

City of
Gainesville

Inter-Office Communication

January 31, 2005

TO: Audit and Finance Committee
Mayor Pegeen Hanrahan, Chair
Mayor-Commissioner Pro Tem Tony Domenech, Member

FROM: Brent Godshalk, City Auditor

SUBJECT: Review of the Gainesville Regional Utilities Purchasing Bid Process

RECOMMENDATION

The Audit and Finance Committee recommend that the City Commission:

- 1) Accept the City Auditor's report and the General Manager's response; and
- 2) Instruct the City Auditor to conduct a follow-up review on recommendations made and report the results to the Audit and Finance Committee.

EXPLANATION

In accordance with our Fiscal Year 2003 - 2004 Annual Audit Plan, we have completed a review of the Gainesville Regional Utilities Purchasing Bid Process. Our report and the General Manager's response are attached.

We request that the Committee recommend the City Commission accept our report and the General Manager's response. Also, in accordance with City Commission Resolution 970187, Section 10, Responsibilities for Follow-up on Audits, we request that the Committee recommend the City Commission instruct the City Auditor to conduct a follow-up review on recommendations made and report the results to the Audit and Finance Committee.

City of
Gainesville

Inter-Office Communication

October 4, 2004

TO: Michael L. Kurtz, General Manager for Utilities
FROM: Brent Godshalk, Interim City Auditor
SUBJECT: Review of the Gainesville Regional Utilities (GRU) Purchasing Bid Process

On December 8, 2003, the City Commission approved the City Auditor's Annual Audit Plan, which included a review of the GRU Purchasing Bid Process. During our review, we conducted interviews with key personnel, reviewed operating and financial information and tested management controls. We have completed our review and the attached draft report indicates where further efforts are needed to strengthen management controls.

In accordance with Commission Resolution 970187, Section 9, please submit your written response to the recommendations presented in the attached report within 30 days and indicate an actual or expected date of implementation. Our final report, which will include your written response, will then be submitted to the City Commission's Audit and Finance Committee for review and approval.

We would like to thank Utility Purchasing Manager Ruth Davis, Utility Chief Financial Officer Jennifer Hunt and their staff for the courteous and cooperative treatment afforded us during our review. Please let me know if you have any comments or questions.

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EXECUTIVE SUMMARY

On December 8, 2003, the City Commission approved the City Auditor's Annual Audit Plan, which included a review of the Gainesville Regional Utilities (GRU) Purchasing Bid Process. The primary focus of this review was to provide the City Commission with reasonable assurance on the adequacy of the system of management control in effect over the GRU bid process. This review will provide a foundation for the City Auditor's Office to conduct recurring periodic reviews of GRU bid processes, on a sample basis, beginning in Fiscal Year 2005. Based on the results of our review, we made recommendations in the following areas:

1. During our review, we noted two separate purchase orders issued to a vendor for the replacement of an intercom system at the Kelly Plant. The first purchase order was issued for approximately \$5,500 to remove existing speakers and indicated that no other vendor could provide the services, even though two quotes were obtained. When the contractor submitted a second invoice for time and materials necessary to replace existing wire, a second purchase order had to be created for an additional \$15,185. We also noted instances when final purchases differed from written bids, quotes or estimates without adequate explanation or documentation. We recommend the Purchasing Division improve efforts to review source justified purchases submitted by operating departments to ensure the classification is correct and that sufficient steps were taken to identify other potential bidders; and provide periodic training and communications to operating departments to ensure an adequate understanding of purchasing policies and procedures and the importance of properly evaluating and documenting significant changes to purchase order amounts from original bids, quotes or estimates.
2. During our review, we noted several contracts signed by management where no date was recorded next to the signatures. We also noted one professional services contract that was developed two weeks after the contractor was already providing services. We recommend management record the dates when contracts are signed to more effectively document when formal agreements are executed. We also recommend management ensure that vendor services requiring formal signed contracts are not initiated without first creating and executing a contract documenting the responsibilities of the parties.
3. During our review, we noted a professional services contract in a not to exceed amount of \$75,000 indicating that the consultant is to be paid a monthly retainer of \$2,400 plus the consultant's daily rate of \$700 for general consulting services, special projects or authorized trips. The contract indicates that the consultant may engage in off-site general consulting services for up to four chargeable days per month without prior approval. Invoices submitted do not provide sufficient information to enable a reviewer to reconcile the detailed listing of tasks by date with the chargeable days invoiced for the month. We recommend management increase efforts to ensure that invoices provide sufficient information to ensure payment amounts can be reconciled to specific contractual terms.
4. In October 2003, management sent a bid request to potential local vendors for personal computers and peripheral equipment expected for purchase over the ensuing 12 months. The bid process required bidders to provide itemized prices for several personal computer configurations and for components and peripheral equipment specifically designated. Management also provided prospective vendors with estimated purchase quantities for each item requested, although GRU was not required to purchase at these quantities. We compared the prior year purchases of personal computers and peripheral equipment to the estimated purchase quantities included in the October 2003 bid request and found the estimated purchase quantities varied greatly from the actual historical usage patterns. We recommend that management include estimated purchase quantities in future bid processes

that accurately reflect historical purchasing trends or some other reasonable forecasting methodology to ensure that the basis used to compare bids is reasonable. If there is significant fluctuation between the prior year's actual usage and the estimated usage in the bid package, management should indicate in the bid process the reasons for the change to ensure that all bidders are provided relevant and consistent information.

5. During our review of the purchasing process, we noted several areas where we believe operational and procedural improvements could be implemented including:

- Travel Procedures for Contractors - We noted instances where contracts allowed vendors to arrange their own travel and to charge GRU the actual cost of airline tickets, meals and lodging plus a mark up of 10 to 15%. We recommend management consider implementing procedures to handle local contractual lodging arrangements internally in order to obtain the most advantageous rates and to ensure that sales taxes and mark ups are not incurred.
- Purchasing Policies Regarding Competitive Situations - In 1996, City of Gainesville Purchasing Policies were amended and the thresholds for competitive bids/quotes were raised. At the same time, the minimum number of responsive bids/quotes necessary to satisfy competitive requirements was reduced from three to two. We recommend management consider increasing from two to three the minimum number of responsive bids/quotes needed to satisfy the requirement for competitive bidding in the Purchasing Policies and ensure that reasonable efforts are taken to search for other available vendors when less than three qualified suppliers are available.
- Purchasing Procedures Regarding Bidder Debarment or Suspension - Both GRU and General Government (GG) have documented purchasing procedures regarding the possible suspension or debarment of bidders but do not have written procedures to ensure notification to the other if a vendor is debarred or suspended. We recommend management develop written procedures to ensure timely and proper communication occurs between GRU and GG Purchasing Divisions whenever a vendor is debarred or suspended.
- Right to Audit Clauses - We noted several contracts for services that did not include a right to audit clause. This helps to ensure that if questions arise and management or the City Auditor desires to review any additional information supporting invoices generated by the contractor, a mechanism would be in place for obtaining access to necessary records. We recommend management include a right to audit clause as a standard feature in contracts.
- Annual Conflict of Interest Statements for Purchasing Division Staff - City of Gainesville Policies and Procedures Number 28 and City of Gainesville Purchasing Policies include sections regarding conflicts of interest and ethics in public contracting. Although these sections apply to all employees, Purchasing Division staff are placed in a relatively unique situation related to these ethical standards due to the nature of their duties. We recommend management implement a procedure requiring Purchasing Division staff to annually sign a conflict of interest statement certifying compliance with City of Gainesville Policies and Procedures Number 28 and Purchasing Policies.

OBJECTIVES, SCOPE AND METHODOLOGY

In accordance with our Fiscal Year 2004 Annual Audit Plan, the City Auditor's Office has completed an audit of the GRU Purchasing Bid Process. The primary focus of this review was to provide the City Commission with reasonable assurance on the adequacy of the system of management control in effect over the GRU bid process. Management controls, in the broadest sense, include the plan of organization, methods and procedures adopted by management to ensure that goals are met. Management controls include the process for planning, organizing, directing and controlling program operations. They include the systems for measuring, reporting and monitoring program performance. Management is responsible for establishing effective management controls.

Specific audit objectives included evaluating the policies, procedures and internal controls related to the GRU Purchasing Bid Process. An additional objective of this review was to establish a foundation for the City Auditor's Office to conduct recurring periodic reviews of GRU bid processes, on a sample basis, beginning in Fiscal Year 2005.

Our review was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States. We conducted interviews with appropriate personnel from the Utility Purchasing and Finance departments. We reviewed purchasing policies and procedures, observed operations, tested operating and financial data for accuracy and documented the results of our work. Our testing did not include fuel purchases. The scope of our testing was generally for the period from October 2002 through May 2004. Based on the results of our review, we prepared specific issues and recommendations for improvement that were discussed with the Utility Purchasing Manager and the General Manager for Utilities. These recommendations, as well as management's written response, can be found on the following pages of this report.

SUMMARY AND BACKGROUND

GRU purchases more than \$50 million a year in goods and services, excluding employee salaries and fuels. City Commission approved Purchasing Policies indicate that the purchasing divisions of General Government and GRU shall:

- Assist all departments and divisions, including Charter Officers, in making purchases and sales of supplies, materials, equipment and services in accordance with the policies established by the City Commission and the procedures established by the Managers;
- Provide support to enable all purchases to be made at prices which are the most cost effective and through the application of sound business practices;
- Maintain records which document that purchases have been made in accordance with City Commission policy and established procedures;
- Manage the purchase, receipt and delivery of materials, equipment and services;
- Identify qualified suppliers of materials, equipment and services;
- Develop and maintain bid lists of quality suppliers;
- Add and delete vendors and contractors from the list of qualified suppliers in order to maintain performance standards;
- Develop and maintain fair and impartial business relationships with vendors that ensure quality, cost-effective products and services are provided for the benefit of tax and rate payers;

- Conduct quality control and performance checks as needed to ensure vendors fulfill contractual requirements; and
- Supervise the disposition of supplies, materials and equipment by approved processes.

Competitive and Non-competitive Procurement Process

Purchasing Policies indicate that if an item of goods or services costs \$2,000 or less, no competitive bidding is required. Operating departments or the Purchasing Division are required to obtain and document a minimum of two written quotes if an item of goods or services is expected to exceed \$2,000. Purchases with an anticipated cost in excess of \$50,000 require formal bids submitted through the Purchasing Division.

In addition to purchases of \$2,000 or less, Purchasing Policies allow purchases to be made without competitive quotes or bids in the following situations:

- Materials, equipment or services purchased under state or federal contracts or other public agencies cooperative purchasing opportunities;
- Utility services when the subject utility is the only available source of such service;
- Contractual services of a professional nature whose cost does not exceed \$25,000;
- Emergency purchases, at the discretion of the Manager, where the circumstances of the emergency do not permit sufficient time to obtain competitive quotes; and
- Non-competitive situations.

Approval Process

Purchasing Policies generally authorize Charter Officers to approve purchases up to \$25,000 without obtaining specific City Commission approval. Exceptions to this policy include purchases of fuels, materials, equipment or services used for the operation and maintenance of utility plants. However, reports are required to be made to the City Commission of any purchase of materials, equipment or services greater than \$25,000 for which prior approval was not obtained. The General Manager for Utilities delegates signing authority for purchases to Assistant General Managers, department heads and other levels of GRU management. Typically, Assistant General Managers can authorize expenditures up to \$25,000 and department heads expenditures up to \$15,000.

ISSUE #1

<p style="text-align: center;">Management Should Improve Efforts to Review Source Justified Purchases and Change Orders and Periodically Train Operating Departments on Purchasing Policies and Procedures</p>

Discussion

During our review, we noted two separate purchase orders issued to a vendor for the replacement of an intercom system at the Kelly Plant. The first purchase order was issued for approximately \$5,500 to remove existing speakers and indicated that no other vendor could provide the services, even though two quotes were obtained. This purchase order was closed upon payment to the contractor. When the contractor submitted a second invoice for time and materials necessary to replace existing wire, a second purchase order had to be created for an additional \$15,185.

We also noted the following instances when final purchases differed from written bids, quotes or estimates without adequate explanation or documentation.

- A purchase order for emergency repairs was issued for \$300,000, approximately 39% higher than the vendor's estimate of \$216,000 without adequate documentation of the need for the large contingency. The final cost was \$321,240, approximately 47% over the original estimate and 7% greater than the amount established for the purchase order.
- A purchase order for emergency repairs was awarded for approximately \$49,000 through a competitive quote process. The vendor subsequently requested two change orders totaling \$46,115, increasing the purchase to \$95,115 or almost double the original quote. Purchasing Policies do not require City Commission approval of emergency purchases, but reports are to be made to the City Commission of any purchase greater than \$25,000 for which prior approval has not been obtained. The City Commission was not notified of the second change order, which exceeded \$25,000.

Conclusion

It appears that the Purchasing Division did not ensure adequate documentation was provided to justify classifying the first purchase noted above as a non-competitive situation. Also, operating departments may not be receiving continuing training on certain aspects of purchasing policies and procedures.

Recommendation

We recommend the Purchasing Division:

- Improve efforts to review source justified purchases submitted by operating departments to ensure the classification is correct and that sufficient steps were taken to identify other potential bidders; and
- Provide periodic training and communications to operating departments to ensure an adequate understanding of purchasing policies and procedures and the importance of properly evaluating and documenting significant changes to purchase order amounts from original bids, quotes or estimates.

Management's Response

In the case of emergency repairs, oftentimes the extent of the repair and/or the cost is not known. The users may request an emergency purchase order number based on an estimated repair cost. Back-up documentation is then submitted to the Purchasing Department for review and issuance of a purchase order. In the cases noted, management agrees that the buyer involved should have obtained further documentation.

There have been staff changes within Purchasing and management does not anticipate similar issues in the future. Management recognizes the need for consistency in documentation provided by the user departments, as is customarily the practice. Management agrees that periodic training for user departments will assist them in their understanding of policies and procedures and reinforce the importance of proper documentation. Currently, management is in the process of filling a position that will focus on contract administration and general purchasing training.

ISSUE #2

<p style="text-align: center;">Contracts Should Be Signed and Dated Prior to Services Being Initiated</p>
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Discussion

During our review, we noted several contracts signed by management where no date was recorded next to the signatures. We also noted one professional services contract that was developed two weeks after the contractor was already providing services. This contract did not require competitive bidding or City Commission approval. There was no indication that an emergency situation existed and a contract should have been established prior to the vendor providing services.

Conclusion

All contracts should be signed and dated and any services requiring formal contracts should not be initiated without first completing the process of creating and executing a contract documenting the responsibilities of the parties and clearly defining the scope and terms of the work to be performed.

Recommendation

We recommend management record the dates when contracts are signed to more effectively document when formal agreements are executed. We also recommend management ensure that vendor services requiring formal signed contracts are not initiated without first creating and executing a contract documenting the responsibilities of the parties. This will help to ensure the terms of the contract are clearly understood and provide an opportunity for management and the vendor to properly review the contract before services are initiated.

Management's Response

Management agrees.

ISSUE #3

Management Should Ensure that Invoices Provide Sufficient Information to Reconcile Payments Requested to Contractual Requirements
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Discussion

During our review, we noted a professional services contract in a not to exceed amount of \$75,000 indicating that the consultant is to be paid a monthly retainer of \$2,400 plus the consultant's daily rate of \$700 for general consulting services, special projects or authorized trips. The contract indicates that the consultant may engage in off-site general consulting services for up to four chargeable days per month without prior approval. Where off-site general consulting services are to exceed four chargeable days in any given month, the consultant is required to obtain GRU written approval before engaging in the additional services.

The consultant submits monthly invoices indicating the number of days for which payment is requested and a detailed listing of tasks completed by date. However, the invoices do not provide sufficient information to enable a reviewer to reconcile the detailed listing of tasks by date with the chargeable days invoiced for the month.

This contract has been renewed annually for several years based on the consultant's positive history with GRU. When the contract was renewed for FY 2004, management requested City Commission approval to increase the vendor's daily service fee from \$600 to \$700, an increase of 17%. While this increase was covered in the City Commission consent agenda item, we could find no documentation that the consultant requested such an increase.

Conclusion

Invoices and contracts for services should provide sufficient information to ensure payments are for services rendered and based on contractual fee structures. Vendors should provide adequate justification for price increases requested upon contract renewal.

Recommendation

We recommend management increase efforts to ensure that invoices provide sufficient information to ensure payment amounts can be reconciled to specific contractual terms.

Management's Response

It is GRU's practice to ensure invoices provide sufficient information to reconcile payment amounts to specific contractual terms. The referenced contract is atypical and has been restructured to address the Auditor's concern.

The price increase was requested verbally by the Consultant; however, the user department did not record the request in the file. The requested new rates were determined to be consistent with or less than prevailing rates for these services and this was reported to the City Commission in an agenda item.

ISSUE #4

Management Should Ensure that the Basis Used to Compare Bids Is Reasonable and Results in the Best Possible Pricing

Discussion

In October 2003, management sent a bid request to potential local vendors for personal computers and peripheral equipment expected for purchase over the ensuing 12 months. The bid process required bidders to provide itemized prices for several personal computer configurations and for components and peripheral equipment specifically designated. Management also provided prospective vendors with estimated purchase quantities for each item requested, although GRU was not required to purchase at these quantities. Based on the bid prices submitted and management's estimated purchase quantities, the bid was awarded to the lowest responsive bidder.

We compared the prior year purchases of personal computers and peripheral equipment to the estimated purchase quantities included in the October 2003 bid request and found that the estimated purchase quantities varied greatly from the actual historical usage patterns.

Quantity Estimated Per RFP versus Actual Quantity Purchased in Preceding Year

Component	Estimated Purchase Quantities in October 2003 RFP	Actual Quantity Purchased During Fiscal Year 2002-2003	Difference Between Estimated Quantity for RFP and Previous 12 Months Actual Purchases
Motherboard	150	0	(150)
Mid Tower	50	0	(50)
Full Size Tower	100	0	(100)
Keyboard	150	0	(150)
System 1	50	0	(50)
System 2	100	245	145
40 GB Drive	100	561	461
60 GB drive	50	0	(50)
80 GB Drive	50	0	(50)
Matrox Card	150	250	100
CD ROM	150	252	102
Network Card	150	275	125
Plextor CD/RW	25	0	(25)
Plextor DVD Writer	25	24	(1)
19" monitor	100	70	(30)
22" monitor	50	28	(22)

One reason for the large variance between estimated purchase quantities and historical usage was that the same estimates used in several previous purchasing processes for personal computer equipment were also used for the October 2003 bid process.

Conclusion

Estimated purchase quantities provided to bidders should accurately reflect historical purchasing trends or some other reasonable forecasting methodology to ensure that the basis used to compare bids is reasonable and results in the best possible pricing. In the bid process described above, more realistic estimated purchase quantities may have resulted in the bid being awarded to a different bidder.

Recommendation

We recommend that management include estimated purchase quantities in future bid processes that accurately reflect historical purchasing trends or some other reasonable forecasting methodology to ensure that the basis used to compare bids is reasonable. If there is significant fluctuation between the prior year's actual usage and the estimated usage in the bid package, management should indicate in the bid process the reasons for the change to ensure that all bidders are provided relevant and consistent information.

Management's Response

Management agrees estimated purchase quantities should accurately reflect historical purchasing trends or some other reasonable forecasting methodology and will make every effort to do so in the future. However, it cannot be determined that changing the estimated quantities would have resulted in the bid being awarded to another bidder because the impact on the pricing submitted may have also changed.

ISSUE #5

Other Operational and Procedural Improvements

Discussion

During our review of the purchasing process, we noted the following areas where we believe operational and procedural improvements could be implemented:

Travel Procedures for Contractors

During our review, we noted instances where contracts allowed vendors to arrange their own travel and to charge GRU the actual cost of airline tickets, meals and lodging plus a mark up of 10 to 15%. In such situations, GRU reimburses vendors for sales taxes on local lodging that would not have been charged if GRU had handled lodging arrangements and payments directly with the hotel. Also, this method does not provide an opportunity for GRU to obtain reduced hotel rates often available to government agencies.

General Government management has indicated that their practice is to ensure that departmental personnel handle local lodging arrangements for contractors/vendors requiring lodging in order to obtain the best available local rates and to ensure that sales taxes and mark ups are not incurred. We believe GRU could generally reduce costs by arranging local lodging for contractors/vendors.

Purchasing Policies Regarding Competitive Situations

City of Gainesville Purchasing Policies specify that competitive bidding processes will generally be used in order to ensure the greatest economic benefit to the City. For purchases with an anticipated cost exceeding \$50,000, formal bids must be submitted through the Purchasing Division. For purchases with an estimated cost of \$50,000 or less, formal bids are not required. However, if a purchase falls between \$2,000 and \$50,000, the Purchasing Division or the originating department must obtain written quotations. Purchases of \$2,000 or less do not require competitive bids or quotes to be obtained.

In 1996, Purchasing Policies were amended and the thresholds for competitive bids/quotes were raised. At the same time, the minimum number of responsive bids/quotes necessary to satisfy competitive requirements was reduced from three to two. Increasing the minimum number of responsive bids/quotes necessary to satisfy the requirement for competitive bidding could increase opportunities for competition and help to ensure the greatest economic benefit to the City.

Purchasing Procedures Regarding Bidder Debarment or Suspension

Both GRU and General Government (GG) have documented purchasing procedures regarding the possible suspension or debarment of bidders. In the past three years, GRU has suspended only one vendor for failing to pay subcontractors and has not debarred any vendors. Vendors who are suspended or debarred are flagged on GRU's financial system to ensure purchase orders and checks are not issued. However, GRU and GG do not have written procedures to ensure GRU and GG are notified if the other debars or suspends a vendor.

Right to Audit Clauses

During our review, we noted several contracts for services that did not include a right to audit clause. A right to audit clause would require contractors to retain and make available to management or its representatives the documentation supporting all invoices related to the contract. This helps to ensure that if questions arise and management or the City Auditor desires to review any additional information supporting invoices generated by the contractor, a mechanism would be in place for obtaining access to necessary records.

Annual Conflict of Interest Statements for Purchasing Division Staff

City of Gainesville Policies and Procedures Number 28, Code of Ethical Standards has a conflict of interest section which states:

No employee shall solicit or accept free or discounted goods, services, prizes, gifts, favors, accommodations, entertainment, discounted loans or anything else of value. This code must be read as proscribing the appearance of impropriety as well as actual conflicts of interest.

City of Gainesville Purchasing Policies Section 4 – Ethics in Public Contracting states:

City employees shall have no interest, financial or otherwise, direct or indirect, nor engage in any business transaction or professional activities nor incur any obligation of any nature which is in conflict with the City's Code of Ethical Standards and Florida Statutes, Chapter 112 as applicable. To this end, City employees are expected to demonstrate the highest standards of personal integrity in public activities and conduct their duties in ways that are free from the inference or perception that favorable treatment was sought, received or given and to avoid any interest or activity which is in conflict with the conduct of official duties.

Although these sections apply to all employees, Purchasing Division staff are placed in a relatively unique situation related to these ethical standards due to the nature of their duties. Management does not have a process in place requiring Purchasing Division staff to periodically sign conflict of interest statements stating that they have read and abided by the requirements of the City's Code of Ethical Standards and Purchasing Policies.

Recommendation

We recommend management:

- Consider implementing procedures to handle local contractual lodging arrangements internally in order to obtain the most advantageous rates and to ensure that sales taxes and mark ups are not incurred.
- Consider increasing from two to three the minimum number of responsive bids/quotes needed to satisfy the requirement for competitive bidding in the Purchasing Policies and ensure that reasonable efforts are taken to search for other available vendors when less than three qualified suppliers are available.
- Develop written procedures to ensure that timely and proper communication occurs between GRU and GG Purchasing Divisions whenever a vendor is debarred or

suspended. This will ensure that a vendor found in violation at GRU or GG will not remain eligible to bid or perform services for the other.

- Include a right to audit clause as a standard feature in contracts. The City Auditor's Office can provide language used by other governmental entities.
- Implement a procedure requiring Purchasing Division staff to annually sign a conflict of interest statement certifying compliance with City of Gainesville Policies and Procedures Number 28 and Purchasing Policies.

Management's Response

Several of the best practices suggested by the Auditor, such as obtaining more than 2 quotes, including right to audit clauses, and making travel arrangements for consultants, are already being utilized when appropriate. Management agrees to review these best practices as time permits in light of the cost effectiveness, relevancy and/or benefits to be derived.