CITY AND COUNTY OF SAN FRANCISCO
OFFICE OF THE CONTROLLER

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MEMORANDUM

TO: Commission President Mazzola and Commissioners
San Francisco Airport Commission

John L. Martin, Airport Director
San Francisco International Airport

FROM: Tonia Lediju, Director of City Audits
City Services Auditor Division

DATE: February 27, 2014

SUBJECT: Airport Commission: The Airport's Equipment Procurement Process Is Adequate but Should Be Strengthened

EXECUTIVE SUMMARY

The equipment procurement process at the Airport Commission (Airport) is generally adequate but should be improved to increase compliance with City and County of San Francisco (City) requirements and to reduce the risks associated with equipment procurement. Although it capitalized equipment assets at the proper value, the Airport:

- Does not have written equipment purchasing policies that would guide staff and promote process uniformity and compliance with requirements.
- Will improve its internal controls over the purchasing process if it reviews its purchases by vendor.

The Airport has reviewed the three findings and concurs with the three related recommendations. The Airport's response is attached.

BACKGROUND, OBJECTIVES & METHODOLOGY

Background

Audit Authority. This audit was conducted under the authority of the Charter of the City and County of San Francisco (City), Section 3.105 and Appendix F, which requires that the Office of the Controller's City Services Auditor Division (CSA) conduct periodic, comprehensive financial

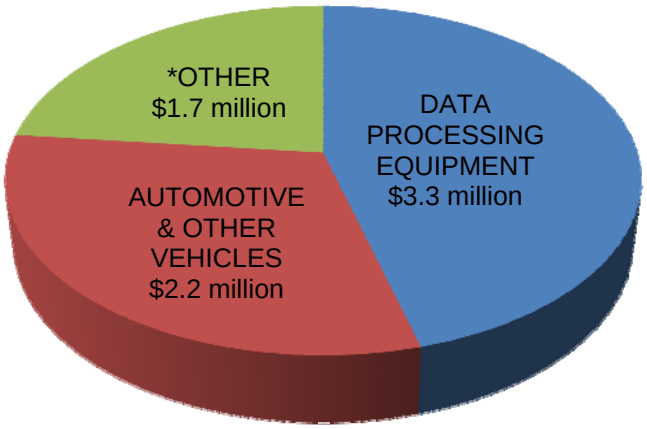
and performance audits of city departments, services, and activities. In accordance with its fiscal year 2012-13 approved work plan, CSA audited the Airport's equipment procurement process.

San Francisco International Airport. San Francisco International Airport (SFO) has four terminals, three of which are domestic and one international. SFO serves more than 41 million domestic and international passengers yearly.

Procurement Function. According to Airport staff, the purpose and essential function of procurement at the Airport is to purchase the materials, equipment, supplies, and services that support the Airport's operations and the traveling public. In serving the Airport's needs, the procurement staff is dedicated to providing efficient and responsive services, in full compliance with the City's legal requirements, while upholding the highest ethical and professional standards.

Exhibit 1 gives an overview of how the Airport used the $7.27 million it spent buying equipment in fiscal year 2012-13.

EXHIBIT 1 Airport Equipment Purchases Fiscal Year 2012-13



* Note: "Other" consists of "Animal Purchase, Broadcast Equipment, Equipment ($5k or less), Other Equipment, Safety & Rescue Equipment, and Shop; Building & Field Maintenance Equipment"

Source: Airport's asset purchases from FAMIS Purchasing in fiscal year 2012-13.

Airport Business and Finance Division. The Business and Finance Division (Business and Finance), in association with the Office of Contract Administration (OCA), is responsible for processing the Airport's equipment procurement. Specifically, two groups in Business and Finance process purchases. The Operations Accounting Group processes equipment funded from local or nonproject funds. The Capital Project & Grant Accounting Group processes project-funded purchase requests. In addition to Business and Finance staff, there are two OCA employees located at the Airport who help procure equipment.

Office of Contract Administration. OCA manages more than 1,500 contracts valued at approximately $2 billion. At the Airport, OCA staff participates in the procurement of all equipment valued at over $10,000. OCA requires departments to use competitive bidding procedures to select vendors and requires that all city vendors comply with city ordinances and other requirements before entering into a contract with the City. The following are the common types of purchase order agreements.

- *Citywide Blanket Purchase Order (term contract):* Citywide blanket purchase orders, also called term contracts, are fixed price, multiyear (at least three years) contracts used by one or more departments for large quantities of products or services. Term contracts may cover a wide variety of goods and services for which the City has a large and reccurring need. For example, term contracts may be used for office supplies, fuel, information technology, and janitorial services.

- *Contract Purchase Order:* For construction, professional services, and other transactions, the City may prepare a contract purchase order (signed by OCA with the exception of construction) and a separate contract (approved by the department, the vendor, the Office of the City Attorney, and OCA). The contract purchase order verifies that funds have been encumbered and, consequently, performance can begin. The contract itself provides a detailed description of the duties and responsibilities of the vendor and the City.

- *Departmental Blanket Purchase Order:* A departmental blanket purchase order (DPBO) enables a department to order goods and/or services directly from a vendor in accordance with the DPBO's terms. Each DPBO must be approved by OCA and is for the department's use only.

- *Departmental Purchase Order for Delegated Departmental Purchases (Prop Q Purchases):* Under OCA guidelines, a department may place its own orders for products up to $10,000 (including tax and shipping). Departments are encouraged—but not required—to solicit competitive bids.

Airport Procurement Process. The Airport primarily uses four documents in the procurement process. These are the:

- *Initial requisition form,* which is used by the requesting Airport section to initiate the purchase request. Business and Finance staff uses this form to commence the procurement and approval process.

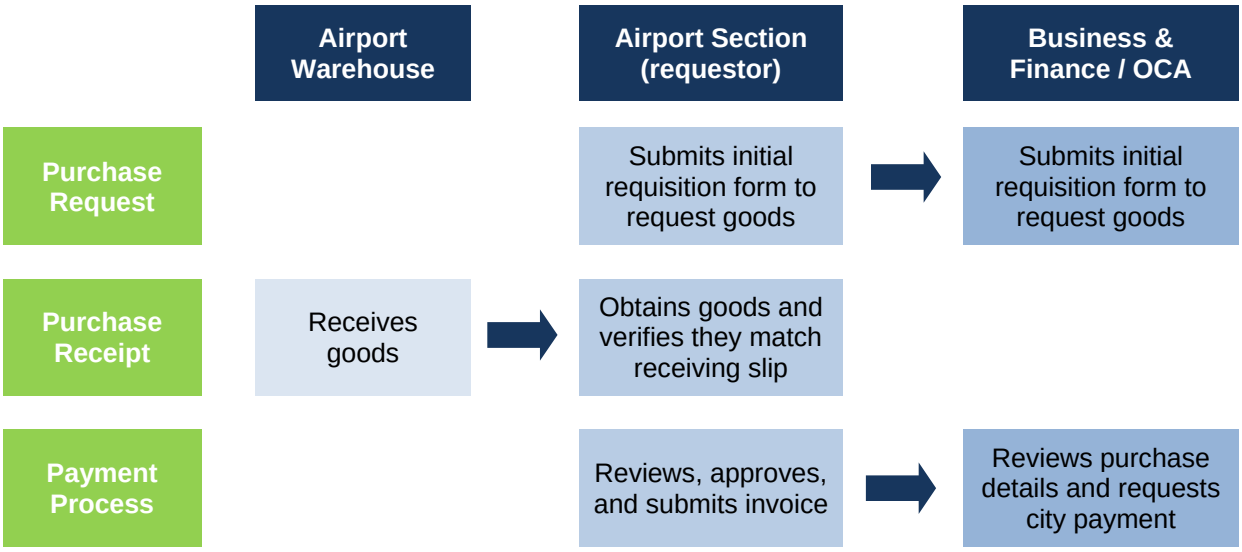
- *Purchase order,* which is used for a one-time purchase of a definite quantity of goods and is approved by Business and Finance or OCA, depending on the purchasing authority. Funds are encumbered before a purchase order is issued.

- *Receiving slip,* which is shipped with the goods and is used as a supporting document that lists the purchased goods shipped. The requesting section must reconcile the receiving slip to the invoice.

- *Invoice* for the purchase, which is reviewed and approved by the Airport section that requested and received the purchase. Business and Finance verifies the section's approvals on the invoice and compares the invoice to the purchase order for payment processing.

Exhibit 2 shows the Airport's procurement procedures and use of purchasing documents.

EXHIBIT 2 Summary of Airport's Purchasing and Payment Process



Note: For purchases $10,000 and less and not under term contracts.

Source: Auditor's interviews with the Airport and OCA.

The City's Accounting and Purchasing System. The Airport uses the purchasing component of the City's accounting system, Financial Accounting and Management Information System (FAMIS). Called FAMIS Purchasing, this component is used to record accounting entries related to purchases. All purchases of goods and services are processed through FAMIS Purchasing at the Airport. FAMIS Purchasing information automatically interfaces to the accounting component of FAMIS. Through the process of posting an encumberance transaction in FAMIS Purchasing, certification of available funds for all purchases, contracts, and other obligations is confirmed.

Objectives

The objectives of the audit were to:

- Evaluate the adequacy of the Airport's purchasing procedures and internal controls over the purchasing process.

- Determine whether the Airport complied with city and Airport requirements when purchasing equipment.

- Determine whether the Airport properly recorded equipment purchases.

Methodology

The audit focused on the equipment procurement process at the Airport during July 1, 2012, through June 30, 2013. To conduct this audit, CSA:

- Interviewed OCA and Airport staff to understand the equipment procurement process. Staff of the following Airport divisions and sections was interviewed: Business and Finance, Design and Construction, Maintenance, and Information Technology and Telecommunications.

- Surveyed all Airport sections to understand procurement procedures, including receiving purchases.

- Randomly and purposefully selected and tested samples as follows:

    - 40 equipment purchases and 10 asset equipment additions were tested for compliance with city and Airport requirements, including proper approvals, proper retention of supporting documentation, and appropriateness according to the item's purchasing contract and/or purchasing authority.
    - 18 equipment assets were tested to verify that the assets were recorded at the correct value.
    - 22 equipment assets from the maintenance section that were serviced during the audit period were tested for proper approval and purchasing documentation.
    - 17 vendor files were tested to verify that vendors met two eligibility requirements: compliant with requirements of Chapter 12B of the City's Administrative Code and current on business taxes.

This performance audit was conducted in accordance with generally accepted government auditing standards. These standards require planning and performing the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. CSA believes that the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objectives.

RESULTS

Finding 1 – The Airport increases the risk of making purchases improperly because it lacks written equipment procurement policies.

The Airport has not issued written policies and procedures to its sections documenting their responsibilities in the equipment procurement process. Of the 29 Airport sections that responded to the audit's survey, 28 (97 percent) did not have written purchasing and receiving procedures. Further, Business and Finance does not have internal written policies or procedures for equipment procurement processing or recording.

No departmental policy. According to Airport staff, the Airport's sections must send Business and Finance an initial requisition form when the section needs to purchase an item. This requisition must contain information in the required fields for the purchase request, including:

- Vendor name and identification number
- Type of purchasing authority
- Quantity of item purchased
- Description
- Unit price

Signatures of at least two section staff (requestor and approver) are required. When purchases are received, Airport sections must verify that the goods received and receiving slips match the purchase order. When the invoice is received, Airport sections must verify that the invoice is accurate, document this approval, and send the approved invoice to Business and Finance for payment. However, these requirements are not in writing and have not been distributed to Airport sections. Without a departmentwide equipment procurement policy explaining the procurement responsibilities of Airport sections, they may inconsistently or incorrectly request, receive, or process equipment purchases.

No Business and Finance Division policy. Business and Finance staff performs various reviews and keeps incompatible duties segregated, but these procedures and requirements are not documented. For example, Business and Finance staff verifies that the initial requisition form was requested and approved by two section personnel before processing the purchase request. After a Business and Finance employee enters the purchase in FAMIS Purchasing, a different Business and Finance employee reviews the entry. If the purchase exceeds $10,000, one of the Airport's OCA purchasers also reviews the entry.

Business and Finance staff reviews that an invoice requesting payment for goods was correctly approved by section personnel and verifies that the invoice matches the purchase order. An employee then enters the request for payment into FAMIS Purchasing, and then the request is reviewed and approved by a Business and Finance supervisor.

According to Airport staff, although they have not been documented, these processes and requirements are understood and always performed for purchases. However, the lack of written

policies and procedures increases the risk of purchases not being made in compliance with Airport or city purchasing requirements. Also, a new employee may have more difficulty in assuming purchasing duties when no written procedures exist.

The United States Government Accountability Office states that an organization's internal controls and transactions must be clearly documented, and the documentation should appear in management directives, administrative policies, or operating manuals.

Business and Finance has a "Procurement Booklet," which has been distributed to Business and Finance staff and other Airport sections to explain the purchasing process. However, the booklet only provides a general overview for staff reference and does not explain section purchasing responsibilities in detail.

Recommendations

The Airport Commission should:

1. Document and implement formal policies and procedures for processing and recording equipment purchases.

2. Create and distribute departmental equipment procurement policies and procedures that document the required responsibilities of Airport sections in the equipment procurement process.

Finding 2 – The Airport will improve its internal controls over the purchasing process if it reviews its purchases by vendor.

The Airport lacks adequate detective controls over the purchasing process and will improve these controls by analyzing its purchases by vendor. The Airport does have preventive controls over the purchasing process. For example, Business and Finance:

- Reviews initial requisition forms that are submitted by Airport sections at or near the same time for order splitting to prevent evasion of OCA competitive-bidding procedures that are required for purchases exceeding $10,000.
- Reviews initial requisition forms for appropriateness and proper approvals.
- Verifies that the Airport has sufficient funds to procure the requested equipment asset.
- Requires multiple reviews of entries to be made in FAMIS before a purchase order is initiated.

However, the Airport does not have detective controls that are needed if the preventive controls fail. Although the Airport reviews initial requisition forms for order splitting, Business and Finance may not identify a section's attempts to split orders if the purchases are submitted far enough apart to avoid detection. Also, without a review of its purchase activity by vendor, the Airport may miss opportunities for cost savings or may not detect purchases made from unusual

vendors that should be further investigated. Based on a sample of 40 equipment purchases and 10 assets tested, the audit found no improper purchases, inappropriately approved purchases, or purchases that did not comply with city and Airport requirements. This may indicate that the preventive controls are operating as intended.

Regularly reviewing purchasing data, especially by vendor, is a recommended practice. For example, the City and County of Denver's Office of the Auditor recommended in a 2013 audit report[1] that Denver International Airport review purchasing data quarterly to prevent or detect the inappropriate approval of high-dollar or high-risk purchases and to prevent split purchases intended to circumvent signature authority or authority limits. Also, according to New York's state comptroller, reviewing purchases by vendor provides management with a big picture of the scope and nature of purchases made. This review may indicate opportunities for cost savings and can be used to identify aggregate purchases that may be subject to competitive bidding. It may also reveal unusual and questionable vendors.

Recommendation

3. The Airport Commission should review at least quarterly its equipment purchase activity by vendor and identify if all equipment purchases and vendors appear to be proper or, alternately, unusual or improper.

Finding 3 – The Airport capitalized equipment assets at the correct value.

Based on 40 audited equipment purchases, 18 included the completed purchase of at least one piece of equipment that was $5,000 or more in value. CSA verified that at least one of the equipment assets procured through each of these purchases was properly capitalized at the correct value. According to the City's Fixed Assets Definitions and Guidelines, city departments must capitalize equipment fixed assets worth $5,000 or more and have an estimated life or more than one year. The purchase price of each of these items was compared to the price on the invoice, the price on the purchase order, and the price recorded in the Airport's fixed asset list. In all cases, the prices matched. The assets also had an estimated life of more than one year. Therefore, the Airport complied with the City's fixed assets guidelines in this regard.

The Airport's response is attached. CSA will work with the Airport to follow up on the status of the recommendations in this memorandum. CSA extends its appreciation to you and your staff who assisted with this audit. If you have any questions or concerns, please contact me at (415) 554-5393 or Tonia.Lediju@sfgov.org.

[1] Office of the Auditor, Audit Services Division of the City and County of Denver, *Denver International Airport Signature Authority Performance Audit*, December 2013, pp. 18-20, 24.

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Budget Analyst
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City Attorney
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Mayor
Public Library

ATTACHMENT: DEPARTMENT RESPONSE

San Francisco International Airport

February 20, 2014

Ms. Tonia Lediju
Director of City Audits
City Services Auditor Division
Office of the Controller
City and County of San Francisco
1 Dr. Carlton B. Goodlett Place, Room 477
San Francisco, CA 94102

Subject: Equipment Procurement Process Audit

Dear Ms. Lediju:

In response to your email to Mr. John L. Martin, Airport Director, dated January 31, 2014, attached is the Airport's response to the Equipment Procurement Process Audit.

If you have any questions, please feel free to call me at (650) 821-2850.

Very truly yours,

Wallace Tang, CPA, CGMA
Airport Controller

Attachment

cc: John L. Martin
Tryg McCoy
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For each recommendation, the responsible agency should indicate whether it concurs, does not concur, or partially concurs. If it concurs with the recommendation, it should indicate the expected implementation date and implementation plan. If the responsible agency does not concur or partially concurs, it should provide an explanation and an alternate plan of action to address the identified issue.

RECOMMENDATIONS AND RESPONSES

Recommendation	Response
The Airport Commission should:	
1. Document and implement formal policies and procedures for processing and recording equipment purchases.	Concur. The Airport will supplement the Procurement Booklet and the Accounting Guidelines already published and issued Airportwide to include written procedures in processing and recording equipment purchases. Target completion date is May 31, 2014.
2. Create and distribute departmental equipment procurement policies and procedures that document the required responsibilities of Airport sections in the equipment procurement process.	Concur. The Airport will distribute written equipment procurement procedures to Section staff. Target completion date is May 31, 2014.
3. Review at least quarterly its equipment purchase activity by vendor and identify if all equipment purchases and vendors appear to be proper or, alternately, unusual or improper.	Concur. As stated in the audit report, the Airport has effective preventive controls over the purchasing process. For continuous improvement purpose, the Airport will institute detective control where a periodic analysis of vendor's purchases under $10,000 will be performed. The Airport will create and perform a historical analysis of these purchases at the end of fiscal year 2014. Quarterly reporting and analysis will be performed effective fiscal year 2015 and onwards.