

# California State Auditor

B U R E A U O F S T A T E A U D I T S

## **State Contracting:**

**Improvements Are Still Needed  
To Ensure the Effective Use of  
Public Resources**



July 1997  
96015

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**California State Auditor  
Bureau of State Audits  
660 J Street, Suite 300  
Sacramento, California 95814**

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# CALIFORNIA STATE AUDITOR

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KURT R. SJOBERG  
STATE AUDITOR

MARIANNE P. EVASHENK  
CHIEF DEPUTY STATE AUDITOR

July 24, 1997

96015

The Governor of California  
President pro Tempore of the Senate  
Speaker of the Assembly  
State Capitol  
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As required by Chapter 1044, Statutes of 1990, the Bureau of State Audits presents its audit report concerning deficiencies we found in contracts between five state departments and their contractors. These deficiencies occurred because the departments' management of contracts and interagency agreements, current law related to public contracting, and the State's existing system for overseeing contracts have failed to prevent recurring contract deficiencies.

This report concludes that the state departments we reviewed did not always protect the public interest by adequately planning and managing contracts. We found that some departments restricted rather than fostered competition, did not ensure that all contracts contain specific terms so that contract or performance can be measured, and did not ensure that invoices were adequately supported or the goods received before the departments paid the contractors. We also found that one state department misused interagency agreements with the California state universities to avoid competitive bidding and incurred unnecessary administrative costs. Further, the department used interagency agreements to enter into sole-source contracts with private parties. Finally, we found that the State may be missing opportunities to obtain lower prices by using master agreements to take advantage of the State's buying power.

Respectfully submitted,

KURT R. SJOBERG  
State Auditor

Enclosure

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BUREAU OF STATE AUDITS

660 J Street, Suite 300, Sacramento, California 95814 Telephone: (916) 445-0255 Fax: (916) 327-0019

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# Summary

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**Audit Highlights . . .**

***Our review of contracting practices at five state departments revealed that:***

- Generally, the departments did not always protect the public interest by adequately planning and managing contracts.***
- The California Department of Education misused interagency agreements to avoid competitive bidding.***
- The State has not ensured that master agreements are used to obtain the best prices.***

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## ***Results in Brief***

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In this and previous audits, we have found deficiencies in contracts between state departments and their contractors because the departments' management of contracts and interagency agreements, current laws related to public contracting, and the State's existing system for overseeing contracts have failed to prevent their recurrence.

We found that state departments we reviewed did not always protect the public interest by adequately planning and managing contracts. For example, in planning to obtain services, some departments restricted rather than fostered competition. Further, departments did not adequately monitor contractor performance and evaluate the services received. In addition, departments paid contractors without ensuring that invoices were adequately supported or that services were consistent with the terms of the contract. If departments do not adequately plan and monitor their contracts, they cannot ensure that state resources are used efficiently and effectively.

We also found that a state department has misused interagency agreements with the California State University (CSU), to avoid competitive bidding. For such agreements, existing laws related to public contracting as well as state policies do not require departments to solicit competitive bids. Rather, these agreements allow state entities to take advantage of each others expert services. However, the California Department of Education did not use the public employees to perform the contract services; instead, the department, in effect, used the interagency agreements to enter into sole-source contracts with private parties. In doing so, the department has avoided competitive bidding and added unnecessary costs to the contracting process.

The Department of General Services (DGS), and individual departments we reviewed, share responsibility for ensuring that the State's contracting program is effective. Master agreements represent one effective method for obtaining needed services and their use can lower prices for services and reduce administrative costs. However, the State has not established a

centralized approach that ensures master agreements are used when warranted. As a result, the State may be missing opportunities to take advantage of its collective buying power.

Our review of 46 contracts at five state departments revealed the following specific concerns:

- The Department of Developmental Services restricted competition to a sole contractor.
- Two departments awarded contracts without sufficient funding for their completion. Although in both instances the departments subsequently provided the necessary funding, they risked receiving incomplete products, or no products at all, if additional funding had not been approved.
- Some departments' planning and management of contracts did not always protect the public interest. For example, departments entered into contracts that did not specify the departments' requirements for the contractors. Without such detail, neither the departments nor the contractors knew what was to be delivered for the contracted price.
- We found instances in which the California Department of Education misused interagency agreements to contract with private parties. Although the department initially contracted with CSU, the campuses invoiced expenditures for subcontractors who performed the actual services. The department should have used the competitive bidding process to contract directly with the private parties to avoid paying additional administrative costs.
- At the California Department of Education, an inadequate separation of duties permitted employees to both authorize contract expenditures and then serve as contract monitors to review and approve invoices for the same expenditures.
- Finally, the State may not obtain the best prices for services because it has not centralized negotiations for master agreements nor information regarding available master agreements. Moreover, departments were frustrated because the procedures for obtaining service from a master service contractor varied considerably depending on the type of service.

## ***Recommendations***

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To use state funds as economically as possible and improve the State's contracting process, state departments we reviewed should plan contracts to include all the elements necessary to monitor contractor performance and to evaluate the services received. Specifically, departments should:

- Exercise care in preparing requests for proposals and estimating the cost of needed services to ensure that competitive processes are fair and attract a good selection of qualified bidders;
- Include sufficiently defined payment provisions and clearly defined deliverables in their contracts to ensure that payments are for actual services rendered;
- Obtain sufficient funding to complete all contract objectives before entering into contracts;
- Ensure that contractors stay within the budget specified in contracts;
- Require that invoices be properly approved, adequately supported, and consistent with contract terms before paying their contractors;
- Avoid unnecessary costs by contracting directly with private parties when appropriate rather than using interagency agreements to circumvent competitive bidding; and
- Monitor compliance with the State's policy prohibiting state employees from accepting responsibilities with other organizations incompatible with their assigned departmental responsibilities.

Further, the California Legislature should adopt new legislation that would prohibit departments from misusing interagency agreements by obtaining contract services from private consultants without participating in the competitive process.

Finally, the DGS should:

- Identify the appropriate use of master agreements through its Office of Legal Services. As part of the responsibility for their own contracting program, departments should also determine whether master agreements would better serve their needs and the State's interests;
- Maintain a complete listing of master agreements and ensure its availability to appropriate personnel at all state agencies; and
- Adopt simple, uniform procedures that would encourage the use of master agreements and minimize the burden that multiple procedures presently impose.

### ***Agency Comments***

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With the exception of the Department of Developmental Services (DDS), the departments generally agreed with our findings and recommendations. The DDS took exception to concerns we raised related to the planning and monitoring of a \$3.3 million contract for workers' compensation cost-containment.

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# *Introduction*

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## ***Background***

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The California Public Contract Code and the State Administrative Manual establish basic guidelines for state departments entering into and approving contracts and interagency agreements. Specifically, the laws and policies dictate detailed requirements for planning the deliverables of contracts, soliciting bids from potential contractors, monitoring contractors' progress, and approving payment for services.

By law, the Department of General Services (DGS) has the duty for overseeing the review and approval of contracts entered into by state departments. This duty includes broad oversight responsibilities in addition to its responsibility for ensuring compliance with detailed legal provisions for each contract submitted for approval. The Office of Legal Services within the DGS is responsible for developing the standard contracting procedures. These procedures are designed to aid public officials in the efficient and uniform administration of public contracting.

## ***Scope and Methodology***

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This audit fulfills our fiscal year 1995-96 audit requirement as dictated by Chapter 1044, Statutes of 1990. Specifically, these statutes require the Office of the Auditor General to evaluate the State's compliance with state laws and regulations for consultant contracts. The Bureau of State Audits assumed this responsibility pursuant to the Government Code, Section 8546.8.

To evaluate the State's compliance with the laws and policies governing contracts, we reviewed the California Public Contract Code and the State Administrative Manual and identified provisions and policies pertaining to consultant contracts, interagency agreements, and other contracts. In addition to our broad-based review of the DGS, we determined compliance with relevant laws and policies by reviewing consultant contracts, interagency agreements, and other contracts at the five state departments listed below. Our selection of the five departments for this year's review was based on several factors

such as the departments we reviewed in prior years, dollar volume of contracts, other audits conducted by our office, and size of departments as required by Chapter 1044, Statutes of 1990. For our fiscal year 1995-96 audit, we reviewed the following state departments:

- Department of Corrections
- Department of Developmental Services
- Department of Education
- Department of Forestry and Fire Protection
- Department of Pesticide Regulation

These departments contracted with public and private entities for significant amounts of goods and nonconsultant services. We selected a sample of the various types of contracts and interagency agreements, including related amendments, and tested the agreements for appropriate contract language and provisions, supporting documentation, and approvals. Further, we evaluated each contract and determined whether the departments had appropriately planned and monitored the contracts. In addition, we reviewed the contracts and interagency agreements to determine if the departments administered those agreements in the best interest of the State.

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# Chapter 1

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## *Departments Need To Adequately Plan and Monitor Contracts*

### *Chapter Summary*

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**B**ecause many state departments spend a significant amount of money on contractual services, departments need to award and manage contracts prudently in order to ensure the effective use of public resources. During fiscal year 1995-96, the Department of General Services (DGS) approved approximately 8,800 contracts and amendments entered into by state departments that totaled approximately \$6.3 billion. The DGS also delegated approval authority to various state departments for contracts below certain dollar amounts. These smaller contracts are not accounted for centrally, and therefore are not included in the numbers cited above.

During our review, we found that departments did not always adequately plan and monitor their contracts. With regard to planning, departments did not always:

- Ensure that competitive processes were fair;
- Ascertain that sufficient funding was available to complete contract objectives; and
- Include clearly defined deliverables and payment provisions in the written contract.

With regard to monitoring, departments did not always:

- Ensure that work progressed in accordance with budgets specified in the contracts;
- Determine that invoices were properly approved, adequately supported, and consistent with contract terms before making payments; and
- Retain appropriate amounts from progress payments when required.

When departments do not adequately plan and monitor their contracts, they cannot ensure that public resources are used effectively.

### ***State Policies Emphasize Key Elements of Contract Management***

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As described in the State Administrative Manual, the essential elements of contract management require proper planning and adequate monitoring as follows:

#### ***Planning***

- Developing a clear, precise scope of work with timelines and specific deliverables that can be monitored and managed.
- Identifying qualified contractors and facilitating competition so the State receives the best goods or services for the most reasonable price.

#### ***Monitoring***

- Monitoring and evaluating contractor work performance in relation to the contract terms and conditions.
- Reviewing requests for payment to ensure that payment is consistent with the deliverables received.
- Evaluating completed contracts to determine whether contract objectives have been met.

### ***Contract Planning Can Be Improved***

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Adequate planning is a vital component of the effective management of contracts. When contracts are poorly planned, the quality of services to be delivered can suffer, the contract can become more difficult to manage, and the cost of the contract can be unnecessarily high. In our review of 46 contracts, we found flaws in the planning of 10 of these contracts. The following examples illustrate numerous instances of poor planning related to the contracts we reviewed.

***The Department of Developmental Services  
Awarded a Contract Without Competition***

In one of the ten poorly planned contracts, the Department of Developmental Services (DDS) restricted competition on a contract for a workers' compensation cost-containment project so only one contractor could provide the services. Specifically, the DDS awarded a \$3.3 million contract to Industrial Management Services, Inc. (IMS), after issuing a request for proposal (RFP). One of the purposes of an RFP is to obtain complex services in which professional expertise is needed and to examine different methods and approaches that may be applied to solve a problem. Contrary to this objective, the DDS required all respondents to the RFP to base their proposals on a specific approach to workers' compensation called the Total Employee and Management Commitment, Accountability, Responsibility, and Empowerment (TEAM CARE) model. This model had been developed specifically for the DDS with the help of IMS through an earlier pilot project at the Camarillo Developmental Center. By restricting respondents to the TEAM CARE model, the DDS did not allow the introduction of alternate approaches and gave IMS an advantage over other potential bidders since IMS had worked on the pilot project.

  
*The DDS may have ruled out other contractors possessing the expertise necessary to successfully complete the project.*

Further, the DDS specified minimum qualifications that were excessively restrictive and appeared to match the experience of IMS. For example, the RFP required respondents to have at least eight years of experience treating injured employees who work with the developmentally disabled. In addition, respondents must have completed a similar workers' compensation project for injured employees in a public institutional setting with a population of at least 1,500 employees per facility within the last five years. Because these minimum qualifications were restrictive and appear tailored to IMS, the DDS may have ruled out other contractors possessing the expertise necessary to successfully complete the project. In fact, of the 28 parties that requested a copy of the bid package, IMS was the only one to actually submit a proposal.

***Inaccurate Estimates and Advertising of a Contract for the California Department of Corrections May Have Limited Competition***

In another example of poor planning, we found that institutions of the California Department of Corrections (CDC) did not always accurately estimate costs for needed services or disclose

these costs when advertising their contracts. In one example in which the department was successful in fostering competition, one of the institutions advertised the need for medical laboratory services in the California State Contracts Register (register) and stated the value of the contract at greater than \$100,000. Nine qualified bidders responded, offering various rates. The institution ultimately awarded a contract for approximately \$136,000 to the lowest qualified bidder. In this case, the department fostered competition to obtain a competitive price.

However, another CDC institution advertised in the register for the same type of services, but did not state the expected value of the contract. In this case, only one bidder responded. The institution awarded a one-year contract to this bidder for approximately \$49,000. Yet, four months after the award, the institution submitted a request to the DGS to increase the contract by almost \$151,000 (approximately 300 percent of the original amount). In its request to amend the contract, the institution stated that it is difficult to determine the actual amount of laboratory tests needed and that the number of tests was grossly underestimated in this case. We do not agree with this assessment because the two previous years' contracts with the same vendor did provide a reasonable approximation of the extent of the services the institution would require. Specifically, the institution paid the vendor approximately \$194,000 for similar services in fiscal year 1993-94 and \$165,000 in fiscal year 1994-95.

  
*Improperly estimating and disclosing the value of its contracts when advertising for them may have limited the number of bidders responding to the institutions' advertisements.*

We noted four other instances in which the CDC increased funding for contracts by more than 100 percent through amendments. Improperly estimating and disclosing the value of its contracts when advertising the contracts may have limited the number of bidders responding to the institutions' advertisements.

***The California Department of Education and the Department of Forestry and Fire Protection Awarded Contracts Before Sufficient Funding Was Available***

Ensuring that sufficient funds are available to pay for contract services is another important step in contract planning. We found two instances in which this did not occur. In one example, the California Department of Education (CDE) entered into a \$215,000 contract with the San Jose State University Foundation to provide child nutrition services before adequate funding was available. The original contract contained a work plan with broadly described requirements, such as finalizing curriculum materials and presenting a teleconference; however,

halfway through the contract period, the CDE received approval to amend the contract to increase funding for the contract by 51 percent—an additional \$110,000—and to expand the services required in the work plan. In its justification for the amendment, the CDE stated that when the original contract was initiated, the department was limited to fewer funds than it knew was necessary to complete the original work plan. By entering into contracts before adequate funding was available, the department risked failing to accomplish the contracts' objective. In this instance, if additional funds had not subsequently become available, the CDE may have received an incomplete product or no product at all.

  
*By entering into contracts before adequate funding was available, the department risked failing to accomplish the contracts' objective.*

In another example of a contract that was awarded without sufficient funding and adequate benchmarks, the California Department of Forestry and Fire Protection (CDF) entered into a contract to convert its OV-10 airplanes to aid in firefighting. The department awarded the contract for \$630,000 to the bidder with the lowest monthly labor cost. Although the contract was specific regarding cost, it did not specify the number of airplanes the CDF wanted to convert. Approximately halfway through the contract term, the CDF obtained approval to amend the contract amount from \$630,000 to \$2.5 million, an increase of 297 percent. All other terms of the contract remained the same. In its justification for the amendment, the CDF stated that when it prepared the original contract, it allocated only an initial amount of \$630,000 of fiscal year 1994-95 money to begin major modifications to OV-10 airplanes. Further, the CDF stated that, although it did not include costs for future fiscal years, the CDF estimated the cost of the OV-10 project at \$227,000 per aircraft for a total of \$2.48 million.

As a result, we also determined that the amendment was not justified, because the CDF knew the total cost of the project at the time it prepared the original contract. That cost should have been part of the original contract. Alternatively, the CDF could have specified that the original contracted amount of \$630,000 was only an initial amount for limited service.

Finally, the contract did not quantify what the CDF required of the contractor. Specifically, the contract did not include the number of airplanes the department wanted converted, the hours or dollars to be spent per airplane, or a schedule for completion. Without such detail, neither the CDF nor the contractor knew what should be delivered at the original cost. As a result, we conclude that the department was unable to determine exactly what deliverables were required by the contract.

The conditions described in these examples occurred because departments did not adhere to one or more of the key components of effective contract planning, including:

- Identifying qualified contractors and facilitating competition so the State receives the best goods or services for the most reasonable price; and
- Developing a clear, precise scope of work with specific contract terms and measurable deliverables that can be monitored and managed.

As described below, this poor planning also can make it difficult for departments to adequately monitor contractor performance.

### ***Departmental Monitoring of Contractor Performance Was Inadequate***

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*Departments did not consistently compare invoices to contract terms, obtain adequate support for payment of invoices, or retain a portion of periodic payments as required.*

A department's responsibility does not end once a contractor has been selected. Rather, the department must monitor the contractor's performance to ensure the work meets the terms of the contract. Specifically, the department's contract manager, who is responsible for approving invoices for payment, should be familiar with the services provided as well as with contract terms. Without comparing services received to the contract requirements, departments may pay contractors for services that fail to meet contract objectives. For 19 of the 46 contracts we reviewed at five departments, we found that departments did not always adequately manage contracts or monitor compliance with contract terms. In particular, the departments we reviewed did not consistently compare invoices to contract terms, obtain adequate support for payment of invoices, or retain a portion of periodic payments as required by the contract. The following examples describe monitoring problems we noted related to the contracts we reviewed.

### ***The Department of Developmental Services' Poor Monitoring of Its Cost-Containment Project Contributed to Time and Cost Overruns***

For one of the contracts we reviewed and described earlier, we found the DDS did not adequately monitor contractor performance of its contract with IMS. The DDS agreed that IMS would provide 1,500 hours of team effort at each of four different developmental centers. In spite of this agreement, the DDS allowed the contractor to plan activities that exceeded

the budget by 53 percent at the first developmental center, and by 24 percent at the second center. Further, the DDS paid invoices that were 20 percent higher than the budget at the first developmental center. In response, department officials stated that they anticipated work at the first two developmental centers would take more time than at the last two, even though this is not reflected in the contract budget. However, the department expects that work at all four of the developmental centers will be completed within the total budget of 6,000 hours.

  
*The DDS allowed the contractor to plan activities that exceeded its budgets and paid invoices without sufficient support or proper authorization.*  


In addition, the DDS established an hourly team rate of \$480 to pay IMS. However, paying the contractor for each task based on a certain number of team hours reduces the DDS' ability to determine if the services were properly provided. This method presumed that all 11 members of the IMS staff contributed to the accomplishment of each task although the DDS did not know if all 11 staff actually contributed to each task. In one instance, we noted that IMS estimated four team hours would be necessary to hold a meeting with another DDS contractor at a cost of \$1,920 ( $\$480 \times 4$  hours). The meeting lasted four hours and was only attended by three IMS staff. In a more typical contract, the contractor is paid by the hours worked, in this case 12 hours. However, because the DDS based the contractor's pay on team hours, the DDS essentially paid IMS for 42 instead of 12 hours.

Finally, we found that the DDS paid five of the IMS invoices we reviewed without sufficient support that services had been provided. We also found that two of these invoices were paid without proper authorization. In addition to requiring the contractor to certify that costs claimed on invoices match the task order and the contract, the DDS project coordinator and contract manager also must certify that the contractor has completed the work described. However, we could not match the amounts billed on the invoices to the amount of time budgeted on the related task orders. Although four of the five invoices were less than the task order total, one invoice exceeded the task order by approximately \$13,000. In addition, the DDS paid two of the invoices without obtaining the required approval of the project coordinator and contract manager.

As a result of these problems, the DDS does not have adequate assurance that project tasks were completed or finished within the time budgeted. In addition, if the department does not take action to mitigate the effects of the cost overrun, the contract will eventually need to be amended to add more money before the project can be completed.

### ***The California Department of Corrections Did Not Adequately Review Contracts***



*Institutions allowed contract charges to exceed contractual dollar limits before they requested amendments, and in two instances, the contracts had expired before amendments were requested.*



We also found that institutions of the CDC did not always properly monitor their contracts. Specifically, we noted that the institutions allowed contract charges to exceed contractual dollar limits before they requested amendments. The institutions also approved invoices for payment without adequate evidence that services had been provided.

For each of the four amended contracts we tested at the CDC, dollar limits were exceeded before the CDC's institutions submitted amendments to increase funding, even though the CDC policy specifically requires that amendments be submitted prior to the exhaustion of contract funds. Contract amendments added 33 percent to 100 percent of the original contract amount. In addition, it took between 73 and 141 days for the institutions to submit amendments after the original contract amounts had been exceeded.

Further, CDC policy requires that contract amendments be requested before the ending date of the contract term. However, we found that the term for two of the four contracts had expired before amendments were requested. By allowing contractors to provide services that exceeded contract balances, the department put the State at risk because it had no assurance that sufficient funding would be available to pay for additional services until amendments were approved.

For two of the seven contracts we reviewed at two CDC institutions, we found that staff at the California Medical Facility (Medical Facility) did not always reconcile invoice charges with the services or rates allowed per the contract. Specifically, we determined that staff approved an invoice from an ophthalmology services provider for payment without evidence that the contractor furnished the service. We found 13 additional invoices in which the same contractor charged for the same service without evidence that the service was provided.

—◆—  
*Staff approved each invoice although the rates charged did not match the rates agreed upon in the contract.*

We also found that staff approved each invoice for payment although the rates charged did not match the rates agreed upon in the contract. In fact, the contractor's invoice charged rates that were less than those specified in the contract. Staff did not question the contractor and the CDC paid the lower charges. This also occurred on a contract for nursing services at the Medical Facility. Part of the problem is that the CDC has not designated an individual to be responsible for comparing the rates charged on invoices to rates approved in the contract. Staff who verify that the contractor provided the service and who approve payment do not have copies of the contracts and do not know the agreed upon rates. Because the department did not resolve why the rates paid to the contractor were less than the rates agreed upon in the contract, it may eventually have to make additional payments to the contractor.

***The Department of Forestry and Fire Protection Did Not Determine That Billings Were Correct***

—◆—  
*We found that the rates billed for labor on two invoices did not match contract rates.*

The CDF also did not appropriately review and approve invoices the contractor submitted for payment. Specifically, for each invoice we tested that the contractor submitted for labor charges, the CDF did not properly determine that the hours billed were correct. More specifically, the CDF did not require that the contractor validate the accuracy of hours billed. Recently, however, the CDF has required the contractor to identify on each invoice the name and job title of each employee with billed hours so the department can verify the hours.

We also found that the contractor overcharged on its labor billings for the same contract. Although the contract allowed for increases in the hourly rates for inflation, the increase was only permissible if the State renewed the contract for additional one-year periods. In this instance, the contract was not renewed. We found that the rates billed for labor on two invoices did not match contract rates. For example, the contractor billed regular time for mechanics at \$23.42 per hour, although the contract rate was \$21. As a result, the actual charges for regular time on just one invoice should have been approximately \$11,700, rather than \$13,800, a difference of \$2,100.

***The Department of Forestry and Fire Protection  
Contract Monitoring Was Insufficient***

In a contract between the CDF and the California State Polytechnic University, Associated Students, Inc. (CSPU) at San Luis Obispo, the CDF paid \$10,000 to support a statewide symposium on oak tree management in California. The contract called for the CSPU to publish 3,000 copies of the symposium proceedings, approximately 500 pages long, by the summer of 1996. However, even though the CSPU had not yet published the proceedings, the CDF contract monitor approved the full amount of the contract for payment. Furthermore, before making this payment, the CDF had amended the amount of this contract by \$7,000, increasing the total cost to \$17,000 "to cover additional costs for disseminating information obtained at the symposium and publishing the results." In our view, however, this increased cost was not justified because the original scope of services in the contract remained the same and the original contract already included provisions to pay the costs associated with publishing and disseminating the information presented at the symposium.

  
*Under the terms of the contract, the full amount should not have been paid since the State has not received the final product.*  


Under the terms of the contract, the full amount should not have been paid since the State has not received the final product. Also, the contract required that an amount equal to 10 percent of each invoice should be withheld pending satisfactory final completion of the project. However, the CDF did not retain 10 percent from invoices as required. Rather, the CDF paid the full amount of \$17,000 as requested by CSPU in its final invoice, although the published proceedings had not been received.

***The Department of Forestry and Fire Protection  
Did Not Determine That Goods Were Received***

In a contract discussed earlier, we found that the CDF's contract monitor did not confirm that aircraft parts had actually been received before approving an invoice. The invoice, which appropriately listed reimbursable parts and expense charges, was supported by additional invoices from other vendors. However, we found that none of these additional invoices was stamped or signed by CDF's receiving personnel to indicate that the goods had been received. Consequently, the CDF manager who approved the invoice for payment had not confirmed that the parts had been received. According to the contract monitor, no other effort was made to verify receipt. We determined that the CDF's receiving personnel stamped a copy

of the invoice packed with the parts, then filed the invoice in a drawer. According to the clerk and the contract monitor, these filed invoices were not reviewed by the manager who approved the invoice for payment.

***The Department of Education Did Not Obtain Sufficient Invoice Documentation***

  
*For one contract, the CDE approved invoices for costs in excess of contract terms.*

We also found that the California Department of Education (CDE) did not always monitor contract invoices and payments to ensure compliance with terms stated in their contracts or in the California Public Contract Code. For one contract, the CDE approved invoices for costs in excess of contract terms. Specifically, for invoices we reviewed totaling approximately \$63,000, the CDE paid a different rate than had been approved in the contract, resulting in approximately \$1,300 in excessive costs. However, the CDE has since adjusted a subsequent invoice and recouped its overpayment.

We also found that the CDE could not always provide evidence that \$168,000 of contractor invoices agreed with the deliverables outlined in the contract. Without comparing invoices for services received to their contracts, departments may pay contractors for services that do not accomplish the contract objectives. In another instance, we found that the department approved payment for invoices totaling approximately \$1.2 million that did not sufficiently detail the services provided. If department staff do not obtain and review sufficiently detailed invoice documentation, they may fail to detect inappropriate costs. However, the CDE has recently implemented new invoicing policies and procedures designed to reduce this risk. The policies state that, when appropriate, employees should request time sheets to support time charged by contractors or travel receipts to ensure travel costs are within state rates.

Finally, we found that the CDE did not always monitor contract payments to ensure compliance with laws and regulations. Although the Public Contract Code requires departments to retain 10 percent of payments until contractors complete the work satisfactorily and fulfill their contractual obligations, the CDE did not retain the required 10 percent of an invoice totaling approximately \$36,000.

The conditions that we have just described occurred because the departments did not adhere to one or more of the key elements related to effective contract monitoring, including:

- Examining contractor work performance, for both quantity and quality, in relation to the contract terms and conditions;
- Reviewing requests for payment to ensure that payment is consistent with the deliverables received as well as with the terms of the contract; and
- Evaluating completed contracts to determine whether contract objectives have been met.

These procedures are designed to ensure that the State receives quality services at agreed upon prices.

### ***Conclusion***

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State departments we reviewed did not always protect public resources by adequately planning and managing contracts. Further, departments did not adequately ensure that all contracts contained specific terms that allowed the departments to monitor contractor performance and evaluate the services received. In addition, departments paid contractors for services without ensuring that invoices were adequately supported or that services were consistent with the terms of the contract. If departments do not adequately plan and monitor their contracts, or evaluate the goods and services received, they cannot ensure that state resources are used efficiently and effectively.

### ***Recommendations***

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To use state funds as economically as possible, state departments should plan contracts to include all the elements necessary to monitor contractor performance and to evaluate the goods and services received. Specifically, departments should:

- Exercise care in preparing requests for proposals and estimating the cost of needed services to ensure that competitive processes are fair and attract a good selection of qualified bidders;
- Obtain sufficient funding to complete all contract objectives before entering into contracts or limit the scope of services in the original contract to the level of service that can be adequately funded;

- Include in their contracts sufficiently defined payment provisions, and clearly defined deliverables so that they can have assurance that payments are for actual services rendered;
- Ensure that contractors stay within the budget specified in the contracts;
- Require that invoices be properly approved, adequately supported, and consistent with contract terms before paying their contractors; and
- Retain appropriate amounts from progress payments when required.

Further, the California Department of Corrections should designate a contract monitor at the institution to ensure rates charged on invoices agree with contract terms.

Finally, the California Department of Forestry and Fire Protection internal audit unit should review all invoices paid thus far on its OV-10 airplane conversion contract to determine the total amount of overcharges. The California Department of Forestry and Fire Protection should then take steps to recoup these moneys from the contractor, or offset future invoices until the total amount is reimbursed.

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# Chapter 2

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## ***One Department Has Misused Interagency Agreements and Has Allowed Its Employees To Assume Incompatible Duties***

### ***Chapter Summary***

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**B**ecause state departments spend a significant amount of their funds on contracts for goods and services, departments need to authorize and manage contracts prudently in order to effectively control expenditures and protect the State's best interests. Further, if departments do not have adequate controls to prevent the circumvention of laws related to public contracting, the State can be placed at risk of financial or legal liability or public embarrassment.

During our review of five state departments, we found that the California Department of Education (CDE) misused interagency agreements with California State University (CSU) and thus avoided existing controls over state contracting. Although interagency agreements are excluded by law from competitive bidding to promote the efficient use of existing state resources, we found instances where the CDE used interagency agreements to essentially subcontract with private-sector consultants for the actual contract services.

We are concerned that current state law does not specifically prohibit state departments from misusing interagency agreements in this manner. Although the Department of General Services (DGS) has developed policies to prohibit the use of these agreements to circumvent the competitive bidding process, these policies were not put into effect until July 1996. As a result, we are not able to determine the effectiveness of the new DGS policies until we conduct our audit of the State's contracting process for fiscal year 1996-97.

During our review, we also found that weak controls exist over interagency agreements involving quasi-state organizations, such as vocational student organizations, that are not completely independent from the State. Specifically, weak controls allowed CDE employees to assume incompatible duties and authorize contracts without proper oversight. As a result, there is a potential risk that undetected illegal or improper activities could occur unless the department further strengthens

its controls. Currently, the CDE has completed several internal reviews of vocational student organizations and is in the process of taking corrective action.

***The Department of Education Paid Unnecessary Administrative Costs While Circumventing the Competitive Bidding Process***

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Certain types of contractual agreements are not subject to competitive bids. Specifically, current state law requires that interagency agreements and contracts between state departments and CSU, the University of California, the Chancellor’s Office of the California Community Colleges, or their auxiliary organizations be exempt from competitive bidding requirements. The purpose of exempting these agreements from competitive bidding is to take advantage of existing state resources, such as the expertise of university and college faculty.

  
*Because private contractors performed the services, the CDE did not make use of existing state resources and, in essence, circumvented the competitive bidding process.*

However, similar to our prior year audit report, we found instances in which the use of agreements between state departments and CSU campuses was not done to take advantage of this expertise. Rather, one department misused interagency agreements to enter into sole-source contracts with private-sector consultants. Specifically, we found that although the department initially contracted with CSU, its campuses merely handled invoicing of expenditures but existing CSU faculty did not perform the actual contract services. Because CSU’s responsibilities were administrative in nature, the campuses were merely fiscal agents of the State. By using fiscal agents in this manner, the department spent part of the total contract funds to pay administrative costs. Further, because private contractors ultimately performed the services without submitting bids, the department did not make use of existing state resources and, in essence, circumvented the competitive bidding process.

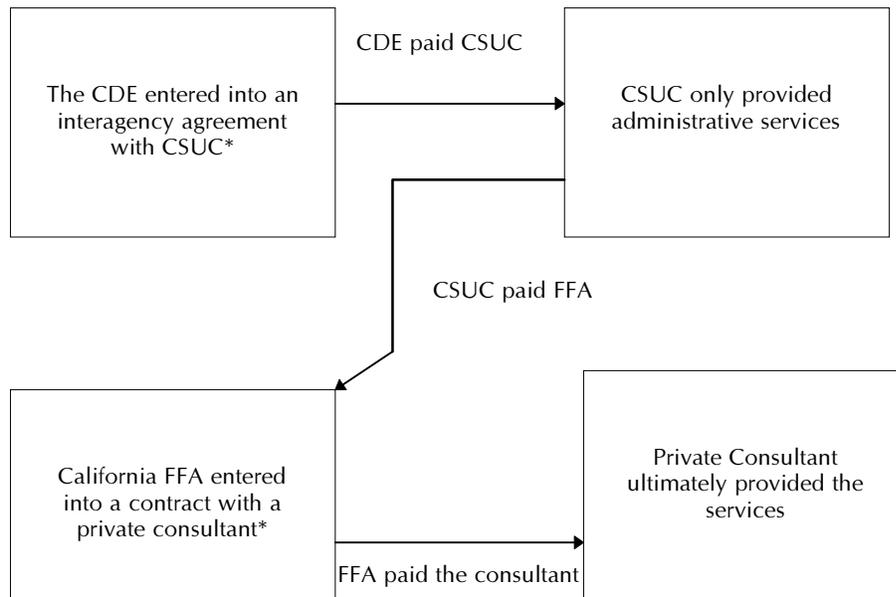
For example, the California Department of Education (CDE) entered into an agreement with California State University, Chico (CSUC) to prepare and conduct a leadership-development conference for vocational education students participating in the California Future Farmers of America (FFA) organization. The CDE oversees the FFA and other vocational student organizations. In fact, the CDE has designated one of its employees to serve as the state FFA adviser and coordinate the FFA program. However, despite the scope of work discussed in the agreement, CSUC appears to have only provided administrative services to the department. Specifically, evidence we obtained from the parties involved

indicates that CSUC only handled invoicing of contract expenditures. In essence, CSUC acted as a fiscal agent because a consultant coordinated the leadership conference. The FFA hired the consultant through a separate contract. As a result, the CDE paid approximately \$1,000 to the CSUC for administrative costs. In our view, these administrative costs are unnecessary because the CDE could have contracted directly with the consultant and avoided the additional \$1,000 in expenditures. Furthermore, because a private consultant actually performed the contract services, the CDE circumvented the competitive bidding process by denying other parties the opportunity to compete for the \$21,000 contract.

The following diagram depicts the relationship among the parties involved in the interagency agreement between the CDE and CSUC.

***Relationships Between Parties Involved  
in CDE's Interagency Agreement With CSUC***

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\*(CDE contract monitor and state FFA adviser are the same employee.)

In another instance, the CDE paid additional administrative costs on another interagency agreement valued at approximately \$31,000. Specifically, the CDE entered into an agreement with California State Polytechnic University, Pomona (CSPUP) to provide leadership training to students and teachers

participating in health career programs through California Health Occupations Students of America (Cal-HOSA), another vocational student organization. Similar to the previous example, it appears that CSPUP merely handled invoicing of contract expenditures. Further, the actual training services were provided by outside consultants not employed by CSPUP. As a result, the CDE paid CSPUP approximately \$2,300 in administrative costs and again denied other qualified consultants the opportunity to participate in a competitive bidding process. In both of these examples, the CDE cannot ensure that it obtained the best available services at the most reasonable prices.

As discussed above, the CDE has gone beyond the intent of the law that exempts interagency agreements from competitive bidding. Instead of using existing government resources and expertise, the CDE misused interagency agreements by hiring CSU campuses to act only as fiscal intermediaries for private contractors. The department has, in essence, awarded sole-source contracts to private consultants and circumvented the usual competitive bidding process. By avoiding competitive bidding, a department cannot ensure that it has contracted with the most qualified individual or that the amount paid to the contractor was reasonable. Further, awarding services to private contractors without soliciting competing proposals denies potential bidders the chance to compete for contracts.



*Neither existing contract law nor the State's oversight process prevents departments from misusing interagency agreements and avoiding the competitive bidding process.*



Neither existing contract law nor the State's oversight process prevents departments from misusing interagency agreements and avoiding the competitive bidding process. Because the law does not contain specific prohibitions against circumventing the competitive bid process, departments have used these agreements to ultimately subcontract with private-sector consultants. The Department of General Services (DGS), which has oversight responsibilities for the statewide review and approval of contracts and interagency agreements, attempts to ensure that departments comply with laws and protect the State's best interests. However, the DGS' review of contracts and interagency agreements is not designed to detect the circumvention issues discussed above. To prevent the future misuse of interagency agreements, the DGS has recently developed a state contracting manual that specifically prohibits the use of interagency agreements to circumvent competitive bidding. However, we will not be able to determine the effectiveness of these directives until we conduct our audit of the State's contracting process for fiscal year 1996-97.

### ***Weak Controls Exist Over Interagency Agreements Involving Quasi-State Organizations***

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During our review of interagency agreements, we found that weak controls over agreements involving quasi-state organizations, such as vocational student organizations, have allowed state employees to assume incompatible duties and authorize contracts without proper oversight. While we only noted these issues at the CDE, the potential exists for these situations to be present elsewhere. As a result, there is a risk that undetected illegal or improper activities could occur. In fact, we found that an illegal and improper act recently occurred at the CDE. In our investigative audit that we issued in September 1996, we reported that weak controls at the CDE allowed an employee involved with a vocational student organization to submit false expenditure claims and misappropriate public funds. Immediately following our audit, the CDE initiated its own internal reviews of vocational student organizations to determine whether funds were properly managed. As a result of these reviews, the CDE has strengthened its internal controls over invoice payments and is in the process of correcting its incompatible duties problem.



*When state employees assume incompatible duties with quasi-state organizations, risks of improper activities increase.*



As stated above, the CDE is closely linked to vocational student organizations, which are authorized by the federal Carl D. Perkins Vocational Education Act of 1984 to play an integral part in educational programs that prepare individuals for employment. During our audit, we reviewed interagency agreements at the CDE involving the California Future Farmers of America (FFA) and California Health Occupations Students of America (Cal-HOSA), two of ten officially recognized vocational student organizations.

The National FFA, which came into existence in the 1920s to provide students with leadership skills through agricultural education, is incorporated at the federal level as a nonprofit corporation. In California's FFA, a CDE employee working in agricultural education is assigned the position of state FFA adviser and conducts FFA activities, including the fiscal management of FFA funds. Because FFA activities are mainly handled by the state FFA adviser and other CDE employees, the California FFA is not completely independent from the CDE.

Similarly, a CDE employee working in health education holds a position on the executive committee as executive director and directs the daily operations and funding of Cal-HOSA. Again, because CDE employees are responsible for its daily operations, Cal-HOSA is not completely independent from the CDE.

***Employees' Roles in Vocational Student Organizations Are Incompatible With Their Assigned Departmental Duties***

During our review of interagency agreements, we found that state employees' responsibilities in certain organizations resulted in the employees performing duties that were incompatible with their assigned departmental responsibilities. In some cases, employees were responsible for both authorizing and approving expenditures. In its description of proper organizational controls, the State Administrative Manual states that an employee should not be responsible for both the authorization and approval of expenditures without independent review by another person. By allowing employees to perform incompatible duties, state departments increase the risk that illegal or improper activities could occur and go undetected. In addition, because of their close involvement with state contracting activities, these employees may not have the requisite independence from the vocational student organizations to protect the State's interests.

—◆—  
*Employees were designated responsibility to enter into contracts with student organizations and then review and approve invoices as CDE's contract monitors.*  
—◆—

We documented a situation in which the CDE utilized one employee as the state FFA adviser to coordinate the FFA program and direct the handling of FFA funds. In his capacity as the FFA adviser, the employee was able to enter into contracts, approve purchases, and authorize payments. However, the department also designated this same employee to function as the contract monitor over interagency agreements and contracts to provide FFA services. As a result, the employee was in a position to control and authorize contract expenditures as the FFA adviser and then review and approve invoices for the same expenditures as the contract monitor. This arrangement is an inadequate separation of duties because the state employee can both authorize expenditures as the FFA adviser and approve expenditures for payment as the CDE contract monitor.

In another instance, the CDE designated one of its employees as Cal-HOSA executive director. Similar to the FFA adviser, the Cal-HOSA executive director was in a position to control and authorize contract expenditures as executive director and then review and approve invoices for the same expenditures as the contract monitor. Clearly, the CDE designated the employee with incompatible duties to serve both as Cal-HOSA executive director and as contract monitor.

The issues addressed above may partially be the result of the link between the CDE and its vocational student organizations. Specifically, the CDE needs to function in an advisory capacity over vocational student organizations.

Although federal bylaws guiding the FFA require state educational departments to advise the student organization, they do not require the department to control daily operations, such as authorizing expenditures. To fulfill its required responsibility to student organizations and also tighten its controls, the CDE could consider assisting the organizations in establishing independent boards to manage and monitor their daily operations.

Allowing state employees to assume incompatible duties increases the risk that undetected illegal or improper activities could occur. As mentioned earlier, our investigative audit report in September 1996 noted that a CDE employee responsible for the oversight of another type of vocational student organization, the California Association of Vocational Industrial Clubs of America, circumvented state policies and controls. Specifically, we reported that weak controls at the CDE allowed the employee to illegally approve over \$44,000 in personal expenses, submit false travel claims, and make an illegal political contribution. However, since that audit, the CDE has strengthened its internal controls by requiring a deputy superintendent or a division director to approve all contract invoices prior to payment.



*In September 1996, CDE's internal auditors initiated fiscal reviews over the management of vocational student organizations.*



The CDE is aware of the weak controls existing over its management of vocational student organizations and, immediately following our investigative audit, in September 1996, requested that their internal auditors conduct fiscal reviews over the FFA, Cal-HOSA, and other vocational student organizations. As noted in their reports, the CDE auditors found control weaknesses similar to those we have highlighted here. For instance, the internal auditors found that department staff participate in some FFA activities incompatible with their duties as state employees and that the CDE's existing control structure over FFA funds lacks adequate process controls. To address these issues, the department is in the process of establishing the FFA as a private nonprofit corporation governed by its own board of directors. The board of directors will be responsible for the fiscal management of FFA funds, thus removing such duties from the state employees. Although the internal auditors have not finalized their report on Cal-HOSA, it is anticipated that similar corrective action will be taken.

In addition to their internal reviews, the CDE's managerial and administrative staff are reviewing the administration of vocational student organizations to identify ways for improving fiscal controls and safeguarding funds. One way the CDE could further improve its controls and avoid conflict-of-interest situations is to assign contract monitoring to employees not

involved with the vocational student organizations. In fact, the CDE has already reassigned Cal-HOSA contract monitoring responsibilities from the Cal-HOSA executive director to a different CDE employee. By having different employees responsible for the initial approval of contract invoices for payment than those that manage the student organizations, the CDE will avoid assigning employees incompatible duties.

### ***State Employees Awarded Contracts Without Proper Oversight***

At the CDE, we found that staff approved contracts between vocational student organizations and private contractors without proper department oversight. The State Administrative Manual limits authority to enter into contracts and interagency agreements to those officers who have express statutory authority or to those individuals that have been duly authorized in writing by the department head and whose names are on file with the DGS. Further, the CDE requires its employees to submit all contracts and interagency agreements to its contracts office in the fiscal and administrative services division for review and approval.

In one instance, in which we reviewed an interagency agreement between the CDE and California State University, Chico (CSUC) to conduct an FFA leadership-development conference, we learned that CSUC only provided administrative services. A private contractor was hired to actually conduct the conference through a separate contract that was never authorized by the CDE's contracts office. The contract was not routed through the department's approval process but was authorized by the state FFA adviser, who is also a department employee. Although the CDE employee awarding the contract acted in his capacity as the FFA adviser, he had neither statutory nor delegated authority to enter into contracts that involved state funds.



*The CDE allowed employees to award contracts that involved state funds without adequate department oversight.*



Similarly, the department allowed another CDE employee, who had neither statutory nor delegated authority, to award contracts that involved state funds as part of her position as the executive director of Cal-HOSA. Based on our review of a CDE interagency agreement with CSPUP, we learned that the department contracted with the university to train students and teachers involved in Cal-HOSA. However, CSPUP merely handled the invoices, while private consultants ultimately performed the training. These consultants, mainly local educational administrators, were hired by the CDE employee through verbal or written contracts.

## ***Conclusion***

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By misusing interagency agreements with CSU campuses, the CDE avoided competitive bidding and added unnecessary costs to the contracting process. For such agreements, existing laws over state contracting and state policies do not require departments to solicit competitive bids because these agreements are designed to allow government agencies to take advantage of each other's resources. However, the department did not use the public employees to perform the contract services; instead, the department in effect, used the interagency agreements to enter into sole-source contracts with private parties. In doing so, CDE avoided competitive bidding and added unnecessary costs to the contracting process. We acknowledge that the DGS implemented policies that specifically prohibit state departments from misusing interagency agreements to circumvent the competitive bidding process. But, because the DGS policy was not effective until July 1996, we cannot evaluate its effectiveness until our audit of the State's contracting process covering fiscal year 1996-97.

In addition to the above issue, weak controls exist at the CDE over interagency agreements involving vocational student organizations. These weak controls have allowed state employees to accept responsibilities in these organizations incompatible with their assigned departmental duties. Further, some state employees have authorized and approved contracts between the vocational organizations and private contractors without proper oversight. The CDE should continue to strengthen its controls in order to prevent illegal and improper activities from occurring.

## ***Recommendations***

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All departments should restrict the use of interagency agreements to their appropriate purpose and prohibit the use of such agreements to evade existing state contracting procedures. Specifically, state departments should contract directly with private parties when appropriate rather than use interagency agreements to circumvent competitive bidding.

The California Legislature should adopt new legislation to prohibit departments from misusing interagency agreements to obtain contract services from private consultants without participating in the competitive process.

To further strengthen controls and eliminate incompatible duties of employees, the Department of Education should do the following:

- Re-emphasize the State's policy that prohibits state employees from accepting responsibilities with other organizations incompatible with their assigned departmental responsibilities. Also, the department should monitor compliance with the policy;
- Assign all contract monitoring responsibilities to employees not involved with vocational student organizations;
- Consider establishing independent governing boards to oversee vocational student organizations so that state employees are not faced with incompatible duties;
- Communicate and emphasize the State's policy prohibiting employees from negotiating and awarding contracts or subcontracts without appropriate department oversight; and
- Ensure that all contracts and subcontracts are submitted to the appropriate departmental unit or the Department of General Services for review and approval.

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# Chapter 3

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## ***The State Is Not Using Statewide Master Agreements to the Fullest Extent Possible***

### ***Chapter Summary***

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One objective of the Department of General Services (DGS) is to provide central support services to state departments, thereby promoting greater efficiency than if the departments individually provided such services. One method the DGS uses to achieve this objective is through statewide master agreements (master agreements). Master agreements are contracts awarded for specific types of services—such as security, strategic planning, paging, copier maintenance, and electronic data processing—which can then be used by many state departments. In establishing a master agreement, state departments take advantage of their combined buying power while reducing steps for procuring needed services.

During our review, we found the State may not be using master agreements to the fullest extent possible. We encountered three examples in which the State could have clearly benefited from a master agreement and we believe that other factors indicate that this method for procuring services is not fully utilized. Specifically, the State has not centralized the award or management of master agreements. In addition, lists of master agreements are not always distributed to the appropriate personnel at every state agency. Finally, departments are frustrated because the procedures required to obtain services under a master agreement vary considerably. As a result, the State may be missing opportunities to obtain better prices for services by taking advantage of the buying power of all state departments.

### ***The State Has Not Established a Centralized Approach To Ensure Master Agreements Are Used When Warranted***

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According to the Office of Legal Services within the DGS (OLS), there are no standard procedures for determining when a statewide master agreement is needed. The DGS believes that determining the need for such contracts is primarily the responsibility of each department. In keeping with this

philosophy, we found that current master agreements had, in fact, been awarded by other state departments as well as by several offices within the DGS.

The Procurement Division and the Office of Information Services within the DGS award and approve master agreements related to commodity purchases; equipment purchases, service, and repair; and information technology. While the DGS normally awards and approves master agreements, in some cases it has delegated this authority to other departments. For example, the DGS has allowed the California Highway Patrol (CHP) and the Department of Personnel Administration (DPA) to award master agreements for security and strategic planning services, respectively.

While we recognize that departments have a responsibility to determine whether using a master agreement serves their needs, we also believe that the DGS can best recognize when a new master agreement is warranted. Because it reviews and approves many department contracts, the OLS within the DGS has a unique opportunity to identify circumstances which call for a master agreement. For example, if different departments submit contracts for approval to procure the same type of services, the OLS could propose the use of a master agreement instead of several separately awarded contracts. Currently, the OLS, as part of its decision to approve or deny an agency's request for a master agreement, specifically considers whether there is a broad-based need for similar services at multiple state agencies. However, the OLS does not currently seek to identify and award master agreements. By placing the responsibility for identifying the need to use master agreements solely on the awarding departments, the DGS may be missing opportunities to identify when master agreements would best serve the State's interests.



*The DGS may be missing opportunities to identify when master agreements would best serve the State's interests.*



In addition, we found that distribution lists used to send out information about available master agreements do not always include all state departments. We reviewed distribution lists used by the Office of Information Services and the Procurement Division within the DGS, as well as lists used by the CHP and the DPA. While the distribution list maintained by the DGS offices was mostly complete and included almost all of the 110 state departments, we found that the CHP and DPA lists did not include many departments. Specifically, the CHP list included only 75 departments while the DPA list only included 29 departments. For an example of omissions, neither list included the Youth and Adult Correctional Agency, which oversees six other state departments.



*State departments may not be aware of all available master agreements, because distribution lists are incomplete or do not always target the personnel responsible for contracting.*



Furthermore, we found that department contracting offices did not always receive the master agreement information. Instead, listings were distributed to a wide variety of personnel, such as health and safety officers, security officers, or program managers. None of the contracting personnel at the five departments we reviewed were included on the distribution lists. Because these lists are incomplete or do not always target personnel responsible for contracting, state departments may not be aware of all available master agreements. Unless all state departments are aware of available master agreements, the State cannot take full advantage of its collective buying power.

Finally, departments are frustrated when trying to obtain services from master agreements because the process to obtain services varies considerably. In fact, the five departments we surveyed generally expressed frustration and confusion over these varying requirements. For example, under one master agreement, a department only needs to complete a one-page form to obtain services from a moving contractor. However, to obtain electronic data processing services under a master agreement, the department must complete six different forms, including an order form, duty statement, contract submittal, certificate of compliance, hiring activity report, and a performance report. Some amount of variation in these procedures is unavoidable because existing laws related to contracts require that contracts be treated differently depending on the type of services involved. However, contract staff find lengthy and varying procedures difficult to keep track of and may be less inclined to use master agreements with multiple requirements. Therefore, we encourage DGS to develop uniform procedures for accessing master agreements when possible to encourage departments to use master agreements.

The factors described above indicate that the State's present approach to master agreements is not efficient. As a result, the State may be missing opportunities to obtain better prices for services by taking advantage of the departments' collective buying power.

***The State Could Benefit by  
Negotiating Master Agreements  
for Medical Laboratory Services***

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We encountered three examples during our review at the California Department of Corrections (CDC) that present good opportunities for use of master agreements. However, neither the CDC nor the DGS consolidated multiple contracts into one master agreement.

A CDC contractor charged them widely varying prices for the same tests at 10 institutions.

In the first example, we found that 10 of the CDC's 32 institutions awarded individual contracts for medical laboratory tests for a total value of more than \$2 million. Although the same contractor won the competitive bidding at all 10 institutions, the contractor charged them widely varying prices for the same tests. For example, a blood screen for Dilantin levels cost 50 cents at one institution, \$5 at another, and \$10 at yet another. A test for the Hepatitis Delta virus antibody ranged from no charge to \$60 per test. The price variance did not appear to be caused by the location of the testing laboratory or the quantity of tests requested by a given institution.

Table 1 below shows the estimated number of tests during the year, the unit price per the contract, and the total cost to the institution for one of the CDC's most requested tests, Rapid Plamaster Reagin (RPR). As the table shows, based on the terms of contracts with nine of the ten institutions that needed this particular test, the CDC estimated it would pay more than \$39,500 for approximately 34,000 RPR tests.

**Table 1**  
**Rapid Plamaster Reagin**  
**Tests at Nine Institutions**

Institution Number	Estimated Number of Tests Per Year	Unit Price	Total Price
1	24,000	\$ 0.90	\$21,600
2	12	0.50	6
3	175	2.00	350
4	1,200	1.00	1,200
5	960	0.25	240
6	5,256	2.00	10,512
7	24	2.00	48
8	1,020	2.00	2,040
9	1,800	2.00	3,600
<b>Total</b>	<b>34,447</b>		<b>\$39,596</b>

Based on the table, the average unit price for the RPR test is \$1.15 (\$39,596 divided by 34,447 tests). If the CDC had requested a price for 34,447 RPR tests in its request for proposals, it might have obtained a unit price less than the average it paid. In addition, if the CDC had requested a master agreement for medical testing services, the State could have avoided additional administrative costs for the department to process and the DGS to approve nine separate agreements.

The CDC was not the only department to use this contractor for medical laboratory tests. We found that the Camarillo and Sonoma Developmental Centers, both under the Department of Developmental Services, independently hired the same contractor. Had these two departments established a master agreement, the State might have benefited by obtaining lower prices than each department obtained on its own.

  
*The CDC recognizes that master agreements between several institutions and one or more contractors will likely result in lower rates for services.*

Although the CDC did not negotiate a master agreement for past medical testing, it recently assigned staff to develop and implement a pilot project to centralize institutional contract activities. According to its contract branch chief, the CDC recognizes that master agreements between several institutions and one or more contractors will likely result in lower rates for services. According to the assistant deputy director in the CDC's Health Care Services Division, in 1994 the CDC began to competitively negotiate contracts with hospitals to provide medical services for inmates. These initial negotiations resulted in a plan to designate preferred providers in exchange for competitive rates.

In the second example of a missed opportunity to employ a master agreement, two of CDC's institutions independently awarded separate contracts for nurse registry services to provide nurses on an as-needed basis. The value of these contracts was approximately \$633,000. Neither the department nor the DGS, which approved each of the contracts, attempted to consolidate these contracts into one master agreement.

In the final example, we found that three CDC institutions independently awarded contracts for ophthalmology services. If a single master agreement had been used, the State could have saved itself administrative costs of awarding three separate agreements.

### ***Conclusion***

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The DGS and other state departments share responsibility for ensuring that the State's contracting program is effective. Master agreements represent one efficient method for obtaining needed services and their use can result in savings to the State by lowering prices and reducing administrative effort. However, the State has not established a centralized approach that ensures master agreements are used when warranted. As a result, the State may be missing opportunities to obtain better prices and reduce administrative effort.

## ***Recommendations***

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The Office of Legal Services within the Department of General Services should identify, during its review of department contracts, when using master agreements would better serve the State's interests. In addition, departments should also bear responsibility in determining whether master agreements would better serve their needs.

Finally, the Department of General Services should:

- Ensure a complete updated listing of all master agreements is sent to the appropriate personnel at every state department; and
- Establish simple, uniform procedures for obtaining services under master agreements where possible to encourage their use and minimize the burden that multiple procedures impose on departments.

We conducted this review under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. We limited our review to those areas specified in the audit scope of this report.

Respectfully submitted,



KURT R. SJOBORG  
State Auditor

Date: July 24, 1997

Staff: Steven M. Hendrickson, Audit Principal  
John F. Collins II, CPA  
Catherine M. Giorgi, CPA  
Scott Denny  
Payam Fardanesh  
Jim Gabler  
Arn Gittleman  
Regina Harmonson, CPA  
Craig Lewis, CPA  
Chris Ryan  
Jian Wang

***Response to the report provided as text only***

State and Consumer Services Agency  
Office of the Secretary  
915 Capitol Mall Suite 200  
Sacramento, CA 95814

July 17, 1997

Kurt R. Sjoberg, State Auditor  
Bureau of State Audits  
660 J Street, Suite 300  
Sacramento, California 95814

Dear Mr. Sjoberg:

RE:   AUDIT REPORT NO. 96015  
      STATE CONTRACTING: IMPROVEMENTS ARE STILL NEEDED TO  
      ENSURE THE EFFECTIVE USE OF PUBLIC RESOURCES

Attached is our response prepared by the Department of General Services to the Bureau of State Audits' Report No. 96015 entitled "State Contracting: Improvements Are Still Needed To Ensure the Effective Use of Public Resources."

If you have any questions or need additional information, please contact me at 653-4090.

Sincerely,

George Valverde  
Deputy Secretary

Attachment

# Memorandum

Date: July 17, 1997

File No.: 96015

To: Joanne C. Kozberg, Secretary  
State and Consumer Services Agency  
915 Capitol Mall, Room 200  
Sacramento, CA 95814

From: **Department of General Services  
Executive Office**

Subject: **RESPONSE TO BUREAU OF STATE AUDITS' REPORT NO. 96015 -- "STATE CONTRACTING:  
IMPROVEMENTS ARE STILL NEEDED TO ENSURE THE EFFECTIVE USE OF PUBLIC  
RESOURCES."**

Thank you for the opportunity to respond to Bureau of State Audits' (BSA) Report No. 96015 which addresses recommendations to the Department of General Services (DGS) within Chapter 3 of the report. The following response addresses each of those recommendations, plus two statewide recommendations contained in Chapter 2.

## OVERVIEW OF THE REPORT

The DGS has reviewed the findings, conclusions and recommendations presented in Report No. 96015. As discussed in this response, the DGS will take appropriate actions to address the recommendations.

As noted in previous reports by the BSA, the immediate responsibility for ensuring compliance in contracting for services rests with the state departments planning to be parties to the contracts. To assist state departments in complying with their responsibilities and to accomplish its oversight responsibilities, the DGS has implemented numerous administrative control activities. The DGS has also established and works closely on contracting issues with a group comprised of state agency contracting personnel, i.e., the State Contracting Advisory Network (SCAN). The results of the BSA's audit will be presented to the SCAN at its August 1997 meeting.

It should be noted that, subsequent to the BSA's 1995/96 fiscal year audit period, the DGS took a number of significant actions that will further improve the state's contracting program. Specifically, the first edition of the State Contracting Manual (SCM) was issued as a resource to those persons in state government who are involved in the state's contracting process. The SCM, which was distributed in July 1996, is designed to serve as a toolbox to provide assistance to those engaged in contracting. It contains statutory and policy references as well as practical advice. The manual deals primarily with the types of contracts included in the BSA's audit scope, i.e., services, consultant services, and interagency agreements.

In addition, during the 1996/97 fiscal year, the DGS' Office of Legal Services (OLS) developed and implemented a more comprehensive contract training course. This three day course covers the SCM and includes a contract management module. This module should result in improvements to the contract management issues presented in Chapter 1 of the BSA's report. A total of 270 state employees attended the course during the 1996/97 fiscal year.

Over the last two years, the OLS has also sponsored two statewide contracting conferences. The conference participants, which totaled approximately 250 at each conference, attended sessions covering various contracting issues, including those raised in the BSA's audit report.

The following response addresses the first two recommendations in Chapter 2 related to statewide control systems for using interagency agreements. Further, responses are provided to the recommendations specifically addressed to the DGS in Chapter 3. It is our understanding that the specific findings and recommendations pertaining to other departments have been discussed and reported to those departments. Therefore, the DGS has not attempted to verify the accuracy of those findings and will not respond to those issues.

## RECOMMENDATIONS

### CHAPTER 2

**RECOMMENDATION # 1:** *All departments should restrict the use of interagency agreements to the proper use of existing public resources and prohibit the use of such agreements to avoid existing state contracting procedures. Specifically, state departments should contract directly with private parties when appropriate rather than use interagency agreements to circumvent competitive bidding.*

#### DGS RESPONSE # 1:

The report identifies concerns with the use of interagency agreements by state agencies with the California State University (CSU) system to circumvent state contracting requirements. Subsequent to the BSA's 1995/96 fiscal year audit period, the DGS took significant actions to address this method of procuring services. Specifically, as noted in the report, the DGS previously recognized that some state agencies have used interagency agreements with the CSU to circumvent existing state contracting requirements. Therefore, information was greatly expanded in the new SCM on state requirements related to circumvention, interagency agreements, and contracts with universities or foundations. In fact, SCM Section 3.18 specifically addresses the BSA's concerns by stating that agreements with the CSU or its foundations cannot be used to circumvent the state's competitive bidding requirements. The previously discussed OLS' contract training course also includes instruction on the proper use of interagency agreements.

In addition, OLS' staff met in the summer of 1996 and the spring of 1997 with management and staff of the CSU Chancellor's Office University Services Program to discuss the contracting process used by state agencies to procure the services of the CSU. The University Services Program was established to provide a systemwide network of services and expertise to state departments. The University Services Program's management and staff agreed that interagency agreements should not be used to circumvent state contracting requirements. They indicated that they would take action to assist in ensuring that interagency agreements are only used in accordance with SCM requirements.

**RECOMMENDATION # 2:** *The California Legislature should adopt new legislation that would prohibit departments from misusing interagency agreements by obtaining contract services from private consultants without participating in the competitive process.*

**DGS RESPONSE # 2:**

Although DGS staff are available to work with the Legislature on this issue, the recently issued policy direction provided in the SCM and the other actions discussed under the previous recommendation appear to address the findings of the BSA. Therefore, the DGS believes it is premature to pursue new legislation. We would expect that the BSA's next audit of contracting scheduled for the spring of 1998 will disclose improvements in the process used by state agencies to procure the services of the CSU.

### CHAPTER 3

**RECOMMENDATION # 1:** *To identify situations warranting the use of master agreements, the OLS within the DGS should identify, during its review of department contracts, when using master agreements would better serve the State's interests. In addition, departments should identify whether using master agreements would better serve their needs as part of the responsibility for their own contracting program.*

**DGS RESPONSE # 1:**

During the last few years, the DGS has greatly increased the number and types of master agreements available for use by state agencies. These agreements have been primarily awarded and administered by the Procurement Division and the Office of Information Services within the DGS. However, in two instances, the DGS has authorized the California Highway Patrol and the Department of Personnel Administration to award and administer master agreements within their areas of expertise.

Although the number and types of master agreements have greatly increased, the DGS recognizes that there may be further opportunities for expansion of the use of this type of contracting arrangement. Therefore, the OLS will implement procedures to identify additional opportunities for master agreements based on the contracts submitted for its review and approval. The issue of identifying further opportunities for master agreements will also be presented to the previously discussed SCAN group.

**RECOMMENDATION # 2:** *To ensure that departments are aware of all available master agreements, the DGS should maintain a complete listing of all master agreements and ensure this list is made available to the appropriate personnel at all state departments.*

**DGS RESPONSE # 2:**

The DGS will study the distribution process used for master agreements. Based on the results of this study, appropriate procedures will be implemented to ensure that a complete master agreement listing is centrally maintained and that the listing is made available to appropriate state personnel.

**RECOMMENDATION # 3:**      ***The DGS should require simple, uniform procedures to be used for obtaining services under master agreements that would encourage the use of such agreements and minimize the burden that multiple procedures impose on users of the agreements.***

**DGS RESPONSE # 3:**

The DGS will review the existing procedures for obtaining services under master agreements and, to the extent possible, develop uniform and simplified procedures. However, there are several different types of contracts and contracting approaches which are collectively considered as "master agreements." Also, there are several specific factors that may vary between master agreements. These different types of master agreements and variable factors dictate use of different access procedures. Thus, only one form may be needed or several forms may be needed. Likewise, a simple task order may suffice or a complete contract may be required. Consequently, while it may be possible to simplify some of these procedures, it will not be possible to eliminate variances.

Specific variances between access procedures may be caused by such factors as the laws applicable to the type of services involved, how competition is built into the particular contract process, the number of suppliers involved, the options available to the using agencies, how the awarding agency is to be reimbursed for costs incurred, what information the awarding agency needs to manage the contract, and what contractual or legal requirements are met as part of the master agreement versus subsidiary agreements or task orders.

**CONCLUSION**

The DGS has a firm commitment to provide efficient and effective oversight of the state's contracting program. As part of its continuing efforts to improve policies over this program, the DGS will take appropriate actions to address the issues presented in the report.

If you need further information or assistance on this issue, please call me at 445-3441.

PETER G. STAMISON, Director  
Department of General Services

*Response to the report provided as text only*

STATE OF CALIFORNIA—YOUTH AND ADULT CORRECTIONAL AGENCY  
PETE WILSON, Governor

DEPARTMENT OF CORRECTIONS  
P.O. Box 942883  
Sacramento, CA 94283-0001

Kurt R. Sjoberg  
State Auditor  
California State Auditor  
660 J Street, Suite 300  
Sacramento, CA 95814

Dear Mr. Sjoberg:

This is in response to the draft copy of your report entitled "State Contracting Improvements Are Still Needed to Ensure the Effective Use of Public Resources," dated July 11, 1997. The following is the California Department of Corrections' (CDC) response to the issues cited in this report.

Issue:

Inaccurate estimates and inadequate advertising of the value of a contract may have limited competition. Specifically, CDC entered into a contract for laboratory services, and subsequently amended it for substantial amounts, up to 300 percent of the original contract.

Response:

The CDC concurs that proper advertising and planning for services is necessary to encourage more competition. It is standard procedure for contract analysts to include an estimation of costs in all requests for advertisement. This estimation of costs should be measured by reviewing prior year usage and other historical data.

The Institution staff person responsible for the contract cited in this example was new to CDC and was unfamiliar with the contracting process; consequently, the ad placed for this contract did not give an estimation of the value of services needed. However, the contract issued in the prior year was adequately funded. To ensure that historical data is considered for future contracts, CDC's contracts office will issue a reminder through a contract news bulletin item to contract analysts in headquarters and institutions to include an estimated value of services in all advertisements in addition to soliciting vendors from an established bidders list.

Instructions will also include checking historical data to derive accurate usage estimates.

Issue:

Monitoring of contractor performance was inadequate.

Response:

Currently, CDC staff spend considerable effort ensuring that invoices are paid in conformance with the terms of existing contracts. In the medical area, typically clinical staff determine that services are provided, and that the services are appropriate. Other medical staff are charged with the task of adjusting the invoices to reflect the rates established in the contracts. In Fiscal Year (FY) 1995/96, for example, at just one of the institutions audited by the Bureau of State Audits, medical contract invoices were adjusted downwards by a total of \$4,043,994, to properly reflect the State's contractual obligations.

Although the Health Care Services Division's (HCSD) efforts in this area have resulted in millions of dollars in invoice reductions over the past few years, the CDC acknowledges that the process for monitoring medical contracts has been implemented in a variety of ways at the 32 institutions. In our judgment, standardized policies and procedures, as well as clearly established roles and responsibilities would improve accountability and provide greater assurance that invoices are paid in conformance with contract terms.

Therefore, the HCSD will establish a CDC Medical Invoice Process Team to analyze the current medical invoicing practices and make recommendations concerning the contract monitoring function, including a standard invoice review process, and service verification procedure. The HCSD will develop an implementation plan, including any necessary resources and staff training requirements, to establish standardized policies and procedures with the goal of ensuring effective medical contract monitoring statewide.

Issue:

Inadequate contract review by CDC has resulted in amendments being processed late.

Response:

The CDC concurs that close monitoring of expenditures will result in better planning for amendments. The Contract and Audit Management Branch (CAMB) has implemented a strict policy for late requests. Any requests that are received late in CAMB must include a statement which explains the circumstances why it is late.

Additionally, a late amendment request must be submitted for review to the Regional Administrator prior to submission to CAMB. This policy of elevating the late amendment request ensures closer awareness of requests which are not submitted in a timely manner and aids in reminding staff to plan in advance for amendments.

In response to this audit, CAMB will reiterate the policy on late contract submittals and request program staff to monitor the funds more closely to ensure advance planning for future amendments.

Issue:

The State could benefit by negotiating Master Service Agreements (MSA) for medical laboratory services.

Response:

The CDC agrees that there are benefits to be gained by combining institution purchasing power through MSAs. Further, CDC has utilized this contracting approach in several medical contracting areas and plans to increase its usage in the future.

Since its establishment in 1993, the HCSD has targeted its contracting efforts on services with high volumes and large dollars of expenditures. For example, CDC spends over half of its contract medical budget on community hospital and associated physician services. As a result of our strategic competitive hospital negotiations, the majority of inmate hospital days during FY 1995/96 occurred in our 12 largest Master Contract "preferred provider" hospitals offering CDC competitive hospital and physician rates and, in most cases, a locked custody unit for guarding efficiencies. The CDC continues to seek Master Contract partnerships with hospitals and encourage their use. In FY 1996/97, we estimate that over two thirds of all inmate hospital days occurred in "preferred provider" Master Contract hospitals. This is a noteworthy achievement since several of CDC's institutions are

located in remote areas of California without easy access to major medical markets where our Master Contract hospitals are typically located.

Additionally, during the audit period (FY 1995/96), CDC utilized MSAs for such purchases as pharmaceuticals (one MSA with a prime vendor McKesson Drug Company, and another MSA covering drugs purchased through several drug vendors) and intravenous solutions and supplies. Pharmaceutical purchases through MSAs totaled approximately \$20 million. Statewide pharmaceutical recovery and destruction was provided through a vendor under a CDC Master Contract with Devos LTD. Individual institutions use MSAs for some common medical commodity purchases such as certain medical supplies.

While it would be difficult to enter into an MSA for physician services statewide because of the widespread locations of CDC institutions, CDC does maintain a standard for contract physician compensation. The rate schedule applies to all physician contracts and is comparable to the rates paid by Preferred Provider Organizations (PPOs) and other health insurance payers. A rate exemption must be submitted and approved by Central Office before a physician contract can be written at a higher rate.

To continue with the concept of consolidating costs, CDC has begun a pilot project to centralize the administration of all contracts for services to institutions in Northern California. Although some institutions such as Pelican Bay State Prison are too remote to benefit from regionalized bidding, the centralization pilot project has been successful in securing regional contracts for nursing services (serving 9 out of the 13 centralized institutions), medical waste removal and pharmacy relief services. Although this pilot for these contracts was small, it has resulted in a savings of processing time and money. The CDC will continue to plan to do more regional bidding in the future.

The CDC believes that these contracting strategies, combined with other targeted health management efforts, have resulted in major savings and cost avoidance in recent FYs. For example, the overall contract medical budget decreased from \$76.3 million in FY 1992/93 to \$70.8 million in FY 1995/96. This occurred despite a significant increase in the inmate population. When contract costs are adjusted for inmate population growth, the per capita costs for contracted medical services decreased by 25 percent during this period. The HCSD estimates that the downward trend in per capita inmate medical contract costs continued in FY 1996/97, based on preliminary year-end data.

Finally, while CDC concurs with the overall concept of consolidating costs through the use of regional contracts and Master Agreements, there is still a substantial

Kurt R. Sjoberg  
Page 5

amount of administrative costs and effort in using Master Agreements. Additionally, we do not agree that the Department of General Services (DGS) should administer the Master Agreement. Because there may be technical issues or conditions which are unique to our institutions, this responsibility should be delegated to CDC. The DGS' current policy requires each of CDC's institutions to submit internal orders to encumber the funds to DGS for approval, as well as the Master Agreement. Each order is reviewed by DGS at a cost of \$95.00 per order. In the past year, CDC's 23 Master Agreements generated approximately 205 orders. Therefore, the use of Master Agreements does not substantially reduce administrative costs or effort for CDC. Nevertheless, CDC will continue to consolidate like services through Master Agreements.

The CDC has always taken its responsibility for administering all contracts in a timely and cost effective manner. Through a combination of continued training, dissemination of information and possible further expansion of the Institution Centralization Project, CDC will ensure that contracts are issued in accordance with State laws and policies and will continue to strive towards developing efficiencies to reduce untimely contract requests.

If you have any questions or if you need additional information, please call Richard L. Burrows, Assistant Deputy Director, Office of Financial Management and Support Services, at (916) 323-4185.

Sincerely,

THOMAS M. MADDOCK  
Interim Director  
Department of Corrections

cc: Joe G. Sandoval

Kurt R. Sjoberg  
Page 6

bcc: Thomas M. Maddock  
Gregory Harding  
James E. Tilton  
Richard L. Burrows  
Frank E. Renwick  
Sharon E. Planchon  
Bill Whitney  
Adora Henderson  
Subject  
Chron  
Reading

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DDS RESPONSE

To

California State Auditor Report Draft

Titled

“State Contracting: Improvements Are Still Needed  
To Ensure The Effective Use of Public Resources”

July 17, 1997  
Paul D. Carleton

## Chapter 1

### ***Departments Need To Strengthen Contract Management To Ensure the Effective Use of Public Resources***

#### **Chapter Summary**

Because many state departments spend a significant amount of money on contractual services, departments need to award and manage contracts prudently in order to ensure the effective use of public resources. During fiscal year 1995-96, the Department of General Services (DGS) approved approximately 8,800 contracts and amendments entered into by state departments totaled approximately \$6.3 billion. The DGS also delegated approval authority to various state departments for contracts below certain dollar amounts. These smaller contracts are not accounted for centrally, and therefore are not included in the numbers cited above.

During our review, we found that departments did not always adequately plan and monitor their contracts. With regard to planning, departments did not always:

- o Ensure that competitive processes were fair;
- o Ascertain that sufficient funding was available to complete contract objectives; and
- o Include clearly defined deliverables and payment provisions in the written contract,

With regard to monitoring, departments did not always:

- o Ensure that contractors kept pace with benchmarks specified in the contracts;
- o Determine that invoices were properly approved, adequately supported, and consistent with contract terms before making payments; and
- o Retain appropriate amounts from progress payments when required.

When departments do not adequately plan and monitor their contracts, they cannot ensure that state resources are used effectively.

#### **State Policies Emphasize Key Elements of Contract Management**

As described in the State Administrative Manual, the essential elements of contract management require proper planning and adequate monitoring as follows:

##### *Planning*

- o Developing a clear, precise scope of work with specific measurable deliverables and benchmarks that can be monitored and managed.

- o Identifying qualified contractors facilitating competition so the State receives the best goods or services for the most reasonable price.

### ***Monitoring***

- o Monitoring and evaluating contractor work performance, for quality, in relation to the contract terms and conditions.
- o Reviewing requests for payment to ensure that payment is consistent with the deliverables received.
- o Evaluating completed contracts to determine whether contract objectives have been met.

### **Contract Planning Can Be Improved**

Adequate planning is a vital component of the effective management of contracts. When contracts are poorly planned, the quality of services to be delivered can suffer, the contract can become more difficult to manage, and the cost of the contract can be unnecessarily high. In our review of 46 contracts, we found flaws in the planning of 10 of these contracts. For example, in one instance, we found that the contracting department's poor design of its proposal requests may have restricted the number of vendors responding to the requests. The following examples illustrate numerous instances of poor planning related to the contracts we reviewed.

## ***Department of Developmental Services Awarded a Contract Without Competition***

In one of the ten poorly planned contracts, the Department of Developmental Services (DDS) restricted competition on a contract for a workers' compensation cost-containment project so that only one contractor could provide the services. Specifically, the DDS awarded a \$3.3 million contract to Industrial Management Services, Inc. (IMS), after issuing a request for proposal (RFP). One of the purposes of an RFP is to obtain complex services in which professional expertise is needed and in which different methods may be applied to solve a problem. In contrast, DDS required all respondents to the RFP to base their proposals on a specific approach to workers' compensation called the Total Employee and Accountability, Responsibility, and Empowerment (TEAM CARE) model. This model had been developed specifically for the DDS with the help of IMS through an earlier pilot project at the Camarillo Developmental Center. By restricting respondents to the TEAM CARE Model, the DDS did not allow the introduction of alternate approaches and gave IMS an advantage over other potential bidders since IMS had worked on the pilot project.

Further, the DDS specified minimum qualifications that were excessively restrictive and appeared to match the experience of IMS. For example, the RFP required respondents to have at least eight years of experience treating injured employees who work with the developmentally disabled. In addition, respondents must have completed a similar workers' compensation project for injured employees . in a public institutional setting with a population of at least 1,500 employees per facility within the last five years. Because these minimum qualifications were restrictive and appear tailored to IMS, the DDS may have ruled out other contractors possessing the expertise necessary to successfully complete the workers' compensation cost-containment project. In fact, of the 28 parties that requested a copy of the bid package, IMS was the only one to actually submit a proposal. In addition, by restricting competition to one respondent, the DDS denied other potential bidders the opportunity to compete.

***RESPONSE:*** *The Department believes the example cited by the State Auditor of problems related to poor contract planning by DDS, does not reflect the problem they are attempting to address. As noted, this contract was to be the statewide extension of an extremely successful pilot project at Camarillo State Hospital and Developmental Center. Based on that pilot, DDS had a clear vision of what it needed and what it wanted to accomplish in the contract. DDS staff developed the TEAM CARE MODEL and while we were open to some modifications to that model we were not interested in any major changes to the basic approach. What we were interested in was contracting with practitioners in the applicable disciplines that could help us implement this specific model in other developmental centers. As a result, the Department developed a very clear and precise scope of work statement with specific measurable deliverables and benchmarks. It is important to note that the role of Industrial Management Services (IMS) ( the company eventually awarded the contract) is significantly different under the terms of the contract than it was during the pilot period. During the pilot, the principles of IMS were the individuals who directly delivered the services to the staff at Camarillo who had been injured on the job. They were*

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\*The California State Auditor's comments on this response start on page 55.

*not the architects of the Team Care approach and they were not responsible for its implementation. It is true that their basic philosophy of treatment coincided with that of the Departments and the experience gained in working collaborative with them throughout the pilot provided the manager of the project a very important experiential base used in developing the principles of the Team Care approach. Given the uniqueness of the project, it clearly met the requirements for sole source contracting, but the Department was not certain that the participants in the pilot would be able to provide the types of services needed to implement the project statewide. Therefore, DDS did not want to prematurely exclude the possibility that other companies could provide the required services and possibly even improve on the approach used in the pilot. That is why DDS went to the effort and expense of conducting an extensive competitive procurement, rather than immediately opt for a sole source contract. In our post-bid survey of all potential bidders, there were few comments indicating that the RFP requirements were too restrictive to meet or that no organization other than IMS could meet them. Likewise, there were no protests to the bid.*

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**Monitoring of Contractor Performance Was Inadequate**

A department’s responsibility does not end once a contractor has been selected. Rather, the department must monitor the contractor’s performance to ensure that the contractor’s work meets the terms of the contract. Specifically, a department’s contract manager who is responsible for approving invoices for payment should be familiar with the services provided as well as with contract terms. Without comparing services received to what is specified in the contract requirements, departments may pay contractors for services that fail to meet contract objectives. For 17 of the 46 contracts we reviewed at five departments, we found that departments did not always adequately manage contracts or monitor compliance with contract terms. In particular, four of the five departments we reviewed did not consistently compare invoices to contract terms, obtain adequate support for payment of invoices, or retain a portion of periodic payments as required by the contract. The following examples describe monitoring problems we noted related to the contracts we reviewed.

**Department of Developmental Services’ Poor Monitoring of Cost-Containment Project Contributed to Time and Cost Overruns**

For one of the contract we reviewed and described earlier, we found the DDS did not adequately monitor contractor performance of its contract with IMS. The DDS agreed that IMS would provide 1,500 hours of team effort at each of four different developmental centers. But, in spite of this agreement, the DDS allowed the contractor to plan activities that exceeded the budgeted level of effort by 53 percent at the first developmental center, and by 24 percent at the second center. Further, the DDS paid invoices that were 20 percent higher than the level of effort budgeted at the first developmental center. Department officials stated that they anticipated that work at the first two developmental centers would take more time than at the last two, even though this is not reflected in the contract budget. However, the department expects that work at all four of the developmental centers will be completed within the total budget of 6,000 hours.

**RESPONSE:** *There have been no time or cost overruns under this contract, nor does DDS anticipate any overruns for the original scope of work outlined in the contract. The State Auditor is referring to Exhibit C, page 3 (Estimated Level of Effort) of the contract. This displays an average level of effort over the four developmental centers designated for participation in the contract. It was necessary to initially show an average level of effort for the contract because it was impossible to predict the exact distribution of the work effort over the three year life of the contract. However, both the State and the Contractor were always fully aware that the contract would of necessity be heavily "front-loaded" in terms of time and expenditures; and the language of the contract very clearly authorizes flexibility in adjusting the workload between tasks and facilities. The "overruns" referred to be the State Auditor are merely measured against the original average distribution shown in the contract, not the negotiated Task Orders that define the actual work expectations. However, if you look at how the contract funds were encumbered for the life of the contract and are actually being expended, it is clear that the contract is on schedule and within budget.*

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FISCAL YEAR	CONTRACT ENCUMBRANCE	ACTUAL EXPENDITURES
Dec 95 - Jun 96	\$600,000	\$411,722.90
Jul 96 - Jun 97	\$1,200,000	\$1,011,345.93
Jul 97 - Jun 98	\$1,200,000	\$156,549.31
Jul 98 - Dec 98	\$300,000	\$0

In addition, the DDS established a team hourly rate of \$480 to pay IMS. However, paying the contractor for each task based on a certain number of team hours reduces the DDS' ability to determine if the services were properly provided. This method presumed that all 11 members of the IMS' staff are contributing to the accomplishment of each task. However, it was difficult for the DDS to monitor the contractor's performance because it did not know if all 11 staff actually contributed to each task. In one instance, we noted that IMS estimated 4 team hours would be necessary to hold a meeting with another DDS contractor at a cost of \$1,920 (\$480 x 4 hours). The meeting lasted 4 hours and was only attended by three IMS staff. If this had been a more typical contract, in which the contractor is paid by the hours worked, the contractor would have been paid for 12 hours of effort. However, in this contract, because the DDS paid for the contractor's effort based on team hours, the DDS essentially paid IMS for 42 hours of effort instead of the 12 for which a contractor would typically be paid.

***RESPONSE:*** *DDS and IMS negotiated the use of an all inclusive rate for the firm, rather than an individualized cost-reimbursement method, specifically to improve our ability to monitor cost vs progress under the contract and to keep the negotiation of individual task orders clearly focused on obtaining the desired deliverables within a fixed price. Exhibit C, page 2 (Hourly Rate Calculation) of the contract clearly shows that the rate reflects an anticipated average level of effort for the firm's three principals, plus all of their administrative and clerical support and overhead -- not the individual efforts of the 11 members of the firm. As specified in the contract, the fully loaded rate includes "all general and administrative overhead expenses, all other direct and indirect expenses, and profit charges", except for authorized travel expenses and sub-contractor costs.*

*In response to the example used by the State Auditor, it was never envisioned, nor would it be efficient to expect all three principals to be fully engaged 100% of the billable hours and the rate reflects that reduced level of effort for the principals. Likewise, there are many examples where all three of the principals did simultaneously participate in billable tasks; and by the logic used by the State Auditor, IMS was underpaid for their level of effort in those instances. As to the clerical and administrative support included in the rate, such support is built into every professional's billing rates and given the complexity of this project, DDS is satisfied that the level of support included is reasonable. However, the State Auditor's focus on documentation of effort does not begin to address the real issue of achieving successful outcomes at the best possible price. Based on the contractor's initial proposal, DDS would have been paying \$636 per hour for IMS for a total of 5,660 hours at a total contract cost of \$3.6 million. However, in order to ensure the best value for the State, IMS and DDS negotiated a reduced billing rate of \$480 per hour for a total of 6,052 hours at a total contract cost of \$3.3 million.*

⑥

Finally, we found that the DDS paid five of the IMS invoices we reviewed without sufficient evidence that services had been provided. We also found that two of these five invoices were paid without proper authorization. In addition to the contract requiring the contractor to certify that costs claimed on invoices match the task order and the contract, the DDS project coordinator and contract manager also must certify that the contractor has completed the work described on the invoice. However, we could not match the amounts billed on the invoices to the amount of time budgeted for the task on the related task orders. Although four of the five invoices were less than the task order total, one invoice exceeded the task order by approximately \$13,000. In addition, the DDS paid two of invoices without obtaining the required approval of the project coordinator and contract manager.

**RESPONSE:** *A review of the DDS files indicate that all IMS invoices were properly authorized by the DDS project coordinator and contract manager before submission to the State Controller's Office for payment. However, due to a clerical error, the contract payment file in the Accounting Section of DDS did not include some copies of the invoices with the authorized signatures. The contract manager's file, which had copies of the properly authorized invoices, was reconciled with the contract payment file and all documentation is now properly filed in the payment file. DDS has reviewed it's current procedures and will ensure that the contract payment file is properly maintained. With respect to the monthly progress payments, the contract is clear that individual task orders can authorize progress payments, subject to the state required 10% withholding. However, the progress payments themselves are to be based on the percentage of work completed. Since the contract authorizes task orders to be "lump sum" payments for the contractor's deliverable products in each task order, DDS has determined that the most appropriate progress payment method is an even payment level for the contractor based on the duration of the task order, plus actual cost reimbursements for authorized travel and subcontractor costs. The monthly invoices reflect progress payments based on level spread of the "lump sum" amount, not the hours reported in the monthly status reports that are submitted to DDS and used to monitor progress and manage the contract. That is why the State Auditors could not match the invoices to the time budgeted in the task orders. By negotiating the task orders on a lump sum basis, DDS has protected the fiscal interests of the State by limiting the risk of exposure to any potential cost overruns on an extremely complex project. IMS has agreed to accept the risk of guaranteeing delivery of the required work products in each task order within the fixed price because of the benefits to their firm of having a steady cash flow and the simplified administrative process for submitting invoices under this contract. State contract policies are clear that "lump sum" contracting is preferred when possible.*

As a result of these problems, the DDS does not have adequate assurance that project tasks were completed or finished within the time budgeted. In addition, if the department does not take action to mitigate the effects of the cost overrun, the contract will eventually need to be amended to add more money before the project can be completed.

**RESPONSE:** *DDS has already shown that the project is proceeding within the benchmarks established by the contract and that there are no cost overruns, nor are any overruns anticipated based on the original scope of work. The original*

*scope of work was for three new facilities, plus completion of the work already underway at the original pilot developmental center-- Camarillo. With the recent closure of Camarillo, DDS has substituted Lanterman Developmental Center for Camarillo Developmental Center. But, since Lanterman is a "new" center without benefit of the prior work that Camarillo had completed under the pilot, the existing funds may not be adequate to fully complete the project at Lanterman. If that proves to be the case, DDS would initiate an amendment to the contract to add the required funds. Likewise, if DDS adds Agnews Developmental Center to the project. However, these additions would represent an expansion of the level of effort beyond what was originally included in the contract, not a cost overrun.*

### **Conclusion**

State departments we reviewed did not always protect the public interest by adequately planning and managing contracts. Further, departments did not adequately ensure that all contracts contained specific terms that allowed the departments to monitor contractor performance and evaluate the services received. In addition, departments paid contractors for services without ensuring that invoices were adequately supported or that services were consistent with the terms of the contract. If departments do not adequately plan and monitor their contracts, they cannot ensure that state resources are used efficiently and effectively.

## Recommendations

To use state funds as economically as possible, state departments should plan contracts to include all the elements necessary to monitor contractor performance and to evaluate the goods and services received. Specifically, departments should:

- o Exercise care in preparing requests for proposals and estimating the cost of needed services to ensure that competitive processes are fair and attract a good selection of qualified bidders;
- o Include in their contracts sufficiently defined payment provisions, time lines to measure progress, and clearly defined deliverables so that they can have assurance that payments are for actual services rendered;
- o Obtain sufficient funding to complete all contract objectives before entering into contracts or limit the scope of services in the original contract to the level of service that can be adequately funded;
- o Ensure that contractor progress keeps pace with the time lines, budget, or any other benchmarks specified in the contracts;
- o Require that invoices be properly approved, adequately supported, and consistent with contract terms before paying their contractors; and
- o Retain appropriate amounts from progress payments when required.

***RESPONSE:*** *DDS concurs with all of these recommendations. While we feel our contract management practices already embody these principles, we are constantly endeavoring to find innovative new means to improve our performance. We are currently in the process of reviewing the remaining tasks and resultant costs required to complete the contract requirements. Where appropriate, modifications to the task orders will be made to reflect the results of this review. We are also reviewing all of our procedures to ensure we have the best possible system in place to manage this contract and to reach our ultimate goal of obtaining the deliverables in the most efficient and cost-effective manner possible. We firmly believe that the only way to achieve that goal is through constant innovation.*

*While the structure and design of the IMS contract are unfamiliar to the State Auditor, we believe this contract does contain all of the elements of control recommended by the State Auditor. The control focus of this contract is on negotiating each task order individually with a capped price, rather than using the traditional cost-reimbursement model for the entire contract as suggested by the State Auditor. Given the unique nature of the services under this contract, a pure cost reimbursement method could result in what everyone wants to avoid -- spending dollars on effort without any guarantee of a successful outcome.*

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# Comments

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## ***California State Auditor's Comments on the Response From the Department of Developmental Services***

To provide clarity and perspective, we are commenting on the Department of Developmental Service's (DDS) response to our audit report. The numbers correspond to the numbers we have placed in the response.

- ① We disagree with the DDS's assertion that the IMS contract does not address the problem of poor contract planning. In fact, the department's response evades the issue. The DDS limited the number of qualified consultants who submitted proposals on this contract by tailoring the request for proposal to suit the qualifications and experience of the consultant who ultimately was awarded this work. In our view this is a good illustration of a poorly planned contract.
- ② Though the department states it was open to some modifications to the TEAM CARE model, this willingness was not expressed in the project's advertisement or in the Request For Proposals (RFP). The advertisement stated, "The QA (quality assurance) cost containment program must utilize the TEAM CARE model as the foundation." Further, the following comments in the RFP suggest that no other model would be considered: "All standards of practice will follow the TEAM CARE model . . . The TEAM CARE model will be utilized as the foundation and benchmarking tool in developing and implementing the QA and I (quality assurance and improvement) program."
- ③ As we point out on page 5 of the report, the DDS limited the number of consultants who submitted proposals on this contract by tailoring the RFP to the qualifications and experience of the firm ultimately awarded the contract. Given this, the department's statement that it "was not certain that the participants in the pilot would be able to provide the types of services needed to implement the project statewide" is not supported by the actions they took on this contract. The participants in the pilot were employees of IMS Company, the same firm that was awarded the statewide contract.

- ④ The department understates the significance of the comments obtained in its post-bid survey. At least two potential bidders either questioned the minimum qualifications or cited them as the reason for not submitting a proposal. In questioning the minimum qualifications, one potential bidder commented that such requirements would likely rule out many potential bidders who otherwise would have the expertise to complete the project. This potential bidder also asked, “Does the department have reason to believe that there will be at least two potential contractors who meet the criteria specified in this paragraph, so that there is an opportunity for fair competition?” Another potential bidder, in commenting on why it did not meet the minimum qualifications, explained that it had performed a similar project for a public utility company but not in a public institutional setting. Despite expressing interest in the project, neither of these potential contractors submitted a proposal because they could not meet restrictive qualifications. Finally, during our audit, the department did not inform us of other contractors who would have met the minimum qualifications and made no statement in its response that any other contractors would have met the minimum qualifications.
- ⑤ The department now states it was “always fully aware that the contract would of necessity be heavily ‘front-loaded’ in terms of time and expenditures.” This assertion implies the contractor’s efforts at the first two sites would take longer and cost more than at the second two sites. However, none of the documents related to this contract nor the contract itself mentions this situation. We remain concerned that the work at the first site consumed 39 percent of the total contract budget.
- ⑥ The department’s response increases our discomfort with the team hourly rate of \$480 per hour, the fee it is paying this contractor. The department claims it never envisioned that all three principals would be fully engaged for 100 percent of the billable hours; consequently, the rate reflects a reduced level of effort for the principals. However, the hourly rate calculation presented in Exhibit C of the contract specifically includes a monthly time base of 100 percent for two of the three principals and 50 percent for the third. It also reflects a monthly salary of \$10,000 for each of the three principals. In other words, the contract does not reflect a “reduced level of effort” for all three principals, but rather only one principal. Furthermore, it should be noted the costs for clerical and administrative support are not included in the rate for the principals; rather, the salaries for eight support staff appear on separate line items.

- ⑦ In accordance with state contracting policies, when a department agrees to make progress payments to a contractor, the amount of these payments should reflect the amount of work the contractor has accomplished. With this contract, however, the DDS has agreed to make progress payments “based on level spread of the ‘lump sum’ amount” of the task order. In other words, the DDS is making progress payments to this contractor that do not reflect the contractor’s actual progress.

*Response to the report provided as text only*

California Department of Education  
721 Capitol Mall  
P.O. Box 944272  
Sacramento, CA 94244-2720

July 17, 1997

Kurt R. Sjoberg  
California State Auditor  
660 J Street, Suite 300  
Sacramento, CA 95814

96015

Dear Mr. Sjoberg:

Thank you for the opportunity to review and comment on your draft audit report titled, "State Contracting: Improvements Are Still Needed To Ensure the Effective Use of Public Resources." The CDE has taken many steps in the past two-and-a-half years to strengthen procedures for approval and use of contracts and to improve controls over the vocational student organizations. Your draft audit report does not recognize the CDE's accomplishments. ①\*

First, in January of 1995, when State Superintendent of Public Instruction, Delaine Eastin assumed office, she strengthened CDE procedures for approval and use of contracts. In Fall 1995, Superintendent Eastin commissioned a contracts and grants work group with CDE staff representation from all program and fiscal areas to develop a handbook of guidance for CDE staff. The work group compiled information on all aspects of the contracting and granting processes, and in Fall 1996 through training classes and discussions with co-workers, began to disseminate the guidance to CDE staff. In May 1997, the CDE released its first written procedures - invoicing guidelines for contract monitors, which provided information to assist contract monitors in fulfilling their responsibilities for progress reports, payments including invoice content and detail, and evaluation and follow-up. Within the next year, the CDE plans to disseminate all of the work group information in writing through periodic CDE memorandum.

Second, in August 1996 (Bureau of State Audits, Investigative Report Number I940262, issued September 3, 1996), the CDE was shocked to learn of misuse of funds and mismanagement by one of its managers with responsibility for administration of a vocational student organization and took immediate corrective measures to ensure that internal controls over the vocational student organizations were strengthened. CDE audit, fiscal, and program staff began discussions to determine

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\*The California State Auditor's comments on this response start on page 65.

Kurt R. Sjoberg  
California State Auditor  
July 17, 1997  
Page 2

the best way to transfer the governance and fiscal operations of each of the six vocational student organizations to an independent body, outside the CDE.

Also in August 1996, the CDE's internal auditors began a thorough examination of the operations of the five vocational student organizations not reviewed by your investigators. The CDE's auditors completed their examination in Spring 1997 and found no misuse of federal or state funds by CDE staff. The CDE's internal auditors, with input from CDE fiscal and program staff, developed recommendations to improve the administration of the vocational student organizations, including the recommendation that vocational student organization operations be transferred to independent boards of directors to eliminate potential incompatible activities by CDE staff.

The Distributive Education Clubs of America—A Marketing Association (DECA) and the Future Business Leaders of America (FBLA) had independent, nonprofit, statewide boards established prior to July 1996 to administer their respective student organizations. In September 1996, the CDE took action to facilitate the formation of an independent, nonprofit board of directors in California for the Vocational Industrial Clubs of America (VICA). The VICA board is operational. In April 1997, CDE staff began action to facilitate the formation of independent, nonprofit boards for the Future Farmers of America (FFA), the Health Occupations Students of America (Cal-HOSA), and the Future Homemakers of America-Home Economics Related Occupations (Cal FHA-HERO).

Finally, in October 1996, to ensure that all contract payments are authorized for specific contract services, the CDE began requiring division directors to approve all contract invoices prior to payment. The CDE's specific comments on each report finding are provided below.

#### Chapter 1 - Contracts Were Awarded Before Funding Was Available

It is not uncommon to enter into a contract for a portion of a project with anticipation that additional funds will be available for completion of the activities. When the CDE entered the contract with the San Jose State University Foundation, the CDE knew the amount of carryover funds from the previous year. However, the administrative procedures to obtain authority to spend the funds had not yet been completed. Contracts can only be written for funding for which there is budget authority to spend. The CDE knew the funds were available and was not risking failure to accomplish the contract objectives when the contract was entered.

However, the CDE now requires more detail in contract scope of work statements, including delineation of curricula developmental stages and a clear list of deliverables that can be tied to a line item budget and invoices.

Kurt R. Sjoberg  
California State Auditor  
July 17, 1997  
Page 3

### Chapter 1 - Department of Education Did Not Obtain Sufficient Invoice Documentation

In the second paragraph, your draft audit report states “that the CDE could not always provide evidence that \$168,000 of contractor invoices agreed with the deliverables outlined in the contract.” We agree, that for two (valued at \$62,000) of the five invoices, the CDE lacked sufficient supporting documentation. However, for three of the invoices, valued at \$106,000, the CDE has a significant amount of documentation and is able to tie nearly all of the invoiced amounts to specific contract deliverables. The three documented invoices were received by the CDE in November and December 1996, after CDE staff received training on proper invoicing procedures. (2)

The CDE will continue to work with contractors to ensure that invoices include documentation in sufficient detail to identify contract services. Also, the CDE’s written invoicing guidelines, issued in May 1997, require a written progress report which explains the work accomplished during the invoice period.

The two sentences at the end of the second paragraph describing corrective action taken by the CDE do not reflect the extent of the action taken by the CDE to improve contract planning and monitoring. Your statements indicate that the CDE “recently implemented new invoicing policies and procedures.” In Fall 1996, the CDE began dissemination of the procedures after a year-and-a-half of meetings, research and discussions by its contract and grants work group. The information was distributed in training classes and through discussions among CDE staff. In May of this year, the procedures were formally put in writing. As mentioned earlier, Superintendent Eastin began in 1995 to implement policies to ensure compliance with state contracting procedures.

The ten percent withhold (\$3,582.44) reported in paragraph 3, was inadvertently not withheld from one contract invoice. In addition to the standard ten percent, the CDE will withhold \$3,582.44 from the contractor’s next invoice.

### Chapter 2 - Departments Continue To Avoid the Competitive Bidding Process and Assume Incompatible Duties by Misusing Interagency Agreements

In entering the interagency agreements with California State University, Chico and California State Polytechnic University, Pomona, at no time did the CDE intend to circumvent competitive bidding procedures. The purpose of the interagency agreements was simply to obtain assistance in the administration of the operations of the vocational student organizations. The CDE was intending to take advantage of the valuable source of knowledge at the California State Universities.

The CDE did not subcontract with private parties, nor did CDE staff award contracts without proper oversight. The CDE staff who awarded subcontracts were acting on behalf of the vocational student organizations - not as CDE employees.

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The governance of the vocational student organizations is complex. Since their inception, the California student organizations have been sponsored and operated by the CDE. CDE staff have served in the capacities of state and regional advisors and coordinators. CDE staff have carried out the programmatic and fiscal responsibilities of the vocational student organizations on behalf of the students. This relationship has been strengthened over the years by both strong support from federal and state legislation and policy that has recognized the importance of using the student organizations as an integral method of teaching leadership and interpersonal skill development to students. California teachers, business leaders, and students feel that without the CDE's assistance, the vocational student organizations would not exist. For example, the Farm Bureau and the Agriculture Networks support the CDE's leadership role with the FFA.

As explained earlier, in Fall 1996, with the assistance of the CDE's fiscal and program staff, the CDE's internal auditors developed recommendations to improve the administration of the vocational student organizations. The auditors recommended and the CDE has implemented the transfer of responsibility for the management of the vocational student organization assets and fiscal operation from the State Advisor to an independent board of directors. DECA and FBLA already had independent, nonprofit boards. The VICA board was established in late 1996. The CDE has begun the process to establish the FFA, the Cal-HOSA, and the Cal FHA-HERO as nonprofit organizations governed by an adult board of directors. Each board of directors will manage the finances and resources of the student organization, including the establishment of policies for the expenditure of funds, contracting for services, and the hiring and supervision of employees.

To further strengthen internal controls, the CDE has assigned contract monitoring responsibilities to staff not involved with the vocational student organizations. It is important that CDE staff who work with vocational student organizations maintain their role of providing strong leadership and technical assistance to their respective student organizations. This includes maintaining their roles as organization advisors which has proven essential to the integral delivery of the leadership component within the subject area curriculum and statewide programs. Providing an independent contract monitor will permit CDE advisors to continue in their valuable role. It should also be repeated that in October 1996, the CDE began requiring division directors to approve all contract invoices prior to payment.

Kurt R. Sjoberg  
California State Auditor  
July 17, 1997  
Page 5

Finally, at the end of Chapter 2, buried just before the "Conclusion," you provide a paragraph describing the work of the CDE's internal auditors to strengthen controls over the vocational student organizations. You indicate that the internal "auditors found control weaknesses similar" to those you highlight in your draft report, when in fact, the CDE knew of the control weaknesses in August 1996 and have been working ever since to resolve the governance and fiscal issues. The corrective action statement in your draft audit report at the end of Chapter 2 does not acknowledge the work the CDE has been doing over the past ten months. In addition, the location of the corrective action at the end of the chapter misleads the reader and should be moved closer to the front of the chapter to place an accurate perspective on the findings.

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If you have questions about the CDE's response, please contact our Audit Response Coordinator, Peggy Peters, at (916) 657-4440.

Sincerely,

J. Richard Whitmore  
Chief Deputy Superintendent  
Educational Policy, Finance and Accountability

JRW:map

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# Comments

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## ***California State Auditor's Comments on the Response From the California Department of Education***

To provide clarity and perspective, we are commenting on the California Department of Education's (CDE) response to our audit report. The numbers correspond to the numbers we have placed in the response.

- ① Based on information provided during several telephone conversations with CDE staff held during the five-day response period, we modified our report to better highlight those CDE efforts that are noteworthy.
- ② For the \$168,000 of invoices we reviewed, we found either all or some part of the invoices lacked sufficient information to reconcile costs shown on the invoices to specific deliverables stated in the contract.
- ③ While we agree that the CDE did not directly subcontract with private parties, CDE employees, in essence, authorized the expenditure of state funds through a separate contract between the vocational student organizations and private consultants. To accomplish this, the CDE first established an interagency agreement with the California State University, Chico (CSUC) to provide a Future Farmers of America (FFA) leadership conference. However, the CSUC did not conduct the leadership conference. Rather, a CDE employee, acting in his official FFA capacity, entered into a contract with a private consultant to conduct the leadership conference, which occurred without CDE oversight. The FFA organization then paid the private consultant with \$14,000 of state funds obtained through the interagency agreement between the CDE and the CSUC. In essence, the CDE employee authorized the expenditure of state funds through the separate contract with the private consultant.
- ④ We agree that the department became aware of its control weaknesses in August 1996; our investigative audit brought the weak controls to the department's attention.

- ⑤ We do acknowledge that the department is in the process of instituting improvements to the FFA and Cal-HOSA organizations. Specifically, on page 23 of the report, we included information on the department's efforts to now require additional approvals on contract invoices and to begin the process to establish two independent boards of directors for the FFA and the Cal-HOSA organizations. However, the control weaknesses have not yet been fully resolved as of this report. Further, we have modified our report on pages 21 and 23 to acknowledge the CDE initiated its reviews immediately following our investigative audit. We also recognize the CDE has reassigned contract monitoring responsibilities, and we have added a brief statement on the CDE's efforts to our Chapter 2 summary.

***Response to the report provided as text only***

The Resources Agency of California  
The Resources Building  
Sacramento, CA 95814

Mr. Kurt Sjoberg  
State Auditor  
Bureau of State Audits  
660 J Street, Suite 300  
Sacramento, California 95814

Dear Mr. Sjoberg:

Response to “State Contracting: Improvements Are Still Needed To Ensure the Effective Use of Public Resources”, report number 96015.

We have reviewed your report, “State Contracting: Improvements Are Still Needed To Ensure the Effective Use of Public Resources”, dated July 11, 1997. We appreciate the recommendations that you have provided. We continually strive to identify opportunities for improvement and will incorporate your audit recommendations in our efforts. The California Department of Forestry and Fire Protection Contracts Office has proactively worked to implement some of the recommendations even before the written audit report was produced.

The California Department of Forestry and Fire Protection had approximately 535 active contracts in the 95/96 fiscal year reviewed. The auditors reviewed 34 of those contracts and determined that two of those contracts were subject to areas of improvement. We also recognize that no findings were presented in this report regarding 32 of the 34 contracts reviewed due to policies and procedures already in place.

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\*The California State Auditor’s comments on this response start on page 73.

Mr. Kurt R. Sjoberg  
July 17, 1997  
Page Two

Please see our attached response to the audit report. If you have any questions, please contact Don Wallace, Assistant Secretary, at (916) 653-9709, or Bill Hogan, Chief Auditor, at CDF at (916) 653-9862.

Sincerely,

Don Wallace  
Assistant Secretary  
Resource Agency

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Attachment

***Response to the report provided as text only***

STATE OF CALIFORNIA - THE RESOURCES AGENCY  
DEPARTMENT OF FORESTRY AND FIRE PROTECTION  
P.O. Box 944246  
SACRAMENTO, CA 94244-2460

July 17, 1997

Mr. Kurt R. Sjoberg  
State Auditor  
Bureau of State Audits  
660 J Street, Suite 300  
Sacramento, California 95814

Dear Mr. Sjoberg:

Response to Draft Audit Dated July 11, 1997

Thank you for the opportunity to respond to your draft audit report to Secretary Wheeler. The California Department of Forestry and Fire Protection (CDF) agrees that there are some areas where improvements can be made in planning and monitoring contracts. CDF is already in the process of proposing changes which should result in clearer specifications defining the deliverables and the expected funding. The Contracts Office will prepare and distribute a responsibility checklist to all Contract Coordinators to assist them in monitoring contracts and to ensure that the issues discussed below do not reoccur.

The following is CDF's response to specific issues cited in this report.

Planning Issues Regarding OV-10 Aircraft Contract:

CDF did not specify sufficient funding and adequate benchmarks.

**Response:**

CDF was only appropriated \$630,000 by the Legislature for the first two aircraft conversions. This was an experimental project and it was unknown if additional funds would be appropriated at the time of the award and original contract. When additional funds were appropriated, an amendment added those funds to the contract. Because the amended amount exceeded 30% of the original contract, an exemption was required and approved by the Department of General Services (DGS) Procurement Division. The amendment was later approved by DGS Office of Legal Services.

Mr. Kurt R. Sjoberg  
July 17, 1997  
Page Two

CDF intended to convert thirteen aircraft. Since this contract was an experimental project, it was very difficult to estimate the costs at the time. Therefore, CDF proposed converting two aircraft to determine the amount of time and cost needed to convert these aircraft. CDF is in the process of preparing an amendment to the contract which will specify expected results.

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Monitoring Issue #1 regarding OV-10 Aircraft Contract:

CDF did not require contractor to provide sufficient information on its invoices to validate hours billed for contractor's employees.

**Response:**

As of January 1, 1997, CDF required the contractor to identify on each invoice the name and job title of each employee whose hours were being billed so CDF could determine that the hours billed were accurate. Prior to January 1, 1997, the contractor did not provide positions of contract employees on the timecards attached to the invoices. However, the Contract Manager had daily contact with the eight contract employees and was aware of their positions and related rate of pay. Subsequent contracts will include provisions for identifying names and positions on invoices.

Monitoring Issue #2 regarding OV-10 Aircraft Contract:

CDF paid contractor for hourly rates higher than those in the contract.

**Response:**

In December 1995, the bid rates were recalculated by Serv-Air, Inc. and CDF to reflect rates based on "productive hours" rather than "all hours". "Productive hours" consist of work hours only, calculated to be 163.3 hours per month. "All hours" consist of work hours, vacation, sick leave, and holidays calculated to be 176 hours per month. Although this increased the per hour rate for the positions, it did not increase the total contract monthly cost for all labor of \$26,664. For example, rates were adjusted for mechanics as follows:

	<u>Hourly</u> <u>Rate</u>		<u>Monthly</u> <u>Hours</u>		<u>Monthly</u> <u>Wages</u>
Prior Method - All Hours	\$21.00	x	176	=	\$3,696
Current Method - Productive Hours	\$22.63	x	163.3	=	\$3,696

Mr. Kurt R. Sjoberg  
July 17, 1997  
Page Three

In April 1996, San Joaquin Helicopters (SJH) purchased the contract from Serv-Air, Inc. and the rates were reviewed by CDF and SJH. From this review, two positions (a parts person and a secretary) were eliminated from the contract and the remaining positions' hourly rates were increased to reflect parity with the SJH regular maintenance contract labor rates with no change in level of service. For example, the mechanics' wage rate was adjusted from \$22.63 per hour to \$23.42 per hour. The total actual monthly labor cost decreased to \$26,652 per month. CDF is preparing a formal amendment to retroactively include these revised rates which CDF and SJH previously agreed to in verbal form and documented with a written rate sheet.

CDF Program Accountability, the internal audit unit, will evaluate the prospect of recovering any "overcharges" related to this contract, based upon the facts surrounding the contract, legal advice by CDF Chief Counsel, and recommendation of CDF management.

Monitoring Issue #3 regarding OV-10 Aircraft Contract:

CDF's contract monitor did not confirm that aircraft parts had actually been received before approving invoices.

**Response:**

As of July 7, 1997, CDF notified contractor that the parts packing slips must be verified by a CDF employee and be attached to all parts invoices.

Monitoring Issue #1 regarding Cal Poly Contract:

CDF approved final invoice before work was completed.

**Response:**

CDF agrees that the Contract Coordinator approved the final invoice before the final product was received. This was done because he believed the final product would be received shortly, but it was not. CDF contacted the contractor regarding this and was assured that the final product would be received. Delays occurred because the needed information was not received by the contractor from the symposium speakers. The program is in the process of requesting substantiation from the Contract Coordinators that services or products have been received before invoices are approved.

Mr. Kurt R. Sjoberg  
July 17, 1997  
Page Four

Monitoring Issue #2 regarding Cal Poly Contract:

The amendment was not justified.

**Response:**

The original contract did not include publishing of the information from the speakers at the symposium. It was unknown, until after the symposium, what the costs would be to publish this information or even how much information needed to be disseminated. Since the symposium was a cooperative effort between several entities, CDF agreed to pay a share of the publishing costs which amounted to \$7,000, and the amendment reflected these added costs. (3)

Monitoring Issue #3 regarding Cal Poly Contract:

CDF did not withhold 10% from invoices as required in the contract.

**Response:**

CDF agrees the payment should not have been made in full since the final product was not received. CDF will reinforce this responsibility by including this issue in a checklist to all Contract Coordinators.

**Final Audit Conclusion:**

This audit report is a positive step toward improving contracting services in CDF. The issues presented in the report have already been corrected or are in the process of being corrected.

Sincerely,

Richard A. Wilson  
Director

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cc: Douglas P. Wheeler, Secretary for Resources  
Ronny J. Coleman, Acting Chief Deputy  
Howard A. Sarasohn, Deputy Director  
James E. Owen, Deputy Director  
Craig E. Anthony, Deputy Director  
Bill Hogan, Chief Auditor

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# Comments

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## ***California State Auditor's Comments on the Responses From the Resources Agency and Department of Forestry and Fire Protection***

To provide clarity and perspective, we are commenting on the California Department of Forestry and Fire Protection's (CDF) response to our audit report. The numbers correspond to the numbers we have placed in the response.

- ① The Resources Agency misunderstands the scope of our review. The agency's response indicates that we reviewed 34 contracts. However, we reviewed only 8 contracts for contract planning and monitoring and determined that the CDF inadequately administered 5 of these. To illustrate the flaws we found in planning and monitoring, we discussed in detail only 2 of the CDF's contracts in the report.
- ② Although the CDF may have proposed converting two aircraft to determine the amount of time and cost needed to convert the OV-10 aircraft, our concern is that the CDF did not state in the contract the number of aircraft it wanted converted.
- ③ We disagree with the CDF's statement that the original contract did not include the cost of publishing the symposium speakers' information. The original contract language specified that each presenter would provide a paper, that 3,000 copies of the symposium proceedings would be published, and that the proceedings would be published by summer 1996. Moreover, the contract identified the publisher. If the CDF did not intend to require the contractor to provide proceedings or if the costs of publication could not be determined, as the CDF indicates in its response, the specific language above should not have been in the contract.

***Response to the report provided as text only***

California Environmental Protection Agency  
555 Capitol Mall  
Suite 525  
Sacramento, CA 95814

TO: Kurt R. Sjoberg  
State Auditor  
California State Auditor

FROM: Enrique G. Farias  
Assistant Secretary for Policy Development

DATE: July 17, 1997

SUBJECT: RESPONSE TO DRAFT OF STATE CONTRACTING REPORT 96015

Thank you for the opportunity to review and respond to the Bureau of State Audits (BSA) draft report number 96015 entitled "State Contracting: Improvements Are Still Needed To Ensure the Effective Use of Public Resources."

We have read the report and discussed the issues contained therein. We are pleased to note that the Department of Pesticide Regulation (DPR) had no deficiencies reported. DPR takes their responsibility to process all contracts in accordance with State policies and procedures very seriously and will continue to comply with all regulations.

We wish to take this opportunity to thank the BSA staff for all the work that they performed and their suggestions to DPR staff.

cc: Members of the Legislature  
Office of the Lieutenant Governor  
Attorney General  
State Controller  
Legislative Analyst  
Assembly Office of Research  
Senate Office of Research  
Assembly Majority/Minority Consultants  
Senate Majority/Minority Consultants  
Capitol Press Corps