



Internal Audit Report

Noncompetitive Contracts Procurement Audit

Report Number: 2018 - 05 | Report Date: September 13, 2018

Executive Summary

Audit Report No.: 2018 - 05

September 13, 2018

WE AUDITED the current Procurement & Contracts process to ensure that the division has effective controls in place over noncompetitive contracts.

AUDIT OBJECTIVE was to determine whether the agency has the effective controls in place:

- To ensure that adequate consideration was given during contract procurement to noncompetitive contracts that could potentially stem from the original contract.
- To ensure all noncompetitive contracts including emergency and proprietary procurements are properly classified with approval and sufficient documentation.
- To ensure that financial change orders to noncompetitive contracts are proper and in accordance with ST policies and procedures.
- To ensure that noncompetitive contract reporting to ARC/Board is complete & accurate.

The audit examined management controls in place as of March, 2018.

WHAT DID WE FIND?

Full and open competition is the guiding principle of Sound Transit procurement to provide equal opportunities for all qualified offerors to participate in agency business. The guidance is embodied in Resolution 78-2, agency policies, and the Procurement and Contracts Administration Manual (PCAM).

Competition is required for goods and services valued at \$3,000-plus with federal funds or at \$5,000-plus without federal funds. However, full and open competition isn't feasible in all procurements. In recognition, the agency allows sole sourcing (i.e., no competition) "only under certain limited circumstances," as follows:

- Unique capability or availability from only one source
- Emergency procurement
- Proprietary procurement
- Single Bid or proposal

Between 2013 and 2017, total noncompetitive contracts awarded were \$44.2 million, over 98% of which were proprietary and sole source contracts.

The audit concluded that management has effective controls over noncompetitive change orders and reporting. However, the controls to ensure the proper use of noncompetitive contracts are not working effectively as designed. In addition, the audit issued a management letter related to whether consideration was given during contract procurement to noncompetitive contracts that could potentially stem from the original contract.



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Background

The agency has a centralized procurement contract administration function, the Procurement and Contracts (P&C) Division under the Executive Department. The division is comprised of three functional areas: Materials, Technology & Services (MTS), Design & Construction Contracts (D&CC), and Systems & Operations (S&O).

Contract management is governed by agency Policies 5 and 6, Resolution 78-2, the Procurement and Contracts Administration Manual (PCAM), and applicable federal and state regulations. These policies and procedures are designed to ensure high value for their contracted dollars and equal opportunity to compete for contracts. Specifically, Procurement & Contracts division's goal is to procure goods/services in an efficient, effective and responsive manner while ensuring full and open competition. P&C strives to provide transparency regarding their procurement & contracting actions, while delivering value added services to maximize the use of public funds.

Competition is required for goods and services valued at \$3,000-plus with federal funds or at \$5,000-plus without federal funds. However, full and open competition isn't always feasible. In recognition of the practicality, sole sourcing (i.e., no competition) may be used "only under certain limited circumstances," as follows:

- Unique Capability or availability from only one source or sole source procurements

The property or services are available from one source due to unique or innovative concept, patent or data rights restrictions, and in case of a follow-on contract that awarding to another contractor would result in substantial duplication costs or delays in fulfilling Sound Transit needs.

- Emergency procurements:

Sound Transit has an unusual and urgent need for the property or services that public or the agency would be seriously injured unless it was permitted to limit the solicitation.

- Proprietary procurements:

The item is an associated capital maintenance item as defined in 49 U.S.C. 5407(a) (1) that is procured directly from the original manufacturer or the supplier of the item to be replaced. Sound Transit's Board motion 78-2 permits use of proprietary procurements when only local funds are applied.

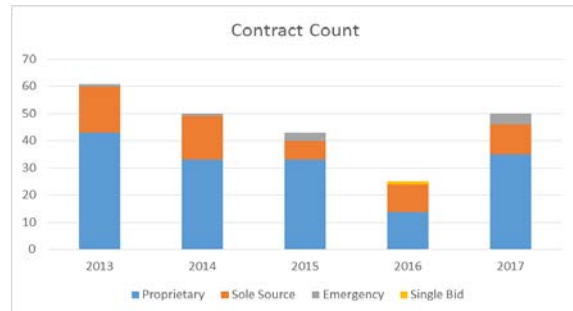
- Single Bid:

There is a single bid or proposal received in response to a solicitation and the Contract Specialist along with the Project Manager determines that the competition was adequate.

Between 2013 and 2017, total noncompetitive contracts awarded were \$44.2 million which is 0.68% of all contracts awarded (\$6.5 billion) for the same time period. Of \$44.2 million, sole source and proprietary contracts accounted for over 98%.

Noncompetitive Contracts Awarded 2013 – 2017

Contract Amount (in thousands)				
Year	Sole Source	Proprietary	Emergency	Total
2013	\$400	\$2,800	\$100	\$3,300
2014	11,000	2,200		13,200
2015	800	2,000	1,800	4,600
2016	300	2,300		2,600
2017	400	19,700	300	20,400
Total	\$13,000	\$29,000	\$2,200	\$44,200



Source: Enterprise One (provided by P&C, Systems & Operations).

Sole source contract award amount was on average \$464,000 (excluding 2014) per year during 2013 through 2017. 2014 was the highest year in the last 5 years which is largely attributable to a contact related to ticket vending machines.

On the other hand, proprietary contract award amount on average was \$2.4 million from 2013 through 2016 with a significant increase in 2017 reaching \$19.7 million. The increase in 2017 primarily relates to multi-year contracts for light rail vehicle parts and/or services.

Audit Objectives

To determine whether the agency has the effective controls in place:

- To ensure that adequate consideration was given during contract procurement to noncompetitive contracts that could potentially stem from the original contract.
- To ensure all noncompetitive contracts including emergency and proprietary procurements are properly classified with approval and sufficient documentation.
- To ensure that financial change orders to noncompetitive contracts are proper and in accordance with ST policies and procedures.
- To ensure that noncompetitive contract reporting to ARC/Board is complete & accurate.

Scope and Methodology

We conducted this performance audit in accordance with the International Standards for the Professional Practice of Internal Auditing. 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.

We gained an understanding of Procurement & Contracts Division noncompetitive processes through data analysis, documentation reviews, and personnel interviews. We identified risks in the processes and assessed management controls in place to mitigate those risks. Based on the assessment, we determined to focus on management practices related to lifetime procurement as an element of Total Cost of Ownership (TCO), noncompetitive procurement approvals, approvals for change orders for noncompetitive contracts, and accuracy of Board reporting for noncompetitive contracts.

We examined policies, procedures, and process documentation and records as of March, 2018.

1. To determine whether the agency has the effective controls to ensure that adequate consideration was given during contract procurement to noncompetitive contracts that could potentially stem from the original contract, we performed the following procedures:
 - a. We reviewed all applicable agency policies/procedures including industry standards and best practices.
 - b. We conducted management interviews to identify stakeholders and current practices of Total Cost of Ownership.
 - c. We selected 21 samples representing 37% of 2016 & 2017 noncompetitive contracts (57).
2. To determine whether the agency has the effective controls to ensure all noncompetitive contracts including emergency and proprietary procurements are properly classified with approval and sufficient documentation, we performed the following procedures:
 - a. We reviewed policies/procedures including resolution 78-2, PCAM, and regulatory requirements.
 - b. We performed walkthroughs of the noncompetitive approval process.
 - c. We tested a selection of 25 noncompetitive transactions for proper approval, justification, classification, supporting documents, etc. The sample selection represented 33% of the total number of noncompetitive contracts during 2016 and 2017 (75).
3. To determine whether the agency has the effective controls to ensure that financial change orders to noncompetitive contracts are proper and in accordance with ST policies and procedures, we performed the following procedures:
 - a. We reviewed policies/procedures including resolution 78-2 and the PCAM.
 - b. We performed walkthroughs of the current change order processes for noncompetitive contracts.
 - c. We tested a selection of 10 financial change orders to ensure justification was reasonable, proper, and within company policies. The sample selection represented 38% of the total number of contracts with change orders during 2016 and 2017 (26).
4. To determine whether the agency has the effective controls to ensure that noncompetitive contract reporting to ARC/Board is complete & accurate, we performed the following procedures:
 - a. We reviewed policies/procedures including resolution 78-2 and the PCAM.

- b. We performed walkthroughs of the current Board reporting processes.
- c. We tested 2016 and 2017 noncompetitive procurements against quarterly Board reporting. The testing included all 58 noncompetitive procurements awarded in 2016/2017 with the award amount of \$100,000 or over.

Conclusion

Management has effective controls over noncompetitive change orders and reporting. However, the controls to ensure the proper use of noncompetitive contracts are not working effectively as designed. See Finding #1.

In addition, the audit issued a management letter related to whether consideration was given during contract procurement to noncompetitive contracts that could potentially stem from the original contract.

Findings and Recommendations

1. Checks and Balances to Review Noncompetitive Procurement Requests Are Ineffective

Full and open competition is the guiding principle of public procurement to provide equal opportunities for all qualified offerors to participate in public business. Except as permitted by Federal Law or regulations, the Common Grant Rules require a recipient of Federal assistance to provide full and open competition. Consistent with the federal requirement, the agency has embraced the principle in Resolution 78-2 and incorporated it into the agency procurement manual, PCAM. The stated goal of PCAM is to procure goods and services effectively and efficiently “while ensuring full and open competition.” In reality, however, open competition may not always be feasible. For example, emergency repairs and limited availability of goods/services may require procurements to be sole sourced. PCAM recognizes such necessary exceptions “only under certain limited circumstances” and provides guidance for due diligence to ensure each exception to open competition is fully vetted and truly warranted.

The agency utilizes the role of the Competition Advocate (CA) to validate sole source procurement requests. Each sole source request is assigned a procurement specialist as the CA. Working closely with the Program Manager and Contract Specialist, the CA evaluates the noncompetitive request and determines whether to recommend the use of the noncompetitive procurement method to the Director of Procurement & Contracts.

The CA as a management control to promote competition appears to be adequately designed. It provides independent checks and balances without unreasonably impeding the procurement process. When performed as specified in Noncompetitive Procurement Process Instructions¹, the CA role should ensure the proper usage of the noncompetitive procurement method without compromising the guiding principle. However, the audit noted that the CA role is not always utilized effectively, as intended.

Based on review of 25 noncompetitive procurement contracts awarded during 2016 & 2017, the audit noted less than due diligent efforts by the CA. Although each sample had evidence of review by the CA and the Director, the intended checks and balances were not effectively provided. The following exceptions as a whole demonstrate the ineffectiveness of the CA role in providing assurance that each noncompetition request was proper and justified.

- For 10 out of 25 (40%), there was inadequate or incomplete verification of management information.

Six of ten contracts were procured noncompetitively on the basis of Original Equipment Manufacturer (OEM). An OEM is a company whose goods are used as components in the

¹ “Noncompetitive Procurement” Process Instructions - a step by step procedure for the CA to follow.

products of another company, which then sells the finished item. For example, the vendor parts in light rail vehicles are OEM parts to the vehicle manufacturer.

For existing equipment, PCAM requires potential procurement sources be exhausted before sole sourcing purchases to the equipment manufacturer. For the six contracts, however, there was no indication that all other alternative sources had been exhausted. The CA appears to have relied upon requesting management's assertions without verification. Examples of the management assertions include:

- "The justification is based primarily on requesting party's determination and assertion, per the Sound Transit Noncompetitive Procurement Request Justification Form, that no other source is practicable and reasonable. ... is the original equipment manufacturer and changing to another style will require configuration changes to the fleet..."
- "... The justification is based primarily on the requesting parties determination and assertion that requested parts are proprietary parts available only from the OEM vendor of the hardware and cannot be procured through other channels..."

The remaining four exceptions noted either no independent efforts or incomplete follow-up procedures after initial verification by the CA.

- For 4 out of 25 (16%), the Competition Advocate (CA) and the Contract Specialist (CS) were the same.

Many organizations utilize independent competition advocacy in some form or other. Federal Acquisition Regulation (FAR), for example, under Subpart 6.5 requires an independent competition advocate in each executive agency of the federal government.

There was no segregation of duties in the noted exceptions between the CA and the CS. Contract administration role of the CS is not compatible with the advocating role of the CA. Commingling of the two incompatible duties is not consistent with the intent of checks and balances.

- An extension (3rd change order) from an emergency contract wasn't approved by the CEO as stipulated by the resolution. The extension was done 9 months after the emergency event. The services associated with the extension should have been procured using a different method.

Procurement must rely upon the expertise of the requesting party to evaluate the technical merits of noncompetition requests. The reliance, however, should not be uncontested acceptance of the request. Procurement must be free from undue influence or pressure in the award and administration of contracts. The CA is expected to challenge information and assertions provided by the requesting party. These checks and balances assure the agency that the necessity for noncompetition is based on substantive, valid and documented reasons in the best interest of the public, and not on administrative expediency. Without effective assurance management controls, there is greater risk of losing full and open competition in the agency's procurement practices.

Recommendations:

We recommend management:

- Strengthen the role of the Competition Advocate to ensure each noncompetition procurement is proper and valid.

The following specific procedures are suggested for management consideration:

- ✓ Require complete information from the requesting department claiming limited availability and/or technical uniqueness. The requesting department must provide support information for statements of uniqueness/unavailability.
- ✓ Provide independent verification of noncompetitive requests.
- ✓ Provide segregation of duties between Competition Advocate and Contract Specialist.
- ✓ Update PCAM for the Competition Advocate roles & responsibilities.
- ✓ Proper planning for noncompetitive contracts.

Management Response:

Management does not fully agree with the finding that “checks and balances to review noncompetitive procurement requests are ineffective,” but we do agree improvements can be made.

We believe our process is effective, as evidenced by:

- The performance data illustrates the agency’s very low percentage of noncompetitive contract awards (in the words of the audit report, at page 1: “Between 2013 and 2017, total noncompetitive contracts awarded were \$44.2 million which is **0.68%** of all contracts awarded (\$6.5 billion) for the same time period”); and
- The audit report identifies no contract awarded without competition when more than one source was available to meet the particular need.

Sound Transit’s procurement policies and procedures “are designed to ensure high value for their contracted dollars and equal opportunity to compete for contracts,” and its “goal is to procure goods/services in an efficient, effective and responsive manner while ensuring full and open competition.”

Competition is the fundamental principle of public procurement. Our internal processes in Sound Transit are designed to challenge and discourage any request for a noncompetitive purchase.

To maintain this low incidence of noncompetitive procurement (**0.68%** of total dollars), the Procurement and Contracts Division (P&CD) created a robust, best-in class program for the evaluation and approval of non-competitive procurement requests. The process strives to balance diligent, case-to-case review with reasonable administrative efficiency.

Our program far exceeds the legal requirements (federal, state or local) that apply to Sound Transit. The agency is not subject to the requirements of the Federal Acquisition Regulation (FAR), however, P&CD elected to model our noncompetitive process on the FAR. We created the role of the Competition Advocate, for example, based on the FAR process applicable to federal agencies. To our knowledge, Sound Transit is the only transit agency in the country that has introduced a Competition Advocate into its procurement program. The purpose is to put a spotlight on full and open competition in Sound Transit and evaluate and challenge barriers to competition.

The Sound Transit noncompetitive process places high value on a systematic and transparent presentation and examination of the pertinent facts, together with a business case justification of need and validation of the sole source or proprietary nature of the purchase. It includes the separation of duties between the request and the subsequent evaluation and approval, the signed certification of no conflict of interest, and the added oversight and analysis of the Competition Advocate.

We have also elected to require, for proposed sole source or proprietary actions greater than \$100,000, the advance public notice (advertisement) for seven business days of the agency's intention to award a contract without competition. This feature, like the others noted above, is voluntary, and is required not by law but by the process and procedure we have formulated for ourselves in Sound Transit.

The basis for the audit report's finding is its statement that: "However, the controls to ensure the proper use of noncompetitive contracts are not working effectively as designed." And, drilling down further, on page 5 of the report, it is found in the sentence, "However, the audit noted that the CA role is not always utilized effectively, as intended."

We appreciate the audit's single recommendation to management to "Strengthen the role of the Competition Advocate to ensure each noncompetition procurement is proper and valid." We agree and are taking steps to implement the recommendation.

Conclusion (and Follow-up)

Management believes we have strong checks and balances, we are in compliance with our own voluntarily established administrative processes, and that the data shows a highly effective program. However, we agree that we can do more.

We thank the Office of Internal Audit for its attention to the processes and procedures of procurement as vitally important to the success and integrity of the agency.

We are grateful for the focus on competition, the foundation of public procurement, and the opportunity to partner with the Internal Audit team to continuously improve and meet the high bar we have set.

The Procurement & Contracts Division is taking the following actions:

- (1) Update and revise Section B.15, Sole Source, of the Procurement & Contract Administration Manual to capture all features of our internal process for the administration of noncompetitive

procurement consistent with the governing Board resolution including evaluation standards and the role of the Competition Advocate;

- (2) Strengthen the role of the Competition Advocate as a full-time position in the Procurement & Contracts Division; and
- (3) Capitalize on the analysis and recommendations of the industry consultant retained by the P & Contracts Division that will begin its assessment later this month of, among other things, Sound Transit's LRV replacement parts supply chain including the proprietary use of OEM replacement parts and best practice alternatives.

Management will continue to consult with and inform the Office of Internal Audit, and will be happy to brief the Audit and Reporting Committee, or other committee of the Board, on our processes and actions at any time.