City paid 303 percent more than a Technology Store vendor paid to procure the same goods.

1. Contracts cap markups on some purchases, but not on others, which costs the City money.

Technology Store contracts establish markup limitations for some purchases and not others. The Technology Store contracts provide that vendors can receive a markup percentage on the manufacturer's price for all goods purchased, up to an amount specified by the contracts, with the exception of certain products manufactured by Cisco, Dell, HP/Compaq, or IBM. The contracts require that the City purchase these specific products at discounted prices. Although the contracts cap the amount of markups vendors can receive on certain commodities, they do not address the profit that vendors can make on discounted goods and services provided by subcontractors. In one instance, the City paid 303 percent more than a Technology Store vendor paid to procure certain discounted goods.

In the audit's random sample, discounted goods totaled $1.1 million. Had the contracts applied the same markup percentage limits to discounted goods, DT, GSA-Admin, and SFPUC hypothetically could have saved $23,459 on the goods in the sample and, overall, possibly between $215,353 and $323,030 over the course of all the Technology Store contracts.

Extending this extrapolation to payments remitted by all city departments to Technology Store Category 1 and Category 2 contracts, hypothetical savings during the terms of the contracts were an estimated $559,299 to $838,949. For fiscal year 2011-12 alone, potential the savings by DT, GSA-Admin, and SFPUC is estimated to be between $77,843 and $116,764 and for all city departments, between $185,537 and $278,305. Exhibit 7 demonstrates the hypothetical savings for discounted

commodities using equipment categories and associated markup percentages from the markups population.

EXHIBIT 7 Hypothetical Savings for Discounted Commodities

Vendor	Invoice Payments for Discounted Commodities	Hypothetical Savings
ComputerLand	$16,981	$29
Cornerstone	48,969	5,779
En Pointe	148,218	937
Xtech	896,422	16,714
Total	**$1,110,590**	**$23,459**
Extrapolated Impact on Payments by DT, GSA-ADM, and SFPUC		$323,030[4]
Extrapolated Impact on Payments by All City Departments		$838,949[5]

Note: *Extrapolated impact is based on payments made throughout the terms of the contracts.

Source: Auditor's analysis

Contracts do not cap percentage markups on discounted goods or subcontractor services.

Technology Store vendors rely heavily on subcontractors to fulfill certain services required by the City. Appendix A of the contracts state that "Contractors will abide by percentage discounts bid for commodities or the mark-up percentage limits set by the City for sale of commodities *and* subcontractor services [emphasis added]." However, the calculations of charges in Appendix B of the contracts do not specify limits on the markup percentages that vendors can charge when subcontractors are used.

The audit compared payments made by the City to Technology Store vendors for subcontracted services and found that, on average, the City paid between 4 and 12 more percent more than what the Technology Store vendors had paid.

[4] Of a random sample totaling $5,785,203, the sample size for commodities with discounts amounted to $1,110,590, or 19.2 percent of the total sample. By applying markup percentages based on comparable equipment categories to the discount sample size, total amounts paid related to markups that exceeded contract maximums totaled $23,459. The ratio of these payments to the sample size of commodities with discounted goods tested is 2.11 percent. Applying the 2.11 percent to the total payments remitted by DT, GSA-ADM, and SFPUC for fiscal years 2008-09 through 2011-12 yields estimated payments of $215,353 to $323,030 that could have been saved. For fiscal year 2011-12 alone, potential savings could be $77,843 to $116,764.

[5] The 2.11 percent was applied to total payments by all city departments for fiscal years 2008-09 through 2011-12 to Category 1 and 2 Technology Store vendors and, using a 95 percent confidence level, resulted in estimated potential savings of $559,299 to $838,949 for the entire terms of the contracts and $185,537 to $278,305 in savings for fiscal year 2011-12.

CSA recognizes that a fair percentage markup would normally be added to the work of subcontractors. For example, in a city construction contract (unrelated to the Technology Store) that involves both a primary vendor and subcontractors, a clause limits the vendor to a 5 percent markup on work performed by a subcontractor. It may or may not be ideal to apply the same percentage limitation for technology-related purchases. However, for purposes of illustration, had Technology Store contracts limited the subcontracted services markup to 5 percent, the City could have saved an estimated $24,705 on the $2.0 million spent for such services.

Limiting profits that vendors can receive on all items purchased through the Technology Store may provide substantial savings to the City.

In most cases, Technology Store vendors act as brokers between the City and manufacturers, distributors, retailers, or subcontractors. In this arrangement vendors typically purchase goods or services at a lower cost than the price at which they sell them to the City. This difference, although not explicitly provided for by the contracts, results in markup or profit received by the Technology Store vendors on discounted goods purchased. Limiting the profits that vendors can receive on all goods and services that they do not directly provide may provide substantial savings to the City.

2. Unclear contract terms cost the City money.

Unclear contract terms enable Technology Store vendors to categorize certain purchases based on where the higher markup is.

Although the contracts list “accessories” and “other” as separate categories, each with different maximum markups, the contracts do not state what types of commodities belong in each category. This lack of clarity enables Technology Store vendors to categorize certain items based on where the higher markup is. For example, when items such as flash drives are purchased, it is unclear whether they should be classified as accessories or as “other.” (In some cases the contract allows for a higher markup on items categorized as accessories.)

Category 1 contracts include two rate tables for services: one that details the hourly rates for technical services and another that details the hourly rates for job titles. However, the contracts do not explain how and when the different tables should be used. As discussed in Chapter 1, many of the 32 service categories listed in the contracts were not used in the audit’s random sample,

and the majority of billed services were categorized as consulting, which permits a high hourly rate. Not defining how services should be categorized—based on the job titles and technical service categories detailed in the contracts—allows vendors to categorize services based on the highest associated labor rates.

3. Additional terms not addressed in the contracts cost the City money.

Electronic Waste Recycling Fees: The Technology Store contracts do not address the treatment of electronic waste recycling (eWaste) fees paid on certain equipment or the cost of travel expenses paid for certain subcontractor consulting services. Such expenses were invoiced by vendors and paid by the City. The eWaste fee is imposed on the purchase of certain covered electronic devices, such as video displays. California retailers that sell or lease the covered electronic devices are required to register with the state Board of Equalization and remit the eWaste fees collected from the buyers. Although OCA's fiscal year 2013-14 annual reminder memorandum reminds purchasing departments to, when ordering a monitor, add a line item to the requisition for recycling charges, such charges are not recognized by the Technology Store contracts as an allowable expense.

Travel and Business Expenses: In three instances in the audit's random sample, the City reimbursed one Technology Store vendor for $2,935 of travel expenses and another for $2,103 of business expenses, all of which were incurred by subcontractors. In most cases, the corresponding POs specified such costs although travel and business expenses are not explicitly recognized as allowable expenses under the contracts.

Contract terms should be clear, consistent, and concise to adequately convey the City's intent, allow effective monitoring of contract compliance, and ensure that the City receives correct prices and discounts for technology purchases.

Recommendations

The Office of Contract Administration should:

16. Ensure that in its next Technology Store contracts, it considers revising the markup percentage that vendors can receive on all commodities and subcontracted services, including those provided through a joint venture partnership.

17. Ensure that its next Technology Store contracts address the treatment of electronic recycling fees.

18. Ensure that its next Technology Store contracts address the treatment of travel and business expenses.

CHAPTER 3 – Oversight and Monitoring of the Technology Store Need Critical Improvement

Summary

Many of the vulnerabilities identified in this report occurred because OCA management did not fully develop, enforce, or formalize contract monitoring policies and procedures. Specifically, inadequate monitoring controls and procedures have caused OCA not to detect or not to follow up on overcharges and other instances of contract noncompliance.

Similar to Chapter 2, findings noted in Chapter 3 do not address vendor compliance. Rather, the chapter addresses shortcomings related to oversight of the current Technology Store and includes recommendations to improve future monitoring efforts.

Finding 3

OCA does not adequately monitor Technology Store vendors' compliance with contract terms or properly administer the contracts, causing the City to overpay for goods and services.

OCA performs a limited review of vendor pricing practices.

OCA is charged with management of the Technology Store and is responsible for issuing purchase orders after reviewing requisitions for completeness and compliance with contract terms. However, the audit identified several deficiencies in OCA's Technology Store pricing review practices and grouped them into four categories:

1. Pricing reviews are not consistently performed.

2. Purchase order approvals and pricing reviews lack adequate documentation to support the conclusions reached.

3. Pricing errors are not always detected through OCA's review and, when identified, corrective action is not always taken.

4. Many reviews often occur months after POs were approved by OCA and paid by the City.

1. Pricing reviews are not consistently performed.

According to OCA's written Technology Store Pricing Review Practices, requisitions are chosen at random for quotes prepared by vendors and the following three types of price reviews may be performed:

- *Percentage discounts off manufacturer's list price for Dell, HP/Compaq, Cisco, and IBM products.* OCA's goal is to attempt to review one requisition per week per vendor where applicable.

- *Hourly rates by job titles for professional services*. OCA's goal is to review each professional service requisition received.

- *Percentage markups on other manufacturers' prices*. OCA performs this review as resources permit.

OCA has not met its goal to review percentage discounts for one requisition per week for each vendor.

According to OCA, in September 2009 the department began maintaining a log of the PO numbers reviewed for percentage discounts and, due to a change in staffing assignments, the log was not maintained from April 2011 to October 2012. Although it is OCA's goal to review percentage discounts for one requisition per week for each vendor where applicable, the log indicates that only 49 POs were reviewed for all vendors during the 78-week period from the log's inception through March 2011.

Each contract includes two rate tables, one for job titles and another for technical services. However, OCA's written Technology Store Pricing Review Practices only include procedures to review hourly rates by job title. Although documented review practices state that OCA aims to review each professional service requisition received, OCA's pricing review documentation indicates that only two price reviews were conducted for professional services and that a review of percentage markups was last performed in May 2011.

2. OCA's purchase order approvals and pricing reviews lack adequate documentation to support the conclusions reached.

Documentation of OCA's pricing review is weak and in some cases does not provide the level of detail to support the conclusions reached. According to OCA, staff goes to the manufacturer's Web site to view list prices, applies the percent discount off manufacturer's list price based on the contract, and compares it to the price offered by the vendor. However, the documentation provided by OCA did not show that these steps had been performed as described. For example, OCA's documentation of its review of percentage discounts off the manufacturer's list price did not state or include support for the manufacturer's list price and did not show calculations to verify whether the correct percentage discount was applied.

Technology Store POs typically include various types of equipment, each with specific discounts required. To determine whether the total requisition complies with the contract's pricing requirements, the manufacturer's list price must be verified and the associated discount must be recalculated for each of the manufacturer's product types requested. However, OCA's review documentation only states whether or not the total purchase amount requested complied and does not detail the list price and discount calculation for each item included. Without this level of detail, it is difficult if not impossible to determine how OCA concluded whether compliance was met.

The City's *Payment Process Guidelines,* issued by the Office of the Controller as Departmental Guideline No. 008-11, require that invoices are reviewed for completeness and accuracy and that the invoice and supporting documents are filed systematically for later audits. Similarly, retaining sufficient documentation of the pricing review executed by OCA staff helps demonstrate whether the findings and conclusions reached were supported by sufficient and appropriate evidence. Without proper documentation, the City cannot be assured that OCA's pricing reviews occur and are effective. Moreover, the lack of documentation may have contributed to overpayments remitted by the City for IT purchases.

No written criteria exist for whether to approve, delay, or reject procurement requests.

All Technology Store department-approved purchase requests must be reviewed and approved by the CIO before being reviewed by OCA. According to an August 10, 2009, memorandum, *Information Technology Procurement Process – New Document Type*, sent by the former CIO to department accounting and procurement staff, the CIO or a designee will review all requests to identify any efficiencies and economies that could otherwise be achieved and to ensure that any established technology policies and standards have been met. However, there are no written criteria for what the review encompasses or how the CIO determines whether to approve, delay, or reject procurement requests. As a result, it is unclear why POs that do not comply with contract terms are approved by the CIO.

After the procurement request has been approved, the CIO will forward all supporting documentation to OCA for review, approval, and processing. According to OCA's Purchasing Procedures Manual, the quote and requisition are reviewed by OCA to ensure the following:

- That the quote has not expired.
- That the administrative fee for Technology Store orders, which is 1.9 percent of the pretax amount of the quotation, is recorded by the requesting department in the specifications of the last line item of the requisition.
- For requests of $100,000 or more, that the department attempted to secure competitive quotes.
- For professional services, that the statement of work includes the project summary that total hourly labor rates and/or fixed costs equal the total cost of the project, that deliverables tie to project milestones, and that test acceptance and knowledge transfer language is included where applicable.
- That the quote number and all of the purchasing or project specifications/deliverables, manufacturer part numbers, and pricing or hourly labor rates and/or fixed costs from the Technology Store quote are included in the requisition and that the correct vendor is selected.

Although OCA's Purchasing Procedures Manual includes measures to ensure that quotes and requisitions include certain information, the manual does not include steps to verify whether items requested and rates quoted comply with contract provisions before a PO is processed. Not ensuring that requisitions comply with contract terms before they are processed into a PO can result in the City paying for goods and services not permitted by the contract or overpaying Technology Store vendors.

3. OCA's reviews do not always detect pricing errors and, when errors are identified, corrective action is not always taken.

While the contracts limit the percentage markup that can be received on each product type purchased, OCA often conducts markup reviews based on the net markup received on the entire invoice. Furthermore, OCA's pricing reviews clearly identified instances where corrective action was not taken when the percentage markup received on certain products exceeded the amounts allowable per the contract.

OCA's markup review does not take into account markups on individual items that exceed contract maximums.

One invoice reviewed by OCA showed that staff calculated the percentage markups for three of the four items invoiced but did not identify whether the percentages exceed contract maximums, although all three did. Also, OCA's review of this invoice did not include all products included on the invoice. OCA calculated that an 8 percent markup was received on the total invoice. However, the calculation excluded two product lines and erroneously included shipping charges and taxes in the vendor's cost basis. Had the markups received been limited to maximums permitted by the contract, the City would have saved $1,872 in markups paid to the vendor. Conducting markup reviews at the total invoice level only assesses the net markup received on the total invoice and does not take into account markups on individual items that exceed contract maximums.

Similarly, another invoice reviewed by OCA indicated that the vendor had received markups that exceed contract maximums on every product included in the invoice. Although the highest markup that could be received on

any item was 10 percent, OCA's documentation showed that the vendor received markups ranging from 21 to 525 percent. When questioned about these markups, OCA staff could not recall whether or not corrective measures were taken.

According to Military Standard *MIL-STD-2155(AS) Failure Reporting, Analysis and Corrective Action System*:

> The earlier a failure cause is identified and positive corrective action implemented, the sooner both the producer and user realize the benefits of reduced failure occurrences…early implementation of corrective action also has the advantage of providing visibility of the adequacy of the corrective action in the event more effort is required.

The purpose of corrective controls is to collect information, analyze information, identify and investigate purchasing problems, and take appropriate and effective corrective and/or preventive action to prevent the recurrence of errors. Verifying or validating corrective actions, communicating corrective action activities to responsible parties, providing relevant information for management review, and documenting these activities are essential in dealing effectively with purchasing problems, preventing their recurrence, and preventing or minimizing errors.

4. OCA's pricing reviews often occur months after POs were approved by OCA and paid by the City.

According to OCA, it does not have the staff or resources to be able to verify that every Technology Store purchase requisition it receives complies with the pricing terms stipulated by its associated contract. As a result, the department instituted a hindsight spot-checking practice to help detect pricing errors. However, this review often takes place months after the PO date. Because OCA's review occurs after payment has been remitted and because the department does not have corrective controls to investigate issues identified, errors can go uncorrected and similar errors may not be prevented from occurring in the future.

Recommendations

19. The Office of Contract Administration should develop, implement, and enforce written policies and procedures surrounding its Technology Store pricing review practices. Such policies and procedures should include:

    - Criteria for evaluating Technology Store vendors' pricing practices for items purchased.
    - Instructions for sufficiently documenting performance of its pricing reviews.
    - Corrective action steps to take when pricing errors are identified.
    - The timing and frequency with which Technology Store pricing reviews are to be conducted.

20. The chief information officer and Office of Contract Administration should formally document their criteria for reviewing and approving Technology Store procurement requests, including how requests are determined to be approved, delayed, or rejected.

APPENDIX A: DEPARTMENTS' RESPONSES

OFFICE OF CONTRACT ADMINISTRATION:

City and County of San Francisco — **Office of Contract Administration**

Edwin M. Lee
Mayor

Jaci Fong
Director and Purchaser

Date: August 15, 2014

To: Ben Rosenfield, Controller

From: Jaci Fong, Purchaser and Director, Office of Contract Administration

CC: Naomi Kelly, City Administrator
Tonya Lediju

Subject: Technology Store Audit

Introduction

The Office of Contract Administration ("OCA") would like to thank the staff of the Controller's Office Audits team ("CSA") for their cooperation and patience in the review of a highly complex contract, comprised of a wide range of business terms and pricing models intended to accommodate the wide array of information technology projects throughout the City. OCA acknowledges the importance of CSA's mission and welcomes their recommendations to improve contracting functions and ensure vendor performance. OCA is always looking for ways to improve the contracting process. Where OCA has found the recommendations relevant and practical, changes are being implemented to make improvements. However, there are a few instances where OCA does not agree with CSA's premise or approach, and therefore only partially agrees with some of the recommendations presented. In other areas, such as the review of invoices and payments, where the responsibility resides with the City departments and the Controller, OCA is ready to assist.

As requested, OCA has responded to the individual recommendations in the table provided by CSA. In addition OCA would like to comment on the general text of the report. To mitigate the issues in 16 of the 20 CSA recommendations, OCA is making a change to the business and pricing model for the next technology contract from a plus or minus price structure, to a proactive competitive bid model where vendors will offer their best pricing transaction by transaction. CSA's other recommendations are responded to in the attachment.

Background

The first Computer Store contract was awarded in the late 1990's and administered by the Controller's Office. The City was in the early stages of implementing computing technology to automate City processes and broadly provide City employees greater productivity through access to basic computing tools. At the time, it was found that traditional purchasing methods and procedures were not effective for an industry experiencing rapid change in both products and pricing. Often, by the time bids were received, the products were obsolete, discontinued and no longer available, or technology had changed. The procurement process would have to be cancelled and then repeated (sometimes multiple times).

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The Store[1] was considered an innovative way of speeding the process to bring innovation, efficiency and technological advancements to the City, such that the benefits in increased efficiency to departments far out-weighed any incremental costs. The contract under review is the first new Store contract since the Computer Store contract was transferred to OCA.

OCA has worked to improve the business model in several areas. Previously, the Store utilized a cost plus model for all product purchases and did not require bidding at any level. Cost plus pricing is extremely cumbersome to substantiate due to lag times between the quoting, purchasing and billing of products. It is also difficult to evaluate due to the different channels of distribution in the industry and range of pricing available to Contractors through various distributors. In order to improve the store pricing model, OCA made two significant changes to the Store in the contract under review:

1. OCA required pricing commitments for four major product lines based on a discount off of the manufacture's list price. This was intended to afford OCA staff the ability to verify prices for approximately 60 to 70 percent of the products purchased from databases maintained by the manufacturers.

2. To further drive prices down through competition, OCA required departments to seek at least three bids for all transactions in excess of $100,000.

Major Issues

At the heart of our disagreement with CSA's findings, is CSA's interpretation of the pricing requirements in the contract. There were three pricing components in the Technology Store contracts.

1. **Discount off Manufacturer's List Price** As previously stated, OCA included a major change to the product pricing model: Contractors were required to offer a discount off of manufacturer's list prices for IBM, HP/Compaq, Cisco and Dell product lines. These four manufacturers maintain online price lists that are accessible to OCA staff as well as Contractors. These price lists change frequently, and are often 100's of pages long. The idea was to have an established benchmark for pricing that was provided by the manufacturers and therefore consistent across the board for the Contractors. At the inception of the new Technology Store contract it was estimated that the product purchases for these four product lines accounted for approximately sixty to seventy percent of all product purchases.

2. **Cost Plus Pricing** The practice from previous Store contracts was that pricing was based on invoiced prices/cost of goods sold plus the agreed upon mark-ups. This is also a standard practice in the industry. When the RFP was issued the intent was to continue to use the "mark-up" (cost plus) pricing model utilized for decades by the Computer Store for all other products (other than IBM, Cisco, HP/Compaq and Dell). Unfortunately, there was a clerical error in the language of

1 "Store" refers to the Computer Store contracts which was later renamed the Technology Store.

the RFP that did not properly articulate this intent. The intent of the resulting contract was clarified to proposers and reflected in the Technology Store Manual for departments. OCA's intent is further evidenced by Addendum No. 1, section 8.2.6 Pricing[2].

Additionally, the phrase "other manufacturers' prices" which was part of the flawed language included in the RFP is meaningless without qualifying which manufacturers' prices are being referred to (i.e. retail or wholesale which is not published). OCA would not have requested that Proposers suggest a mark-up percentage from list price. "Manufacturers' cost" is not public information. The assumption is that many of the products subject to this pricing structure are purchased from a distributor not a manufacturer. Based on the City's intent and past practices with previous Stores, the Contractors have been allowed to base their mark-ups on invoiced prices/cost of goods sold.

In this context, CSA took issue with mark-ups on items such as taxes paid and shipping charges to the Contractor's facility because these costs were not specifically called out. The contract does not allow for shipping charges. Past practice and industry standards have always interpreted this to mean shipping from the Contractor's facility to the City. Standard accounting definitions include shipping to the Contractor's facility in cost of goods sold. From a fairness viewpoint, for bulky items such as some monitors and printers, shipping cost might exceed the profit on the item.

Similarly, because it was not specified in the contract, CSA characterized California's eWaste fees as excess profit. OCA maintains that eWaste fees are comparable to a tax in California. The administrator, the State Board of Equalization, requires resellers to collect this fee from end-users. Again based on past practices and industry standard practices, OCA allowed Contractors to pass this fee through to the City.

In retrospect, we agree with CSA, that the resulting contract should have been more clear and precise regardless of past practices.

3. **Hourly Services Rates** The RFP required proposers to specify a flat hourly rate for services for the term of the contract regardless of whether or not they used a subcontractor. The concept of "mark-up" is irrelevant to the question of whether the vendor was in compliance with the contract as they were never asked to specify a "mark-up". From project to project, the mark-up may vary

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2 Table 3 of the RFP asked for "Percentage Markups on all other manufacturers' prices". Further, Section 5.2.2.2. reads:

"5.2.2.2. Other manufacturers: (up to 100 points)

Calculate the sales price for all other hardware and software products (excluding IBM, HP/Compaq, Dell and Cisco) by adding a "not to exceed" markup percentage to the manufacturer's cost. This section allows each Category 1 proposer to present its mark-up percentage for the six categories presented below…."

and on occasion, Technology Store Contractors have complained that they could not find a subcontractor to perform the work even at the highest hourly rate allowed under the contract. CSA suggests that there should be a "cap" on mark-ups and implies that Contractors are making more than they should, ignoring the cost to the Contractor who bears all risk and must warrant the work of the subcontractor.

CSA also observes that higher rate consulting services were used more than lower rate services. OCA does not think this is necessarily inappropriate given the overall complexity of projects. Since the inception of the Store, the City has employed more staff that can perform lower rate services and in turn, has not utilized Contractors for these tasks. Contracted projects have become increasingly more complex as the City endeavors to replace many legacy systems (i.e. the Water Billing System, Emerge, the Tax Collector's System). OCA does not have the technical expertise or insights into the actual work performed to determine if the higher rate was inappropriate. We defer to departments to make that determination prior to approving invoices based on actual work performed.

Resources for Monitoring

OCA does recognize the value of the CSA's recommendations and the end goal of providing a contract that is 100% auditable, however we find the recommendations to be costly (due to resources required) and impractical.

When OCA assumed responsibility for the Store and the subject contract, pricing spot checks were implemented for the first time.

1. In addition, to its general review of requisitions, OCA staff routinely checked hourly service rates against the contract, randomly checked that prices were consistent with the discounts off of manufacturer's list prices (per contract) on a purchase order basis.

2. OCA conducted a check of cost plus pricing on a random basis. We agree this should have been performed more often, but again it is very labor intensive and time consuming.

3. Finally OCA implemented a procedure requiring departments or OCA staff to seek at least three quotes for any transaction over $100,000. This encouraged additional competition. Previously, departments were required to provide only one quote. All transactions over $100,000 were processed through a competitive process thereby insuring low pricing.

These pricing reviews were never intended to take the place of audits, but rather, were intended to be a deterrent to overcharging. Therefore, we understand that they may not have been documented to CSA's satisfaction. OCA agrees with CSA, that OCA could have been more exhaustive in its review.

We disagree that OCA could or should have performed the 100 percent monitoring and verification process recommended by CSA. Based on the number of transactions performed through the Technology Store, the resources required to perform a 100 percent review and the delay in processing to comply, it would appear impractical as well as inconsistent with general auditing practices. The recommendations set forth by CSA, requiring the addition of manufacturer's list prices by line item on every invoice for discounted products, and the percentage mark-up and evidence of the Contractor's cost for each item with every invoice, would be burdensome to the Contractor and particularly costly to small business participation in the Store because of the added administration required. We maintain that CSA's recommendation for 100 percent review would appear so onerous and costly for both OCA and Contractors that OCA has abandoned the business model used for the Store for the past two decades and will institute competitive bidding on transactions among the new Store vendors to determine price. This new model will provide on-going competitive pricing and will be more in line with the duties of a buyer in contract activities.

Methodology

While CSA presents $26,883 or 1.46% in overcharges, OCA maintains CSA's assumptions and math are incorrect in some areas and this number should be reduced by $2,747 to $24,136. Finally, included in the sampling was an anomaly; an invoice and payment approved by the user department for software licensing and support. This transaction was not approved by OCA and would have more appropriately been processed as a direct payment voucher not against the Technology Store contract. The purchase order was approved by OCA for "Consulting Services". This order of software licensing and support was not approved by OCA either in the Store or outside of the Store, reducing the total payments remitted inside the store by $69,600 to $57,124,231 and overcharges should be reduced an additional $20,288 to $3,848 or.22%.

Other concerns:

1. CSA utilized a small sample size based on over 4900 purchase orders issued through the Store in FY11-12.
2. The overpayments were based on "payments for commodities with markups", "Total payments Remitted" for all Category 1 contracts should be reduced by the service component estimated at 60%.

OCA's Revised Exhibit 6: Extrapolation of Errors Found in Sample of Commodities with Markups Tested

EXHIBIT 6

Description	All City Departments	OCA Revised
Total payments Remitted **A** Less $69,600	$57,193,831	$57,124,231
A – Less Payments for Services Estimated at 60% of Cat 1 Payments -(953,915*.60)-(2,611,477*.60)-(1,813,866*.60)-(15,010,134*.60)		$44,890,596
Percentage of total invoice payments that include invoice payments for commodities with markups* **B**	31.83%	31%
Potential invoice payments remitted for commodities with markups **A x B = C**	**$18,205,631**	$13,916,084
Ratio of net overpayments identified in invoice payments for commodities with markups* **D**	1.46%	.22%
Extrapolated impact of overpayments **C x D = E**	**$265,277**	$30,615
Margin of error **F**	20%	20%
Low range of extrapolated overpayments **E – (E x F)**	**$212,222**	$24,492
High range of extrapolated overpayments **E + (E x F)**	**$318,333**	$36,738

Source: Auditor's analysis based on data in City's purchasing system.

Summary

OCA interprets the majority of issues of the audit are represented in the following areas:

	Issue	Recommendation Number	
1	Adherence to contract pricing requirements.	1,2,5,6,7,8,11,12,13, 14,15	We agree that vendors should adhere to contract pricing requirements, we do not always agree with CSA's interpretation of the contract pricing requirements.
2	Estimated overcharges based on findings.	3	We disagree with the methodology.
3	Clarity of contract terms.	1,2,3,10,17,18	We agree that the terms could have been more clear.
4	Availability of data and resources dedicated to monitoring.	7,8, 9,11,13	We agree that more could be done with more resources.
5	Using higher rate consulting services more often than lower rate services.		This statement is true. Unfortunately, OCA does not have the detailed scope of work, technical expertise or insights into the actual work performed to determine that the higher rate was actually inappropriate. We defer to departments to make that call prior to paying any invoice.
6	Controls on subcontracting mark-ups	16	We do not agree.

DEPARTMENT OF TECHNOLOGY:

City & County of San Francisco
Department of Technology
Powered by Innovation

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March 10, 2014

Ms. Tonia Lediju
Director of City Audits
City Hall, Room 476
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102

Dear Ms. Lediju:

Please see below the response to Item #23 of the Technology Store Audit Report Recommendation.

Recommendation	Responsible Agency	Response
23. The chief information officer and Office of Contract Administration should formally document their criteria for reviewing and approving Technology Store procurement requests, including how requests are determined to be approved, delayed, or rejected.	Chief information officer and Office of Contract Administration	Agreed. Criteria for Approval Delay or Rejection will be explicitly documented by the DT procurement group under Miguel Gamino. Further, the current process is not only too long, it is also too manual. CIO has instructed Miguel Gamino to map the procurement process as-is and will work a streamline process to-be. This process will be jointly discussed with OCA and we will activate a project to digitalize the process into a smart workflow.

Please see the following supplemental information in response to this item:

Purpose: CIO Review Process

- To provide a means for City Departments to obtain Department of Technology Management review of IT related acquisitions and purchases to:
    - Gather specific data and information on the City-wide technology procurement trends, demand analysis, and opportunity for standards and efficiencies.

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- Improve vendor and contract management by consolidating the City-wide relationship scope and reduction of waste, and identify high value priorities for contract negotiation leverage and buying power.
- Validate that policies and standards are followed, as they become established, and to notify City Departments of alternatives that may provide better technology and/or lower costs.

Reasons: CIO Rejection or Delay

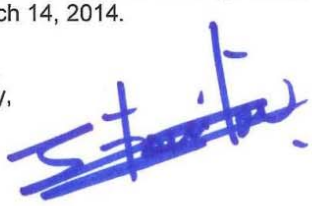
- Insufficient documentation.
- If CIO Review does not receive documentation within 20 days of ADPICS submission reaching 300 approval level.
- If CIO Review receives request but the item is not approved through to ADPICS Level 300, we may hold or send back to the department until the item reaches 300 approval level. DT cannot forward a requisition in ADPICS that is still at an approval level before 300 in the workflow.
- Technology standardization or alternative recommendation may be provided to the submitting department for consideration.
- If the functional use of the technology requested is not clear, CIO Review staff may require additional information or further discussion with the requesting department regarding technology use, justification or optimization opportunities.

Process Improvement & Implementation

A project is underway to fully document the current procurement process, including sub-processes and dependent processes, in DT. This includes the CIO Review process that exists as a component of the larger DT Procurement Approval Process.

- The "as-is" process workflow diagrams and documentation is expected to be completed by March 31, 2014.
- Immediately thereafter we will begin the work to designed an improved "to-be" process, to include the interaction between DT and OCA in the overall procurement lifecycle.
- Upon completion of the improved process design we will be work to implement electronic means of workflow including submission, document management, and review/approval.
- We will be sending a new CIO Review coversheet form along with a memo explaining many of the things described above to reset expectations with our client departments. That memo and form will go out to all department contacts by the end of this week, March 14, 2014.

Respectfully,



Marc Touitou
Chief Information Officer

OFFICE OF THE CITY ADMINISTRATOR:

OFFICE OF THE
CITY ADMINISTRATOR

Edwin M. Lee, Mayor
Naomi M. Kelly, City Administrator

September 22, 2014

Tonia Lediju, Audit Director
Office of the Controller, City Service Auditor
City Hall, Room 476
One Dr. Carlton B. Goodlett Place
San Francisco, CA 94102

Re: CSA Audit – "Office of Contract Administration: The City Significantly Overpays for Goods and Services Purchased Through the Technology Store"

Dear Ms. Lediju:

Thank you for the opportunity to review the recently completed Controller's Office audit report titled "Office of Contract Administration: The City Significantly Overpays for Goods and Services Purchased Through the Technology Store".

We have reviewed the report findings and recommendations related to the operations of the Technology Store, and my office will work with the Office of Contract Administration and the City's Chief Information Officer to implement the recommendations in the manner detailed in their respective responses.

Please contact me if you need additional information.

Sincerely,

Naomi M. Kelly
City Administrator

1 Dr. Carlton B. Goodlett Place, City Hall, Room 362, San Francisco, CA 94102
Telephone (415) 554-4852; Fax (415) 554-4849

SAN FRANCISCO PUBLIC UTILITIES COMMISSION:

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January 31, 2014

Tonia Lediju, Audit Director
Office of the Controller, City Services Auditor Division
City Hall, Room 476
One Dr. Carlton B. Goodlett Place
San Francisco, CA 94102

Subject: Office of Contract Administration: The City Significantly Overpays for Goods and Services Purchased Through the Technology Store

Dear Ms. Lediju,

Thank you for providing us the opportunity to review the audit report *'Office of Contract Administration: The City Significantly Overpays for Goods and Services Purchased Through the Technology Store'*, as prepared by the Controller's Office, City Services Auditor.

We appreciate your thorough review of Technology Store procurement practices and subsequent recommendations made to improve current processes in the areas of transparency, procedural compliance, and strengthening internal controls.

If you have any questions or need additional information, please do not hesitate to contact me at (415) 554-1600.

Sincerely,

Harlan L. Kelly, Jr.
General Manager

cc: Michael Carlin, Deputy General Manager
Todd L. Rydstrom, AGM Business Services & Chief Financial Officer
Nancy L. Hom, Director, Assurance & Internal Controls

Edwin M. Lee
Mayor
Vince Courtney
President
Ann Moller Caen
Vice President
Francesca Vietor
Commissioner
Anson Moran
Commissioner
Art Torres
Commissioner
Harlan L. Kelly, Jr.
General Manager

For each recommendation, the responsible agency should indicate whether it concurs, does not concur, or partially concurs. If it concurs with the recommendation, it should indicate the expected implementation date and implementation plan. If the responsible agency does not concur or partially concurs, it should provide an explanation and an alternate plan of action to address the identified issue.

RECOMMENDATIONS AND RESPONSES

Recommendation	Responsible Agency	Response
1. The Office of Contract Administration should ensure that Technology Store vendors abide by pricing provisions in future contracts and apply markup percentages based on the manufacturers' prices or declare that compliance with this requirement is infeasible. If the Office of Contract Administration finds this requirement to be infeasible, in the next Technology Store contracts it should revise Appendix B to support the current practice.	Office of Contract Administration	Partially Concur. As stated, we maintain that markup percentages should be applied to cost of goods sold/invoiced costs. Because of the large amount of transactions that are processed, resources are only available to perform spot checks for compliance. This is not dissimilar to CSA practices in that it only audits some contracts and only limited transactions associated with them, because of the resources and time that would be required to audit everything. CSA's requested standard for monitoring may not be infeasible but certainly is impractical given the large amount of resources that would be required. Given that the contracts are ending Sept 30, 2014, or soon after, a revision to Appendix B seems unnecessary.
2. The Office of Contract Administration should ensure that Technology Store vendors abide by the markup percentage limits set by the contracts for the sale of certain commodities.	Office of Contract Administration	Concur. See response to Recommendation #1.

Recommendation	Responsible Agency	Response
3. The Office of Contract Administration should seek reimbursement from Technology Store vendors for any overbillings related to markups applied on certain commodities that exceeded contract maximums.	Office of Contract Administration	Partially concur. OCA reviewed CSA's assumptions and calculations and based on OCA's interpretation of the contract terms and standard business practices, does not agree with the CSA total of $26,883. By OCA's calculations, net overbillings are $3,848. OCA would like to perform a more extensive review of the data and will seek reimbursement as appropriate.
4. The Office of Contract Administration should review invoices submitted before and after fiscal year 2011-12 to determine whether Technology Store vendors incorrectly billed for markups on certain commodities and recover any amounts found to be incorrectly paid.	Office of Contract Administration	Partially concur. OCA's review may randomly check invoices and dependent on the results, turn over its findings to the Controller or City Attorney for further review. Note: It is generally not OCA's responsibility to review invoices, rather that responsibility falls to the department and anyone else verifies the receipt of goods and services or approves the payment of invoices.
5. The Office of Contract Administration should ensure that, before approving purchase orders, purchase order amounts comply with the terms of the contract.	Office of Contract Administration	Partially concur. Although OCA has no disagreement in theory with this, it may be impractical due to the amount of resources it would require. Instead, OCA is implementing a new business model in the new Technology contracts to address this recommendation.

Recommendation	Responsible Agency	Response
6. The Office of Contract Administration should ensure that, when a percentage markup is applicable, Technology Store contracts require that invoices submitted to the City clearly state the manufacturer's price and/or vendor's cost basis and the percentage markup for each item purchased and include evidence to support all prices included on the invoice. (As stated in the contracts, evidence may include an actual manufacturer's price list; a letter provided on the manufacturer's letterhead containing a contact name, signature, and telephone number for the manufacturer's representative; or actual invoices from the manufacturers or distributors).	Office of Contract Administration	Partially concur. This may have been a reasonable approach at the bidding stage of the RFP process, allowing the vendors to include the additional administrative costs to comply with this amount of detail. And it may have been worth consideration at some time during the term of the contract. However as we are at the end of the contract term ending September 30, 2014, and by the time this could be implemented the contract would be complete. See our response to Recommendation 1.
7. The Office of Contract Administration should ensure that its next Technology Store contracts require Technology Store vendors, when a percentage markup is applicable, to include evidence supporting the manufacturer's price and/or vendor's proposed cost at the time the bid is submitted to the City for review and approval.	Office of Contract Administration	Partially Concur. OCA will consider implementing this recommendation before the end of the current contract term of June 30, 2014. See our response to Recommendation #6.
8. The Office of Contract Administration should ensure that manufacturers' prices and/or vendors' proposed costs are supported and that correct percentage markups are indicated on the bid documentation before approving procurement requests.	Office of Contract Administration	Partially Concur. See our Response to Recommendation #1.

Recommendation	Responsible Agency	Response
9. The Office of Contract Administration should ensure that its next Technology Store contracts require that services invoiced to the City must align with a service category listed in the contract and that invoices submitted to the City clearly state the hours incurred and rate charged and that evidence to support any services provided by subcontractors are included with the invoice. (As stated in the contracts, such evidence may include actual invoices from subcontractors to the Technology Store vendor).	Office of Contract Administration	Disagree OCA does not receive invoices, rather the ordering department receives the invoices and they are responsible for verifying that invoices match the purchase order and scope of work. OCA is implementing a new business model in the new Store and requisitions will be bid within the store, purchase orders will be required to match the awarded bid, and invoices should match the purchase orders.
10. The Office of Contract Administration should ensure that its next Technology Store contracts clearly state that training and hardware and software maintenance services may be charged in lump-sum amounts and state how these services should be reimbursed.	Office of Contract Administration	Partially concur. Historically, such items as training and software maintenance services have been identified in the individual scope of work for the project. It is impossible to state every possible contracting configuration or contingency that may arise in meeting the needs of departments. Therefore, OCA is implementing a new business model in the new Store and requisitions will be bid within the store, purchase orders will be required to match the awarded bid, and invoices should match the purchase orders.
11. The Office of Contract Administration should ensure that its next Technology Store contracts require Technology Store vendors to a) include evidence supporting their actual costs with the invoice submitted to the City and b) submit invoices that explicitly state when the vendors have taken advantage of special pricing from subcontractors or suppliers to them.	Office of Contract Administration	Not applicable for new contracts. However the new business model for the Technology Store will be to achieve best pricing on transactions by competitive bidding of specified discounts or markups. Competitive bidding will support the pricing for the City is the best pricing to be obtained at the time of the bidding.

Recommendation	Responsible Agency	Response
12. The Office of Contract Administration should seek reimbursement from one Technology Store vendor for $190 of overbillings as a result of one billing error.	Office of Contract Administration	Concur. OCA will request one Technology Store vendor to reimburse the City for $190.
13. The Office of Contract Administration should ensure that, when a percentage discount is applicable, Technology Store contracts require that invoices submitted to the City clearly state the manufacturer's list price and the percentage discounted for each item purchased and include evidence to support all manufacturer's list prices included on the invoice. (As stated in the contracts, evidence may include an actual manufacturer's price list; a letter provided on the manufacturer's letterhead containing a contact name, signature, and telephone number for the manufacturer's representative; or actual invoices from the manufacturers or distributors.)	Office of Contract Administration	Not applicable for new contracts See response to Recommendation 11. However, if that type of business model is used on future contracts then the recommendations are useful in crafting a requirement for invoices.
14. The Office of Contract Administration should ensure that its next Technology Store contracts require Technology Store vendors, when a percentage discount is applicable, to include evidence supporting the manufacturer's list price at the time the bid is submitted to the City for review and approval.	Office of Contract Administration	Not applicable. See response to Recommendation 11.
15. The Office of Contract Administration should ensure that manufacturers' list prices are supported and that correct discounts off of manufacturers' list prices are indicated on the bid documentation before approving procurement requests.	Office of Contract Administration	Not applicable. See response to Recommendation 11.

Recommendation	Responsible Agency	Response
16. The Office of Contract Administration should ensure that in its next Technology Store contracts, it considers revising the markup percentage that vendors can receive on all commodities and subcontracted services, including those provided through a joint venture partnership.	Office of Contract Administration	Not applicable. See response to Recommendation 11.
17. The Office of Contract Administration should ensure that its next Technology Store contracts address the treatment of electronic recycling fees.	Office of Contract Administration	Disagree Again the fees are levied by the State Board of Equalization. Resellers are required to collect the fees from the end users and pay the State.
18. The Office of Contract Administration should ensure that its next Technology Store contracts address the treatment of travel and business expenses.	Office of Contract Administration	Concur
19. The Office of Contract Administration should develop, implement, and enforce written policies and procedures surrounding its Technology Store pricing review practices. Such policies and procedures should include: • Criteria for evaluating Technology Store vendors' pricing practices for items purchased. • Instructions for sufficiently documenting performance of its pricing reviews. • Corrective action steps to take when pricing errors are identified. • The timing and frequency with which Technology Store pricing reviews are to be conducted.	Office of Contract Administration	Not applicable. The new business model will use competitive bidding to insure best pricing at time of bidding.

Recommendation	Responsible Agency	Response
20. The chief information officer and Office of Contract Administration should formally document their criteria for reviewing and approving Technology Store procurement requests, including how requests are determined to be approved, delayed, or rejected.	Chief information officer	Agreed. Criteria for Approval Delay or Rejection will be explicitly documented by the DT procurement group under Miguel Gamino. Further, the current process is not only too long, it is also too manual. CIO has instructed Miguel Gamino to map the procurement process as-is and will work a streamline process to-be. This process will be jointly discussed with OCA and we will activate a project to digitalize the process into a smart workflow.
	Office of Contract Administration	Disagree OCA reviews transactions as it does other City transactions on the basis of do they meet and comply with City contracting requirements and practices.

APPENDIX B: CONTRACTORS' RESPONSES

COMPUTERLAND OF SILICON VALLEY:

ComputerLand *of Silicon Valley*

September 3, 2014

Tonia Lediju, Director of City Audits
Director of City Audits
City Hall, Room 476
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102

Re: Response – Audit Report Technology Store Contract

Dear Mr. Lediju,

ComputerLand of Silicon Valley appreciates the opportunity to respond to the findings of the City Services Auditor with respect to the Technology Store Contract. We agree that improvement and clarification in some of the language in the original RFP and subsequent contract(s) for both Category 1 and 2 is required for better compliance and enforcement. Since the audit showed ComputerLand to be in compliance with contract regulations within a reasonable margin of error, we do take issue that the report lumps all vendors together as non-compliant.

In the overview of highlights of the audit, some key points are made with which we also disagree.

1. "Vendors often include shipping and taxes in the cost basis upon which markups are applied, rather than to the manufacturer's price, contrary to contract requirements."

   This is something ComputerLand did not do.

2. "Service categories and hourly rates on invoices and purchase orders are often inconsistent with the contracted categories. As a result 56 percent of services tested were broadly categorized as consulting, for which the City pays the highest rates, up to $225 per hour.

   Our general overall consulting rate is $120/hour and our highest rate is $175/hr. We always did our best to correctly categorize service rates but a problem does exist because the contract has a very limited group of job titles and technical services available for pricing. That list of services was compiled over 6 years ago and the types of technology and corresponding job functions that the City departments need is much more varied, sophisticated and technologically demanding than what is often listed in the contract specifications. The city department IT executives realize this, and understand what they are paying for, but it creates extreme hardships for the TechStore vendors and OCA to work within the contract language when ever changing technology advancements and skills are required to get the job done. One non sequitur conclusion was the case highlighted in the report of four on-line training courses purchased for two city employees at $3,280. Whether these were self-paced courses or video courses, the course nature was not disclosed, yet the conclusion was that it was not a compliant transaction since end-user training should be billed at no more than $80/hr.

3. "Neither vendors nor OCA maintain the historical manufacturer's prices of discounted goods, which prevent a trail to verify correctness."

   Technology today is extremely fluid. Buying IT is not like buying office supplies or machinery. The manufacture products, discount programs, cost and MSRP pricing is always changing. New technology is coming out fast and furious and resellers like the ones in the

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TechStore have to keep abreast of these new products and pricing models to make sure the city is taking advantage of the best technology at the best price. Some product categories within the TechStore contract are obsolete and other key new and in demand product groups are missing altogether. The audit report infers that the Technology Store vendors should maintain a database of manufacturer list prices for auditing and print them on their invoices. Some of the factors that would make this impossible or so cost prohibitive to be impractical:

- Over 100,000 technology product SKU's available at any given time.
- MSRP (list price) can change on a weekly basis.
- Time in between quote, PO, delivery and invoice could be months in which list price may have changed several times
- Vendors' ERP system may not accommodate list price in addition to selling price on the invoice
- The cost of maintaining a massive database of historical list prices, with changes, for all manufacturers and products is infeasible.
- Not all manufacturers publish list pricing

4. "Additional terms not addressed in the contracts cost the City money".

   The first example cited is for eWaste fees, a state mandated tax that is passed on to the city by resellers as required by law. Rather than infer that Technology Store vendors are adding a charge that "costs the city money" and is not allowable or somehow non-compliant, the contract should include a clause allowing charges mandated by law.

We agree with some of the recommendations mentioned in the report and we believe the new Technology Marketplace Contract addresses some of those concerns. The understanding that technology is ever changing and therefore acknowledging that solutions that are current today will not be so during the entire course of the contract is a positive change. Allowing more vendors to compete for departments business will also serve the City well in the long run as it will bring down prices and make available a wider variety of service providers and offerings.

Respectfully,

Douglas Green,
COO/CFO

CORNERSTONE TECHNOLOGY PARTNERS, JV:

CORNERSTONE TECHNOLOGY PARTNERS JV
Transportation • Facilities • Technology

September 26, 2014

Tonia Lediju, Director of City Audits
City Services Auditor Division
City Hall, Room 476
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102-6033

Subject: Response to Audit Draft Report for Technology Store Vendors Markups

Dear Ms. Lediju:

This letter is to confirm that Cornerstone Technology Partners, Joint Venture is in receipt of your draft audit memorandum.

Based on our review of the draft, we have provided feedback to correct erroneous items in Exhibit 2 and Exhibit 7.

We appreciate the prompt response from your staff in correcting the necessary changes.

Thank you and we look forward to receiving the final report and improving the process.

Sincerely,

Derek Lawson
Vice President
Cornerstone Technology Partners, JV

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September 2, 2014

Tonia Lediju, Director of City Audits
Office of the Controller
City Hall, Room 476
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102

Dear Ms. Lediju,
En Pointe Technologies appreciates this opportunity to respond to the Controller's Office draft audit report, *Technology Store Vendors Do Not Always Abide by Contract Percentage Markup Limits, Resulting in Overcharges for Goods Purchased.* We have read the report thoroughly and do not have any edits of the document to request.

En Pointe Technologies runs its enterprise business, including all aspects of sales orders, POs and customer billing on SAP. For CCSF sales fulfillment, as for all our customers, we enter contract terms in a contract adherence module and regulate quotes and PO invoices strictly according to those terms. This system enables us to maintain contract terms, in this case only $937 (apparent) deviance on total invoiced sales sample of $148,218.

En Pointe was not mentioned in the body of the report, other than as shown in the tables listing all Technology Store vendors in each of Categories 1 and 2, so we do not have any specific information on where our overage figure of $937 was derived from, and I would invite a short discussion with the auditors on the telephone to understand this better.

Otherwise we are satisfied with the content of the report as it pertains to En Pointe Technologies' contract compliance evaluation, and we will make every effort to continue this level of effort, or improve it, in the next Technology Marketplace contract.

Thank you for the opportunity to respond to this report.

Sincerely,

Mac McConnell

Primary Contact:

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Xtech
Enterprise IT Solutions for Government

09-25-14

Tonia Lediju
Director of City Audits
City Hall, Room 476
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102

Re: Technology Store Audit Draft Report; Appendix H-Xtech JV Response

We acknowledge and understand the Controller's office concerns on the current contract and their suggestions for the next one. We agree that the scale and the complexity of the Technology Store contract makes managing and auditing it challenging and we welcome the opportunity to address with OCA any general or specific queries that resulted from the Controller's audit.

We also understand and agree that it is important for the City to have the proper controls and audits in place for managing costs. It is important however to balance the need for control with reasonable expectations from vendors and the particularities of selling high-end technology services and equipment.

Xtech, as a locally operated minority and woman owned partner in the Technology Marketplace, will strive to continue earning City departments support, trust and respect by providing excellent customer services and creative, complete, competitively priced IT solutions, as has been our custom for the past decade.

Sincerely,

Patricia Eaton

Chief Financial Officer

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