



Internal Audit Report: Procurement Compliance Review

Item 11
April 16, 2015
**Building, Investment, Finance
and Audit Committee**

To: Building, Investment, Finance and Audit Committee (BIFAC) **Report:** BIFAC:2015-24

From: Chief Internal Auditor

Date: March 18, 2015 Page 1 of 3

Strategic Plan Priority: **Service Excellence:**

- Demonstrate Value for Money and Public Accountability

PURPOSE:

To provide to the Building Investment, Finance and Audit Committee (“the Committee”) the Internal Audit Report *Procurement Compliance Review*.

RECOMMENDATIONS:

It is recommended that the Committee receive the Internal Audit Report *Procurement Compliance Review* for information.

REASONS FOR RECOMMENDATIONS:

Introduction

As is well known, in 2010 the Auditor General of Toronto (AG) conducted a review of Toronto Community Housing Corporation’s (TCHC) procurement policies, processes, and practices. In the AG’s December 7, 2010 report, *Toronto Community Housing Corporation Procurement Policies and Procedures are Not Being Followed* (the Report), the AG identified several instances of non-compliance with the TCHC procurement policies and procedures, including but not limited to:

- The open tendering process was not always being used;
- Single tendering was common and, in some cases, inappropriately used;
- Purchase orders were routinely split in order to avoid the requirement of seeking proper authorizations;
- A lack of documentation in support of contract awards and decisions to single tender; and
- Controls over purchases less than \$10,000 were inadequate.

Arising from this review 30 recommendations were made. Two of those Recommendations pertained to (i) implementing a program of procurement reviews and (ii) ensuring all future TCHC tenders comply with TCHC's open tender policy.

In 2011 the AG also reviewed the procurement processes of then-TCHC subsidiary Housing Services Inc. The results of that review were similar to the findings in the AG's earlier report, though not as severe as found in that report. Arising from the 2011 report was a recommendation related to appropriate monitoring and enforcement of procurement procedures and controls.

These three Recommendations were the impetus of this engagement.

This is the first substantive internal audit of the TCHC procurement process since that time.

Findings

New Procurement Process

Subsequent to the release of the AG's two reports, TCHC undertook a complete overhaul of its procurement process – an 18 month project. A revised Procurement Policy was drafted, and new Procurement Procedures and Procurement protocols were developed.

The 'new' procurement process:

- Substantially increased the controls within the procurement process;
- Created processes to be followed to ensure procurement projects were properly completed, and within the requirements set out in the revised policy, procedures, and protocols;
- Includes the use of standard form contracts;
- Has increased the efficiency of the procurement process;
- Includes quarterly reporting to the TCHC Board of Directors on various procurement metrics; and
- In 2014, saved TCHC approximately \$22.3 million in potential spend (i.e. cost avoidance).

Results of Award Testing

During this engagement we tested:

- The use of the Vendor Award Committee process;
- File documentation;
- The creation and use of Vendor Rosters;
- Monitoring of the status of procurement projects;
- Every type and size of procurements made (e.g. under \$7,500, between \$7,500 and \$50,000, between \$50,000 and \$100,000, over \$100,000, with and without the use of a vendor Roster, open tenders, direct award contracts, monitoring of Roster vendor selection, etc.); and
- Change orders.

In all cases, no significant exceptions were found.

Recommendations

We did come across some minor areas that do require a further review by management. In summary, these are related to:

- The creation of a change order protocol;
- The creation of a protocol with respect to the use of electronic signatures in the procurement process; and
- The retention in procurement files of business cases for applicable non-capital purchases.

General Comment

As noted, the TCHC procurement process was turned upside down and sideways and essentially recreated subsequent to the AG’s two reports. The fact that no significant exceptions were found during our review of the TCHC procurement process is remarkable, and a testament to the hard work of TCHC Procurement management and staff in making the TCHC procurement process ‘right’.

IMPLICATIONS AND RISKS:

A sound and compliant procurement process significantly reduces the risk that inappropriate and unauthorized procurement transactions are made by the enterprise. It also illustrates to TCHC’s shareholder and the public at large the improved stewardship of management with respect to TCHC’s operations.

“Michael Vear”

Michael Vear, CPA, CA, CPA (Illinois)
Chief Internal Auditor

- Attachments:**
- 1: Internal Audit Report: *Procurement Compliance Review*, March 4, 2015
 - 2: Appendix A: *Management’s Response – March 17, 2015*

Staff Contacts:

Michael Vear	416-981-4065
Chief Internal Auditor	Michael.Vear@torontohousing.ca
David Fanone	416-981-4219
Internal Audit Analyst	David.Fanone@torontohousing.ca
Barb Kapeluch.....	416-981-4209
Business Analyst.....	Barb.Kapeluch@torontohousing.ca

Item 11 - Internal Audit Report: Procurement Compliance Review
April 16, 2015 BIFAC Meeting
Report: BIFAC:2015-24

Attachment 1

Procurement Compliance Review

TCHC Internal Audit Department

**March 4, 2015
(with Management's Response dated March 17, 2015)**

Table of Contents

EXECUTIVE SUMMARY	3
1.0 BACKGROUND	6
1.1 Auditor General Reports	6
1.2 Overhaul of the TCHC Procurement Process	7
1.3 Believe It or Not	8
2.0 ENGAGEMENT OBJECTIVE, SCOPE AND METHODOLOGY	10
2.1 Audit Objective	10
2.2 Audit Scope and Methodology	10
2.3 Acknowledgements	12
3.0 DETAILED FINDINGS	13
3.1 Procurement Infrastructure	13
3.2 Review of Procurement Awards	16
3.3 Change Orders	18
3.4 Monitoring of Roster Selection	22
3.5 Electronic Signatures	22
3.6 Business Case Document Retention	23
3.7 Procurement Savings	23
4.0 FUTURE INTERNAL AUDIT REVIEWS OF PROCUREMENT	25
4.1 General Internal Audit Reviews	25

Appendix A – Management's Response

EXECUTIVE SUMMARY

Introduction

In 2010 the Auditor General of Toronto (AG) conducted a review of Toronto Community Housing Corporation's (TCHC) procurement policies, processes, and practices. In the AG's December 7, 2010 report, *Toronto Community Housing Corporation Procurement Policies and Procedures are Not Being Followed* (the Report), the AG identified several instances of non-compliance with the TCHC procurement policies and procedures, including but not limited to:

- The open tendering process was not always being used;
- Single tendering was common and, in some cases, inappropriately used;
- Purchase orders were routinely split in order to avoid the requirement of seeking proper authorizations;
- A lack of documentation in support of contract awards and decisions to single tender; and
- Controls over purchases less than \$10,000 were inadequate.

Arising from the AG's review, 31 recommendations were included in the AG's report. Two of those Recommendations pertained to (i) implementing a program of procurement reviews and (ii) ensuring all future TCHC tenders comply with TCHC's open tender policy.

In 2011 the AG also reviewed the procurement processes of then-TCHC subsidiary Housing Services Inc. The results of that review were similar to the findings in the AG's earlier report, though not as severe as found in that report. Arising from the 2011 report was a recommendation related to appropriate monitoring and enforcement of procurement procedures and controls.

These three Recommendations were the impetus of this engagement.

This is the first substantive internal audit of the TCHC procurement process since that time.

Findings

New Procurement Process

Subsequent to the release of the AG's two reports, TCHC undertook a complete overhaul of its procurement process – an 18 month project. A revised Procurement Policy was drafted, and new Procurement Procedures and Procurement protocols were developed.

The 'new' procurement process:

- Substantially increased the controls within the procurement process;
- Created processes to be followed to ensure procurement projects were properly completed, and within the requirements set out in the revised policy, procedures, and protocols;
- Includes the use of standard form contracts;
- Has increased the efficiency of the procurement process;
- Includes quarterly reporting to the TCHC Board of Directors on various procurement metrics; and
- In 2014, saved TCHC approximately \$22.3 million in potential spend (i.e. cost avoidance).

Results of Award Testing

During this engagement we tested:

- The use of the Vendor Award Committee process;
- File documentation;
- The creation and use of Vendor Rosters;
- Monitoring of the status of procurement projects;
- Every type and size of procurements made (e.g. under \$7,500, between \$7,500 and \$50,000, between \$50,000 and \$100,000, over \$100,000, with and without the use of a vendor Roster, open tenders, direct award contracts, monitoring of Roster vendor selection, etc.); and
- Change orders.

In all cases, no significant exceptions were found.

Recommendations

We did come across some minor areas that do require a further review by management. In summary, these are related to:

- The creation of a change order protocol;
- The creation of a protocol with respect to the use of electronic signatures in the procurement process; and
- The retention in procurement files of business cases for applicable non-capital purchases.

General Comment

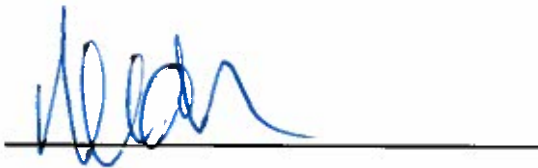
As noted, the TCHC procurement process was turned upside down and sideways and essentially recreated subsequent to the AG's two reports. The fact that no significant exceptions were found during our review of the TCHC procurement process is remarkable, and a testament to the hard work of TCHC Procurement management and staff in making the TCHC procurement process 'right'.

CONTACT

David Fanone
Internal Audit Analyst
Internal Audit Department
416-981-4219
David.Fanone@torontohousing.ca

Barb Kapeluch
Business Analyst
Internal Audit Department
416-981-4209
Barb.Kapeluch@torontohousing.ca

SIGNATURE



Michael Vear, CPA, CA, CPA (Illinois)
Chief Internal Auditor
Internal Audit Department
416-981-4065
Michael.Vear@torontohousing.ca

1.0 BACKGROUND

1.1 Auditor General Reports

Toronto Community Housing Corporation Procurement Report

In 2010 the AG conducted a review of TCHC's procurement policies, processes, and practices. In the AG's December 7, 2010 report, *Toronto Community Housing Corporation Procurement Policies and Procedures are Not Being Followed* (the Report)¹, the AG identified several instances of non-compliance with the TCHC procurement policies and procedures, including but not limited to:

- The open tendering process was not always being used;
- Single tendering was common and, in some cases, inappropriately used;
- Purchase orders were routinely split in order to avoid the requirement of seeking proper authorizations;
- A lack of documentation in support of contract awards and decisions to single tender; and
- Controls over purchases less than \$10,000 were inadequate.

In short, the Report was not complimentary at all about TCHC's procurement practices. The AG did note that at that time the TCHC procurement policies and procedures were well documented and acceptable. The problem was that they were just not being followed.

The AG included 31 Recommendations in the Report. Two of the remaining, unimplemented Recommendations of the Report were the impetus of this engagement:

Recommendation 11

The CEO, as required by the Board approved Policy, implement a structured and ongoing program of procurement reviews. Such reviews should address ongoing compliance with policies and procedures and where instances of non-compliance are identified appropriate action be taken.

Recommendation 14

The CEO direct staff that all future tenders be required to comply with the TCHC's open tender policy.

The Internal Audit Unit conduct regular and random reviews of all future tenders to ensure compliance.

¹ This report was presented to the TCHC Board by the AG at its March 3, 2011 meeting.

Where instances of non-compliance are identified appropriate disciplinary action be taken.

Housing Services Inc. Procurement Report

In 2011 the AG also conducted a review of the procurement policies, processes, and practices of Toronto Community Housing Corporation's subsidiary, Housing Services Inc. (HSI)². In the AG's December 9, 2011 report, *Review of Controls Over Procurement and Payment Functions at TCHC Subsidiary: Housing Services Inc.* (the HSI Report) it was again noted that there were deficiencies in HSI's compliance with its procurement policies and procedures, though not to the extent previously noted at TCHC.

The AG included 19 Recommendations in the HSI Report. One of the remaining, unimplemented Recommendations of the HSI report was also included within the scope of this engagement:

Recommendation 15

The Chief Executive Officer (of HSI) implement procedures to ensure appropriate monitoring and enforcement of procurement procedures and controls. Monitoring should include:

- a) Spot checks or audits of compliance with competitive procurement thresholds by staff independent of the contract award*
- b) Periodic review of exception reports identifying any non-compliance or overrides to the electronic approval process.*

1.2 Overhaul of the TCHC Procurement Process

Subsequent to the release of the AG's two reports, TCHC undertook a complete revamp and overhaul of its procurement policies, procedures, and practices. This was not an insignificant undertaking – it took over 18 months to complete.

The revised procurement policy and accompanying procedures and protocols (collectively the Procurement Policy or the procurement process) were reviewed and approved by the TCHC Board in the non-public session of its October 22, 2012 meeting. As was noted in the covering report submitted to the Board:

- A third party consulting firm was used to develop the Procurement Policy;
- The Procurement Policy took into account applicable recommendations from other AG reports, City of Toronto policies, and the recommendations contained in Madam Justice Bellamy's 2005 report, '*Toronto Computer Leasing Inquiry, Toronto External Contracts Inquiry*';

² Subsequent to the release of the HSI Report, TCHC wound down HSI and HSI's operations were integrated into TCHC. However, the Recommendations contained in the HSI Report are still required to be implemented.

- A high level procurement streaming process was developed, along with document templates for tendering and contracts;
- The Procurement Policy incorporated best industry practices for the public sector; and
- All TCHC staff were to be trained on the new procurement system.

The revised Procurement Policy approved by the Board consisted of

- a) The TCHC *Procurement Policy* (which set out the general principles for the procurement function);
- b) The TCHC *Procurement Procedures* (which detailed the principles, procedures, roles, and responsibilities for the TCHC procurement program); and
- c) 14 different procurement protocols that addressed, in considerable detail, a number of procurement matters.

Since that time two additional protocols have been developed, and three more are in draft stage.

In addition, the procurement process has increased its efficiency and effectiveness through:

- The use of electronic signature approvals which allows for a more streamlined, essentially paperless approval process;
- Pipeline reports which enable status reviews of procurement projects;
- Making the RFP submission program essentially electronic through the MERX website³;
- Not only requiring Purchase Orders for all expenditure payments at TCHC, but also quarterly reporting to the Board on what purchases were made without the use of a purchase order; and
- The use of a Vendor Awards Committee, which requires a committee of four senior TCHC employees to approve all procurements greater than \$50,000.

1.3 Believe It or Not

Procurement Award

In 2014 TCHC won the *Leadership in Public Procurement Award* from Summit Magazine and the Canadian Public Procurement Council. As was reported to TCHC staff, "*the award recognizes leadership, excellence and experience in the public sector purchasing and supply chain management communities.*"

³ MERX is the industry leading service in Canada for electronic tendering in both the public and private sector.

Ontario Government Supply Chain Procurement Directives

In January 2015 the Procurement Department completed a self-review of the Procurement Policy relative to the Ontario Government's Supply Chain Secretariat Broader Public Sector (BPS) Procurement Directives. The BPS Supply Chain Secretariat is a branch of Supply Chain Ontario, Ontario Shared Services, Ministry of Government and Consumer Services.

The BPS Supply Chain Secretariat oversees implementation of the BPS Procurement Directive, which sets out procurement rules in the purchase of goods and services with public funds under the *Broader Public Sector Accountability Act, 2010*.

The Procurement Department has reported that as a result of their self-review, of the 25 BPS Procurement Directives, the TCHC Procurement Policy met or exceeded all 25 directives.

2.0 ENGAGEMENT OBJECTIVE, SCOPE AND METHODOLOGY

2.1 Audit Objective

The objectives of this engagement were to:

- (a) Assess the adequacy of the Procurement Policy;
- (b) Evaluate whether procurement activities comply with the Procurement Policy;
- (c) Determine the extent to which internal controls over procurement activities are operating effectively; and
- (d) Identify opportunities for improvement, as appropriate.

2.2 Audit Scope and Methodology

Engagement History

This engagement has been a long time coming. Subsequent to the Report, TCHC undertook a complete update of its procurement process. This involved not only a review of procurement processes, but also a revised Procurement Policy, a new procurement Procedures document, and the introduction of numerous procurement protocols. This was a comprehensive endeavour, undertaken over many months. This resulted in a delay in the Internal Audit review of the TCHC procurement practices as prescribed by the Report.

During this time period PricewaterhouseCoopers (PwC) was engaged by the TCHC Finance Department to conduct specified procedures with respect to the procurement process, amongst other activities. The Internal Audit Department monitored the results of these engagements.

Assistance from the City of Toronto Internal Audit Department

The City of Toronto's Internal Audit Department has had considerable experience in conducting procurement audits and identifying control points in the procurement process. In anticipation of reviewing the revised TCHC procurement process, at our request, the City of Toronto's Internal Audit Department assisted the TCHC Internal Audit Department in:

- Completing a process mapping of the entire revised procurement process;
- Identifying internal control points in the procurement process; and
- Developing an ongoing procurement compliance monitoring and reporting plan that could be used by the TCHC Internal Audit Department.

Current Procurement Internal Audit

This engagement utilized the procurement compliance monitoring and reporting plan designed with the assistance from the City's Internal Audit Department.

The scope of this internal audit covered procurement activities between January 1, 2014 and December 15, 2014.

The audit approach included, but was not limited to, the following:

- A review of the Procurement Policy;
- A review of the PwC March 2013/April 2014 *Procurement Review* report;
- A review of the PwC January 2014 *Specified Procedures* report;
- A review of the PwC December 2014 *Specified Procedures* report;
- A walkthrough of the various procurement processes (Formal Invitational Competition, Informal Invitational Competition, Direct Award, Single Tender, Emergency Purchases, Formal Agreements, Divisional Purchases, Limited Competition, Open Competition, Roster Selection Process, etc.);
- Documenting and process mapping the various procurement processes, identifying key controls in place, identifying potential gaps in controls and/or recommended controls to be implemented;
- A review of training materials pertaining to new procurement processes that were provided to business unit staff;
- Developing an understanding of functionality and reporting capabilities of computer system(s) supporting the procurement process;
- Interviews with appropriate TCHC staff (i.e., Strategic Procurement Unit, Business Units, etc.) to identify roles and responsibilities;
- Validating our understanding of procurement processes and the practicality of suggested control processes with stakeholders, and revised as necessary;
- Performing audit tests to assess procurement process internal controls and compliance with the Procurement Policy; and
- Discussing our findings and recommendations with management to obtain feedback from the Procurement unit.

For all intents and purposes, this is the first comprehensive internal audit of the TCHC procurement process in a very long time.

2.3 Acknowledgements

During the course of this engagement, Internal Audit received full and unrestricted access to TCHC staff and documents that were available. We would like to particularly thank the management and staff of the Procurement Department for their assistance during this engagement.

Acknowledgement also has to be given to the City of Toronto's Internal Audit Department for the assistance and direction given to the development of the audit plan. The former AG often spoke of shared services amongst the City of Toronto and its ABCCs. This is an example of such shared services, though it was in the form of knowledge transfer.

For the record and for the benefit of TCHC's sole shareholder, the assistance from the City's Internal Audit Department did not come without some cost to TCHC. TCHC was charged, and paid, on a cost recovery basis for this assistance.

3.0 DETAILED FINDINGS

3.1 Procurement Infrastructure

The engagement included a review of the infrastructure in the Procurement Department. By 'infrastructure', we mean those 'behind the scenes' or 'back office' operations that serve as the foundation of the procurement process at TCHC.

Procurement Policy, Procedure, and Protocols

As noted earlier, the previous procurement policies and procedures were completely overhauled subsequent to the AG Report. What was created was a well-structured series of documents as follows:

- Procurement Policy – a document that sets out the overriding principles that govern the procurement function at TCHC;
- Procurement Procedures – this document sets out, in considerable detail, *“the principles, procedures, roles, and responsibilities for Toronto Community Housing’s ... procurement program”*; and
- Protocols – these are more detailed documents that provide even more detailed instructions on specific procurement topic areas (e.g. management of vendor roster, bid irregularities, and direct award and limited competition). There are 16 different protocols in all.

We found the Procurement Policy, Procedures, and all of the protocols to be relevant and up to date.

In addition, the Procurement Department has a quite detailed section on the TCHC intranet that provides even more guidance and assistance to TCHC employees with respect to the procurement process. These pages were updated in January 2015 to enhance usability and navigation.

Vendor Award Committee

The revised procurement processes include the creation of a Vendor Award Committee (VAC). The standing members of VAC are comprised of:

- The Manager of Strategic Procurement (Committee Chair);
- The Senior Director, Strategic Procurement;
- Legal Counsel; and
- The Financial Controller (or designate).

Any item being procured that has an estimated value of \$50,000 or more must submit the procurement request to VAC for review and approval. The general purpose of VAC is to ensure that all proper procurement procedures have been followed with respect to the item seeking approval. Essentially, VAC serves as the first threshold in the procurement process. If a request is not approved by

VAC, it is not going to be procured. The Internal Audit Department has learned this from firsthand experience.

The use of VAC in the procurement process did not exist before. Complementary to the need to have a purchase order for all vendor payments, VAC has proven to be a critical component in the prevention of non-compliant procurements.

How the VAC actually works, and the documents required to be submitted for review, are set out in *Procurement Protocol 10: Vendor Award Committee (VAC) Protocol*. Once a procurement has been approved by VAC, then the appropriate further approval steps are taken.

Our review of procurement awards found no exceptions in the use of the VAC process.

Procurement Contracts

With the assistance of the TCHC Legal Services Department, standard contract templates have now been developed. These can be tailored to fit the needs of a particular procurement order. There are now standard terms and conditions used in the procurement process, designed to provide the most favourable terms to TCHC to mitigate its risk exposure.

In addition, each procurement contract is reviewed prior to execution by the TCHC Legal Counsel that is dedicated to the procurement function.

File Documentation

We selected a number of procurement files at random to ensure that all necessary documents were retained and available. No significant issues were noted.

Procurement Rosters

At TCHC there are many instances where the same type of good or service is required on a regular and/or recurring basis. In those cases, it is not efficient nor is it cost effective to initiate a new open procurement process each time that particular good or service is required. In such cases, a roster of qualified vendors is established to streamline the procurement process⁴.

As noted in *TCHC Procurement Protocol 4: Establishment and Management of Qualified Vendor Rosters* a "Roster means a list of vendors that have participated in and successfully met the requirements of a Request for Vendor Qualifications, and have been prequalified to perform discrete work assignments involving the delivery of a particular type of goods or services".

⁴ In other agencies and levels of government, a 'Roster of Vendors' is known as a 'Vendor of Record' or a 'VOR' list.

It is not uncommon for organizations to create rosters of pre-qualified vendors in common segments of purchasing.

Subsequent to the AG Report, TCHC's Rosters of vendors were updated and refreshed. As at December 31, 2014, the Procurement Department was working on refreshing, again⁵, all of the vendor Rosters through a Request for Vendor Qualifications program, with the support of Facilities Management who are upgrading the related scopes of work.

Monitoring of Procurements

In what could be considered a significant improvement in the efficiency and effectiveness of the procurement process, all procurements are monitored on a regular basis to ensure projects move through the procurement process on a timely basis. Given the dollar spend out of Procurement in 2014 (\$83 million) and the anticipated procurement spend in 2015 (\$110 million), this is a much needed improvement which will ensure, to the greatest extent possible, that the capital and operating amounts approved by the Board are actually spent in the year approved.

The monitoring starts before the procurement is requested:

- Departments are asked to submit future procurement activities so that the Procurement Department can adequately plan resources; and
- Early identification of similar procurement requests also allows for bulk purchasing.

During the procurement process there are pipeline reports generated from the various procurement databases that identify the status of a particular procurement item. Facilities Management and Procurement staff meet weekly to review the status of procurements in the pipeline reports, and identify any potential delays.

Resources in the Procurement Function

The revised procurement process resulted in a more sophisticated procurement function to the organization. This has also required a significant increase in the resources required to properly execute the necessary activities.

Management has recognized this, and the Procurement Department is now nearly at the full employee complement necessary to accomplish the end goals of the procurement function.

⁵ The Roster contracts from the previous refresh were generally three years in duration and due for expiry.

Reporting to the Board

Since 2013 there has been a robust reporting of procurement metrics to the Business Investment, Finance, and Audit Committee (BIFAC)⁶ on a quarterly basis. Items reported to the Committee include the following:

- Procurement Metrics – this includes evaluation of such items as:
 - Post-Approval Procurement Requests – a list of procurements made without obtaining a purchase order in advance of the procurement (in purchasing parlance, the List of Shame). Fortunately this list is not long nor of a large dollar amount; and
 - Procurement Cost Avoidance
- Procurement: Contracts and Rosters – a detailed review of Roster awards
 - By total dollar spend by category; and
 - By rotation of vendor awards in individual roster categories
- Direct Awards Made
 - Including the use of City contracts and provincial VORs.

Such reporting has increased the transparency of the procurement function to management and the Board.

3.2 Review of Procurement Awards

Pursuant to AG Recommendation 14 noted above, we conducted a review of various types of procurement awards made in 2014.

Review of Procurement Call Documents Prior to Issue

There is now a process in place such that procurement call documents are properly reviewed prior to being issued.

Our review included a selection of procurement call documents to determine if:

- They had been reviewed;
- Contained the requisite documented approval; and
- The appropriate level of approval was obtained based on the dollar value of the procurement.

No exceptions were found.

⁶ Prior to January 2015, BIFAC was known as the Corporate Affairs and Audit Committee.

Awards Made Through a Competitive Process – No Existing Roster

When a procurement does not fall within a Roster defined category, the procurement documents set out, in detail, what process must be followed with a particular project. The process to be followed is determined by the estimated value of the project:

- \$7,499 or less – for capital purchases, one written quote is required. For operational purchases the quote requirements are more restrictive;
- \$7,500 to \$49,999 – an Informal Invitation competition is required. This requires that at least three qualified vendors submit written bids;
- \$50,000 to \$99,999 – a Formal Invitation process is used. This means the Procurement Department must conduct a competition by issuing a Solicitation Document to at least three qualified vendors to request submission of written, sealed bids; and
- \$100,000 and higher – an Open Competition is required, meaning a public tender is used.

A selection of procurements within these categories were reviewed to determine that based on the dollar value of the project, the appropriate number of quotes had been obtained and the correct process was used.

No significant exceptions were noted.

Awards Made Through a Competitive Process – Existing Roster

When a procurement falls within a Roster defined category, TCHC *Procurement Protocol 4: Establishment and Management of Qualified Vendor Rosters* sets out the specific procedures that must be followed for that procurement.

If the Roster includes agreed upon pricing for the services to be rendered, then work assignments are offered to vendors on the Roster on a rotational basis. If the first vendor on the list does not accept the assignment, then it is offered to the next vendor on the list. The rotation of work assignments is managed and monitored by the Procurement Department, or its designate, and must support the premise of equal access to all qualified vendors.

If the Roster does not include agreed upon pricing, the vendors on the Roster are invited to compete for particular assignments. This process is similar to that for non-Roster competitions. If the value of the project is:

- Less than \$100,000 – an Informal Invitation competition is required. This requires that *at least three* vendors on the Roster be invited to submit bids in the manner prescribed in the Roster's Framework Agreement;
- Between \$100,000 and \$499,999 – an Informal Invitation competition is required. This requires that *all* vendors on the Roster be invited to submit bids in the manner prescribed in the Roster's Framework Agreement; and

- \$500,000 or greater – the purchase must be made through an open competition, regardless of the availability of an existing Roster or Framework Agreement.

A selection of procurements within these three categories were reviewed to determine that based on the dollar value of the project, the appropriate number of quotes had been obtained and the correct process was used.

No exceptions were noted.

Direct Awards

A Direct Award competition is one in which

- a) The purchase is valued at more than \$7,500; and
- b) A Roster is not available; and
- c) A competitive process of obtaining multiple quotes or bids from multiple vendors is not completed.

Direct award contracts are also known as 'single-source' contracts. A subset of single-source contracts are the commonly referred to 'sole-source' contracts⁷.

The TCHC *Procurement Procedures* sets out the specific circumstances that must be met in order for a Direct Award contract to be made. In addition, TCHC *Procurement Protocol 15: Direct Award and Limited Competition Protocol* describes in detail the process for obtaining authorization to proceed with a Direct Award contract.

The VAC Committee must review and approve all Direct Awards. It should also be noted that the Procurement Department reports on a quarterly basis to BIFAC on all Direct Award contracts made.

A sample of Direct Award procurements were selected and reviewed to determine if they (i) were made in compliance with the Procurement Policy and (ii) obtained the appropriate level of approval.

No significant exceptions were noted.

3.3 Change Orders

A change order is work that is added to or deleted from the original scope of work of a procurement project. In most cases a change order will result in an increased scope of work and contract price.

It must be noted that the change order process and requisite approvals are not dissimilar to that for a new direct award request. The originating department

⁷ A 'single-source' contract is one in which there are several suppliers of a particular product but only one vendor is selected to provide a quote on that purchase. A 'sole-source' contract is one in which there is only one supplier in the marketplace that can provide that product.

submits the change order request to Procurement. The role of Procurement is to ensure that change order request is processed pursuant to the Procurement Policy.

In 2014, approximately 1,222 change orders were approved, as follows:

Change Orders That	No.	\$
Increased the contract price	935	10,037,000
Decreased the contract price	<u>287</u>	<u>(2,013,000)</u>
Total No./ Net \$ Increase	<u>1,222</u>	<u>8,024,000</u>

This is based on an approximate procurement level of \$120 million.

Change Orders – Procedural and Administrative Matters

Our review determined that the change order process generally works well. We did, however, come across some procedural and administrative matters that require further review by management:

Vendor Change Order Request Form

Change orders are generally initiated through a Vendor Change Order Request form (VCOR). We do note that the VCOR requires a minimum of four staff (with increasing seniority) to approve the VCOR before the change order can be processed. This is a good control point.

Though the VCOR meets the general needs of a change order form, we noted a number of improvements that could be made in the VCOR itself or in its use:

- The VCOR appears to allow for verbal quotes to be received for change orders. The Procurement Policy does not allow for verbal quotes to be received in any instance. This option should be removed from the VCOR;
- Approval signatures on the VCOR are oftentimes illegible. As a result, it is difficult to determine if the person signing off on the form has the appropriate authority to do so. Approvers' names should be clearly set out on the VCOR;
- The VCOR provides a section to identify the reasons for the change order (Customer Request, Contractor Request, Site Condition, and Other). We wonder if this section could be expanded to provide more specific reasons (e.g. 'Customer Request' could be further broken down to 'Change in Scope' (e.g. design change), 'Unforeseen Conditions', Changes in building code', etc.). This information could then be used for more extensive analysis of why change orders are made.

Lump-Sum vs. Per Unit Pricing

The change orders reviewed set out quotes received that had either lump-sum or per unit pricing. It was not known if these quotes followed the requirements of TCHC *Protocol #3: Pricing Structure Selection*, which sets out the conditions that would permit either lump-sum or per unit pricing.

Furthermore, this protocol does not address what pricing structure should be used in change orders (e.g. if the original contract used a per unit pricing structure, would a lump-sum pricing structure be acceptable in a change order for that contract?).

Dollar Limits for Change Orders

The VCOR form is the backbone of the change order process. It allows for greater scrutiny of the change order being requested.

It is the practice of the Procurement Department that VCOR forms are supposed be used when the cumulative total of the original procurement amount and the amount of the change order is equal to or greater than \$60,000. This \$60,000 amount is not set out in any official procurement document. We do not know how this amount was arrived at, nor do we know if it is a relevant amount.

It is our thought that a different threshold for the use of VROC forms may be more relevant.

Let's look at two examples to illustrate. Assume:

- 1) That the original contract was for \$58,000, and a change order came through for \$4,000; and
- 2) That the original contract was in the amount of \$25,000, and a change order was submitted for \$15,000.

For the first example, because the sum of the two amounts is greater than \$60,000, a VCOR form would be required. The change order represented a 6.9% increase in the contract price.

In the second example, because the sum of the two amounts is less than \$60,000, a VCOR form would not be required. However, the change order represents a 60% increase in the contract price. It does not appear right that a change order that represents a 60% increase in the original contract does not receive the same scrutiny as the first example.

Though we do not necessarily know what should be the optimum threshold that should be set vis-à-vis the use of a VCOR form, this should be reviewed by management.

Change Order Protocol

Except for two paragraphs in the TCHC *Procurement Procedures*, there is no procedure or protocol that provides more detailed guidance to staff about change orders and the change order process. We did come across a PowerPoint presentation from July 2011 that was given to then-HSI staff about the change order process. However its contents (i) have not been promulgated into a formal document and (ii) refers to a previous corporate structure that is no longer relevant in the current TCHC procurement environment.

As noted above, there are already a few items identified in the change order process that would benefit from such a procedure or protocol.

Recommendation #1

A TCHC protocol on change orders be developed. Such protocol should address, but not be limited to, such items as:

- a) The change order process(s);***
- b) Roles and responsibilities in the change order process;***
- c) Relevant forms that should be used and how they should be used;***
- d) Lump-sum vs. per unit pricing;***
- e) Thresholds for what change order process/document should be used; and***
- f) Authorization requirements for change orders.***

Subsequent to its development, appropriate training documents be developed and presented to the appropriate staff.

Analysis of Change Orders

Change orders are also a useful tool to:

- Assess specifications in previous RFP requirements that had change orders with a view to improving specifications and other requirements in future RFPs; and
- Analyze change order patterns vis-à-vis the integrity of the procurement process. For example, could an analysis of change orders discover a pattern of an excessive number of change orders between a vendor and particular TCHC employee?

It is our understanding that such analysis of change orders is sporadic, at best.

Recommendation #2

Consideration be given to developing a program of change order analysis, with a view to (i) decreasing the number of change orders in future and (ii) identifying unusual patterns of change orders.

3.4 Monitoring of Roster Selection

The use of a Roster generally means that the vendors on the Roster list will receive procurement awards either (i) in a balanced, equitable distribution or (ii) within the terms set out in the RFP for the procurement.

In the past, the distribution of Roster procurements was not necessarily reviewed for fairness of distribution.

Since 2013 Procurement has been regularly monitoring Roster selection. In addition, there has been quarterly reporting to BIFAC on the (i) amount of monies spent using Rosters and (ii) rotation of vendors within specific Roster categories.

3.5 Electronic Signatures

In 2014 the Procurement Department started a pilot project wherein electronic signatures, as opposed to hand-written signatures, would be used to facilitate review and approvals of documents.

In summary, the use of electronic signatures:

- Allows all documents to be scanned, electronically tracked, and emailed to appropriate personnel for review, approval, and 'signature';
- Expedites the approval process - upon one level of approval being made, the documents are automatically sent to the next level of approval;
- Permits real time tracking of the status of a particular procurement project in the system;
- Generally increases the efficiency in the procurement approval process; and
- Significantly reduces the amount of paper hard copy documents used.

The use of electronic signatures has proven to be a success in the procurement process.

However, there is no approved procurement protocol and/or TCHC policy that sets out the parameters etc. of how electronic signatures should be used. The Procurement Department has developed a draft protocol about electronic signatures, it is currently under review and has not been finalized. Given the fact that electronic signatures are currently being used, a protocol and/or policy on the use of electronic signatures should be finalized as soon as possible.

In addition, it may very well be that the use of electronic signatures could be expanded to other TCHC departments or functions.

Recommendation #3

A protocol and/or policy with respect to the use of electronic signatures in the procurement process be developed, approved, and distributed to TCHC staff.

Consideration be given to reviewing the applicability and usefulness of electronic signatures in other TCHC operations.

3.6 Business Case Document Retention

The procurement process requires that for procurements \$50,000 or higher an appropriately approved business case for the procurement must be prepared and submitted. The business case forms a part of a procurement file documentation.

We found that for applicable procurements from TCHC departments other than Facilities Management, not in all cases was a copy of the procurement's business case retained in the procurement file.

Recommendation #4

When a business case is required to commence a non-capital procurement project, a copy of the business case should be sent to the Procurement Department and retained in the particular project's procurement file, as supporting documentation for the procurement being made.

3.7 Procurement Savings

As noted above, there have been many changes and improvements to the procurement process at TCHC. While we have observed that there is general compliance with the procurement process, a question could be asked if TCHC has reaped any savings as a result, particularly with the refresh of vendor Rosters.

In any municipal environment, it is sometimes difficult to measure savings reached. The Procurement Department has found such a measurement:

Since 2013 TCHC has adopted an industry standard procurement metric to monitor the efforts and impact of the Procurement Department and the value being generated on behalf of the Shareholder.

Known as "Procurement Cost Avoidance", the model is predicated on the clear assumption that the competitive public procurement process conducted by TCHC purchasing professionals is an intentional action that results in lower costs for goods, services and construction than would

otherwise be obtained by the organization without such competition.
(**emphasis** not added)⁸

As represented to us by procurement officials, this methodology is used widely in private industry and has been adopted by the public sector, including (i) the National Association of State Procurement Officials (NASPO) in their Research Brief "*Benchmarking Cost Savings & Cost Avoidance*", September 2007 and (ii) the Government of Ontario.

In summary, the Procurement Cost Avoidance amount equals (a) the average value of bids received in a particular procurement award less (b) the amount of the winning bid. The cost avoidance is actually a savings to TCHC.

In 2014, Procurement Cost Avoidance totalled **\$22.3 million or 21%** of the average bids.

⁸ *Procurement: Metrics* report, dated November 20, 2014.

4.0 FUTURE INTERNAL AUDIT REVIEWS OF PROCUREMENT

4.1 General Internal Audit Reviews

As noted above, this engagement was the first substantive review of the TCHC procurement process. We are impressed with the advances that have been made since the AG Report. In addition, there are:

- Numerous checks and balances;
- Self-review programs; and
- Open and transparent reporting to the Board

in place which mitigates the risk of substantive non-compliance taking place in the procurement process.

We are cognisant, however, of the fact that with an increased capital spend over the next 10 years, procurement operations will represent a significant portion of TCHC's annual non-employee expenditures for several years. It is imperative that future Internal Audit reviews of the procurement operation be conducted to ensure that compliance with the Procurement Policy is adhered to.

Accordingly, Internal Audit will be scheduling future reviews of the procurement function every two or three years. Most likely the next review will commence late 2016 / early 2017.

Appendix A

Internal Audit - Procurement Compliance Review
Management's Response - March 17, 2015

Rec. No.	Recommendation	Agree (X)	Disagree (X)	Management Comments	Action Plan / Time Frame
1	<p>A TCHC protocol on change orders be developed. Such protocol should address, but not be limited to, such items as:</p> <ul style="list-style-type: none"> a) The change order process(s); b) Roles and responsibilities in the change order process; c) Relevant forms that should be used and how they should be used; d) Lump-sum vs. per unit pricing; e) Thresholds for what change order process/document should be used; and f) Authorization requirements for change orders. <p>Subsequent to its development, appropriate training documents be developed and presented to the appropriate staff.</p>	X		<p>Agreed. Similar to other procurement processes, the change order process is initiated by the department seeking the change. Procurement is tasked with administering the change order request received. The development of a change order protocol will require inputs from several TCHC departments (Procurement, Facilities Management, Asset Management, Finance, Information Technology, and Legal Services).</p>	<p>Development and approval of a change order protocol. Q315</p> <p>Roll out of appropriate training. Q415</p>
2	<p>Consideration be given to developing a program of change order analysis, with a view to (i) decreasing the number of change orders in future and (ii) identifying unusual patterns of change orders.</p>	X		<p>Agreed. A review was run at year end 2013 to test change order patterns, and no issues were discerned at the time.</p>	<p>A program of change order analysis will be developed. Q315</p>

Appendix A
Internal Audit - Procurement Compliance Review
Management's Response - March 17, 2015

Rec. No.	Recommendation	Agree (X)	Disagree (X)	Management Comments	Action Plan / Time Frame
3	<p>A protocol and/or policy with respect to the use of electronic signatures in the procurement process be developed, approved, and distributed to TCHC staff.</p> <p>Consideration be given to reviewing the applicability and usefulness of electronic signatures in other TCHC operations.</p>	X		<p>A draft protocol with respect to the use of electronic signatures in the procurement process is currently being reviewed by the Executive Leadership Team.</p>	<p>Final protocol will be issued Q215.</p> <p>Consideration will be given to reviewing the applicability and usefulness of electronic signatures in other TCHC operations. Q415</p>
4	<p>When a business case is required to commence a non-capital procurement project, a copy of the business case should be sent to the Procurement Department and retained in the particular project's procurement file, as supporting documentation for the procurement being made.</p>	X			<p>The inclusion of business case documents in non-capital procurement files will be strictly enforced. Q215</p>