



City of Markham

Report of the Auditor General Vendor Management Audit

Presented to: General Committee of Council, City of Markham

Date: October 2, 2017

BACKGROUND

In 2016, the City of Markham spent \$157M on goods and services from vendors, including construction of capital projects and services to support operations such as snow removal and infrastructure repair and maintenance.

Audit focused on four categories of processes:

- Vendor Award and Set-Up;
- Vendor On-Boarding and Performance Monitoring;
- Vendor Budget Adherence and Project Close-Out; and,
- Vendor Performance Evaluation.

AUDIT OBJECTIVE

The objective of the audit was to:

1. Identify and review the effectiveness of internal controls to ensure vendors were approved and authorized prior to any payments made;
2. Evaluate the adequacy, efficiency and effectiveness of governance, risk management, and control processes in the management of vendors;
3. Assess the processes and tools to measure vendor performance and act on any performance issues; and,
4. Review the use of analytics, if any, to monitor and assess vendor activities and performance.

AUDIT APPROACH

1. Project Planning Phase

- Define objective and scope.
- Confirm project duration and schedule.
- Assign team members and develop team structure.
- Describe deliverables.
- Create Audit Planning Memo and distribute to City staff and Council.



2. Project Execution (Information Gathering & Analysis Phase)

- Obtain existing process descriptions and relevant documentation.
- Conduct interviews / discussions.
- Understand current state.
- Evaluate current state, including sample testing.



3. Project Reporting (Improvement Phase)

- Identify improvement opportunities.
- Prepare draft report with findings and recommendations.
- Validate and present recommendations.
- Issue final report.

SCOPE

The scope of the audit concentrated on vendors providing goods and services in 2016, focused on:

- Review of documentation and interviews with key personnel related to:
 - Vendor management policies, processes, and practices;
 - Tools and checklists in place to monitor vendor performance, including the use of analytics; and,
 - Processes and systems for:
 - » New vendor set-up, vendor termination, and inactive vendors;
 - » Contract amendments and purchase order increases; and,
 - » Contract close-out including final payment.
- Review of vendor management processes on a sample of contracts selected within the following departments: Asset Management, Operations, Parks Construction, Engineering, Planning, Finance/Human Resources, and Library.

OUTSIDE OF SCOPE

The following areas were not within the scope of the audit:

- Major capital projects and related project management policies, processes and procedures;
- Vendors with annual billings less than \$5,000;
- Procurement processes prior to vendor award, including compliance to the Purchasing By-Law;
- Processes for the payment of funds to vendors; and,
- The information technology general controls (“ITGCs”) over databases and systems leveraged during vendor management.

Audit Observations – Strengths:

Contract Award Approval and Vendor Set-up Processes

The City has implemented a robust approval process and Expenditure Control Policy, which outlines the level of authority and approval criteria, to ensure that Contract Awards are approved by the appropriate individuals. Approvals are streamlined via SharePoint.

Adequate controls have been implemented for the set-up of new vendors in the City's financial system, including approval from Procurement, Finance, and the department. Inactive vendors are purged from the system annually.

Strengths Continued:

Purchase Order and Budget Controls

The City has strong controls over the approval and mandatory use of purchase orders, as well as having a policy and process to determine and approve a separate contingency purchase order, ensuring that vendor payments are within the City's approved budget.

Escalation and Contract Termination

The City has demonstrated a pragmatic approach to monitoring vendor performance and escalating issues as needed, while having the ability to terminate contracts due to poor or non-performance, balancing the optimization of vendor performance and limiting the City's liability.

CONCLUSION

Observation Rating Scale

Rating	Rating Description
L = Low	The observation is not critical but should be addressed in the longer term to either improve internal controls or efficiency of the process (i.e. 6 to 12 months).
M = Medium	The observation should be addressed in the short to intermediate term to either improve internal controls or efficiency of the process (i.e. 3 to 6 months).
H = High	The observation should be given immediate attention due to the existence of either a potentially significant internal control weakness or operational improvement opportunity (i.e. 0 to 3 months).

- Overall 2 **Medium** and 3 **Low** priority observations were identified.

OBSERVATION #1:

MEDIUM

Conflict of Interest Declaration

Employees are required to adhere to the Code of Ethics and Conduct, dated 1998, as a condition of employment, which defines a Conflict of Interest and sets out what employees shall and shall not do in event of a conflict. Staff are responsible for identifying conflicts of interest, with the onus on each staff to complete an Employee Conflict of Interest Disclosure Form with details of the identified conflict.

The City does not have a policy that requires City staff involved in the preparation of a procurement or in procurement approval/decision making roles to declare that a conflict of interest does not exist.

OBSERVATION #1 CONTINUED:

MEDIUM

Auditor General Recommendation

While we did not identify any conflicts of interest during the audit, the risk of unreported conflicts of interest would be reduced by obtaining a declaration from individuals involved with a procurement or in procurement approval/decision making roles that a conflict of interest does not exist.

The declaration should become a key document to be retained as part of the procurement process to demonstrate adequate due diligence has been performed for each City procurement.

The definition of conflict of interest, contract value materiality and span of influence (i.e. group of individuals who would be able to influence the procurement results) should be determined and included within an updated Code of Ethics and Conduct to ensure conflicts can be assessed.

OBSERVATION #1 CONTINUED:

MEDIUM

Management Response

Management supports the Auditor General's recommendation.

The current policy places the onus on individual employees to declare any conflict of interest and to validate their understanding of the policy on an annual basis as part of the performance review process. The new policy will be enhanced to include a proactive management approach by requiring all employees involved in procurement to sign a declaration specific to each procurement process identifying whether a conflict of interest situation exists.

The City has clarified the current definition of conflict of interest including the sphere of influence (i.e. group of individuals who would be able to influence the procurement results). This will be included in the updated Employee Code of Ethics and Conduct. The City will develop a materiality threshold that would determine which procurements would be subject to a proactive requirement of the declaration of no conflict of interest.

The signed document will be retained within the electronic vendor management file.

Timeline to Implement: Q4 2017 (October 31, 2017)

OBSERVATION #2:

MEDIUM

Vendor Management Policies and Process Documentation

The policies and processes governing vendor management activities, such as vendor award, vendor account management, project management, vendor performance measurement, and vendor termination, exist in several by-laws, policies, and stand-alone process documents.

While City departments generally follow similar processes to manage vendors, the quality and level of documentation of these vendor management processes varies widely from department to department. For example, some departments maintain detailed process flowcharts, while others have limited to no process documentation.

In addition, several processes related to vendor management are not documented, such as processes relating to Procurement's Access Database and guidelines for the storage of documentation on the common network drive.

OBSERVATION #2 CONTINUED:

MEDIUM

Auditor General Recommendation

To ensure consistent application of vendor management activities enterprise-wide, all vendor management policies, processes and procedures should be compiled into a manual that can be used by all departments.

The manual should bring together vendor management processes in a common and easy-to-access format, that outlines the City's policies, established processes and procedures, and that can be adapted to different sized vendor contracts and departments. While facilitating a more consistent approach to vendor management, the manual will also assist with training new staff and succession management.

The manual should leverage the existing project management methodology/framework established by the City's Project Management Support Office ("PMSO"), as well as the City's existing Purchasing Manual, and include: Vendor award; Vendor account set-up; Vendor on-boarding; Conflict of interest; Vendor performance tracking and monitoring; Communication and escalation protocols; Contract management; Project management budget tracking, purchase orders and contingencies; Project close-out; Vendor performance measurement; Termination protocols; and, Vendor account purging.

OBSERVATION #2 CONTINUED:

MEDIUM

Management Response

Management supports the Auditor General's recommendation.

The City will update the existing Procurement Manual & Workflow to address gaps identified by the Auditor General. A project charter has been developed with the following key milestones: New policy development; Development of business process maps; Process documentation; Process manual consolidation; Implementation planning; Approval, and, Implementation, including staff training.

A dedicated resource has been secured to lead the overall project in order to expedite completion.

Timeline to Implement: Q3 2018

Auditor General Response: *The Auditor General accepts the timeframe for implementation of the recommendation in order for management to align a vendor management policies and procedures manual with the priority of moving to a paperless office and the full implementation of eSolutions.*

OBSERVATION #3:

LOW

Vendor Performance Measurement

At the completion of a vendor contract, the vendor's performance is assessed by completing and returning a vendor performance evaluation form/scorecard.

During the audit, we found that there are four commonly used vendor scorecards, in addition to customized scorecards created by departments for specific vendors or circumstances. In reviewing the number of vendor performance evaluation forms/scorecards used by the City, the following observations were made:

- Vendor scorecard do not provide criteria as to what a specific score means, potentially resulting in a wide variance from one assessment to another; and,
- While the City's general practice is to review performance of vendors who are rated below 70%, it is not clear how this would be calculated on several vendor evaluation forms/scorecards.

Further, we found that vendors are not provided with the results of their performance evaluation, nor are the results compiled for analysis and shared with City departments.

OBSERVATION #3 CONTINUED:

LOW

Auditor General Recommendation

For consistent and reliable assessment of vendor performance, the City's approach to conducting evaluations and tracking vendor performance should be revised by implementing the following:

- Standardization of vendor performance evaluation forms/scorecards ensuring a clear quantitative score is given;
- Forms/scorecards provide specific criteria for each aspect of the vendor's performance being assessed;
- Evaluations are retained in an accessible database (i.e. Vendor Performance Database) to perform analytics (i.e. to track trends) and to share vendor performance scores within the City;
- Develop a vendor performance policy that includes communication with vendors regarding the performance process, review of scores with them as well as by City and vendor management, criteria for documentation for outlier evaluations, monitoring and use of evaluation statistics, and an appeals process;

OBSERVATION #3 CONTINUED:

LOW

Auditor General Recommendations Continued

- Mandatory annual evaluations for multi-year contracts and interim evaluations for large-scale projects; and,
- Consider the threshold and develop clear criteria for disqualification, including the potential for longer periods of disqualification for repeated or profound instances of poor performance.

The City should also consider the use of vendor performance scores within the procurement process. For example, past vendor performance scores could form part of a vendor's mark for a future procurement, providing an incentive for vendor's to continually perform well to continue working with the City.

Maintaining a Vendor Performance Database will also allow the City to track specific vendor information, such as the various names they operate under, especially if poor performing vendors change their names often.

OBSERVATION #3 CONTINUED:

LOW

Management Response

Management supports the Auditor General's recommendations.

Staff will revise its current processes to include a standardized approach for conducting evaluations, tracking vendor performance and communicating the results to City staff and vendors.

Staff will also evaluate how best to include past vendor performance scores as part of future procurement processes.

Staff will develop and implement an appeals process at the senior staff level based on best practices.

Timeline to Implement: Q3 2018

OBSERVATION #4:

LOW

Software Integration

There are several software systems used by various departments throughout the vendor management process, such as Cayenta, Microsoft Access, Microsoft Excel, Microsoft Project, Sharepoint, Eclipse, and eSolutions. None of these systems are integrated to share data, resulting in manual movement of data, causing duplication of work.

OBSERVATION #4 CONTINUED:

LOW

Auditor General Recommendation

Allowing for data exchange between systems facilitates more streamlined processes requiring less manual inputting of data, reducing the potential for data entry errors and duplication of work.

The City should investigate and evaluate options to integrate functions between SharePoint, eSolutions, Cayenta, and Procurement's Access Database, where possible, to streamline Procurement's processes and facilitate easier retrieval of information, contract management, as well as stronger internal controls.

Further, the integration of Eclipse and Cayenta could facilitate streamlined invoice verification and project budget and purchase order processes.

The City should also consider implementing Eclipse in all departments with large contracts/projects.

As the integration of software systems introduces different risks related to process change and security access, the City should ensure that these risks are appropriately mitigated.

OBSERVATION #4 CONTINUED:

LOW

Management Response

Management supports the Auditor General's recommendation.

Staff will investigate and evaluate opportunities to integrate key procurement functions into existing or new systems as part of Markham's Digital Strategy.

Timeline to Implement: Q3 2018

OBSERVATION #5:

LOW

File Structure and File Maintenance/Retention

During the audit, we found inconsistencies within the structure and the maintenance of documentation for vendor contract and vendor management files.

For example, there is variation as to the format and types of documents (i.e. formal documents vs informal emails, unsigned vs signed documents) that are retained on the Q Drive by Procurement.

It is understood that the City is currently transitioning to a paperless office and is investigating digitizing all vendor management documents within Procurement in the eSolutions portal.

OBSERVATION #5 CONTINUED:

LOW

Auditor General Recommendation

To allow for consistent file structure and to improve document retrieval, file maintenance and retention, a policy outlining vendor contract and management file structure, naming convention and mandatory document inclusion should be developed.

Well maintained files will ensure there is a clear audit trail for each vendor's file, and will facilitate the evolution to a paperless office.

This could further be augmented with a checklist for vendor files.

OBSERVATION #5 CONTINUED:

LOW

Management Response

Management supports the Auditor General's recommendation.

Procurement staff will develop a standardized checklist that will ensure that all relevant documentation is included in each vendor file in an electronic format.

Timeline to implement: Q4 2017

ACKNOWLEDGEMENT

MNP extends our appreciation to the staff and management of the City for their co-operation and assistance throughout the engagement.

