

**REPORT BY THE
AUDITOR GENERAL
OF CALIFORNIA**

**AN ANALYSIS OF THE STATE'S COMPLIANCE
WITH REQUIREMENTS FOR CONSULTANT CONTRACTS**



Kurt R. Sjoberg, Auditor General (acting)

State of California
Office of the Auditor General
660 J Street, Suite 300, Sacramento, CA 95814
Telephone: (916) 445-0255

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F-066

Honorable Robert J. Campbell, Chairman
Members, Joint Legislative Audit Committee
State Capitol, Room 2163
Sacramento, California 95814

Dear Mr. Chairman and Members:

Summary The Department of General Services is responsible for providing administrative oversight of state departments entering into consultant contracts to ensure they comply with applicable state laws and regulations.¹ Nevertheless, areas of confusion and noncompliance exist in the application of provisions of the California Public Contract Code and the State Administrative Manual relating to consultant contracts. Some confusion exists about the distinction between consultant and other services contracts. In addition, the State does not always adhere to legal requirements that apply to consultant contracts.

Specifically, the State does not always comply with the requirements that consultant contracts be approved before contract work is begun, that contracting departments review prior evaluations of contractors being considered for new contracts and

¹The term "departments," as used generically in this report, means every state office, department, division, bureau, board, or commission, but does not include the Legislature, the courts, or any agency in the judicial branch of government. Used more specifically, "departments" refers to the 19 departments, offices, and boards at which we reviewed consultant contracts.

review resumes of persons expected to perform contract work, and that evaluations of contractors be completed within 60 days of the completion of the contract. For example, at 6 of the 19 departments where we reviewed contracts, 17 (46 percent) of the 37 contracts we reviewed did not have the necessary approval before contract work began. In addition, for 19 (45 percent) of the 42 contracts we reviewed at 6 departments, the departments failed to review post-evaluations or to require resumes of appropriate contractor personnel before contract approval. Moreover, at 7 departments, post-evaluations for 67 percent of all reviewed contracts that required post-evaluations and that were completed in time for the post-evaluation to be required by the end of our fieldwork were not completed promptly.

Further, for 8 of the 60 sole-source contracts we reviewed, the evidence supporting the justifications for sole-source contracting was inadequate. In addition, some of the 19 departments' annual consultant contract reports we reviewed did not always meet the requirement to identify whether the contracts were sole-source contracts. Finally, based on the completed contracts we reviewed, state departments apparently are using the consultant services for which they contract and pay.

Background The State enters into many contracts annually for a wide variety of consultant services. The California Public Contract Code and the State Administrative Manual establish basic guidelines and procedures that state contracting and oversight agencies and departments must follow when entering into or approving consultant contracts. These guidelines and procedures are designed to encourage competition for public contracts and to aid public officials in the efficient and, to the maximum extent possible, uniform administration of public contracting for consultant services.

The immediate responsibility for ensuring compliance in contracting for consultant services rests with the state departments planning to be parties to the contracts. The contracting departments

must comply with requirements for advertising the availability of contracts, soliciting bids from potential contractors, evaluating the bidding contractors, writing the contracts in conformity with state requirements, obtaining the appropriate approvals, approving payment for services, and evaluating the contractors upon completion of the contracts.

Oversight responsibility for the consultant contracting process belongs primarily to the Department of General Services. The California Public Contract Code generally assigns to the Department of General Services the duty of reviewing and approving contracts entered into by state departments for consultant services. Although the law assigns these duties to the Department of General Services, policy also generally exempts consultant contracts under \$12,500 from the Department of General Services' review.

In addition to its responsibilities for ensuring compliance with legal provisions for each contract submitted for its approval, the Department of General Services has broader oversight responsibilities. For example, its Office of Legal Services is responsible for developing the standard contracting procedures contained in the State Administrative Manual. The Department of General Services also periodically reviews contracting units in other state departments, maintains contractor evaluations, and makes the evaluations available to other departments upon request.

In October 1991, the Office of the Auditor General issued its report entitled *The Department of General Services' Administrative Oversight of State Agencies That Award Contracts* (P-014), which summarized 21 reports issued by the Office of the Auditor General about the State's contracting procedures and discussed the effectiveness of the Department of General Services in overseeing contracts, including nonconsultant contracts. Several of the issues raised in that report also apply to consultant contracts and are discussed in this report. Also, Chapter 1044, Statutes of 1990, effective September 1990, revised certain requirements for consultant service contracts. We indicate in our report when these changes are relevant to the information we present.

**Scope and
Methodology**

This audit fulfills the 1991-92 reporting requirements of Chapter 1044, Statutes of 1990. The statutes require the Office of the Auditor General to evaluate the State's compliance with state laws and regulations for consultant contracts for the period July 1, 1990, through June 30, 1991, to determine whether the State overused sole-source contracts and to evaluate whether state departments have used the services or products of consultant contracts.

To evaluate the State's compliance with the laws and policies governing consultant contracts, we reviewed the California Public Contract Code and the State Administrative Manual and identified the critical provisions and policies pertaining to consultant contracts. We determined compliance with these laws and policies by reviewing contracts at 19 state departments for appropriate language and provisions, supporting documentation, and approvals.

To evaluate the propriety of departments' distinctions between consultant and other services contracts, we reviewed contracts departments had classified as consultant contracts and contracts departments had classified as other services contracts, and we determined if the departments had appropriately classified the contracts.

To determine whether the State used sole-source contracts appropriately, we reviewed the California Public Contract Code and the State Administrative Manual and identified the critical provisions and policies applicable to sole-source contracts. Further, we interviewed personnel and examined guidelines from the Department of General Services to identify additional departmental policies for approving sole-source contracts. To determine compliance with the above provisions and policies, we examined approvals of sole-source consultant contracts at the 19 state departments and compared the departments' justifications for the sole-source contracts with the provisions in the California Public Contract Code, the State Administrative Manual, and the Department of General Services' guidelines. From this information, we determined the reasonableness of the State's use of

sole-source contracts. We also summarized certain data departments reported in their annual consulting contracts reports. Specifically, we summarized data about total consultant contracts entered into during the year, the number of these identified as sole-source contracts, and the number for which the sole-source status was not clearly identified.

To determine whether the state departments used the services or products of consultant contracts, we examined contractor evaluations that described contract products and their uses, and we interviewed the appropriate department personnel.

**Overview of
Compliance With
Requirements
for Consultant
Contracts**

Several areas of confusion or noncompliance exist in the application of provisions of the California Public Contract Code and the State Administrative Manual for consultant contracts. For example, although the California Public Contract Code, Section 10356, defines a consultant services contract, some confusion exists in the application of that definition to determine whether certain contracts are actually consultant contracts, subject to the special regulations established for consultant contracts, or other services contracts.

Further, the State does not always adhere to legal requirements that apply to consultant contracts. Table 1 identifies these areas of noncompliance and lists the 19 departments at which we reviewed consultant contracts, the number of consultant contracts reviewed at each department, and the number of instances of noncompliance observed for each area. As the table indicates, the State is not always complying with the requirements that contracts be approved before contract work is begun, that contracting departments review prior evaluations of contractors being considered for new contracts and review resumes of persons expected to perform contract work, and that evaluations of contractors be completed within 60 days of the completion of the contract.

Table 1 Summary of the Major Areas of Noncompliance With Requirements for Consultant Contracts

Agency Name	Number of Contracts Reviewed	Total Dollar Amount of Contracts Reviewed	Lack of Approval Before Start of Work	Failure to Review Post-Evaluation or Failure To Submit Resume Before Contract Approval*	Late Post-Evaluations**
California State Department of Education	12	\$ 1,747,793	5	3	0
Department of Health Services	5	1,158,471	3	3	2
Department of Mental Health	5	363,680	3	0	0
Department of Social Services	5	1,494,421	3	0	0
State Controller's Office	5	340,020	2	0	0
Employment Development Department	5	704,171	1	0	0
California Energy Commission	10	4,255,837	0	7	0
Department of the Youth Authority	5	50,540	0	3	3
Department of Water Resources	5	97,946	0	2	1
California Community Colleges, Chancellor's Office	5	511,777	0	1	0
Public Employees' Retirement System	10	13,430,180	0	0	0
Department of Motor Vehicles	5	2,542,188	0	0	2
Franchise Tax Board	5	251,680	0	0	2
State Treasurer's Office	3	1,760,774	0	0	1
Department of Corrections	5	1,104,496	0	0	1
Department of Transportation	5	3,687,155	0	0	0
Department of General Services	8	409,832	0	0	0
Board of Equalization	5	142,902	0	0	0
State Board of Control	3	1,234,700	0	0	0
Totals	111	\$35,288,563	17	19	12

* Eight of these contracts fell under the new requirements.

** Three of these contracts fell under the new requirements.

Of the 111 contracts reviewed, 57 were completed contracts.

The following sections discuss all these and other issues in more detail.

Definition of Consultant Contract

Despite efforts to define the nature of the consultant contract, some confusion exists in the application of the definition to determine whether certain contracts are actually consultant contracts, subject to special regulations established for consultant contracts, or contracts for other services. The California Public Contract Code, Section 10356, defines consultant contracts as providing “services which are of an advisory nature, provide a recommended course of action or personal expertise, have an end product which is basically a transmittal of information either written or verbal and which is related to the governmental functions of state agency administration and management and state agency program management or innovation, and which are obtained by awarding a procurement-type contract, a grant, or any other payment of funds for services of the above type.” The State Administrative Manual, Section 1280, specifies that a consultant contract calls for a product of the mind, rather than the use of mechanical skills, and may include anything from providing answers for specific questions about the design of a system to providing seminars, workshops, and conferences. The same section of the State Administrative Manual also identifies certain types of contracts that are not consultant contracts, including contracts between state agencies and the federal government, contracts with local agencies, and contracts for architectural and engineering services.

However, we noted certain contracts we believed were consultant contracts but the departments considered to be other services contracts. We questioned the classification of 7 of the 126 contracts we reviewed and that contracting departments identified as other services contracts. We submitted these 7 contracts for our legal counsel’s review, and he concluded that 6 of the 7 were best treated as consultant contracts. For example, our legal counsel concluded that a contract for such legal services as conducting arbitration proceedings, rendering decisions in those

proceedings, and preparing and issuing a final award in the proceedings was a consultant contract, rather than an other services contract. He reached this conclusion because the end product of the contract was basically a transmittal of information related to governmental functions and was a product of the mind rather than the rendering of mechanical skills. According to the chief counsel of the Office of Legal Services, which has oversight responsibility for many aspects of consultant contracts, the office recognizes the possibility for confusion over the distinction between consultant and other services contracts.

Legislation for consultant contracts requires control procedures beyond those for other services contracts. For example, departments must prepare annually a special report on their consultant contracts, disclosing the amount of each contract, the method of bidding, the reasons for any sole-source consultant contract, and other information. In addition, unlike other contractors, who must only be notified they are at risk if they begin contract work before the contract is approved, contractors for consultant services are explicitly prohibited from rendering services before contract approval. Inability to correctly distinguish between consultant and other services contracts may thwart the intention of the legislation to ensure more careful monitoring of consultant activities.

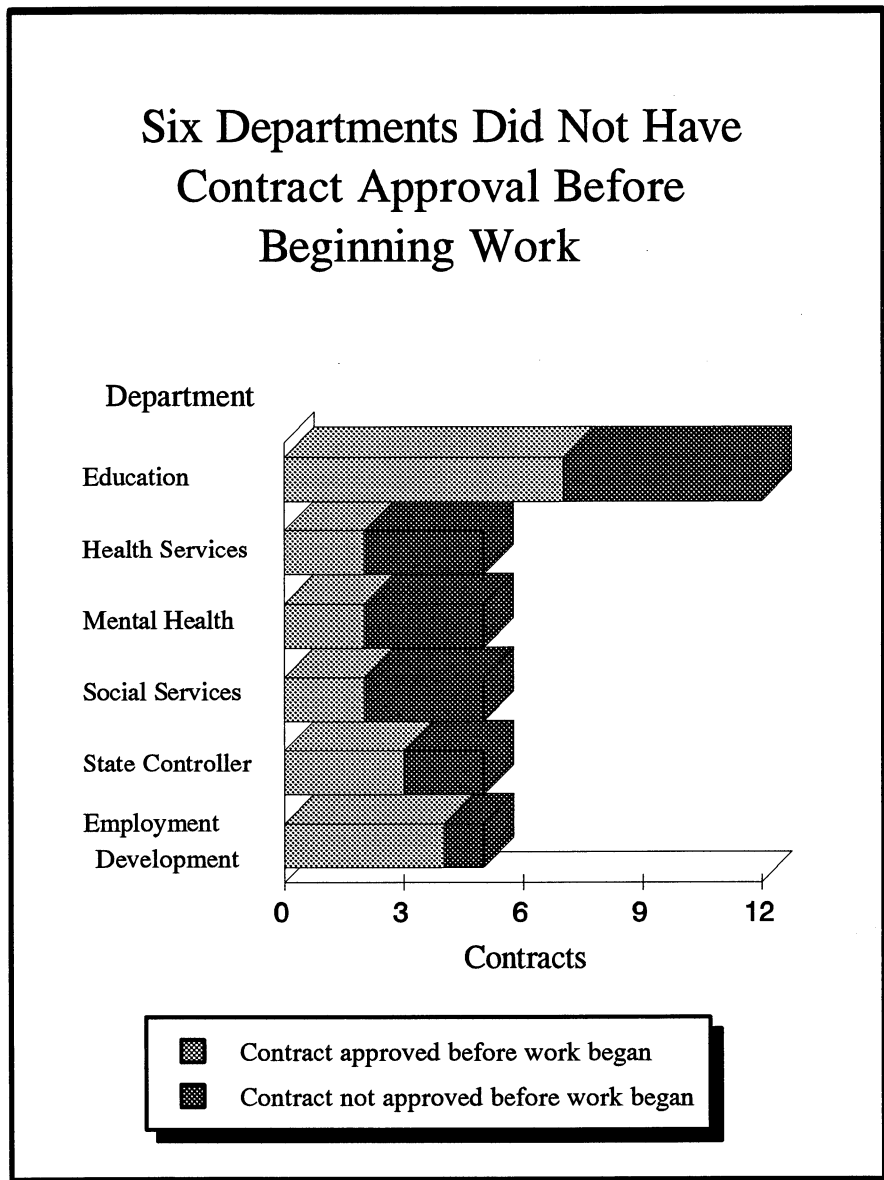
Lack of Approval of Contract Before Start of Work

The State does not always comply with the requirements that contracts be approved before contract work is begun. The State Administrative Manual, Section 1215, requires the Department of General Services' approval for all contracts worth more than \$12,500. In addition, Section 10371(d) of the California Public Contract Code and the State Administrative Manual require that, except in an emergency, work on a consultant contract not be started before the Department of General Services or appropriate department personnel grant formal approval. In this context, Section 10371(d) defines an emergency as a circumstance where the use of contracted services appeared to be reasonably necessary,

but as determined by the Department of General Services, time did not permit the obtaining of prior formal approval of the contract. Section 10360 of the code is more emphatic, stating that all consultant contracts are of no effect unless and until approved by the Department of General Services. Further, a publication of the department entitled *Guideposts on the Road to Contract Approval*, issued to help agencies with the state contracting process, states that contracts received after the time for work has started will not be approved.

Nevertheless, state departments do not always obtain the proper approvals before contractors begin work on a consultant contract. As illustrated in Table 1, 13 of the 19 departments complied with the requirements for all the contracts we reviewed. However, as Figure 1 indicates, at 6 of the 19 departments, 17 (46 percent) of the 37 contracts we reviewed were not in compliance with all the requirements. Of these 17 contracts, 12 did not have the Department of General Services' approval and 5 did not have the appropriate department approval. For example, staff at the Department of Health Services did not obtain appropriate approval before work began in 3 of 5 contracts reviewed. In one instance, the contractor began work on the contract approximately nine months before contract approval. In addition, at the California State Department of Education, work on 5 of the 12 reviewed contracts began before approval. In one instance, the contract was not approved until approximately two months after the start of the contract period.

Figure 1



The Office of the Auditor General has reported similar findings about the State’s administration of all types of contracts for several years. In our report issued in October 1991, we reported that state agencies allowing contractors to begin work before receiving the Department of General Services’ approval has been a continuing problem for all contracts, including consultant contracts. The

department's chief deputy director believed that late contract approval is an area that needs improvement for a number of state agencies. We reported that, because of this concern, the chief deputy director indicated that the department's Office of Legal Services would be implementing procedures to maintain statistics on the number of late contracts received from individual departments and that the Department of General Services would take appropriate action against departments continuing to submit late contracts.

According to the chief counsel of the Office of Legal Services, the office has recently begun keeping records of contracts submitted late for approval, with the ultimate intention of identifying those departments that are late and taking appropriate action with these departments. As of the end of October 1991, the compilation of these data was in a preliminary stage, with numerous issues to be resolved before the department would take action against departments continuing to submit late contracts. Among the issues to be resolved was the need to determine whether departments were clearly distinguishing between consultant and other services contracts. This distinction is important because consultant contracts are legally prohibited from having services rendered before contract approval whereas other services contracts may have services rendered before contract approval as long as the contractor is notified that it is performing work at its own risk. Other issues to be resolved were determining which explanations for late submittal were acceptable (and, therefore, not subject to department action) and establishing the nature of the action to be taken against departments that are frequently late.

The State's consistent failure to ensure contracts are approved before work begins is a serious and long-standing problem. By not ensuring that contracts are approved before services begin, the department cannot be assured that the State's interests are protected. For example, an agency's failure to obtain contract approval before the contractor begins work exposes the State to potential liability for work performed.

Review of Contractor Evaluations and Resumes and Preparation of Evaluations

Certain contracting departments are frequently not complying with requirements to review prior evaluations of contractors being considered for new contracts and review resumes of persons expected to perform contract work. In addition, after contract work is completed, departments are often not preparing evaluations of contractors promptly. Current legal provisions and regulations for contractor evaluations reflect changes, effective in September 1990, that were made in response to perceived inadequacies with the evaluation system. The current California Public Contract Code, Section 10371(e), and the current State Administrative Manual, Section 1281, require that no consultant services contractor be awarded a contract totaling \$5,000 or more unless the state department has reviewed any contractor evaluation on file with the Department of General Services and has required, as part of the contract, a completed resume for each contract participant who will exercise a major administrative role or major policy or consultant role. In addition, the Department of General Services must notify departments seeking approval of a proposed contract within ten working days if the Department of General Services has a negative evaluation in its files of a previous contract or contracts completed by this contractor.

The California Public Contract Code, Section 10369, and the State Administrative Manual, Section 1283, also require each department to complete within 60 days of the completion of the contract a post-evaluation of each consultant services contract totaling \$5,000 or more that it executes. Negative evaluations must be sent to the Department of General Services, which must keep copies on file for 36 months. The California Public Contract Code, Section 10371(h), states that the Department of General Services must restrict or terminate the authority of a state department to enter into consultant contracts if that department has consistently avoided the proper preparation, retention, or submission of post-evaluations.

A post-evaluation assesses the contractor's performance in conducting the work or delivering the services specified in the contract, assesses whether the contract was useful and furthered the

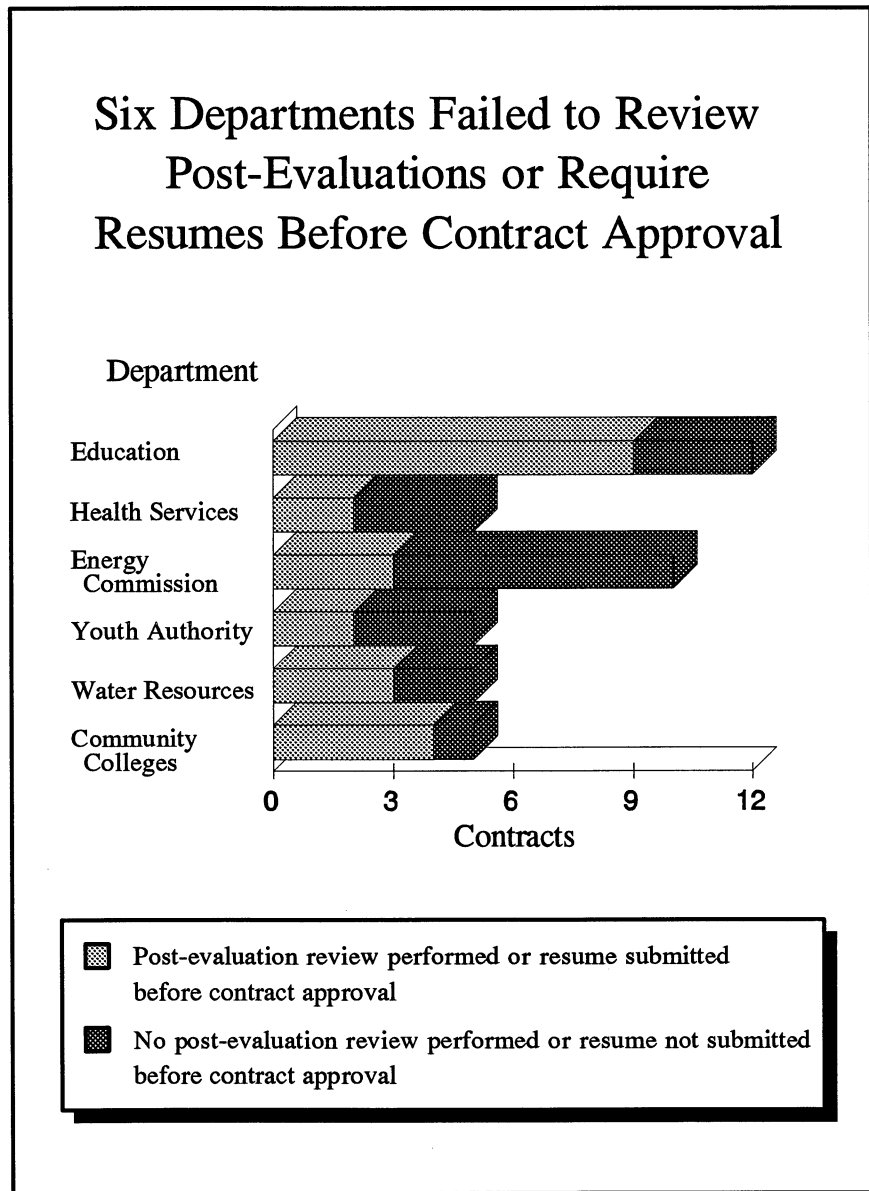
objectives of the department, and provides state departments with information enabling them to determine whether a potential contractor has satisfactorily completed previous state contracts. Therefore, evaluations help to protect the interests of the State in awarding contracts.

The Office of the Auditor General has previously reported problems with the State's compliance with requirements for evaluations of all types of contracts. Because of the deficiencies found in the State's post-evaluation process, our office recommended in 1986 that the Department of General Services review the effectiveness of the post-evaluation process and make recommendations to the Legislature to improve or eliminate the process. The Department of General Services' study, completed in December 1988, reported that the evaluation system then in place did not function effectively and made recommendations to improve the system. Chapter 1044, Statutes of 1990, effective in September 1990, incorporated some of the department's recommendations, and these changes are reflected in the current evaluation requirements described above.

Because the 1990 statutes became effective during the period under review for this report, the old legislative provisions applied to some of the contracts we reviewed and the new legislative provisions applied to others. Many of the 1990 provisions are similar to those in the previous law. Under the new provisions, state departments must complete post-evaluations within 60 days of the completion of the contract, rather than 30 days. The new provisions also require the Department of General Services to keep only negative evaluations on file for 36 months, rather than all evaluations of contractor performance. The Office of Legal Services in the Department of General Services acts as the central depository for all state agencies making evaluations or needing information on a contractor's record with the State. Under previous law, before entering into contracts, state departments were required to review either resumes of specified contractor personnel or to review contractor evaluations on file. The new statutes require departments to review both resumes and evaluations for contracts of \$5,000 or more.

As Table 1 indicates, some of the 19 departments we reviewed did not consistently comply with either set of legislative provisions for contract evaluations. Specifically, at 6 departments, for 19 (45 percent) of the 42 contracts we reviewed, the departments failed to review post-evaluations or to require resumes of appropriate contractor personnel before contract approval. Figure 2 shows these 6 departments.

Figure 2



In addition, 7 of the 19 departments we reviewed failed to complete 12 contractor evaluations promptly. At the 7 departments, the 12 contracts were 67 percent of all reviewed contracts that were for more than \$5,000 and were completed in time for the post-evaluation to be required before the end of our fieldwork. Work on some contracts at these departments was not complete by the end of our fieldwork, and evaluations would, therefore, not have been required at that time. Table 1 indicates the total number of instances of noncompliance with evaluation procedures occurring both before and after the revision to the law became effective. Despite the revisions to the law for contractor evaluations, the system is still ineffective.

According to the chief counsel of the Office of Legal Services, the office does not perform procedures to ensure that contracting departments review available contractor evaluations before entering into contracts. Instead, according to the chief counsel, the office has procedures in place to ensure that no contract is approved for a contractor having a negative evaluation on file without the State's considering the negative evaluation. However, we believe that this is too late in the contracting process to determine that a negative evaluation exists for the proposed contractor. The contracting department should be aware of any negative evaluations before it spends the time and effort to prepare and submit a contract for approval.

The chief counsel also indicated that the office considers the responsibility for ensuring the review of contractor evaluations to rest with the contracting department. In addition, the chief counsel indicated that the department uses periodic audits of contract units in other departments to identify those departments that fail to complete contractor evaluations and fail to submit negative evaluations to the office. The office has no other procedures to ensure contractor evaluations are completed and negative evaluations submitted.

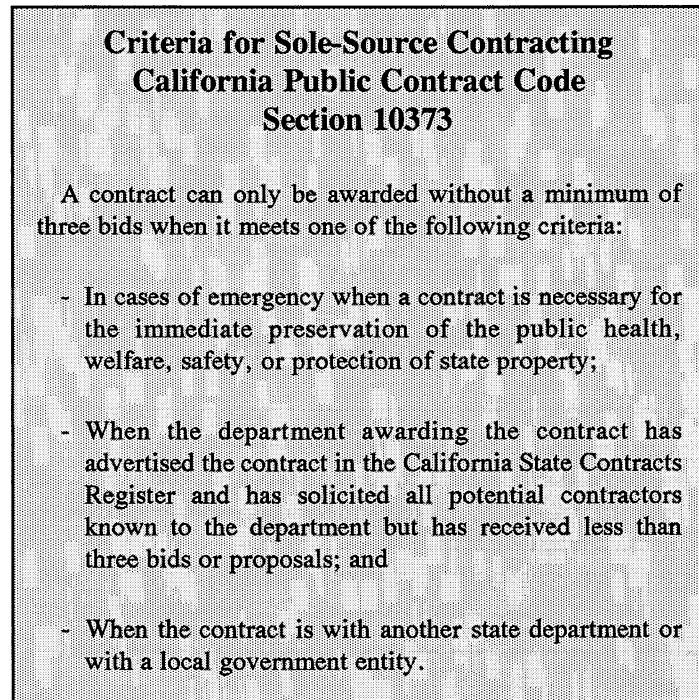
Although the Department of General Services' Office of Management Technology and Planning (OMTP) does review contracting units in other departments, it does not plan to perform many reviews annually. As we noted in our October 1991 report,

the OMTP identified 78 state departments to be audited. However, the OMTP's internal audit manager estimated the OMTP will require from seven to nine years to complete audits of the 78 departments. This extended audit period precludes the early identification of all departments that fail to follow the necessary contracting procedures. In our report, we recommended the OMTP complete the audits of the 78 departments within three years. In the response to our report, the Department of General Services stated that although it would consider increasing the number of audits its audit section conducts, its preliminary conclusion was that the current audit approach was sufficient when combined with existing administrative control processes and the contract audit activities of other audit organizations, including the Department of Finance, internal auditors, and the Office of the Auditor General.

**Use of
Sole-Source
Consultant
Contracts**

The evidence some departments provided to justify certain sole-source contracts was inadequate. In addition, some departments' annual consultant contract reports did not follow reporting requirements and identify whether each contract was a sole-source contract. The California Public Contract Code and the State Administrative Manual permit the limited use of sole-source contracts, which are exempt from bidding and, frequently, advertising requirements. Figure 3 shows the California Public Contract Code's provisions for allowing sole-source contracting.

Figure 3



The California Public Contract Code, Sections 10373 and 10380, also allow the Department of General Services to establish additional conditions under which a contract may be awarded without competition. Figure 4 depicts these additional conditions.

Figure 4

Additional Criteria for Sole-Source Contracting Prescribed by the Department of General Services

The Department of General Services agrees there is only a single source for the services and approves a request for exemption from competitive bidding.

The director of the Department of General Services determines that the State's best interests are better served by exemption.

The contracts are exempt from advertising in the California State Contracts Register. Examples of these specific types of contracts include the following, some of which are also exempted by law:

- contracts solely for obtaining expert witnesses for litigation;
- contracts for legal defense, legal advice, or legal services;
- contracts that can only be performed by a public entity as defined in the State's Unemployment Insurance Code;
- contracts with auxiliary organizations of the California State University or the California Community Colleges or with a foundation organized to support the Board of Governors of the California Community Colleges;
- proprietary software contracts; and
- medical care services with physicians, local community hospitals, and medical groups.

The contracts are for legally mandated services and have specific time frames or restrictions imposed by the courts, the Legislature, the governor, or a central agency.

The contract is for a noncompetitive copyrighted or patented means of delivering services.

Finally, the State Administrative Manual, Section 1236, requires that requests for sole-source status include a narrative of efforts to identify other similar or appropriate services and a justification for costs of the contract. Specifically, the manual indicates that the following factors will be used in determining whether costs are justified: cost information in sufficient detail to support and justify the contract; cost information for similar services, with differences noted and explained; and special factors affecting the cost under the contract.

The California Public Contract Code, Section 10359, requires departments to identify in an annual report all sole-source consultant contracts they entered into during the previous fiscal year. The reports, which the departments must submit to the Department of General Services within 30 working days after the end of the fiscal year, list all consultant contracts, indicate whether they were sole-source contracts, and, if so, provide the reasons for the sole-source contracts. The California Public Contract Code also requires the Department of General Services to report to the Senate Appropriations Committee, the Assembly Ways and Means Committee, other legislative committees, and designated departments, identifying all departments that fail to submit the required report.

The effect of inappropriately allowing a contract sole-source status is to unnecessarily curtail competition for contracts with the State. This curtailment could result in the State's paying more for services than necessary. In addition, the services rendered may not be the most satisfactory available to the State.

As Table 2 indicates, certain departments are not fully complying with mandated reporting requirements by clearly disclosing in their annual reports whether consultant contracts are sole-source contracts. For example, of the 472 consultant contracts that the California State Department of Education reported it entered into during fiscal year 1990-1991, the department did not clearly indicate whether 436 were sole-source contracts. Although these departments did not meet all reporting requirements, the Department of General Services did not report their lack of

compliance in its report to the Senate Appropriations Committee, the Assembly Ways and Means Committee, other legislative committees, and designated departments.

Table 2 Summary of Sole-Source Contracts Entered Into During Fiscal Year 1990-91 as Reported by Departments

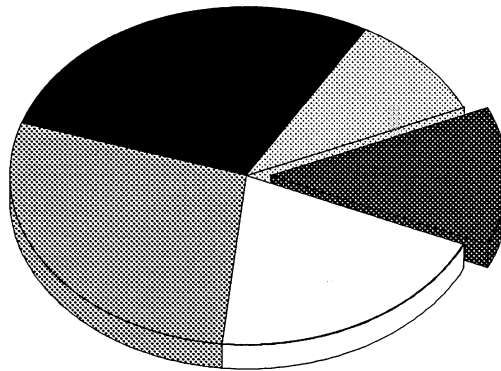
Agency Name	Number of Contracts Reported as Sole-Source by Department	Number of Contracts With Sole-Source Status Not Clearly Disclosed in Departments' Reports	Total Number of Consultant Contracts Reported by Department
California State Department of Education	33	436	472
Department of Health Services	12	0	15
Department of Mental Health	104	0	107
Department of Social Services	37	1	60
State Controller's Office	5	0	5
Employment Development Department	24	0	32
California Energy Commission	56	0	80
Department of the Youth Authority	15	0	17
Department of Water Resources	25	0	30
California Community Colleges, Chancellor's Office	1	0	5
Public Employees' Retirement System	23	0	42
Department of Motor Vehicles	1	0	2
Franchise Tax Board	2	0	2
State Treasurer's Office	2	0	2
Department of Corrections	2	0	5
Department of Transportation	438	21	498
Department of General Services	39	1	136
Board of Equalization	0	0	3
State Board of Control	2	0	2

Note: The information in this table is based on the departments' annual consultant contract reports. The information reflects only data reported for contracts entered into during fiscal year 1990-91 and excludes amended and completed contracts that were entered into in prior years. We have made no attempt to assess the accuracy of the departments' reports or the propriety of reasons provided to justify sole-source contracting.

As Figure 5 indicates, departments frequently used certain reasons to justify sole-source contracting. For example, 12 of the 60 sole-source contracts we reviewed were successfully justified on the basis that services rendered would be for expert witnesses for litigation, legal defense, legal advice, or legal services.

Figure 5

Reasons Provided to Justify Sole-Source Contracting



Reasons for Sole-Source Contracting

	Contracts
■ Inadequate explanation for sole-source contracting	8
▣ Public entity	6
■ Continuation of project	17
▣ Other	17
□ Expert witness, legal services	12
	<hr/> 60

Another commonly used reason for justifying sole-source contracting was that the contractor had prior experience with a particular project that made the contractor uniquely qualified to continue with the project. For example, the State Treasurer's Office successfully used this reason to justify a sole-source extension of a contract for \$384,000 for establishing an automated management system. The contractor had previously assisted in the development of a conceptual design and an implementation plan and in the procurement of computer hardware and software for the system. In addition, the Department of Motor Vehicles successfully justified a \$700,000 sole-source contract for technical support services on the basis of the contractor's having specific technical expertise using the computer hardware and software supplied by the contractor. For 17 of the 60 sole-source contracts we reviewed, the reason used to justify sole-source contracting was the contractors' prior experience.

Six of the sole-source contracts we reviewed were justified because the contractors were either auxiliary organizations of the California State University or were other governmental or public entities. For example, the Department of Transportation entered into a contract for \$1 million with a foundation of the California State University to provide six training courses in managerial effectiveness.

In addition, certain requests included other evidence to reasonably demonstrate the propriety of sole-source status. For example, the Department of Social Services submitted a contract for training in safety awareness and self-defense and justified its request for sole-source status by indicating the alternative contractors in the geographical area, the reasons why each of the alternatives would not satisfy the department's needs, and the cost-effectiveness of the department's choice.

While many of the justifications for sole-source status appeared reasonable based on the evidence provided, the reasonableness of some explanations was not clear. Eight of the 60 sole-source contracts we reviewed did not provide the necessary evidence. Typically, these sole-source contracts were justified on the basis of

the contractors' unique expertise. Although we recognize expertise is limited in many disciplines, in the absence of adequate evidence we question whether only one expert consultant is available and appropriate for training in stress management or recovering abandoned cash or securities. Even for a technical area such as engineering geology for the design and construction of dams and hydroelectric developments, we question whether expertise is so severely limited as to justify eliminating multiple bids, as is permitted for sole-source contracts. These contracts were approved as sole-source contracts even though the contracting departments failed to provide any evidence they had considered other alternatives, had assessed why any other alternatives would be unsatisfactory, or had assessed the cost-effectiveness of the sole-source contract.

**Use of the
Services or
Products
Obtained**

The California Public Contract Code, Section 10355, expresses the Legislature's concern that many state departments are often not using reports produced by consultant contracts. The California Public Contract Code, Section 10369, and the State Administrative Manual, Sections 1283 and 1288, require each state department to prepare a contractor evaluation for all consultant contracts for \$5,000 or more. The contractor evaluation form includes a section for the department to assess the usefulness of the contract.

Based on the contractor evaluations we reviewed and discussions with department personnel, we concluded the state departments are using the results obtained from the consultant contractors. However, our data are limited because 54 contracts reviewed were still in progress as of the end of our fieldwork and we were unable to determine if the state departments will use the results. Thus, we were able to review only 57 contracts to assess whether the State used the services for which it paid.

Recommendations

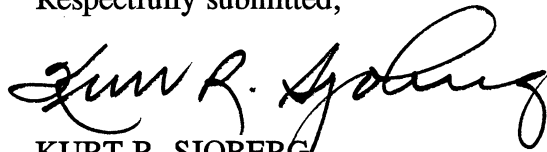
To improve the effectiveness of the State's contracting process for consultant services, the Department of General Services should take the following actions:

- Determine if contracting departments are appropriately distinguishing between consultant and other services contracts and, if departments are not, provide appropriate clarification of the distinction;
- Require its Office of Legal Services to promptly implement all necessary procedures to maintain accurate statistics on the number of late contracts received from individual departments so that the Department of General Services can take appropriate action against departments continuing to submit late contracts;
- Increase the number of departmental contract units it reviews each year to complete reviews in the 78 departments within three years;
- Require departments to prepare written evidence of their review of negative evaluations, if any, of proposed contractors, and submit this evidence with other contract documents to the Office of Legal Services for approval;
- Require state departments to certify annually that they have prepared the required evaluations of completed contracts and have submitted any negative evaluations to the Office of Legal Services;
- Restrict or terminate the authority to enter into consultant contracts of any department that is not appropriately completing, retaining, and submitting evaluations;

- Reiterate what information is required under the California Public Contract Code, Section 10359, in contracting departments' annual reports on consultant contracts, and include in its own report to the Senate Appropriations Committee, the Assembly Ways and Means Committee, other legislative committees, and designated departments a clear indication when the Department of General Services has not assessed the completeness of the reports submitted by contracting departments; and
- Require close adherence to the requirements of the State Administrative Manual, Section 1236, for requests for sole-source status. Specifically, the sole-source request should at least include assertions from the requesting department about how it investigated alternatives to the contractor of choice and why those alternatives were not satisfactory. In addition, any contract approved as a sole-source contract should include a justification of the costs.

We conducted this review under the authority vested in the auditor general by Section 10500 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope section of this letter report.

Respectfully submitted,



KURT R. SJOBERG
Auditor General (acting)

Staff: Sally Filliman, CPA, Manager
Lois E. Benson, CPA
Cathy Giorgi

**Responses to
the Audit**

State and Consumer Services Agency
Department of General Services

California Department of Education
Office of the Auditor General's Comments

The Resources Agency
Department of Water Resources



State and
Consumer Services Agency

OFFICE OF THE SECRETARY

915 CAPITOL MALL, SUITE 200
SACRAMENTO, CA 95814

Building Standards Commission
Consumer Affairs
Fair Employment & Housing
Fire Marshal
Franchise Tax Board
General Services
Museum of Science & Industry
Personnel Board
Public Employees' Retirement System
Teachers' Retirement System
Veterans Affairs

January 22, 1992

Kurt R. Sjoberg
Acting Auditor General
660 J Street, Suite 300
Sacramento, CA 95814

RE: RESPONSE TO AUDITOR GENERAL REPORT NO. F-066

Dear Mr. Sjoberg:

Thank you for the opportunity to respond to your Report F-066 entitled "An Analysis of the State's Compliance with Requirements for Consulting Contracts". The attached response from the Department of General Services addresses each of your recommendations.

If you need further information or assistance on this issue, you may wish to have your staff contact John Lockwood, Director, Department of General Services, at 445-3441.

Best regards,

Bonnie Guiton
for
BONNIE GUITON
Secretary of the Agency

cc: John Lockwood, Director, Department of General Services
Rick Gillam, Audit Manager, Department of General Services

MEMORANDUMDate: *January 21, 1992*

File No: F-066

To: Dr. Bonnie Guiton, Secretary
State and Consumer Services Agency
915 Capitol Mall, Room 200
Sacramento, CA 95814

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

Subject: **RESPONSE TO AUDITOR GENERAL LETTER REPORT NO. F-066 -- AN ANALYSIS OF THE STATE'S COMPLIANCE WITH REQUIREMENTS FOR CONSULTING CONTRACTS**

Thank you for the opportunity to respond to Office of the Auditor General (OAG) Letter Report No. F-066 which addresses recommendations to the Department of General Services (DGS). The following response addresses each of the recommendations.

OVERVIEW OF REPORT

The DGS has reviewed the findings, conclusions and recommendations presented in Letter Report No. F-066. As discussed in this response, the DGS will take appropriate actions to address the recommendations.

As noted in the report, the immediate responsibility for ensuring propriety in contracting for consultant 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. While we believe that overall these existing activities significantly contribute to ensuring compliance with consultant contracting requirements, as with most control systems, there may be additional actions that could be taken to ensure compliance. Therefore, as discussed in our responses to the OAG's recommendations, appropriate actions will be taken to improve procedures.

The following response only addresses the recommendations. It is our understanding that the specific findings related 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

RECOMMENDATION: "Determine if contracting departments are appropriately distinguishing between consultant and other services contracts and, if departments are not, provide appropriate clarification of the distinction."

DGS RESPONSE: As noted in the report, the DGS recognizes the possibility for confusion over the distinction between consultant and other services contracts. However, as shown by the statistics in the report, i.e., only 6 of 126 contracts were possibly misclassified, and by the DGS' own experiences, the actual instances of misclassification are believed to be few.

Since the DGS believes that any patterns of misclassifying contracts by a department will be identified during the resolution process used for late contracts that is discussed under the following recommendation, further improvements in distinguishing between consultant and other services contracts

should occur in the future.

In addition, the DGS' Audit Section will review the classification of contracts during its compliance audits of other State agencies. Instances of noncompliance will be resolved with the auditee and discussed with the Office of Legal Services (OLS).

RECOMMENDATION: "Require its Office of Legal Services to promptly implement all necessary procedures to maintain accurate statistics on the number of late contracts received from individual departments so that the Department of General Services can take appropriate action against departments continuing to submit late contracts."

DGS RESPONSE: The OLS has recently implemented procedures that ensure the maintenance of accurate statistics on late contracts. A computerized database is being used to maintain these statistics and identify within various categories the reasons for late submittals. This database will be used to identify State agencies that have a pattern of unjustifiable late contract submittals.

RECOMMENDATION: "Increase the number of departmental contract units it reviews each year to complete reviews in the 78 departments within three years."

DGS RESPONSE: This recommendation restates a recommendation contained in a recent OAG report entitled "The Department of General Services' Administrative Oversight of State Agencies that Award Contracts", issued in October 1991. To date, sufficient information has not been presented to the DGS that would justify revising its current audit approach. As provided in our November 21, 1991 sixty-day status report to the prior OAG report, the DGS has concluded that its current audit approach is sufficient when combined with existing administrative control processes and the extensive auditing of State agency contract procedures performed by other audit organizations. However, the DGS' Audit Committee will continue to annually evaluate the department's audit function to determine if coverage should be increased. The Audit Committee is composed of the Director, Chief Deputy Director and the department's six Deputy Directors.

For the 1991/92 fiscal year, the Audit Committee has determined that existing resources should be used to continue performing comprehensive external compliance audits. These audits include the review of nine other functional areas in addition to contracting.

RECOMMENDATION: "Require departments to prepare written evidence of their review of negative evaluations, if any, of proposed contractors, and submit this evidence with other contract documents to the Office of Legal Services for approval."

DGS RESPONSE: Upon the next revision of the Contract Transmittal, Std. Form 15, a box will be added that requires the submitting State agency to indicate that it has complied with State Administrative Manual (SAM) Section 1281(4b). This SAM Section clearly provides that no consulting services contractor shall be awarded a contract totaling \$5,000 or more unless the awarding State agency has reviewed any contract evaluation forms on file with the OLS.

RECOMMENDATION: "Require state departments to certify annually that they have prepared the required evaluations of completed contracts and have submitted any negative evaluations to the Office of Legal Services."

DGS RESPONSE: Since it would not be economical to request an additional report providing just this information, the DGS will research the allowability and feasibility of adding this certification to the annual consultant contract report required of each State agency by Public Contract Code Section 10359.

RECOMMENDATION: "Restrict or terminate the authority to enter into consultant contracts of any department that is not appropriately completing, retaining, and submitting evaluations."

DGS RESPONSE: This is a duty that is placed with the DGS by Public Contract Code Section 10371(h). While in the past it has not been necessary to take the referenced actions, those actions will be taken if a State agency consistently avoids the proper preparation, retention, or submission of post-evaluation forms.

RECOMMENDATION: "Reiterate what information is required under the California Public Contract Code, Section 10359, in contracting departments' annual reports on consultant contracts and include in its own report to the Senate Appropriations Committee, the Assembly Ways and Means Committee, other legislative committees, and designated departments a clear indication that the Department of General Services has not assessed the completeness of the reports submitted by contracting departments."

DGS RESPONSE: As performed prior to the 1990/91 fiscal year consultant contract report, the DGS will again send a memorandum to all State agencies reiterating the information required to be included in the annual report by Public Contract Code Section 10359. In addition, in the letter transmitting DGS' listing of departments and agencies that have not submitted the required annual report, the DGS will clearly indicate that it has not assessed the completeness of the reports submitted by contracting departments.

RECOMMENDATION: "Require close adherence to the requirements of the State Administrative Manual, Section 1236, for requests for sole-source status. Specifically, the sole-source request should at least include assertions from the requesting department about how it investigated alternatives to the contractor of choice and why those alternatives were not satisfactory. In addition, any contract approved as a sole source contract should include a justification of the costs."

DGS RESPONSE: Since this is already the policy of the DGS, we agree with the general recommendation to require close adherence with SAM Section 1236. The issue becomes a matter of three elements: the quality of the justifications for sole source as submitted by the agencies; DGS' judgement in approving the justifications; and, whether SAM is sufficiently clear as to what is needed to justify sole source contracts.

In 1988, the DGS recognized weaknesses in the system of review and approval of sole source contracts and initiated a study of the system. The study resulted

in several recommendations and the development of guidelines for approvals of sole source contracts. In August 1990, the responsibility for the system was transferred from the Office of Small and Minority Business to the Office of Procurement. Also, a standard was adopted whereby all sole source contracts over \$250,000 must be approved by the Deputy Director of the Procurement Division and all over \$500,000 must be approved by the Director of the DGS.

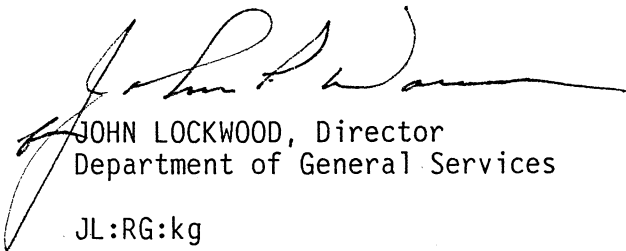
The DGS believes that the above changes have improved DGS' control of sole source contracts. However, there will always be an element of judgement as to what constitutes sufficient documentation, as was the case in some of the examples found in the audit. To possibly alleviate some of these problems, the DGS will consider clarifying the sole source documentation needs as provided in SAM. Also, the DGS will continue to focus particular attention on assuring that justifications for sole source consultant contracts closely adhere to SAM. The DGS is committed to the continual quality improvement of the system used to justify, review and approve sole source contracts.

CONCLUSION

The DGS has a firm commitment to providing efficient and effective oversight of the State's consultant 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.

The DGS appreciates the professional manner in which the review was conducted.

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



JOHN LOCKWOOD, Director
Department of General Services

JL:RG:kg



CALIFORNIA STATE DEPARTMENT OF EDUCATION

721 Capitol Mall; P.O. Box 944272

Sacramento, CA 94244-2720

Bill Honig

Superintendent

of Public Instruction

January 21, 1992

Kurt R. Sjoberg, Auditor General (acting)
Office of the Auditor General
660 J Street, Suite 300
Sacramento, CA 95814

F-066

Dear Mr. Sjoberg:

Thank you for the opportunity to review the audit findings related to the California Department of Education (CDE) as part of your review of the State's compliance with legal requirements for consultant contracts, its use of sole source consultant contracts, and its use of the results obtained from contracts with consultants. Your audit work was performed as part of your comprehensive financial and compliance audit of the State of California for the fiscal year ended June 30, 1991.

The CDE does not agree with your perception of the information as summarized in your December 13, 1991 letter. According to the information provided in your letter, five contractors were found to have started work prior to the approval of their contract by the Department of General Services (DGS). While this is not a desirable practice, the contractor is taking the risk and not the State if the contract is not subsequently approved. All of the CDE's contracts contain language cautioning the contractor not to begin work until the contract is approved. (Attachment 1 is a copy of two versions of contract language.)

①*

It should be noted also that the Public Contract Code allows consultant services contracts to begin prior to DGS approval in case of "emergency" which means "an instance, as determined by the department [of General Services], where the use of contracted services appeared to be reasonably necessary but time did not permit the obtaining of prior formal approval of the contract." All of the cited contracts were approved by the DGS in accordance with this provision (Public Contract Code Section 10371).

②

Secondly, the information in your letter states that the CDE did not review evaluations or resumes prior to awarding three consultant contracts. During the exit conference (March 1991) for the single audit review for the fiscal year ended June 30, 1990, your auditors first identified this compliance issue. Since that time, the CDE has consistently requested copies of Standard 4s from the DGS when required by Public Contract Code Section 10369.

*The Office of the Auditor General's comments on this response begin on page 36.

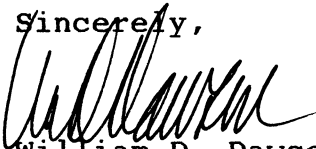
Kurt R. Sjoberg
January 21, 1992
Page 2

Prior to March 1991, the CDE did not routinely request a Standard 4 if the contract was competitively awarded because the contract proposal contained resumes (such as in the case of contract #8260 with Child Development Associates). Two of the contracts cited, #8065 with the Association of California School Administrators and #8130 with Thomas Smyth, are ongoing projects with the contractors and both contracts were awarded prior to March 1991.

Lastly, your letter indicates that 436 of the 472 consultant contracts reported by the CDE in our annual consultant contract report submitted to your office did not have the sole source status clearly identified. It is our understanding that this finding refers to the listing of short term contracts. The CDE's annual consultant services contract report contains a clear description of the bidding procedures used for short-term contracts. (See Attachment 2 for a copy of the description.) The CDE feels that this information satisfies the requirements of Public Contract Code Section 10359 for including information regarding whether the contract was sole source. ③

We hope that the above information will be useful to you in finalizing your report to the Legislature. Contact Peggy Peters, Audit Response Coordinator, at 657-4440 if you have questions.

Sincerely,



William D. Dawson
Executive Deputy Superintendent

In no event shall the contractor commence work before receipt of the fully executed copy of the contract. Should the contractor begin work in advance of receiving notice that the contract is approved as above provided, any work performed in advance of the said date of approval shall be considered as having been done at the contractor's risk as a volunteer unless said contract is so approved.

Should the contractor begin work in advance of receiving notice that the contract is approved as above provided, any work performed in advance of the said date of approval shall be considered as having been done at the contractor's risk as a volunteer unless said contract is so approved.

SHORT-TERM CONTRACTS

CDE's short-term contracts with individuals for FY 1990/91 are listed individually in Appendix A, between July 1, 1990 and June 30, 1991 the Department entered into four-hundred-thirty-seven (437) short-term contracts. These contracts cannot exceed \$9,500 and, thus, DGS I.D. numbers are not required.

Bidding Procedure Used: The department places a periodic ad in the State Contracts Register for general short-term consulting activities. CDE's use of short-term contracts began in 1975 with the delegation of approval authority by the State Personnel Board to the department as long as certain criteria and limitations were followed. Although Sp8 no longer has direct oversight authority for contract approval, short-term contracts still meet these criteria and are consistent with the sole approval criteria now vested with the Department of General Services.

The cost of fees paid to short-term contractors is not a factor in contractor selection since the same rate (usually \$150 per day) is paid to all persons performing similar work. A higher rate may occasionally be paid for consultant work of the highest order of difficulty or to obtain the services of an acknowledged expert in a specialized field of knowledge.

Contract Amount: The total amount for all short-term contracts for the July 1, 1990 through June 30, 1991 period was \$1,078,870.25. See Appendix A for amounts of individual contracts.
Purpose: Short-term consultant contracts are used to provide specialized, professional, technical or scientific services (usually in the field of education) which are of a unique, temporary nature for 30 days or less per fiscal year. Such unique services typically require education at least equivalent to a four-year college degree. Appendix A lists all short-term contractors and gives a brief description of the service provided by each contractor.

Contract Dates: See Appendix A for dates of individual contracts.

**Comments Office of the Auditor General’s Comments
on the Response From the
California Department of Education**

- ① The California State Department of Education (department) disagrees with the conclusions in our report in two areas, the commencement of contract work before the contract is approved and the clarity of the department’s identification of sole-source status for certain contracts in its annual consultant contract report. In the first area, the Office of the Auditor General and the department do not disagree that work on five reviewed contracts began before the contracts were approved. We recognize that a mitigating circumstance arises when the department includes a warning to contractors that they work at their own risk when they begin work before contract approval. Nevertheless, the California Public Contract Code, Section 10371(d), requires that, except in an emergency, work on a consultant contract not be started before formal approval is granted by the Department of General Services or appropriate department personnel. For these contracts, we observed no evidence of emergency conditions, such as legal requirements for immediate action, that precluded the department from getting approval before contract work began.
- ② See our comments in ①.
- ③ In the second area, when we reviewed the department’s consultant contract report, we noted the explanatory language to which the department refers and still found the department’s intention unclear. The department indicated that it advertised the availability of these contracts and solicited bids, suggesting that these are not sole-source contracts. In addition, the department’s statement that contracts “are consistent with sole approval criteria now vested with the Department of General Services” does not clearly indicate whether the department considers these contracts to be sole-source contracts.

Memorandum

Date : DEC 22 1991

To : Kurt R. Sjoberg
Acting Auditor General
Office of the Auditor General
660 J Street, Suite 300
Sacramento, California 95814

From : Department of Water Resources

Subject: Consultant Contract Audit

This is in response to your letter of December 13, 1991. The Department appreciates the opportunity to comment on the information presented.

According to your letter, five consultant contracts were reviewed and some issues noted. The issues include the following: the Department of Water Resources did not review contractor evaluations on file before entering into the contract; DWR did not review resumes of appropriate personnel of the contractor; and, DWR did not promptly complete the post-evaluation for one contract. According to information from Department of General Services Legal Office staff, no negative contractor evaluations were on file or available for review for these consultants.

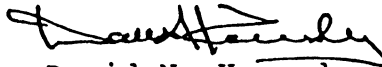
Your records indicate that the DWR entered into 25 sole-source out of 30 total contracts during the 1990-91 fiscal year. This is correct and is explained by the fact that the Department has frequent need to accomplish work that is highly specialized and unique in nature which often can only be done by one specific contractor. These contracts were all approved by the Department of General Services.

The Department takes seriously the need to comply with the many details of contracting rules. Prior to the audit by your staff, DWR Contracts Services Office staff instituted several steps to insure that these rules be followed. For example, the Department routinely holds contract preparers' meetings, conducts training classes, periodically sends out newsletters and revises reference documents to keep contract preparers, program managers and others apprised of contracting laws, rules and procedures. In addition, we consistently update this information to help insure necessary compliance.

We appreciate the advance notice and the opportunity to clarify the information regarding DWR consultant contracts.

Kurt R. Sjoberg
DEC 22 1991
Page Two

If you have any questions, please contact me or have your staff contact Connie Dennis-Anderson at (916) 653-7201.



David N. Kennedy
Director
(916) 653-7007

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