Report #2020-01

COOPERATIVE PURCHASING AGREEMENTS AUDIT

City of Glendale
Internal Audit

09.25.2019

NUMBER OF RECOMMENDATIONS

PRIORITY 1	PRIORITY 2	PRIORITY 3
0	2	2

Contents:

Distribution List:

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Acknowledgment

We would like to thank the Purchasing Section personnel for their support and assistance provided to us throughout this project.

For questions regarding the contents of this report, please contact the lead auditor, Sameel Salim, Sr. Internal Auditor, or Jessie Zhang, Internal Audit Manager at ipa@glendaleca.gov
This report is also available online at http://www.glendaleca.gov

A. Overview

Key Outcomes

Cooperative purchasing agreements (cooperative agreements) are one of the procurement tools available to the City. The potential benefits of this tool include the aggregated buying power which could result in better pricing from vendors than purchases made individually and the time and administrative cost savings by avoiding the need to undergo an in-house bid to procure goods/services. These benefits are well known and were also cited by City departments as to why they prefer utilizing cooperative agreements versus the City's bid process.

While acknowledging these potential benefits, Internal Audit noted a number of inherent risks associated with this procurement tool. These risks include the use of "best value" scoring criteria, administrative fees imposed by leading entities, and the national presence requirements that could limit local vendors.

In order to maximize the benefit of cooperative agreements and mitigate the identified risks, Internal Audit recommends that cooperative agreements be systematically evaluated and strategically utilized. This can be achieved by: 1) establishing guidelines and due diligence requirements when evaluating appropriate use of cooperative agreements; 2) formally establishing requirements based on certain criteria (such as dollar thresholds and/or types of products); 3) performing additional pricing validations prior to the establishment of purchase orders; and 4) providing additional assistance and training to City departments in developing technical specifications.

Impact Dashboard

This table summarizes the applicable value-added categories (total 11) for the four recommendations based on their prority rankings.

	Value Added Categories				Innovation Opportunities
	Risk Reduction	Compliance	Cost Saving	Efficiency	
Priority 1 **0**	0	0	0	0	0
Priority 2 **2**	2	2	1	1	0
Priority 3 **2**	2	1	0	2	0

(Definitions of Priority Rankings and Value-added impacts are located at Appendix 1)

B. Action Plan and Target Completion Dates

The action plan and target completion dates are summarized in the table below. Internal Audit will perform quarterly status follow-up to provide assurance that management is taking appropriate and timely corrective action to address audit recommendations.

Ref.	Management Action Plan	Completion Date
	Priority 2	
1.	Formally establish guidelines and procedures to address the risks associated with cooperative agreements. ***Value added:*** *Risk Reduction, Compliance, Efficiency*	3/31/2020
2.	Develop a due diligence checklist to assist in evaluating and selecting cooperative agreements as a procurement tool. ***Value added:*** *Risk Reduction, Compliance, Cost Saving*	3/31/2020
	Priority 3	
3.	Obtain, validate, and retain itemized price lists and underlying cooperative agreements prior to establishing purchase orders. ***Value added:*** *Risk Reduction, Compliance, Efficiency*	3/31/2020
4.	Provide additional assistance and training to City departments in developing technical specifications. ***Value added:*** *Risk Reduction, Efficiency*	3/31/2020

C. Background

Cooperative purchasing is, at its most basic, when governments buy things together. There are essentially three types of cooperative agreements[1] that are sometimes referred to interchangeably as “piggybacking”.

1) **True Cooperatives** - Two or more organizations combine their requirements and solicit bids or offers for goods or services.

2) **Piggybacking** - One or more organizations represent their requirements and include an option for other organizations to “ride” or “bridge” the contract as awarded.

3) **Third Party Aggregators** - An organization brings together multiple agencies to represent their requirements and manage the resulting contract or contractor.

[1] National Association of State Procurement Officials. Strength in Numbers: An Introduction to Cooperative Agreements

Cooperative agreements are an increasingly used procurement tool within governments. According to the National Association of State Procurement Officials, cooperative agreements "save significant time and money in contract production as well as lower contract prices through the power of aggregation". In 2018, it is estimated that cooperative purchasing accounted for nearly 20 percent of state, local, and educational government spend.[2]

Cooperative agreements are created by a lead agency (single government, regional association of governments, or a third party aggregator) with the intent that the contract be used by other "participating agencies". The lead agency is responsible for conducting the request for proposal (RFP) process, evaluating vendor responses, and ultimately awarding the vendor(s) the cooperative agreement. In exchange for these services, many lead agencies and third party aggregators collect an administrative fee as a percentage of total sales.

Cooperative agreements tend to be awarded using the "best value" criteria. Unlike the "lowest cost" criteria traditionally used in public agencies, "best value" evaluates vendors using a scorecard where a number of different factors are used to subjectively score prospective vendors. The highest scored vendors are awarded the cooperative agreement. Price is one of the factors used to evaluate prospective vendors. Other factors include the vendor's proposed solution, qualifications & experience, and the ability of the vendor to serve a national market.

Glendale City Charter Requirements

Article VI, Section 9 of the City's Charter requires contracts to be competitively bid by stating *"…no contract for supplies, material, labor, or other valuable consideration, or for the construction, improvement, repair, or maintenance of public works shall be authorized by the council except to the lowest responsible bidder after competitive bidding."* However, there are eight exceptions where the Charter does not require competitive biding. One of the eight exceptions is noted in subsection (h) that states *"Contracts with other governmental entities, or their contractors, for labor, materials, supplies or services."* Cooperative agreements fall under this exception and thus are one of the authorized exceptions to the City's competitive bidding criteria.

Benefits

According to the Institute for Public Procurement, the two main advantages of cooperative agreements are: 1) the aggregated buying power of the cooperative could result in better pricing from vendors than purchases made individually; and 2) time and administrative costs are saved by avoiding the need to undergo an in-house bid to procure goods/services.

[2] Stephen Goldsmith and Scott Becker. Cooperative Procurement: Today's Contracting Tool, Tomorrow's Contracting Strategy

<u>Risks</u>

Internal Audit noted four inherent risks associated with this procurement tool:

1) The “best value” scoring methodology may result in higher priced procurements than would otherwise be obtained via the “lowest cost” bid process. Internal Audit noted cooperative agreements where price only accounted for 20% of the vendor’s overall “best value” score. Additionally, determining what exactly constitutes “best value” is subjective and dependent on the preferences of the lead agencies. These preferences may not align with the City’s notion of “best value”.

2) The administrative fees charged by lead agencies and third party aggregators could potentially create a conflict of interest, where the primary motivation is not necessarily to satisfy their own procurement needs, but rather to generate ongoing revenue by creating cooperative agreements that other participating agencies will utilize. These fees may be built into the pricing structure of the vendors and ultimately passed down to the City.

3) By not being involved in the RFP process, participating agencies are limited in their ability to adequately assess the quality of the overall procurement process. RFPs should be written in a way as to maximize the number of competitive offers received. However, if a lead agency wished to intentionally limit the number of bidders, they could tailor the RFP specifications to favor a single company. This type of manipulation risk is also found with internal procurements, however it becomes harder to detect and investigate with external procurements.

4) The national presence requirement will preclude smaller local vendors from participating in the procurement, which could potentially deviate from the City’s Administrative Policy Manual 3-11 Section L that states “preference shall be given to local vendors for purchase of taxable goods and materials only, if all other significant considerations are equal".

The identified benefits and risks will guide the due diligence efforts needed to evaluate when it is in the City’s best interest to use cooperative agreements.

D. Objective, Scope and Methodology

The objective of the audit was to determine whether the City has established adequate controls to address the risks related to selecting and utilizing cooperative agreements.

The scope of this audit focused on cooperative agreements as a procurement tool. The audit period covered January 2018 through June 2019.

In order to accomplish the audit objective, Internal Audit performed the following:

- Reviewed applicable policies and procedures.
- Conducted interviews and walkthroughs with key personnel from the Purchasing Section, Information Services, Community Services and Parks, Public Works, and Glendale Water & Power.
- Interviewed the Purchasing Administrator from a neighboring city and other external subject matter experts to obtain an understanding of the cooperative agreements environment.
- Reviewed documentation related to best practices and potential areas of concern.
- Reviewed the “Planet Bid” system to gain an understanding of the City’s bid process.
- Performed detailed testwork on a sample of cooperative agreement invoices to determine if the purchases were properly substantiated.

As a result of the audit procedures performed, four observations were identified and are detailed in the Observations, Recommendations & Management Responses Matrix beginning on the following page.

E. Observations, Recommendations & Management Responses Matrix

Ref	Observation	Recommendation	Management Response
1.	**Establish Guidelines and Procedures**		
Priority 2	The City's Purchasing Policy (APM 3-11) provides no guidance regarding the proper use of cooperative agreements. The only language related to cooperative agreements is in Section D, which states the Purchasing Section is responsible to "enter into cooperative purchases with other government entities, or their contractors, for supplies, material or labor". Additional guidelines and procedures are necessary in order to ensure the policy is consistently and appropriately followed.	The Purchasing Section develop guidelines and procedures to address the following areas: 1) A brief conceptual description of cooperative agreements, including a description of how they are structured, their benefits, and their inherent risks. 2) A due diligence checklist to evaluate cooperative agreements as a procurement option. 3) Guidelines on situations where cooperative agreements should not be used, such as those that were not competitively bid or if local vendors are preferred. 4) Procedures to ensure purchase orders are in accordance with the cooperative agreements and their applicable prices.	Agrees and will implement by March 31, 2020. Purchasing will develop guidelines and procedures to consider the following: 1) Conceptual framework of cooperative agreements. 2) Due diligence checklist to mitigate the inherent risks of cooperative agreements. 3) Guidelines on when cooperative agreement should not be used. 4) Pricing validations to perform prior to issuing purchase orders.

Ref	Observation	Recommendation	Management Response
2.	**Develop Due Diligence Checklist**		
Priority 2	Cooperative agreements are one of the authorized exceptions to the City's "lowest cost" bid preference. However, the following inherent risks related to this procurement tool were noted: • The "best value" criteria may result in higher prices than would otherwise be obtained via the "lowest cost" bid. • The administrative fees charged by lead agencies and 3rd party aggregators could potentially create a conflict of interest, and may result in higher prices being passed down to the City. • Participating agencies are limited in their ability to adequately assess the quality of the overall procurement process due to not being involved in the RFP process. • The national presence requirement will preclude smaller local vendors from participating in the procurement.	Purchasing Section develop a checklist that incorporates the following due diligence considerations: 1) Establish certain criteria (such as dollar thresholds and/or types of products) where additional due diligence is required. 2) Compare procurement options prior to selecting the best option for the City, including but not limited to undergoing an in-house bid, especially for customized projects involving labor, as these charges are highly variable from one market to another. Additionally, price comparisons between competing cooperative agreements and requests for additional pricing concessions should be made. 3) Review the criteria lead agencies used in selecting the winning vendor(s) in the RFP to determine adherence to City preferences and best interest. A sample checklist from the Office of the Washington State Auditor's Office was provided to the Purchasing Section for reference.	Agrees and will implement by March 31, 2020. Purchasing will consider establishing a checklist that addresses due diligence requirements when evaluating appropriate use of cooperative agreements.

<table>
<tr><th>Ref</th><th>Observation</th><th>Recommendation</th><th>Management Response</th></tr>
<tr><td>3.</td><td colspan="3">Obtain, Validate, and Retain Itemized Price Lists</td></tr>
<tr><td>Priority 3</td><td>Based on the detailed testwork performed on 10 cooperative agreement invoices from 7 vendors, the following were noted:

• 3 vendors had invoices that agreed to or were within the thresholds established in the purchases orders. However, the invoiced amounts could not be matched to the underlying cooperative agreements due to lack of historical price lists and/or un-responsive vendors.

• 3 vendors had incorrect cooperative agreement numbers referenced in the City's purchase orders.</td><td>Purchasing formally establish procedures to ensure the following are consistently performed:

• Purchasing Section obtain, validate, and retain applicable itemized price lists and underlying cooperative agreements prior to establishing purchase orders.

• When purchase orders are not itemized (such as blanket purchase orders), City departments should be instructed to include pricing support, at the time of the purchase, to allow the matching of the invoice to the vendor price list prior to making payment.</td><td>Agrees and will implement by March 31, 2020.

Purchasing will establish written procedures to ensure that:

• The Purchasing Section obtain, validate, and retain applicable contracts and price lists prior to the establishment of purchase orders resulting from cooperative agreements.

• City Departments using blanket purchase orders will be instructed to include pricing support, at the time of the purchase, to ensure compliance with the cooperative agreements pricing terms that are referenced in the purchase orders.</td></tr>
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Ref	Observation	Recommendation	Management Response
4.	**Provide Training and Assistance**		
Priority 3	The time and resources needed to complete technical specifications are one of the primary reasons City departments cited as to why they prefer cooperative agreements over the internal bidding process. Additional training and assistance in this area could assist departments to improve their ability to develop technical specifications.	Purchasing Section perform the following to provide additional assistance to City departments in developing technical specifications: 1) Create a repository of recurring, complex, and/or specification examples that City departments can use as a reference. 2) Recommend the Human Resources Department to include technical specification development training courses in order to help develop technical specification writing skills for applicable City staff.	Agrees and will implement by March 31, 2020. Purchasing will evaluate the feasibility of creating a specification repository and/or add specific language in the procedures to reiterate Purchasing's availability to assist City departments with their specifications. Purchasing will recommend the Human Resources Department to provide periodic technical specification writing training courses for City staff.

Appendix 1: Definitions of Priority Rankings and Value-Added Categories

Definitions of Priority Rankings

The priority rankings are assigned by internal auditors based on their professional judgment. They are also agreed upon by management based on their evaluation of the alignment with strategic goals, priorities and available resources. A timeline has been established based on each priority ranking:

a. **PRIORITY 1** - Critical control weakness that exposes the City to a high degree of combined risks. Priority 1 recommendations should be implemented within **3 months** from the first day of the month following report issuance or sooner if so directed.
b. **PRIORITY 2** - Less than critical control weakness that exposes the City to a moderate degree of combined risks. Priority 2 recommendations should be implemented within **6 months** from the first day of the month following the report issuance or sooner if so directed.
c. **PRIORITY 3** - Opportunity for good or better practice for improved efficiency or reduced exposure to combined risks. Priority 3 recommendations should be implemented within **9 months** from the first day of the month following the report issuance or sooner if so directed.

Definitions of Value-Added Categories

The four value-added impact categories are defined based on their impact from the audit recommendations:

a. **COMPLIANCE** - adherence to laws, regulations, policies, procedures, contracts, or other requirements.
b. **COST SAVING** - lower the costs related to conducting City business.
c. **EFFICIENCY** - ability to avoid wasting resources (money or time) in achieving goals.
d. **RISK REDUCTION** - lower the risks related to strategic, financial, operations and compliance.

In addition, the **INNOVATION OPPORTUNITY** category indicates the assistance and consulting services that may be provided by the Innovation and Performance Team in helping address audit observations.