City of Markham

Vendor Management Audit

October 2, 2017

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MARKHAM

October 2, 2017

Mayor and Members of Council,

I am pleased to present the vendor management audit report ("report") of the Auditor General for the City of Markham. To ensure the results of our audit are balanced, we have provided in this report a summary of identified strengths as well as observations and recommendations for improvement.

The audit work was completed on June 22, 2017. The report was discussed with the City of Markham's management and executive leadership team, who have reviewed the report and provided their responses within. This report is provided to you for information and adoption of the City of Markham's proposed action plans.

Based on the audit, the City of Markham has adequate procedures in place over vendor management; and, the audit found efficient and effective internal controls related to vendor management activities. Noted areas of strength include vendor award and account set up approval processes; purchase order and budget controls; and, escalation of vendor issues and contract termination procedures.

Opportunities for improvement exist with respect to requesting conflict of interest declarations from departments prior to contract award; preparing a manual of the City's vendor management policies, processes and procedures; improvements to vendor performance evaluation forms and use of the performance assessments; integration of the various software systems that are used for vendor management; and implementation of a consistent file structure for file maintenance and retention.

The report will be posted on the City of Markham's website and made available to the public after tabling to Council.

Sincerely,

Geoff Rodrigues, CPA, CA, CIA, CRMA, ORMP

Auditor General, City of Markham

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EXECUTIVE SUMMARY

The City of Markham ("City") relies on vendors to provide a range of goods and services from construction of community centres, to maintenance of roads and sidewalks, to specialized consulting services and consumable goods. Effective management of these vendors ensures vendors deliver the goods or services to meet budget, timeline and quality expectations.

As Auditor General for the City, MNP LLP ("MNP") evaluated the processes and controls in place over vendor management. The focus of the audit was in the following areas:

- Vendor award approval and account set-up, management of vendor information and document maintenance;
- Vendor management activities across City departments; and
- How vendor performance is evaluated, measured, assessed, and shared within the City.

Based on the audit, the City has adequate procedures in place over vendor management; and the audit found efficient and effective internal controls related to vendor management activities. Noted areas of strength include:

- Vendor award and account set up approval processes;
- Purchase order and budget controls; and
- Escalation of vendor issues and contract termination procedures.

Opportunities for improvement exist with respect to:

- Requesting conflict of interest declarations from departments prior to contract award;
- Preparing a manual of the City's vendor management policies, processes and procedures;
- Improvements to vendor performance evaluation forms and use of the performance assessments;
- Integration of the various software systems that are used for vendor management; and
- Implementation of a consistent file structure for file maintenance and retention.

BACKGROUND

The City has a population of approximately 349,000 residents and provides services, infrastructure, recreational amenities and cultural facilities for residents. As part of its operations, the City procures goods and services from external vendors. Vendors provide the City with a variety of goods and services including: commodities, materials, consulting services, architectural and planning services, information and communication systems, vehicles, construction and renovation services, infrastructure repair services, and a wide variety of other goods and services.

In 2009, the City's previous Auditor General completed a procurement audit focused on procurement processes from initiation to contracting; resulting in 20 recommendations. As of October 2015, management reported that only one procurement audit finding was yet to be implemented. This finding related to the establishment of an electronic document management system for procurement, contract and vendor management. Further, in 2010, an audit of the Engineering department's capital projects was completed by the City's previous Auditor General, resulting in five recommendations, including project and vendor management.

As part of its mandate, and in accordance with the four-year audit plan, the Auditor General has conducted an evaluation of the processes and controls related to the enterprise-wide vendor management function at the City.

The City's vendor management activities can be summarized into four sub-processes, which are described below:

Vendor Award and Set-Up: The vendor management process starts after contract award and begins with the approval of an award letter and signing of a contract. Vendors are set-up within the financial system (Cayenta), purchase orders are prepared and approved, and if applicable, contingency funds are determined and approved on a separate contingency purchase order.

Vendor On-Boarding and Performance Monitoring: Vendors are on-boarded by the applicable department, through a project kick-off meeting where items such as scope, timelines, schedule, deliverables and City expectations are discussed and agreed to. On a regular basis throughout completion of work, the City monitors and communicates with vendors on the status of work and tracks vendors' progress against a baseline schedule using Microsoft Project, Excel, and increasingly Eclipse (project management software). Performance of the vendor is assessed and if potential or actual issues are identified, they are escalated as necessary, based on the persistence and level of severity.

Vendor Budget Adherence and Project Close-Out: Throughout and at the completion of a contract, City staff verifies invoices against budget, the contract purchase order and the contingency purchase order (if applicable) prior to approving payment to the vendor. If additional funds are needed for the contract, departments initiate the purchase order adjustment process through Finance and Procurement via a Purchase Order Adjustment Form ("POAF") to obtain the necessary approvals. At project close-out, departments complete various activities and checklists to ensure all deliverables are met, deficiencies are addressed, and final payments are made.

Vendor Performance Evaluation: At the completion of a contract, or at other major milestones, vendor performance is evaluated by the department, using one of several different evaluation forms/templates which are provided to Procurement. If a vendor's performance is less than satisfactory, they could be considered for a two-year disqualification from City tenders, as per the Purchasing By-Law. If a vendor is inactive for two years, they are deleted from the financial system, and after seven years of inactivity are completely purged from the system.

OBJECTIVE

The objective of the audit was to evaluate the processes and controls in place over vendor management, to identify strengths and weaknesses, and provide recommendations for improvement, ensuring they align with the City's operating environment. This was accomplished by performance of the following:

- Identification and review of the effectiveness of internal controls to ensure vendors were approved and authorized prior to payment;
- Evaluation of the adequacy, efficiency and effectiveness of governance, risk management and control processes in the management of vendors;
- Assessment of the processes and tools to measure vendor performance and act on any performance issues; and
- Review of the use of analytics, if any, to monitor and assess vendor activities and performance.

SCOPE

The scope of the audit concentrated on vendors providing goods and services (including consulting) to the City, during the period from January to December 2016, inclusive. Specifically, the scope of the audit focused on the following:

- Review of documentation and interviews with key personnel related to vendor management, such as:
  - 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 used on a sample of contracts selected within the following departments;
  - Asset Management;
  - Operations;
  - Parks Construction;
  - Engineering
  - Planning;
  - Finance/Human Resources; and
  - Library.

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;[1]

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[1] As vendors with annual billings under $5,000 approximate less than 1% of the City's $157 million payments to vendors, they were not included within the scope of this audit.

- 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.
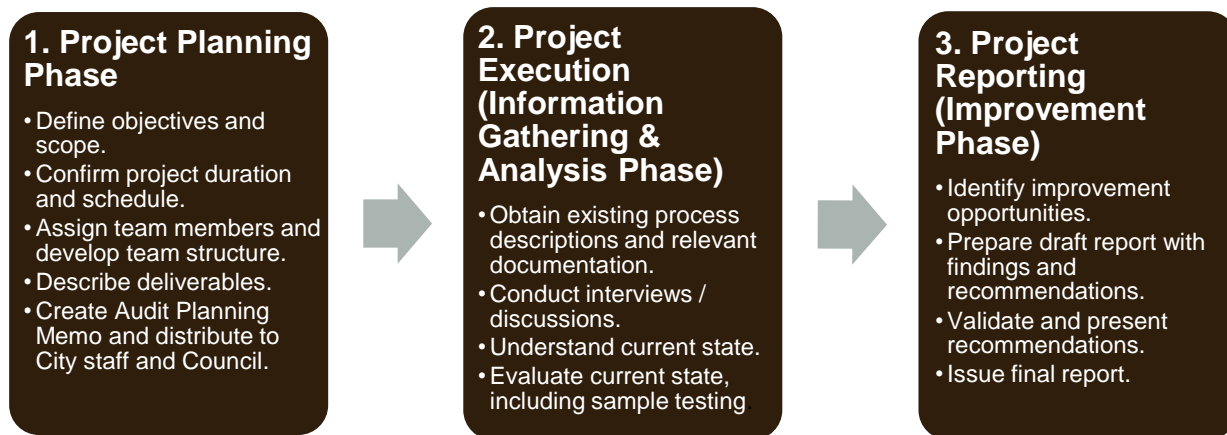
RISKS

Given the stated objective, the following inherent risks were considered during the audit, which given the scope of the audit are typical risks to be considered in an audit of this nature:

- Failure to deliver goods or services within agreed upon prices or timelines;
- Conflicts of interest not identified or dealt with which impact vendor performance and City reputation;
- Delivery of inferior goods or services that do not adequately address the agreed upon scope;
- Disclosure of confidential or sensitive City information by a vendor;
- Unresolved disputes and/or litigation;
- Diminished municipal services because of obligations not being met;
- Failure to act on vendor underperformance;
- Subsequent contracts awarded to vendors who consistently underperform;
- Contracts do not have a contingency plan for unforeseen circumstances (i.e. ability to escalate issues to senior management, back-up supply in the event of emergency, termination clauses);
- Fraudulent or illegal vendor conduct;
- Systems for managing vendor payments are inaccurate or being used inappropriately;
- Fictitious vendors are set up within the financial system;
- Inappropriate payments are made to vendors;
- Contracts, contract amendments, and other vendor management documentation are not maintained/ retained; and
- Vendor issues are not identified and resolved in a timely manner.

APPROACH

In accordance with MNP methodology, the high-level work plan for the vendor management audit included the following:

1. Project Planning Phase
- Define objectives 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.

AUDIT TEAM

The audit was carried out by the following MNP team:

Geoff Rodrigues, **Audit Lead Partner**	Provided expertise in audit methodology and directed the MNP team in all stages of the audit.
Jason Hails, **Quality Assurance Partner**	Provided quality assurance review over entire audit process including planning, execution and reporting.
Veronica Bila, **Audit Manager**	Managed all aspects of the engagement, planned and carried out audit procedures, and reviewed audit results.
Mike Risavy, **Senior Auditor**	Planned and carried out the audit procedures, involving the above resources as needed.

STRENGTHS

In conducting the audit, MNP noted several strengths with respect to how the City manages vendors. The following key strengths are described below:

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. In addition, the City utilizes a SharePoint site to effectively manage and document the approval process. Adequate controls have also been implemented for the set-up of new vendors into the City's financial system, including approval from Procurement, Finance and the department as per the determined levels of authority. A process to regularly purge inactive vendors has also been established.
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 with limitations of the City's liability.

SUMMARY OF OBSERVATIONS AND RECOMMENDATIONS

To enable the City to set priorities in their action plans, we have reported our observations in one of three categories, "**Low**", "**Medium**" or "**High**" based on our assessment of the priority (i.e. significance, complexity, and resources required) of each observation.

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

The chart below provides a summary of our observations and recommendations, based on the rating scale outlined above. Detailed observations and recommendations can be found in **Appendix A**.

REF.	SUMMARY OF OBSERVATIONS AND RECOMMENDATIONS	RATING		
		L	M	H
1	**Conflict of Interest Declaration –** 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. 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.		M	
2	**Vendor Management Policies and Process Documentation –** Policies and processes governing vendor management activities exist in several by-laws, policies, and stand-alone process documents. In addition, the quality and level of documentation of these vendor management processes varies widely from department to department and several processes related to vendor management are not documented. 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.		M	
3	**Vendor Performance Measurement –** Various vendor evaluation templates are used with scoring criteria that does not facilitate consistent scoring of vendor performance. We also 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. For consistent and reliable assessment of vendor performance, the City's approach to conducting evaluations and tracking vendor performance should be revised by implementing standardize evaluation forms and performance measurement best practices.	L		
4	**Software Integration –** There are several software systems used by various departments throughout the vendor management process. The systems are not integrated to share data, resulting in manual inputting of data, which may cause	L		

REF.	SUMMARY OF OBSERVATIONS AND RECOMMENDATIONS	RATING		
		L	M	H
	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.	■		
5	**File Structure and File Maintenance/Retention –** Inconsistencies within the structure and the maintenance of documentation for vendor contract and vendor management files were found during the audit. 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.	■		

ACKNOWLEDGMENTS

We would like to express our appreciation for the cooperation and efforts made by City staff whose contributions assisted in ensuring a successful engagement. City staff provided the Auditor General with unrestricted access to all activities, records, systems, and staff necessary to conduct this audit freely and objectively.

APPENDIX A: DETAILED OBSERVATIONS AND RECOMMENDATIONS

#	Observation	Rating	Recommendation	Management Response
1	**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.	M	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.	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	Rating	Recommendation	Management Response
2	**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.	M	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: 1. Vendor award; 2. Vendor account set-up; 3. Vendor on-boarding; 4. Conflict of interest; 5. Vendor performance tracking and monitoring; 6. Communication and escalation protocols; 7. Contract management; 8. Project management budget tracking, purchase orders and contingencies; 9. Project close-out; 10. Vendor performance measurement;	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: 1. New policy development; 2. Development of business process maps; 3. Process documentation; 4. Process manual consolidation; 5. Implementation planning; 6. Approval; and, 7. 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	Rating	Recommendation	Management Response
			11. Termination protocols; and 12. Vendor account purging.	
3	**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.	L	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; • Mandatory annual evaluations for multi-year contracts and interim evaluations for large-scale projects; and, • Consider the threshold and develop clear criteria for disqualification,	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	Rating	Recommendation	Management Response
	It is the City's practice to compile all previous performance evaluations for a specific vendor which are then forwarded to the City's Project Manager for their review and analysis prior to awarding a new contract.		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.	
4	**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.	L	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	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	Rating	Recommendation	Management Response
			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.	
5	**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.	L	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.	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**