



THE CITY OF SAN DIEGO

DATE: March 20, 2012

TO: Jeffrey Baer, Director, Purchasing and Contracting Department

FROM: Eduardo Luna, City Auditor

SUBJECT: **The City Needs to Address the High Mark-up of Goods Purchased by General Services Facilities Division Under the MRO Cooperative Agreements**

During our audit of General Services Department's Facilities Division (Facilities), we found that the City is paying high price mark-ups for supply and equipment purchases under the newly established Maintenance, Repair, and Operation (MRO) Cooperative Agreements. We are issuing this memorandum prior to completing our performance audit because these mark-ups may have a significant fiscal impact on the City's fiscal year 2012 budget and beyond. For example, Facilities' fiscal year 2012 budget included an expected savings of \$255,000 based on the MROs. However, due to unanticipated mark-ups, these cost savings will not be realized; in fact, the Mid-Year Budget Monitoring Report for fiscal year 2012 projects that the General Services Department's expenses will be over budget by \$792,000 at the fiscal year-end.

Shortly after the MRO agreements were established, Facilities realized that MRO vendors did not directly sell many of the supplies and equipment necessary for its operations. To address this issue, the vendors established sub-agreements with a number of specialty vendors—many of which are local companies where the City had historically purchased supplies. However, the established MRO agreements do not set agreed-upon mark-ups to be charged by the MRO vendors when purchases are made through the sub-vendors. Consequently, instead of receiving the expected discount from the local vendors, the City is charged a significant mark-up. We were able to identify several specific instances of price mark-ups ranging from 23.9 percent to 357.0 percent; some of the most significant examples are provided on the next page, in Exhibit 1.

Exhibit 1: Sample MRO Vendor Price Mark-Ups

Sample	Sub-contracting Vendor Price	MRO Vendor Price	Percent Mark-up
Wood Products	\$112.00	\$138.74	23.9
Furnace	\$4,118.71	\$5,411.39 ^Φ	31.4
Boiler	\$14,336.00	\$25,703.80 ^Φ	79.3
Filter	\$8.61	\$39.35	357.0

Source: OCA generated from sample MRO invoices.

^ΦThese were quotes provided by the MRO vendor, but the City did not move forward with purchasing these specific items from the MRO vendor.

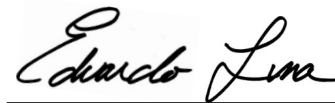
City management advised that they are aware of the issue and are working toward identifying a solution.

Recommendation:

We recommend that the Purchasing & Contracting Department work with the City Attorney's Office to immediately review the terms of the Maintenance, Repair, and Operation (MRO) Cooperative Agreements and identify a solution to ensure the City purchases its MRO supplies at the most economical price and does not continue to pay high mark-ups over the remaining four years of the agreements. (Priority 1) ♦

Attached you will find Appendix A: Audit Objective, Scope and Methodology. The Administration's response to our audit recommendation can be found after page 3.

Respectfully submitted,



Eduardo Luna
City Auditor

- cc: Honorable Mayor Jerry Sanders
Honorable City Council Members
Jan Goldsmith, City Attorney
Jay M. Goldstone, Chief Operating Officer
Wally Hill, Assistant Chief Operating Officer
Mark Leonard, Financial Management Director
Tony Heinrichs, Public Works Director
William DosSantos, Facilities Division Deputy Director
Andrea Tevlin, Independent Budget Analyst

♦ Priority 1 recommendations require immediate action due to fraud or serious violations being committed or significant fiscal or equivalent non-fiscal losses occurring.

Appendix A: Audit Objective, Scope, and Methodology

In accordance with the City Auditor's Fiscal Year 2012 Audit Work Plan, we are currently conducting a performance audit of the Facilities Maintenance Division of the General Services Department. The objective of this audit is to determine whether the Facilities Division maintains, repairs, and enhances the City's assets efficiently and effectively. This memorandum reports on one audit finding relative to this objective. The remainder of the audit is currently ongoing. In conducting this review, we focused our scope on all Facilities' maintenance, repair, and enhancement activities between July 2007 and December 2011. To determine whether Facilities maintains, repairs, and enhances the City's assets efficiently and effectively, specifically relating to Cooperative MRO agreements, we reviewed the City's contract agreements with each of the MRO vendors, assessed a sample of procurement invoices, and conducted extensive interviews with department officials to identify the process for procuring materials under the new Cooperative Agreements.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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THE CITY OF SAN DIEGO
MAYOR JERRY SANDERS

MEMORANDUM

DATE: March 16, 2012

TO: Eduardo Luna, City Auditor

FROM: Jeffrey Baer, Purchasing & Contracting Director
Ed Plank, Purchasing & Contracting Deputy Director

SUBJECT: Audit Response- GS/Facilities Maintenance Audit

This memo provides the Management response to the audit of the City's MRO contracts activities related to the Facilities Maintenance Audit.

Recommendation

We recommend that the Purchasing & Contracting Department work with the City Attorney's Office to immediately review the terms of the Maintenance, Repair and Operations (MRO) Cooperative Agreements and identify a solution to ensure the City purchases its MRO supplies at the most economical price and does not continue to pay high mark-ups over the remaining four years of the agreements.

Response

The Purchasing & Contracting Department agrees with this recommendation and has been taking actions to ensure competitive pricing under the MRO contract. Implementation of the existing MRO contract began in July 2011 and P&C has been evaluating the program over the past 8 months. Based on our evaluation, we have found that the mark up rate exceeds our initial expectation and as a result we have been engaged in a number of actions to ensure optimal competitive pricing and effective implementation. We have also identified programmatic changes that we expect to bring before Council by June 2012.

The existing MRO contracts provide the City with competitive discounted pricing for all items which are available in the catalogs of each MRO vendor or were part of a City identified market basket. When purchases are made outside the vendors' catalogs and go through the vendor's product sourcing process (specialty and vendor non-stock items) then vendor mark-ups are added and pricing, in many cases, becomes non-competitive. Some procurement of non-cataloged items through MRO vendors was anticipated with an industry average mark up of 10-15%.

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However, the frequencies of MRO vendor sourcing and the mark ups which have been applied have exceeded expectations. Therefore, P&C has been proactively working with City departments to better understand effective utilization of the MRO program to keep orders within the vendor's catalogs or the market basket of items for which discounted pricing has been established.

In order to obtain more economies, get improved discounted prices for what are currently non-catalog items, and broaden the number of items available to City departments via MRO, P&C met with the City Attorney's Office in November 2011 to discuss adding vendors to the Council approved MRO contract. It was determined that Council action is required to expand vendor participation beyond the original five vendors. P&C is working with City departments to identify the additional high volume items for incorporation into the program through established discount pricing. P&C will conduct market analysis to determine which vendors are able to provide the City with maximum price advantage for these high volume items. Upon completion of the analysis, P&C anticipates docketing an expansion of MRO vendors for Council consideration in June, 2012.

P&C is committed to ensuring the success of the MRO contract and to maximizing the cost savings available to City departments by procuring consumable supplies from the catalogs of the MRO vendors. P&C has initiated monthly reviews with all five of the current MRO vendors to ensure that items are being properly ordered, that items purchased are coming from the vendors existing catalogs and that the correct contract discounts are applied. P&C will continue to meet with City departments to ensure that their specific MRO materials and supplies requirements are met and that they are most effectively utilizing the MRO contract in order to maximize the costs savings available through the contract.

cc: Wally Hill, Assistant Chief Operating Officer