

# CITY OF LAGUNA NIGUEL

## AGENDA ITEM CITY COUNCIL

SEPTEMBER 5, 2017

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**TO:** Honorable Mayor and Council Members

**FROM:** Stephen Erlandson, Interim City Manager/Director of Finance

**SUBJECT:** Independent Accountants' Report on Agreed-Upon Procedures Applied to Purchase Orders and Contract Processes

**SUMMARY:** Under the current contract with The Pun Group, LLP, the independent accounting firm engaged to perform the City's annual financial audit, the Mayor and Mayor Pro Tem may select two (2) Agreed-Upon Procedures (AUP) engagements of which City management has no knowledge of at the time the procedures are selected. The Mayor and Mayor Pro Tem requested that The Pun Group perform an AUP on purchase orders and contract processes for the two years ended June 30, 2017. It is recommended that the City Council hear the presentation from The Pun Group representatives and approve the Independent Accountants' Report on Agreed-Upon Procedures Applied to Purchase Orders and Contract Processes for the Two Years Ended June 30, 2017.

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### BACKGROUND

Under the current contract with The Pun Group, LLP, the independent accounting firm engaged to perform the City's annual financial audit, the Mayor and Mayor Pro Tem may select two (2) AUP engagements of which City management has no knowledge of at the time the procedures are selected. In April 2017, the Mayor and Mayor Pro Tem requested that The Pun Group perform an AUP on purchase orders and contract processes for a two year period beginning July 1, 2016. Between April 2017 and August 11, 2017, at least four (4) drafts of the AUP report were prepared by The Pun Group. The City Attorney and Director of Finance were presented with the first two drafts of the report in the middle of July 2017. During the City Council meeting on August 1, 2017, City staff stated a status update would be placed on the August 15, 2017 City Council agenda related to the AUP report prepared by The Pun Group. Interim City Manager/Director of Finance Erlandson provided the City Council with that update, which included all activity between August 1, 2017 and August 11, 2017, during the regularly scheduled City Council meeting on August 15, 2017.

Pun Group representatives Kenneth Pun and Frances Kuo will provide a presentation explaining the AUP report (Attachment A) and answer any questions the City Council may have related to the contents of the report and the procedures undertaken during the course of the engagement.

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**FISCAL IMPACT**

The cost of the professional auditing services related to the AUP engagement through August 11, 2017 is \$10,818; however, The Pun Group provided the City with a \$2,000 courtesy discount, reducing the total cost to \$8,818.

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**RECOMMENDATION**

That the City Council:


- A. Hear the presentation from The Pun Group representatives; and
- B. Approve the Independent Accountants' Report on Agreed-Upon Procedures Applied to Purchase Orders and Contract Processes for the Two Years Ended June 30, 2017.

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**SUBMITTED**

**BY:**

  
Stephen Erlandson  
Interim City Manager/Director of Finance

**REVIEWED**

**BY:**

  
Terry Dixon  
City Attorney

Attachment:

- A. Independent Accountants' Report on Agreed-Upon Procedures Applied to Purchase Orders and Contract Processes for the Two Years Ended June 30, 2017

# **ATTACHMENT A**

Independent Accountants' Report on Agreed-Upon Procedures Applied to Purchase  
Orders and Contract Processes for the Two Years Ended June 30, 2017

# **City of Laguna Niguel**

**Laguna Niguel, California**

## **Independent Accountants' Report on Agreed-Upon Procedures Applied to Purchase Orders and Contracts Processes**

*For the Two Years Ended June 30, 2017*





## INDEPENDENT ACCOUNTANTS' REPORT ON APPLYING AGREED-UPON PROCEDURES

To the Honorable Mayor and Members of City Council  
of the City of Laguna Niguel  
Laguna Niguel, California

We have performed the procedures enumerated below, which were agreed to by the Mayor and Mayor Pro Tem of the City of Laguna Niguel, California (the "City"), on the purchase orders and contracts processes of the City for the two years ended June 30, 2017. The City's management is responsible for the purchase orders and contracts processes. The sufficiency of these procedures is solely the responsibility of the City. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purposes.

The procedures and associated findings are as follows:

- A. We read the City's Municipal Codes *Title 3 – Revenue and Finance, Division 6 – Polices and Procedures for Purchasing of Supplies and Equipment for Procuring Professional and Maintenance Services, and for the Disposal of Surplus Property* and the City's Administrative Policy on Purchasing.

*Finding:* No exceptions were noted as a result of our procedures.

- B. We selected ten (10) vendors for which the City Manager and/or his designee approved the purchase orders and/or contracts during the year ended June 30, 2017:
- Obtained all purchase orders and/or contracts approved for the selected ten (10) vendors during the year ended June 30, 2017 for appropriateness on the approval process.
  - Compared the total invoiced amounts during the year ended June 30, 2017 to the approved purchase order or executed contract for any excess.

*Findings:*

- Aggregated purchase order amount issued to Westamerica Communications, Inc. was \$54,766 for the year ended June 30, 2017, which was above the City Manager or his designee's approval threshold of \$25,000. The purchase orders were issued for seasonal recreation brochures (\$26,571), for neighborhood newsletters (\$25,063), for national night out postcards (\$3,132) and for related postage. Purchase orders issued to Westamerica were approved by the Purchasing Manager, whom the City Manager designated to serve as the purchasing officer.
- Purchase orders issued to Horizon Mechanical were approved by the Purchasing Manager, whom the City Manager designated to serve as the purchasing officer. Aggregate purchase order amount was \$24,850 for the year ended June 30, 2017.

3. Purchase orders issued to Knorr Systems, Inc. were approved by the Purchasing Manager, whom the City Manager designated to serve as the purchasing officer. Aggregate purchase order amount was \$22,871 for the year ended June 30, 2017.
4. Purchase orders issued to Soils Solutions LLC were approved by the Purchasing Manager, whom the City Manager designated to serve as the purchasing officer. Aggregate purchase order amount was \$24,773 for the year ended June 30, 2017.

*Recommendations:*

We recommended the City follow its policies and procedures over the approval processes on purchases made through purchase orders. Although the purchase order individually for Westamerica Communications, Inc. was below \$25,000, it was above the \$25,000 threshold in aggregate for the year ended June 30, 2017. By entering into a contact or multi-year agreement, the City can better budget for its programs and manage its expenditures.

We also recommended the City update its Administrative Policy over Purchasing, specifically relating to the designation of purchasing officer. In accordance with the City's Municipal Code Sec. 3-6-2, the City Manager has the authority and is responsible for the purchase of supplies and equipment, procurement of professional services. The City Manager may designate a person to serve as the Purchasing Officer and delegate to that person the duties and responsibilities imposed on the Purchasing Officer. As a result of the City Manager designating the Purchasing Manager to serve as purchasing officer, the Purchasing Manager has approval authority of \$25,000, which is above the department heads' approval threshold of \$10,000. We recommended the City limit the \$25,000 approval authority to the City Manager and his/her designee who is the next chain of command, instead of a manager position.

*Management Responses:*

*Finding 1:*

The purchase orders for Westamerica Communications, Inc. during the year ended June 30, 2017, included work for both the Parks and Recreation department and Police Services. The City entered into a three-year agreement with Westamerica Communications, Inc. effective February 13, 2017 for professional services for the brochures distributed by Parks and Recreation. The agreement went to City Council for the January 17, 2017 meeting and was approved by the Council. The purchase orders mentioned above were for the brochures for Parks and Recreation that were issued prior to the start of the agreement in February 2017. The current Purchasing Manager will be facilitating the bid process and working with Police Services in the first quarter of Fiscal Year 2017-2018 for the City to go out to bid for the quarterly brochures distributed by Police Services.

*Findings 1 to 4:*

The City Manager, within the authority of the Municipal Code and Administrative Policy on Purchasing, had designated the Purchasing Manager as his designee to fulfill the role of purchasing officer. Per the Laguna Niguel Municipal Code Sec. 3-6-2(a): "...The city manager may designate a person to serve as the purchasing officer and delegate to that person the duties and responsibilities imposed by this division on the purchasing officer." The City Manager had delegated that responsibility to the Purchasing Manager effective on October 21, 2015.

Currently, the Interim City Manager is the Purchasing Officer. The City will reevaluate who, if anyone other than the City Manager position, should be designated as the purchasing officer, at least at the minimum in the absence of the City Manager. That designee should be an upper management level position, such as the Assistant City Manager or a Director level position.

- C. We selected five (5) vendors for which the Director of Public Works approved the purchase orders and/or contracts during the year ended June 30, 2016:
  - a. Obtained all purchase orders and/or contracts approved for the selected five (5) vendors during the year ended June 30, 2016 for appropriateness on the approval process.
  - b. Compared the total invoiced amounts during the year ended June 30, 2016 to the approved purchase order or executed contract for any excess.

*Findings:*

- 5. While obtaining the purchase orders issued to Hydro-Scape Products in FY2016, we noted purchase order number 23089 in the amount of \$23,929 for irrigation parts was not approved by the City Manager or his designee and was approved by the Park and Recreation Director, whose approval threshold was \$10,000.
- 6. Aggregated purchase orders issued to Triton Air for the year ended June 30, 2017 was \$10,632. Invoice numbers 29004, 29665, and 29705 issued by Triton Air in the amounts of \$2,353, \$406, and \$3,228, respectively, do not have matching purchase orders or contracts. These three invoices are for maintenance work performed totaling to \$5,987.

*Recommendations:*

We recommended the City improve its monitoring processes in approving purchase orders to ensure all purchase orders above the department heads' approval threshold are approved by the designated Purchasing Officer.

In accordance with the City's Municipal Code Sec. 3-6-9, award of contract for the maintenance and repair of City facilities requires Request for Proposal ("RFP") and written bids for contracts with estimated cost of \$10,000 or more. Contracts for which the estimated cost is less than \$10,000 may be awarded without obtaining bids. In accordance with the City's Administrative Policy on Purchasing, purchase orders shall not be utilized for purchase of maintenance or repair service. The requesting department shall issue a contract with contractors providing maintenance and/or repair of City facilities. We recommended the City strengthen its internal control activities and monitoring processes to ensure contracts are executed for maintenance and repair work. In addition, work to be performed by the contractor shall be clearly defined prior to commencement of work to ensure all invoices have matching contracts or purchase orders.

*Management Responses:*

Finding 5:

Purchase order number 23089 was approved by the Purchasing Manager, however, there was an administrative oversight resulting in the omission of the wet signature on the manual purchase order. The copy of the purchase order was included in the Purchasing Manager's files; therefore, the Purchasing Manager was involved in the purchase order process. The City is aware to ensure that all appropriate signatures are included on all purchase orders. In addition, with the new financial system approved by the City Council on July 18, 2017, the City will be moving towards electronic approvals for purchase orders.

Finding 6:

Management concurs with the finding. The current Purchasing Manager will coordinate with the Public Works department in the first quarter of Fiscal Year 2017-2018 to enter into an agreement with a vendor for air conditioning maintenance and repair services based on the guidelines within the Maintenance and Repairs section (Section C.8.) of the Administrative Policy on Purchasing.

- D. We selected five (5) vendors for which the Director of Parks and Recreation approved the purchase orders and/or contracts during the year ended June 30, 2017:
- a. Obtained all purchase orders and/or contracts approved for the selected five (5) vendors during the year ended June 30, 2017 for appropriateness on the approval process.
  - b. Compared the total invoiced amounts during the year ended June 30, 2017 to the approved purchase order or executed contract for any excess.

*Finding:*

7. Invoice number 22976 from Minuteman Press Aliso Creek was issued by the vendor on September 7, 2016. However, the purchase order number 23072 approving the order was issued to Minuteman Press Aliso Creek on September 19, 2016.

*Recommendations:*

We recommended the City improve its monitoring activities over the purchase order processes to make sure purchase orders are approved and issued prior to ordering goods from the vendors.

*Management Responses:*

Finding 7:

Management concurs with the finding. Sea Country Senior and Community Center staff proceeded with ordering from Aliso Creek Printing (Minuteman Press) prior to filling out the purchase order and receiving approval on the purchase order.

The City will distribute an email city-wide to ensure all employees who make purchases on behalf of the City are aware to obtain proper approval, whether through a purchase order or agreement or otherwise, prior to initiating the purchase or service. This has already been reiterated during the purchasing training sessions presented by the Finance Department that was held for City staff on June 13, 2017 and July 11, 2017.



- E. We obtained invoices received from one vendor with multi-year contract and performed the following:
- a. Obtained a copy of the executed multi-year contract with the vendor.
  - b. Obtained a listing of invoices received during the two years ended June 30, 2017.
  - c. Compared the total invoiced amounts for each year to the executed contract for any excess.
  - d. Selected invoices from 5 months each year and reviewed for appropriateness of the invoices against to the executed contract.

*Finding:*

8. We selected Westcoast Arborist for the multi-year contract procedures. During our procedures, we noted that both FY15-16 and FY16-17 total invoiced amounts were over the executed contract amounts. Total invoiced amounts for FY15-16 and FY16-17 were \$209,683 and \$466,047, respectively. The approved contract amount was \$140,000 annually.

*Recommendations:*

We recommended the City improve its internal control activities and monitoring processes over multi-year contracts. When additional work is needed, change orders need to be approved prior to commencement of additional work. Furthermore, we recommended the City establish policies and procedures over the change order approval processes and to clearly define the approval authority for the change orders.

*Management Responses:*

*Finding 8:*

Management concurs with the finding that the expenditures for West Coast Arborists were over that contracted amounts.

City staff prepared an analysis of activity relating to WCA from the inception of the original agreement dated October 6, 2015 through July 28, 2017. This analysis reflects the following:

- For October 7, 2015 through September 30, 2016, staff expended \$301,951, or \$161,951 greater than the agreement limit and budget amount of \$140,000 per annum.
- For October 1, 2016 through July 28, 2017, staff expended \$387,743, or \$247,743 greater than the agreement limit of \$140,000 per annum; however, that the amount expended is within the budgetary authority adopted by all five City Council Members during the FY 2016-17 Mid-Year Budget Review held on February 7, 2017.
- On February 7, 2017, a contract between WCA and the City was in force. With the Polyphaegous Shot Borer (the "PSB") creating a public safety issue, staff believed timing was of the essence to remove these diseased trees. As such, staff contacted WCA and was able to have WCA commit to holding the previously competitively bid per unit pricing in the original agreement steady.

When City staff was made aware of the contract overage, an amendment to the WCA agreement was placed on the May 16, 2017 City Council agenda. The May 16, 2017 WCA contract amendment was subsequently pulled off the May 16, 2017 City Council meeting agenda. City staff subsequently put the first amendment back on the agenda for the August 1, 2017 City Council meeting. During the August 1, 2017 meeting, the City Council opted to table the item until further information is provided by the City Attorney.

To the Honorable Mayor and Members of the City Council  
of the City of Laguna Niguel  
Laguna Niguel, California  
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This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. We were not engaged to and did not conduct an examination or review, the objective of which would be the expression of an opinion or conclusion, respectively on the purchase orders and contracts processes. Accordingly we do not express such an opinion or conclusion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the City Council and management of the City and is not intended to be and should not be used by anyone other than these specified parties.

*The Per Group, LLP*

Santa Ana, California  
August 1, 2017