

**REPORT BY THE
AUDITOR GENERAL
OF CALIFORNIA**

**THE DEPARTMENT OF GENERAL SERVICES'
ADMINISTRATIVE OVERSIGHT OF
STATE AGENCIES THAT AWARD CONTRACTS**



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October 3, 1991

P-014

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 (department) is responsible for providing administrative oversight of state agencies that award contracts to ensure compliance with state laws and regulations. However, in 20 of 21 reports we issued from January 1986 through April 1991 pertaining to contracting issues, we found that state agencies did not always follow state contracting laws or regulations. For example, in the reports, we noted instances in which state agencies consistently allowed contractors to begin work on contracts before receiving the department's approval. Additionally, state agencies did not review the evaluations of contractors maintained by the department before awarding contracts. Conversely, if contractors did not previously have contracts with the State, the agencies did not include in the original contracts resumes for the contractors' major personnel. We also found that state agencies consistently did not obtain three competitive bids or proposals for each contract. Many of these deficiencies occurred because the department is not always taking the appropriate actions to ensure state agencies comply with state contracting laws and regulations. Also, the department is not conducting prompt or thorough audits of all state agencies' contracting programs. As a result of the department not taking appropriate actions, the State's interests may not be protected.

Background The Legislature created the department in 1963. The department provides centralized services including planning, acquisition, construction, maintenance, and police protection of state buildings and property; purchasing; printing; architectural services; administrative hearings; and accounting services. A primary objective of the department is to provide supportive services to state agencies to achieve greater efficiency and economy in conducting state business. In addition, the department develops and enforces policies and procedures as it deems necessary to conserve the rights and interests of the State.

The California Public Contract Code generally assigns to the department the duty of reviewing and approving all contracts entered into by state agencies for materials, supplies, equipment, services, consultant services, or construction. Although it assigns these duties to the department, the law also exempts consultant and service contracts under \$50,000 from the department's review, provided state agencies meet specified provisions. The Public Contract Code also allows the department to delegate the purchase of materials, supplies, and equipment, including electronic data processing equipment and services, to state agencies whose contracting processes meet certain requirements.

The department's Office of Procurement has oversight responsibility for the purchase of materials, supplies, and equipment, including data processing and telecommunication equipment and services. The department's Office of Legal Services has oversight responsibility for all other types of contracts. This responsibility includes reviewing and approving contracts requiring the department's approval. The Office of Legal Services is responsible for developing the standard contracting procedures contained in the State Administrative Manual, beginning with Section 1200. These sections include guidelines for preparing and advertising contracts, using competitive bids, evaluating the need for the contract, and evaluating contractors' performance. Attachment A presents a flowchart of the department's organization.

**Scope and
Methodology**

The purpose of this audit was to assess the department's effectiveness in providing administrative oversight of those state agencies that award contracts. We did not review the department's own contracting activities. However, we are currently reviewing the contracting activities of the department's Office of Procurement, and we will issue an audit report at a later date.

To evaluate the department's effectiveness in providing administrative oversight, we identified and reviewed 21 audit reports we issued from January 1986 through April 1991 concerning state contracting for materials, equipment, supplies, consultant services, other services, and construction. Specifically, we identified areas in which state agencies did not follow state contracting laws and regulations. Attachment B lists the reports we reviewed.

We also reviewed state laws and regulations and department policies and procedures on contracting, including provisions about exemptions and the delegating of contract activities. Additionally, we reviewed the department's management controls established to ensure agency compliance with state requirements. Finally, we interviewed department officials and reviewed contract records. However, we did not consider the new requirements under Chapter 1044, Statutes of 1990, which revised consultant evaluation requirements.

**Oversight of
the State's
Contracting
Process**

The department is responsible for providing administrative oversight of state agencies that award contracts to ensure compliance with state laws and regulations. However, in 20 of 21 reports we issued from January 1986 through April 1991 pertaining to contracting issues, we found that state agencies do not always follow state contracting laws or regulations. For example, in 4 of our annual comprehensive financial and compliance audit reports issued in 1988, 1989, 1990, and 1991, we found that, as shown in the following table, 343 (51 percent) of the 672 contracts reviewed did not fully comply with provisions of the Public Contract Code. Examples of these deficiencies

include starting work before obtaining proper department approvals, not preparing a contractor evaluation within the prescribed period after completion of the contract, not reviewing contractor evaluations before approving contracts, not providing required documentation, and not following other required procedures. The table shows the deficiencies that these 4 audits found and the relative frequency of the deficiencies. The following sections discuss in more detail the major deficiencies noted in all 20 reports we issued.

**Summary of Office of the Auditor General
Contract Findings From Four Reports
by Report Issue Date**

Area of Noncompliance ^a	1988 ^b	1989 ^b	1990 ^b	1991 ^b	Total
Contracts reviewed with at least one deficiency	80 of 160 (50%)	66 of 150 (44%)	97 of 182 (53%)	100 of 180 (56%)	343 of 672 (51%)
Lack of approval before start of work	30 of 160 (19%)	24 of 150 (16%)	48 of 182 (26%)	44 of 180 (24%)	146 of 672 (22%)
Lack of prompt post-evaluations	42 of 160 (26%)	31 of 150 (21%)	46 of 182 (25%)	46 of 180 (26%)	165 of 672 (25%)
Lack of review of post-evaluation or failure to submit resume before contract approval	NA	NA	17 of 182 (9%)	22 of 180 (12%)	39 of 362 (11%)
Other ^c	42 of 160 (26%)	19 of 150 (13%)	34 of 182 (19%)	22 of 180 (12%)	117 of 672 (17%)
Number of Agencies Reviewed	16	15	17	17	

Source: Office of the Auditor General Comprehensive financial and compliance audit reports

^a Some contracts may contain more than one deficiency.

^b These columns show the number of deficiencies found in the total number of contracts reviewed.

^c "Other" includes lack of required documentation (except evaluations) and lack of other required procedures.

NA Data not available.

Contract Approvals

The Public Contract Code generally assigns to the department the responsibility of reviewing and approving contracts entered into by state agencies for materials, equipment, supplies, consultant services, other services, or construction. Specifically, Section 10295 of the code states that all contracts, unless otherwise exempt, entered into by any state agency for the purchase of equipment, supplies, materials, services, or construction are void unless and until approved by the department. Additionally, Section 12100 of the code states that the department must enter into or supervise all contracts for the acquisition, whether by lease or purchase, of electronic data processing or telecommunication goods and services. Also, Sections 10335 and 10360 of the code state that, unless specifically exempted, a service or consultant contract is not valid until reviewed and approved by the department.

Moreover, Section 1209 of the State Administrative Manual, except in emergency cases to protect human life or state property, requires state agencies to submit each contract in sufficient time for the department to review and comment on it before work on the contract begins. Contractors who begin work before receiving notice of the contract's approval may be considered as having performed the work at their own risk and may not be paid. Further, a publication of the department's 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 commenced will not be approved. Finally, in 1989, the Legislative Counsel stated that contract amendments are generally subject to the same requirements as the original contract.

However, state agencies do not always obtain the proper approvals from the department before contractors begin work on a contract. According to 17 of the 21 reports we issued, 18 state agencies allowed contractors to begin work before receiving the department's approval in 312 (36 percent) of the 859 contracts reviewed. For example, in a report issued in February 1989, we noted that the Employment Development Department did not obtain the department's approval in one of nine contracts and

2 of 15 amendments up to 24 months after the contractors started work. In another report issued in March 1989, we found similar problems at the Department of Social Services. Of the ten contracts reviewed for approximately \$9.8 million in goods and services, the department had not approved seven of the contracts before the work began. The department approved one of the seven contracts after June 27, 1988, even though the contract ran from October 1, 1987, to December 31, 1989.

As shown in the table on page 4, allowing contractors to begin work before receiving the department's approval has been a continuing problem. For example, the table shows that, on average, state agencies did not receive the necessary approvals before starting work for approximately 22 percent of the contracts reviewed. The noncompliance rate for this condition ranged from 16 percent for all contracts reviewed in the 1989 report to 26 percent in the 1990 report. The department needs to improve its contract review and approval process to ensure that state agencies submit each contract in sufficient time for the department to review and comment on it before work begins, as required by state contracting laws and regulations.

The department's chief deputy director believes late contract approval is an area that needs improvement for a number of state agencies. He also stated that he had concerns that our four audits have not been effective in reducing the number of late contracts in some of these state agencies. Because of this concern, the department's Office of Legal Services and the Office of Procurement will be implementing procedures to maintain statistics on the number of late contracts received from individual agencies, and the department will take appropriate action against agencies continuing to submit late contracts.

Contract Evaluations

State agencies are required to complete post-evaluations to assess the contractor's performance in conducting the work or delivering the services specified in the contract. In addition, post-evaluations assess whether the product resulting from the

contract was useful and furthered the objectives of the agency. Finally, post-evaluations provide state agencies with information that enables them to determine whether a potential contractor has satisfactorily completed previous state contracts. Therefore, post-evaluations help to protect the interests of the State in awarding contracts.

Chapter 1044, Statutes of 1990, effective September 1990, revised the requirements for service and consultant service contracts. The following sections discuss the former and new post-evaluation requirements.

Former Consultant Evaluation Requirements: Before September 1990, the Public Contract Code required state agencies to prepare quarterly reports that included a list of the consultant contracts they had entered into during the previous three months. The reports were required to include other information such as the name of the contractor, the amount of the contract, whether the contract was a sole-source contract, and the purpose and potential beneficiaries of the contract. Additionally, the Public Contract Code required every state agency to complete a contract post-evaluation 30 days after completion of the contract. The state agency would then forward a copy of the post-evaluation to the department's Office of Legal Services. If a state agency failed to forward a post-evaluation to the office, the department could restrict or terminate the authority of a state agency to enter into a consultant contract.

The code also required the Office of Legal Services to retain post-evaluations for 36 months and to make them available to agency directors upon written request. The code further stated that an agency could, except in emergencies, award a consultant contract only after reviewing the contractor's post-evaluation maintained on file by the Office of Legal Services. Conversely, if the contractor had not previously contracted with the State, the state agency had to request and review a completed resume for each contract participant exercising a major role in the contract. The agency would then attach the resume to the contract.

As shown in the table on page 4, state agencies, on average, did not promptly prepare or submit post-evaluations of contracts for 165 (25 percent) of the 672 contracts awarded. Also, as shown in the reports issued in 1990 and 1991, state agencies did not review post-evaluations or resumes for approximately 39 (11 percent) of the 362 contracts awarded and reviewed.

Because of the deficiencies found in the State's post-evaluation process, our office recommended in 1986 that the department review the effectiveness of the post-evaluation process and make recommendations to the Legislature to improve or eliminate the process. The department's 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 September 1990, incorporated the changes the department indicated would make the evaluation process more effective.

New Consultant Evaluation Requirements: Many of the provisions of the 1990 statutes are similar to the previous law. Under the new statutes, agencies need to prepare reports on consultant services contracts and to submit them annually rather than quarterly to the department and to the Legislature. Further, the department must notify the legislative committees annually of state agencies that fail to submit the required reports. Additionally, state agencies must now complete the post-evaluations within 60 days of the completion of the contract, rather than 30 days. The new statutes also require the department to keep only negative evaluations of contractor performance on file for 36 months. Nevertheless, within ten working days, the department must notify any agency seeking approval of a proposed contract of a negative evaluation regarding the proposed contractor. This report does not consider these new requirements. However, we are currently conducting a review of statewide consultant service contracts and are scheduled to report the results to the Legislature in January 1992.

Competitive Bids

According to the Public Contract Code, the Legislature intends that state agencies procure goods and services in a competitive framework. The code states that competitive bid requirements in the awarding of public contracts encourage competition; guard against favoritism, extravagance, fraud, and corruption; and secure the best work or supplies at the lowest price practicable. State contracting laws and regulations generally require state agencies to award contracts based on at least three competitive bids, except under specific circumstances.

The department must determine the conditions, methods, criteria, and reasonableness of cost when awarding a contract without competition. Contracts are generally exempt from competitive bidding requirements in cases where a good or service is necessary for the immediate preservation of public health, welfare, or safety or to protect state property; when less than the required number of bids or proposals have been received; or when the department determines it is in the State's best interest to award the contract to a specific contractor.

However, in 11 of the 21 reports we issued, we found 13 state agencies did not competitively bid at least 255 (25 percent) of the 1,011 contracts reviewed. For example, in a report we issued in April 1986, we found five state agencies did not competitively bid 81 (65 percent) of the 124 service and consultant service contracts reviewed. Also, in a report issued in October 1988, we found that the Department of Health Services awarded 19 (42 percent) of 46 consultant service contracts, valued at more than \$9 million, without obtaining at least three competitive bids or meeting the exemption requirements of the Public Contract Code. Furthermore, the department reviewed and approved the agency's exemption requests for these 19 contracts even though the agency could not establish these contracts met the criteria for exemption.

Additionally, in a report we issued in November 1990 on the fiscal and operational activities of the Antelope Valley Fair, we found the fair did not adhere to state laws and regulations governing purchasing and contracting. For example, the fair completed many purchases without purchase orders or with

purchase orders that were not complete, authorized, or competitively bid. Additionally, staff did not issue purchase orders in sequential order and did not always compare invoices with purchase orders before payment. Also, the fair back dated some purchase orders. Finally, it paid for services without a valid contract, entered into contracts without competitive bids, and did not always obtain the department's approval.

The department's chief deputy director believes the competitive bid requirements are generally complied with by state agencies and while, as with most control systems, there may be instances of noncompliance, these are not widespread and the cause is not consistent among the state agencies. The chief deputy director further states that while the department has numerous control systems in place to assist in ensuring state agencies conform with competitive bid requirements, the primary responsibility for compliance with those requirements rests with each agency's management.

While we agree with the chief deputy director that the cause of noncompetitive bidding may not be consistent among state agencies, the fact that our audits found the lack of competitive bidding to be a problem in 11 of 21 reports suggests a systemic problem. Also, we agree that the primary responsibility for compliance with state contracting requirements rests with the management of state agencies; however, this does not relieve the department of its oversight responsibilities in ensuring that all state contracts are awarded in the best interests of the State.

Effects of Lack of Oversight

As a result of the department's lack of administrative oversight of state agencies' awarding of contracts, the State's interests may not be 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. Also, failure to review or prepare contractor evaluations may cause the State to enter into contracts with unreliable vendors. Finally, because

competitive bid requirements are not always followed, the State may not be protected against fraud and abuse, favoritism, extravagance, or it may not receive the best product or service at the lowest price possible.

**Department's
Review of State
Agencies'
Contracting
Practices**

The use of an audit review process is an effective means for the department to ensure state agencies comply with state contracting requirements. In a report we issued in April 1986, we found the department had not established routine and comprehensive audits of all state agencies to ensure compliance with the State's contracting procedures. The report recommended the department conduct periodic audits of all state agencies to correct improper or inefficient contracting practices. The following sections discuss the department's auditing efforts undertaken to ensure agencies comply with state contracting requirements.

OMTP Reviews of Contracts

Until 1989, the department's Office of Management Technology and Planning (OMTP) conducted audits of state agencies that requested or were granted an exemption from contract approval. According to Sections 10351 and 10364 of the Public Contract Code, the department can exempt from its approval service and consultant service contracts under \$50,000 if agencies meet certain requirements. One of the requirements is that the exempted agency conduct an internal audit of its contracting program every two years. Also the department is required to conduct a quality control review of the internal audit of the exempted agency. Before September 1990, the department was required to review each of these agencies once every three years.

In 1989, the OMTP increased its audit coverage to include other state agencies that perform contract activities. The scope of the audit was also expanded to include a compliance review of additional areas of agency management, such as equipment rentals, moving and hauling services, office machine and personal

computer repair, records management, and insurance coverage. The OMTP conducts its audits according to generally accepted auditing standards.

Of the 121 state agencies, the OMTP had identified 78 agencies to be audited. According to the OMTP's internal audit manager, the OMTP is not reviewing 43 agencies because the agencies are small and their contracting activities are negligible. In March 1990, the OMTP had completed a tri-annual review of the six agencies granted an exemption. However, as of June 28, 1991, the department had completed only 10 audits of the 72 remaining agencies. According to the OMTP's internal audit manager, the OMTP will require from seven to nine years to complete audits of the 78 state agencies.

Office of Procurement Reviews

The department's Office of Procurement is also responsible for auditing state agencies delegated with purchasing authority. Section 10331 of the Public Contract Code allows the department to delegate authority to state agencies to purchase certain materials, supplies, and equipment. Section 10330 of the code establishes a dollar limit, which an agency with delegated purchasing authority may not exceed. As of July 1, 1991, the Office of Procurement can delegate to state agencies the authority to make individual purchases ranging from \$1,150 to a maximum of \$9,999. State agencies must submit to the Office of Procurement a request for delegated authority to make such purchases. The Office of Procurement approves the request based on the agency's demonstrated ability to manage and control its own procurement program. Section 10333 of the code requires the Office of Procurement to audit agencies delegated with purchasing authority once every three years. Also, Section 1236 of the Government Code requires all state agencies that conduct internal audits or related activities to utilize the audit standards as specified by the Institute of Internal Auditors, Inc.

In 1980, the Office of Procurement granted delegation authority to 114 state agencies for contracts valued at a total of approximately \$19 million. In 1986, the Office of Procurement granted 116 agencies delegation authority for contracts valued at approximately \$75 million. The office currently grants purchasing delegations to 145 state agencies for contracts valued at up to \$158 million.

While the Office of Procurement has instituted a procurement review process that generally meets the mandated time frames, its review is neither thorough nor in compliance with the auditing standards of the Institute of Internal Auditors, Inc. For example, these audit standards require auditors be independent of the activities they audit. However, the individuals who conduct these audits are Office of Procurement program personnel who also provide training to agency personnel in how to conduct contracting activities.

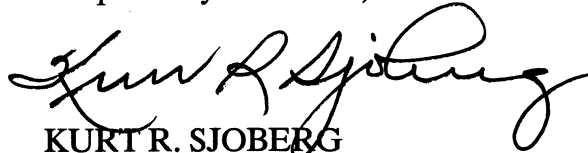
Also, the results of the Office of Procurement's audit of an agency's procurement program consists of a one-page checklist of 15 items. The checklist does not identify the number of contracts reviewed nor the frequency or magnitude of any deficiency. Also, the checklist does not identify the criteria used by the reviewer. For example, the checklist requires the reviewer to verify whether an agency's purchase is cost-effective and whether supplies are being kept at an excessive level. However, the checklist does not define what is cost-effective or what constitutes excessive inventory.

Moreover, for a sample of 19 audit results we reviewed, the Office of Procurement could not provide documentation to support any of its findings. Further, when the office identified a deficiency, it did not identify whether the agency needed to take corrective action, and it did not plan any follow-up activity to ensure that the deficiencies were corrected, as required by auditing standards.

- Recommendations** To improve the effectiveness of the Department of General Services' oversight of the State's contracting process, the department should take the following actions:
- Ensure that all state agencies follow state contracting laws and regulations during the review and approval process of contracts, and take action, such as conducting audits of the agency's contract program or revoking an agency's delegation authority, when an agency consistently fails to follow state contract requirements;
 - Consider increasing the number of agencies the department's Office of Management Technology and Planning audits each year to complete audits of each of the 78 agencies within three years; and
 - Ensure that the Office of Procurement develops a comprehensive audit program for reviewing state agencies' procurement activities based on generally accepted auditing standards.

We conducted this audit 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,



KURTR. SJOBERG
Auditor General (acting)

Staff: Robert E. Christophel, Audit Manager
Gary L. Colbert
Andrew Collada
Pamela Haynes

Attachments

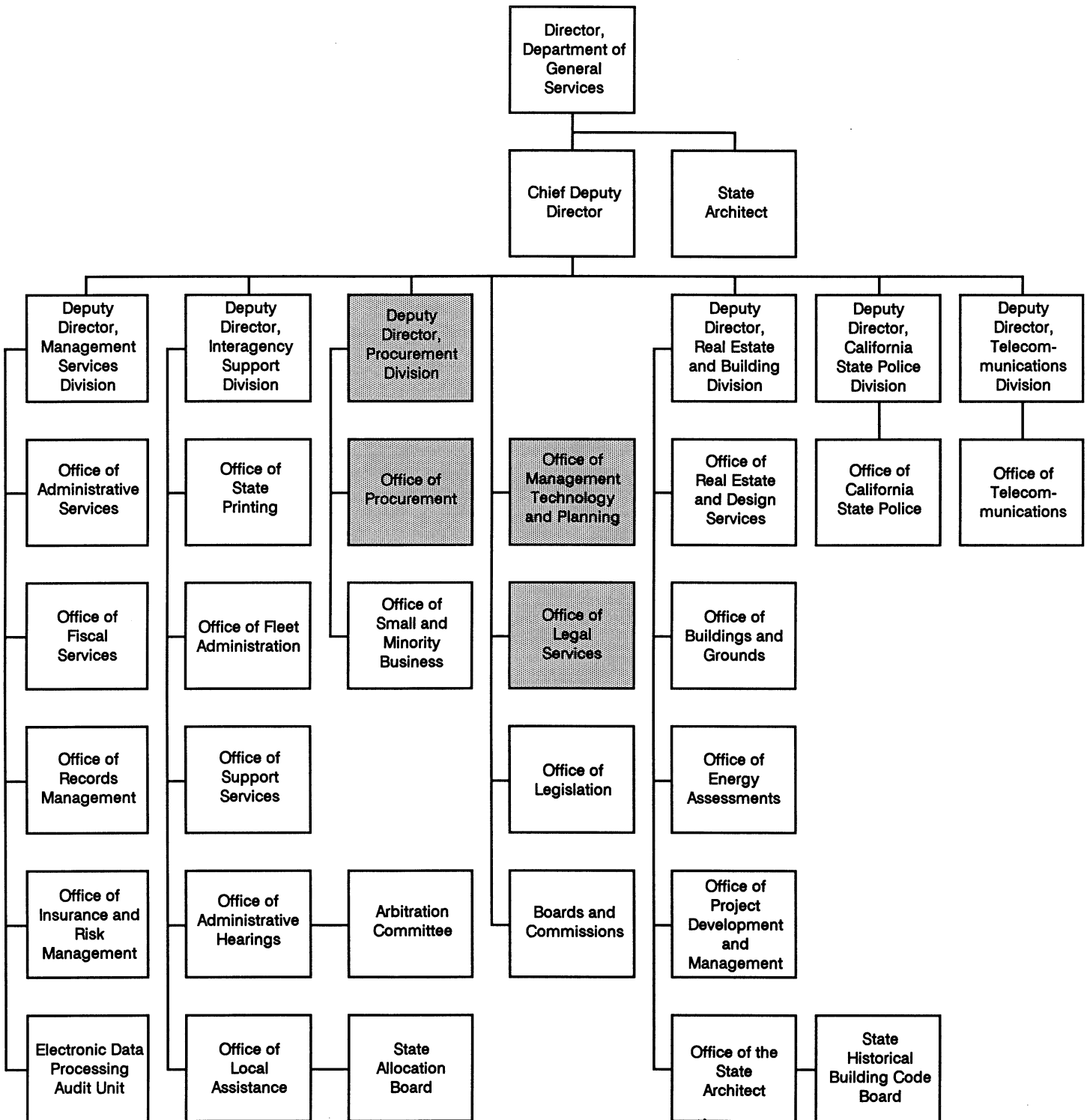
- A** Department of General Services
Organization Chart
March 11, 1991
- B** Reports Issued by the Office of the Auditor General
Concerning Contracting by State Agencies
January 1986 Through April 1991

Response to the Audit

State and Consumer Services Agency
Department of General Services

Attachment A

Department of General Services
 Organization Chart
 March 11, 1991



■ Offices we discussed in this report.

Source: Department of General Services

**Attachment B Reports Issued by the Office of the Auditor General
Concerning Contracting by State Agencies
January 1986 Through April 1991**

<u>Issue Date</u>	<u>Report Number</u>	<u>Report Title</u>
January 10, 1986	P-490.1	The State of California Needs To Improve the Management of Its Local Fairs Program
March 13, 1986	P-582.1	The Department of Health Services Needs Better Control of Hazardous Waste Contracts
April 3, 1986	P-529.3	A Review of Management Practices at Folsom State Prison, the Deuel Vocational Institution, and the California Institution for Men
April 8, 1986	P-515.1	A Review of Contracts to Collect Entrance Fees at Folsom Lake State Recreation Area
April 9, 1986	P-504	The State Needs To Improve Its Control of Consultant and Service Contracts
April 8, 1987	P-658	A Review of the State's Spending Related to the Acquired Immune Deficiency Syndrome
November 25, 1987	F-759	A Review of the California Maritime Academy's Interactions With the California Maritime Academy Foundation
March 17, 1988	F-700	State of California Comprehensive Financial and Audit Report Year Ended June 30, 1987

<u>Issue Date</u>	<u>Report Number</u>	<u>Report Title</u>
April 6, 1988	P-741	A Review of the State's Contracts With Positive Incident Control, a Contractor for Hazardous Waste Cleanup
October 19, 1988	P-753	The Department of Health Services Did Not Comply With All Requirements for Awarding and Managing Consultant Contracts
March 3, 1989	F-804	State of California Comprehensive Financial and Audit Report Year Ended June 30, 1988
February 22, 1989	P-752	A Review of the Employment Development Department's Acquisition of New Automated Systems and Its Management of Its Programs' Field Offices
May 10, 1989	P-768	The Chancellor's Office of the California Community Colleges Has Developed Procedures That Result in a Circumvention of Many State Fiscal Controls
July 6, 1989	F-859	The Departments We Reviewed Within the Health and Welfare Agency Are Not Complying With Direct Service Contract Reforms
February 12, 1990	P-938	A Review of the California Authority of Racing Fairs
March 28, 1990	F-904	A Review of the State's Controls Over Its Financial Operations
April 25, 1990	P-939	The California Museum of Science and Industry Needs To Modify Its Agreement With Its Foundation and Improve Management Controls

<u>Issue Date</u>	<u>Report Number</u>	<u>Report Title</u>
November 28, 1990	C-957	Review of the Fiscal and Operational Activities of the Antelope Valley Fair
March 21, 1991	P-945	A Review of the California Horse Racing Board's Contracting for Equine Drug Testing and Its Personnel Practices
March 28, 1991	F-005	A Review of the State's Controls Over Its Financial Operations
April 11, 1991	F-025	The California Exposition and State Fair's Financial Status for the Fiscal Year Ended June 30, 1990

Memorandum

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

Date: September 25, 1991

From: Office of the Secretary
(916) 323-9493
ATSS473-9493

Subject:

RESPONSE TO AUDITOR GENERAL REPORT NO. P-014

Thank you for the opportunity to respond to your Report P-014 entitled "The Department of General Services' Administrative Oversight of State Agencies That Award 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.

Sincerely,



BARBARA FITZER
Deputy Secretary

mb

cc: John Lockwood, Director,
Department of General Services

Rick Gillam, Audit Manager
Department of General Services

MEMORANDUM

Date: September 24, 1991

File No: P-014

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. P-014 -- THE DEPARTMENT OF GENERAL SERVICES' ADMINISTRATIVE OVERSIGHT OF STATE AGENCIES THAT AWARD CONTRACTS**

Thank you for the opportunity to respond to Office of the Auditor General (OAG) Letter Report No. P-014 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. P-014. As discussed in this response, the DGS will take appropriate actions to address the recommendations.

The DGS is pleased that the report recognizes that the primary responsibility for compliance with State contracting requirements rests with the management of State agencies. This requirement is provided in The Financial Integrity and State Manager's Accountability Act of 1983 (FISMA), Sections 13400 through 13407 of the Government Code. To accomplish its oversight responsibilities and assist State agency management in complying with their responsibilities, the DGS has implemented numerous administrative control activities. While we believe that overall these existing activities significantly contribute to compliance by State agencies with contracting requirements, as with most control systems, there may be procedures that could be improved to ensure additional compliance. Therefore, as discussed in our responses to the OAG's three recommendations, where feasible, appropriate actions will be taken to improve procedures.

The following response only addresses the recommendations. Since they have been extensively discussed in past meetings with OAG staff and in prior correspondence, our disagreements with some specific findings and, especially, the effects and conclusions resulting from those findings, will not be repeated in this response. *

RECOMMENDATIONS

RECOMMENDATION: "Ensure that all state agencies follow state contracting laws and regulations during the review and approval process and take action, such as conducting audits of the agency's contract program or revoking an agency's delegation of authority, when an agency consistently fails to follow state contract requirements."

DGS RESPONSE: The DGS will continue to take appropriate action when an agency consistently fails to follow State contracting requirements. To meet its responsibilities in reviewing contracts, both the department's Office of Legal

*The Office of the Auditor General's comment: We have considered the Department of General Services' comments and believe that the report accurately reflects the department's effectiveness in providing administrative oversight of state agencies that award contracts.

Services (OLS) and Office of Procurement (OP) have procedures in place that ensure the nonapproval of any contract that does not comply with State contracting laws and regulations. For example, if competitive bidding of a contract is required by law, the contract will not be approved without documented compliance with these requirements. Without DGS' approval, the contract is not legal and payments will not be made to the contractor by the State Controller's Office.

While the DGS already has procedures in place for the nonapproval of contracts that do not comply with State contracting laws and regulations, it has recently implemented additional procedures to address contracting policy violations that do not result in the nonapproval of the contract. For example, as noted in the report, the late submission of contracts for approval issue is also a concern of the DGS. Since it is not in the best interests of the State to refuse approval of a contract, which is otherwise in order, solely because the contract is submitted late for approval, these contracts are approved by the DGS. However, the DGS recognizes that an agency that consistently does not process contracts in a timely manner has weaknesses in its contracting program that should not exist if contracts are to be processed efficiently and effectively. Therefore, recently, the OLS and OP have implemented procedures to refer to DGS' executive management any State agencies that have a pattern of unjustifiable late contract submittals. At that time, appropriate actions will be taken to address the condition.

RECOMMENDATION: "Consider increasing the number of agencies the department's Office of Management Technology and Planning audits each year to complete audits of each of the 72 agencies within three years."

DGS RESPONSE: While the DGS will consider increasing the number of audits conducted by its Audit Section, its preliminary conclusions are that the current audit approach is sufficient when combined with existing administrative control processes and the contract audit activities of other audit organizations. The administrative control process includes: publishing contracting requirements in the State Administrative Manual (SAM); with some exceptions, the DGS reviewing and approving contracts in excess of \$12,500 (SAM Section 1215); requiring the advertising of contracts with a dollar value of \$1,000 or more (SAM Section 1232); requiring contracts with a dollar value of \$1,000 or more to be awarded without competitive bids or proposals only if approved by the DGS; and publishing a detailed guide on the contracting process for use in the State Training Center's contracting course.

Other audit organizations that perform contracting compliance review activities include the:

- . OAG - Performs annual financial audits of the largest State agencies (17 as of June 30, 1990).
- . Department of Finance (DOF) and Internal Auditors - The DOF requires the 37 State agencies listed in SAM Section 20011 that have internal audit functions to include contracting policies and procedures in their biennial FISMA audit if contracts are a material activity of the agency. The DOF has recently issued a contract audit guide for this review. Where applicable, the DOF also uses the contract audit guide for its direct reviews of other State agencies.
- . \$50,000 Exemption Agencies - Currently, six State agencies, i.e., Department of Transportation, Department of Health Services, Department of Toxic Substances Control, Department of Food and Agriculture, Department of Developmental Services and the California Energy Commission, that have

extensive contracting activities have been granted exemptions from DGS approval of contracts under \$50,000. As provided in Public Contract Code Sections 10351 and 10364, these agencies are required to audit their contracting program every two years. The DGS has issued a guide for these audits and performs a quality control review of the results.

In addition, to date, the results of the DGS' Audit Section's audits have not justified adding additional resources to reduce the audit cycle. Further, since the Audit Section's comprehensive external compliance audits include the review of nine other functional areas in addition to contracting, the use of existing resources to increase the coverage of contracting would by necessity reduce the coverage of these areas that are also under the purview of DGS. This reduction would increase the risk of noncompliance in these areas.

RECOMMENDATION: "Ensure that the Office of Procurement develops a comprehensive audit program for reviewing state agencies' procurement activities based on generally accepted auditing standards."

DGS RESPONSE: The OP will take appropriate action to ensure that its reviews are conducted based on generally accepted auditing standards. DGS' Audit Section staff will work with the OP in this process.

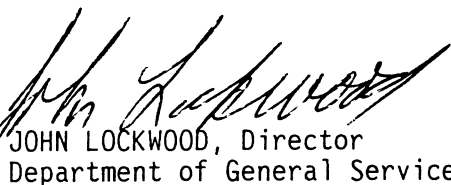
While the DGS concurs with the need to improve the OP reviews based on audit standards, it believes the current review approach is in compliance with Public Contract Code Section 10333. This section does not define the term audit as being in conformance with generally accepted auditing standards. Further, Section 1236 of the Government Code referenced in the audit report applies to internal audit activities within the DGS and not to the external audit activities performed by the OP of other State agencies.

It should also be noted that the DGS' Audit Section's comprehensive external compliance audits of other State agencies include an extensive review of activities delegated by the OP. To date, the results of the Audit Section's twenty audits that have been either completed or are in-progress have in the great majority of cases shown that the OP reviews have identified all significant areas of noncompliance and that corrective action has been taken by the reviewed agency.

CONCLUSION

The DGS has a firm commitment to providing efficient and effective oversight of the State's contracting program. As part of its continuing efforts to improve policies and procedures 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.



JOHN LOCKWOOD, Director
Department of General Services

JL:RG:kg

**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
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