

Departments: Many Do Not Comply With Consultant Contract Requirements

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Summary

Results in Brief

Departments do not always adhere to the requirements of the California Public Contract Code and other state regulations that apply to consultant contracts. In fact, we found significant areas of noncompliance.

Our review of 19 state departments found that:

- 55 percent of the 1,688 consultant contracts awarded were sole source;
- Not all consultant contracts provide adequate documentation to justify the cost of sole-sourcing;
- Several departments' annual reports for consulting contracts failed to disclose required information, such as the type of bidding used or the justification for sole-sourcing;
- Certain departments did not always adhere to legal requirements for consultant contracts, such as approval prior to commencement of work, reviewing credentials of potential contractors, and providing contractor evaluations after completion of work; and
- Faithful performance bonds were not always obtained from contractors as required for certain electronic data processing (EDP) or telecommunication goods and service contracts.

Further, the Department of General Services (DGS) did not ensure that departments complete internal audits of their contracting programs and submit reports to DGS as required.

Finally, we found that California State University (CSU):

- Is deficient in complying with its own requirements to provide adequate documentation to justify contracts exempt from competitive bidding;
- Does not always obtain approval before the contractor starts work; and
- Does not provide adequate guidance in its State University Administrative Manual to ensure that campuses award and manage contracts in the best interest of the State.

Specifically, we reviewed 19 state departments' annual reports of their consultant contracts and found that some failed to indicate the type of bidding used for certain contracts. The annual reports did not always meet the requirement to identify sole-source contracts. In addition, 8 departments either did not submit a fiscal year 1993-94 annual report, as required, or submitted it late to DGS.

A total of 12 sole-source contracts in our sample from 6 departments did not have adequate documentation to justify the contract costs. We also found that 23 contracts from 12 departments did not have the necessary approval before work began.

Eight departments failed to review prior evaluations of contractors before approving 22 contracts in our sample. Six departments did not prepare prompt post-evaluations for 6 of the contracts reviewed. Two departments failed to obtain performance bonds from contractors when making progress payments on certain types of contracts for EDP or telecommunication goods and services.

Finally, DGS did not ensure that two departments met all of the conditions to retain the contracting authority that was delegated to them.

DGS is responsible for providing administrative oversight of state departments entering into consultant contracts to ensure they comply with applicable state laws and regulations. However, DGS is not responsible for providing this type of administrative oversight to CSU.

We reviewed four contracts at CSU that were not competitively bid. None of the contracts contained sufficient evidence to indicate that they were exempt from the competitive bidding requirements. Further, one of the four did not have the necessary approval before contract work began.

Recommendations

State departments should:

- Obtain required approvals before a contractor begins work to ensure they do not expose the State to potential financial liability for work performed if the contract is not approved;
- Document that a review of the contractor's prior evaluation was performed to ensure that new contracts are not awarded to contractors whose prior work for the State was substandard;
- Complete evaluations of contractor performance promptly so that information about contractor performance and contract usefulness can be reviewed before other contracts are awarded; and
- Secure a performance bond when making progress payments on contracts for EDP or telecommunication goods and services that are not suitable for sale to others to ensure the State is protected from potential loss;

The Department of General Services should:

- Re-emphasize the requirements of Section 10359 of the California Public Contract Code to ensure that state departments provide all of the information required in their annual report of consultant contracts;
- Require departments to provide sufficient documentation to justify the costs of all sole-source contracts before they are approved; and
- Ensure that departments submit internal audit reports of contracting programs by the due dates specified by DGS.

California State University should:

- Comply with the requirements in the State University Administrative Manual regarding adequate justification on contracts exempt from competitive bidding requirements to ensure that state funds are protected from misuse and to stimulate competition in a manner conducive to sound fiscal practices;
- Submit contracts to the appropriate CSU officials in time for contracts to be reviewed and approved before work is begun; and
- Re-evaluate and improve its guidelines for contracting included in its State University Administrative Manual.

Agency Comments

In its response to this report, the DGS states that it has a firm commitment to provide efficient and effective oversight of the State's consultant contracting program. As a 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.

Twelve of the 19 departments whose contracts we reviewed also responded to this report. The Chancellor of the California State University also provided a response to the report. These departments and the California State University generally concur with the findings and recommendations of the report and have agreed to take corrective action.

Introduction

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 to specific questions to the design of a system or conducting seminars, workshops, and conferences. This section also identifies certain types of contracts that do not fit into the consultant category, including contracts between state agencies and the federal government, contracts with local agencies, and contracts for architectural and engineering services. The California Public Contract Code, Section 10356, describes consultant contracts as providing services of an advisory nature, such as providing a recommended course of action. Consultant contracts usually result in the delivery of a report that is related to the governmental functions of state agency administration and management. Consultant contracts are obtained by awarding a procurement-type contract, a grant, or any other form of payment for services of the above type.

California law places additional requirements on state departments when using consultant contracts. For example, departments must prepare an annual report on their consultant contracts, disclosing the amount of each contract, the method of bidding, the reasons for any sole-source consultant contracts, and other information. In addition, consultant service contractors are explicitly prohibited from rendering services before the contract is approved, unlike other contractors who must only be notified they are at risk.

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. For example, departments must comply with requirements for advertising the availability of contracts, soliciting bids from potential contractors, evaluating the bids, writing the contracts in conformity with state requirements, obtaining the appropriate approvals, approving payment for services, and completing an evaluation when the contract is completed.

The California Public Contract Code generally assigns to the Department of General Services (DGS) the duty of reviewing and approving contracts entered into by state departments for consultant services. Although the law assigns these duties to DGS, the State Administrative Manual generally exempts consultant contracts under \$15,000.

In addition to its responsibilities for ensuring compliance with legal provisions for each contract submitted for its approval, DGS 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. These procedures are designed to aid public officials in the efficient and, to the maximum extent possible, uniform administration of public contracting for consultant services. In addition, DGS periodically performs management audits of contracting units in other state departments. DGS also maintains a central depository of negative contractor evaluations and makes them available to other departments upon request.

DGS, however, does not provide oversight responsibility for the contracting program of California State University (CSU), nor does it review or approve its contracts. Because of a change in law effective January 1994, CSU is no longer required to submit consultant contracts worth more than \$100,000 to DGS for review and approval. Instead, CSU's Chancellor's Office provides contract management guidance to its campuses as directed in Sections 2400 and 2500 of its State University Administrative Manual, which generally mirrors requirements in the State Administrative Manual. However, we noted several deficiencies within the State University Administrative Manual that we discuss in Chapter 4 of this report.

Scope and Methodology

This audit fulfills the fiscal year 1993-94 requirements of Chapter 1044, Statutes of 1990. These statutes require the Office of the Auditor General to evaluate the State's compliance with state laws and regulations for consultant contracts annually. The Bureau of State Audits assumed the responsibility for these audits pursuant to the Government Code, Section 8546.8.

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 provisions and policies pertaining to this type of contract. We determined compliance with these laws and policies by reviewing consulting contracts at 19 state departments. The 19 departments entered into a total of 1,688 consultant service contracts during 1993-94 totaling approximately \$91.2 million. We reviewed some of these contracts for appropriate contract language and provisions, supporting documentation, and approvals. We reviewed both contracts departments had classified as consultant services and other services to determine if the departments had appropriately classified the contracts.

We reviewed the California Public Contract Code and the State Administrative Manual and identified those provisions and policies applicable to sole-source contracts. We also interviewed department personnel to identify additional policies for approving sole-source contracts. We examined sole-source contracts (55 percent of total consultant contracts reported for the year) at 19 state departments and assessed the propriety of approval and cost justification.

To determine whether DGS had fulfilled its responsibilities to oversee state departments with delegated authority to purchase consultant services, we reviewed the California Public Contract Code and the State Administrative Manual and identified provisions and policies applicable to this delegated authority. Further, we obtained status reports of the state departments' internal audits from DGS and determined the timeliness of the internal audits as of the date of our review.

To evaluate CSU's compliance with the laws and policies governing the use of sole-source contracts, we reviewed the State University Administrative Manual and identified the provisions and policies pertaining to entering into and approving sole-source contracts. We determined compliance with these policies by reviewing four sole-source consultant contracts and examining approvals and justifications for using sole-source contracts.

Finally, to determine if the campuses had adequate guidance to enable them to conduct contracting practices that are in the best interest of the State, we compared the policies and guidelines for consultant contracts in the State University Administrative Manual to the policies in the State Administrative Manual.

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Chapter 1

Many Consultant Contracts Are Sole-Sourced

Chapter Summary

The California Public Contract Code and the State Administrative Manual permit the limited use of sole-source contracts, which are exempt from competitive bidding and, frequently, advertising requirements. At the 19 departments we visited, 55 percent of the 1,688 consultant contracts awarded were sole-source. The departments cited a variety of reasons for using a sole-source for the contract. The most commonly cited reason was that the contract required specialized services from the contractor.

Each year state departments are required to prepare a report of consultant contracts, indicating the type of bidding used for each contract. In this report, the departments are to identify the sole-source contracts entered into during the year along with an explanation of why only one vendor was considered to provide the required services. We found that state departments do not always comply with these reporting requirements. Specifically, some departments did not clearly disclose the type of bidding used for each contract, and other departments did not clearly indicate why some contracts were sole-source.

The California Public Contract Code allows the Department of General Services (DGS) to establish conditions under which a contract may be awarded without competition. One such condition is that the departments justify the appropriateness or reasonableness of the cost of a sole-source contract. This condition is included in the State Administrative Manual. We found that 12 of the 74 sole-source contracts we reviewed did not contain adequate documentation to justify the cost.


Reasons for Sole-source Contracting

The California Public Contract Code and the State Administrative Manual permit the limited use of sole-source contracts, which are exempt from competitive bidding and, frequently, advertising requirements. The following are examples of contracts exempt by the State Administrative Manual:

- 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 California State University (CSU) 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.

Figure 1 shows the California Public Contract Code's provisions for allowing sole-source contracting.

The California Public Contract Code, Sections 10373 and 10380, also allows DGS to establish additional conditions under which a contract may be awarded without competition. Figure 2 depicts these additional conditions.

 *Departments are required to justify the cost of all sole-source contracts.*

Finally, the State Administrative Manual, Section 1236, requires state departments to justify to DGS the appropriateness or reasonableness of the costs of contracts awarded without competition. 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 costs under the contract.

Figure 1

**Criteria for Sole-source Contracting
California Public Contract Code
Section 10373**

A contract can only be awarded without a minimum of three bids when it meets one of the following criteria:

- In cases of emergency when a contract is necessary for the immediate preservation of the public health, welfare, safety, or protection of state property;
- When the department awarding the contract has advertised the contract in the California State Contracts Register and has solicited all potential contractors known to the department but has received less than three bids or proposals; and
- When the contract is with another state department or with a local government entity.

Figure 2

**Additional Criteria for Sole-source
Contracting Prescribed by DGS**

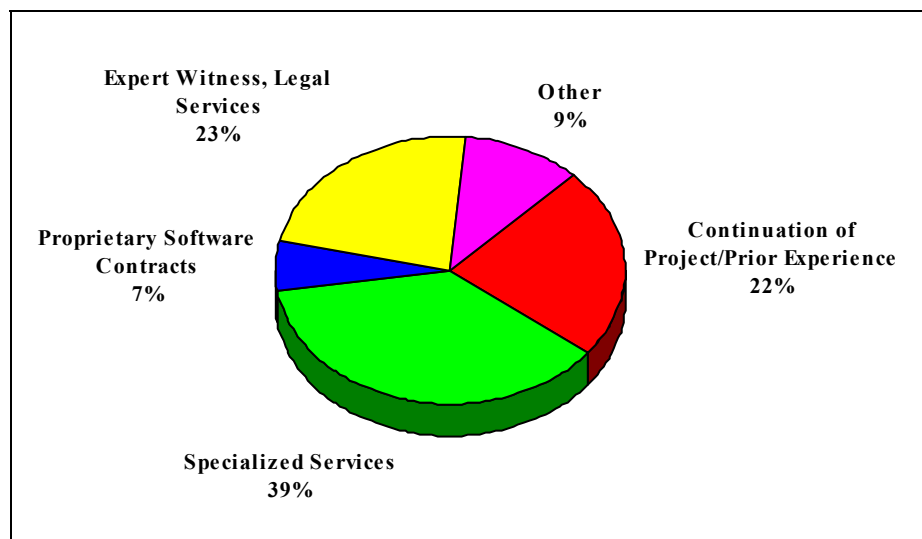
- DGS agrees there is only a single source for the services and approves a request for exemption from competitive bidding.
- The director of DGS determines that the State's best interests are better served by exempting a contract from competitive bidding.

As Table 1 on page 10 indicates, the 19 departments we selected for review reported that 1,688 consultant contracts were entered into during the fiscal year. Of these, 924 (55 percent) were sole-source contracts. Departments use sole-source contracting for a variety of reasons. However, as Figure 3 indicates, they frequently use similar justifications. For example, 29 of the 74 sole-source contracts (39 percent) we reviewed were justified as specialized services that could only be provided by one contractor. In addition, 17 of the 74 sole-source contracts (23 percent) were successfully justified on the basis that services rendered were for expert witnesses for litigation, legal defense, legal advice, or legal services. The State Administrative Manual specifically exempts contracts for obtaining expert witnesses for litigation, legal defense, legal advice, or legal services from competitive bidding requirements.

Figure 3

Reasons for Sole-source Contracting

Another common justification for sole-source contracting was prior experience with a particular project that made the contractor uniquely qualified to continue. For 16 of the 74 sole-source contracts (22 percent) we reviewed, the reason used to justify sole-source contracting was the contractor's prior experience or continuation of prior services.



Failure to Comply With Reporting Requirements

The California Public Contract Code, Section 10359, requires each state department to prepare an annual report that lists the consultant contracts it has entered during the fiscal year and the type of bidding

used for each contract. State departments are also required to identify those contracts that were not competitively bid and indicate why the contracts were sole-source.

Departments do not always comply with reporting requirements.

As Table 1 indicates, 5 of the 19 departments did not disclose in their annual reports the type of bidding entered into for certain consultant contracts. For example, of the 100 consultant contracts that the Department of Developmental Services entered into during fiscal year 1993-94, the department did not indicate the type of bidding used for 80 contracts. Furthermore, 3 of the 19 departments that did indicate the type of bidding used for their consultant contracts did not provide justification for 26 sole-source contracts. For example, of the 49 sole-source consultant contracts DGS entered into during the fiscal year, it did not indicate why 24 were sole-source awards.

If departments do not disclose the type of bidding used for each contract or the reason for using sole-source contracts in their annual reports, the State cannot be assured that departments are using the most effective type of bidding or that contracts awarded without competition are in the best interest of the State.

Lack of Cost Justification

Departments did not always provide adequate documentation to justify the costs of sole-source contracts. We reviewed 99 consultant contracts for fiscal year 1993-94 at 19 departments. As Table 2 below indicates, 74 were sole-source contracts, and the departments did not have sufficient documentation to justify the costs for 12 of them.

The State Administrative Manual, Section 1236, requires departments to justify the appropriateness or reasonableness of the costs of all sole-source contracts. In spite of this, 10 of the 12 sole-source contracts that lacked cost justification were approved by DGS. The remaining 2 contracts were exempt from DGS approval and were approved by officials within the contracting departments.

Table 1
**Consulting Contracts Entered Into
During Fiscal Year 1993-94 as
Reported by Departments Reviewed**

Departments	Total Number of Consultant Contracts Reported	Number of Contracts Reported as Sole-Source	Number of Sole-source Contracts Lacking an Explanation	Number of Contracts With Type of Bidding Not Disclosed
California Community Colleges, Chancellor's Office	16	10		
Conservation, Department of	12	4		
Corrections, Department of	19	12	1	
Developmental Services, Department of	100	15		80
Education, Department of	476	33*		1
Employment Development Department	18	12		
Franchise Tax Board	12	9		
General Services, Department of	154	49	24	1
Health Services, Department of	19	16		
Health & Welfare Data Center	1	1		
Justice, Department of	392	392		
Mental Health, Department of	36	29		2
Motor Vehicles, Department of	7	4		
Rehabilitation, Department of	1			
Social Services, Department of	55	25		
State Controller's Office	7	3		2
Stephen P. Teale Data Center	5	5		
Transportation, Department of	322	282		
Water Resources, Department of	29	23	1	
Total	1,688	924	26	91

Note: The information in this table is based on the departments' annual consultant contract reports. The information reflects data reported for contracts entered into during fiscal year 1993-94 only and excludes amended and completed contracts that were entered into in prior years. We did not audit the accuracy of the departments' reports.

* The Department of Education did not provide a list that clearly identified its sole-source contracts for fiscal year 1993-94. As a result, we estimated the number of sole-source contracts based on information provided to us by the department's contract manager.

Table 2

Lack of Cost Justification for Sole-source Contracts

* The 11 contracts reviewed at the Board of Governors includes 6 sole-source contracts which we reviewed only for compliance with laws and policies applicable to sole-source contracts.

Conclusion

The 19 departments we reviewed used sole-source contracting approximately 55 percent of the time. Similar justifications for using sole-source contracts were often used. The most commonly used justifications were:

- The contract required specialized services;
- The contract was for expert witnesses for litigation, legal defense, legal advice, or legal services; or
- The contractor had prior experience.

Departments	Number of Contracts Reviewed	Number of Sole-source Contracts Reviewed	Lack of Cost Justification for Sole-source Contracts
California Community Colleges, Chancellor's Office	11*	10	4
Conservation, Department of	5	3	2
Corrections, Department of	5	3	1
Developmental Services, Department of	5	4	
Education, Department of	5	3	
Employment Development Department	5	2	
Franchise Tax Board	5	4	
General Services, Department of	8	6	1
Health Services, Department of	8	7	
Health & Welfare Data Center	1	1	
Justice, Department of	5	5	
Mental Health, Department of	5	5	3
Motor Vehicles, Department of	5	4	
Rehabilitation, Department of	1		
Social Services, Department of	5	3	
State Controller's Office	5	3	1
Stephen P. Teale Data Center	5	5	
Transportation, Department of	5	2	
Water Resources, Department of	5	4	
Total	99	74	12

We found that some departments failed to prepare annual reports on consultant contracts that include information on the type of bidding, which ones are sole-source, and an explanation for considering only one contractor, all required by the California Public Contract Code. In addition, we found that departments did not always provide adequate documentation to justify the costs of sole-source contracts as required. If departments do not sufficiently justify the appropriateness or reasonableness of the costs of contracts that are awarded without competition, the State could be paying more for services than necessary.

Recommendations

DGS should re-emphasize the requirements of Section 10359 of the California Public Contract Code to ensure that departments clearly identify in their annual reports on consulting contracts

the type of bidding entered into for all consultant contracts and explain why only one contractor was considered for each sole-source contract.

To ensure that the costs of sole-source contracts are adequately justified, DGS should require departments to provide sufficient documentation before they are approved.

Chapter 2

Departments Do Not Always Comply With Legal Requirements

Chapter Summary

We found that certain state departments did not always adhere to legal requirements for reviewing and approving consulting contracts. Specifically, some departments failed to comply with the requirements that: contracts be approved before work is begun; contracting departments review prior evaluations of contractors being considered for new contracts and review resumes of persons expected to perform contract work; departments prepare contractor evaluations within 60 days of the completion of the contract; and annual reports be submitted promptly to the Department of General Services (DGS). Table 3 on page 14 lists the 19 state departments at which we reviewed consultant contracts and indicates the areas of noncompliance that apply to each.

We also found that certain state departments failed to comply with the requirement for obtaining performance bonds when making progress payments on some contracts for electronic data processing (EDP) or telecommunication goods and services.

Lack of Contract Approval Before Start of Work

Of the 93 contracts we reviewed, 23 were not approved before contract work began. Of these 23 contracts, 17 did not have the required approval by DGS before contract work began. The remaining 6 contracts were exempt from DGS approval but did not have the appropriate department personnel approval before the contractor began work. For example, 3 of the 5 contracts reviewed at the Department of Justice did not have the required approval before work began. In fact, one of the 3 contracts was approved more than four months after the contractor began work. In addition, at the Department of Corrections, a contract was approved more

than six months late and one contract at the Employment Development Department was approved almost seven months after services began.

Table 3

***Noncompliance With Requirements
for Consultant Contracts***

Departments	Number of Contracts Reviewed	Dollar Amount of Contracts Reviewed	Lack of Approval Before Start of Work	No Review of Post- Evaluation Before Contract Approval	No Review of Resumes Before Contract Approval	Late Post- Evaluations	No Annual Report or Report Submitted Late
California Community Colleges, Chancellor's Office	5	\$ 698,275	2				1
Conservation, Department of	5	725,245	3	3	3		
Corrections, Department of	5	421,374	1			1	
Developmental Services, Department of	5	1,494,908	2				1
Education, Department of	5	252,500		1			
Employment Development Department	5	838,277	2				1
Franchise Tax Board	5	1,195,415		1			1
General Services, Department of	8	385,340	1	2			
Health Services, Department of	8	892,470	1	3	3	1	1
Health & Welfare Data Center	1	3,283,500					
Justice, Department of	5	39,100	3	5		1	1
Mental Health, Department of	5	1,287,763	1			1	1
Motor Vehicles, Department of	5	604,247		2		1	
Rehabilitation, Department of	1	100,000					
Social Services, Department of	5	128,965	2				
State Controller's Office	5	497,000					
Stephen P. Teale Data Center	5	900,790	3			1	
Transportation, Department of	5	780,095		5			
Water Resources, Department of	5	8,415,000	2				1
Total	93	\$22,940,264	23	22	6	6	8

The State Administrative Manual, Section 1215, requires DGS approval for all contracts worth more than \$15,000. In addition, the California Public Contract Code, Section 10371(d), and the State Administrative Manual, Section 1209, require that, except in an emergency, work on a consultant contract not be started before DGS or appropriate contracting department personnel grant formal approval. In this context, Section 10371(d) defines an emergency as a situation in which the use of contracted services appears to be reasonably necessary, but, as determined by DGS, time does not allow prior formal approval of the contract. Section 10360 is more

emphatic in defining the effective date of consulting services, stating that all consultant contracts are of no effect unless and until approved by DGS.

The Bureau of State Audits reported this weakness for fiscal years 1991-92 and 1992-93, and the Office of the Auditor General has reported similar findings about the State's administration of all types of contracts for several years.

By not ensuring that contracts are approved before services begin, departments cannot be assured that state interests are protected. For example, a department's failure to obtain contract approval before the contractor begins work exposes the State to potential financial liability for work performed if the contract is never approved.

Failure To Review Contractor Evaluations and Resumes and Late Preparation of Post-Evaluations

Some state departments fail to comply with requirements to review prior evaluations of contractors being considered for new contracts and to review resumes of persons expected to perform the work.


—◆—
Departments failed to review post-evaluations for 22 of the 93 contracts reviewed.

As Table 3 on page 14 indicates, 8 of the 19 departments we reviewed did not consistently comply with statutory requirements to review contractor evaluations on file with DGS. Specifically, the departments failed to review post-evaluations for 22 of the 93 contracts reviewed. Two of the 8 departments had not reviewed post-evaluations for any of the contracts reviewed. For example, neither the Department of Transportation nor the Department of Justice could provide us evidence that they had looked at evaluations on any of the 5 contracts we reviewed in each department. When negative evaluations are not reviewed, contracts may be approved even though prior work performed by that contractor was substandard.

The California Public Contract Code, Section 10371(e), and the State Administrative Manual, Section 1281, require that no consultant service contractor be awarded a contract totaling \$5,000 or more unless the state department has reviewed any contractor evaluation on file with DGS and has required, as part of the contract, a completed resume for each participant who will exercise a major role in the completion of the contract. In addition, DGS

must notify departments seeking approval of a proposed contract within ten working days of any negative evaluations 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 end of the contract a post-evaluation of each consultant contract totaling \$5,000 or more. Negative evaluations are to be submitted to DGS, which must keep copies on file for 36 months. DGS acts as the central depository for all state agencies making negative evaluations or needing information on a contractor's negative performance record with the State. The California Public Contract Code, Section 10371(h), states that DGS 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.

 We also found that departments often do not prepare evaluations of contractors' performance promptly. Six of the 19 departments failed to complete all contractor evaluations within 60 days of contract completion. Evaluations help to protect the interests of the State in awarding contracts. A post-evaluation assesses the contractor's performance in conducting the work or delivering the services specified in the contract, evaluates the contract's usefulness, and provides state departments with information to determine whether a potential contractor has satisfactorily completed previous state contracts.


Six of 19 departments did not complete all contractor evaluations within the required time limit.

Missing and Late Annual Reports

The California Public Contract Code, Section 10359, requires each state department to prepare an annual report that, among other things, lists the consultant contracts the department entered into during the fiscal year. Copies of the report are to be submitted within 30 working days after the end of the fiscal year to DGS, several other state departments, and legislative committees. However, some state departments failed to comply with this requirement. For example, as shown on Table 3 (page 14), 8 of the 19 state departments we reviewed either did not submit an annual report or submitted it late.

Lack of Performance Bonds

Some departments did not always comply with the requirement to obtain performance bonds from contractors when making progress payments on certain types of contracts for EDP or


*Certain EDP contracts
require faithful
performance bonds.*

telecommunication goods and services. The California Public Contract Code, Section 12112, states that contracts for EDP or telecommunication goods and services that are manufactured or performed especially for the State and not suitable for sale to others may provide for progress payments if the following two conditions are met:

- A department must withhold not less than 10 percent of the contract price until final delivery and acceptance of the goods or services; and
- The contractor must submit a bond in a sum not less than one-half of the total amount payable under the contract, securing faithful performance of the contract by the contractor.

Specifically, two departments failed to obtain a faithful performance bond from the contractor for four of the ten contracts reviewed in those departments. Specifically, three out of the five contracts reviewed at the Teale Data Center and one of the five contracts reviewed at the Department of Developmental Services were for either EDP or telecommunication goods and services and met the criteria for requiring performance bonds. However, the departments failed to obtain faithful performance bonds on the four contracts.

Failure to obtain faithful performance bonds on EDP or telecommunication goods and service contracts exposes the State to potential losses that could be substantial when contracting for these types of goods and services.

Conclusion

State departments are not consistently complying with certain legal requirements for consulting contracts. We found that some departments did not have all contracts approved before work began, exposing the State to potential financial liability if the contract was not approved. We also found that some departments did not review prior evaluations or resumes of contractors being considered for new contracts. Contractors whose prior work for the State was substandard could be awarded additional contracts.

In addition, state departments were deficient in completing timely contractor evaluations and in preparing annual reports. Timely evaluations ensure that contractors have satisfactorily performed the work and provide assessment on the usefulness of the contract.

Finally, two departments did not comply with the requirements for obtaining performance bonds when making progress payments on certain types of contracts. Performance bonds protect the State from potential losses on contracts for goods or services not suitable for sale to others.

Recommendation

To ensure that they do not expose the State to potential financial liability for work performed if the contract is not approved, state departments should ensure that their consultant contractors do not perform work or provide services before the contract is approved.

To ensure that contracts are not awarded to contractors whose prior work for the State was substandard, departments should document that a review of the contractor's prior evaluation was performed.

To ensure that a contractor has satisfactorily completed a contract and to assess whether a contract was useful and delivered the services called for, departments should complete contractor evaluations promptly.

To protect the State from potential substantial losses on contracts for EDP or telecommunication goods and services that are not suitable for sale to others, departments should secure a performance bond when making progress payments on these types of contracts.

Chapter 3

DGS Did Not Ensure That All Required Audits Were Conducted

Chapter Summary

The Department of General Services (DGS) oversees the contracting practices of all state departments. As part of this responsibility, DGS is able to delegate contracting authority to those departments that it determines capable of the effective use of such authority. Departments with delegated contracting authority may conduct the entire procurement process, including final contract approval for competitive acquisitions of goods and services.

We found that DGS did not ensure that two departments met all of the conditions to retain the contracting authority that has been delegated to them. For departments to retain the contracting

authority delegated by DGS, the California Public Contract Code requires departments to submit copies of audit reports to DGS. The California Public Contract Code also states that delegated authority may be withdrawn at any time if DGS finds that the department is not in compliance with the conditions that accompany the delegated authority.

Two Departments Did Not Submit Their Audit Reports, As Required

In a departure from control procedures over the State's contracting process, the DGS did not ensure that two departments conduct an internal audit of their contracting activity and report the results of the audit to DGS as required by the California Public Contract Code, Section 10364.

This section states that DGS may exempt departments from the requirement that it approve their consulting services contracts under \$50,000. However, to retain the exemption, state departments must fulfill all of the requirements of Section 10364, including conducting an audit of their contracting program every two years and reporting the results to DGS. The California Public Contract Code, Section 10365, requires DGS to conduct a quality control review of these internal audits.

As of April 1995, DGS issued delegation authority for consulting contracts under \$50,000 to eight departments. However, two of the eight departments, the Departments of Food and Agriculture and Pesticide Regulation, had not completed their internal audits and submitted a copy of the audit report to DGS by March 31, 1994, the date specified by DGS. In June 1995, after the end of our field work, DGS received the internal audit reports from both departments.

DGS cannot be assured that state departments are exercising effective use of delegated purchase authority or procuring consulting contracts in the best interest of the State if the required audits of the contracting programs are not conducted and submitted to DGS timely.

Recommendations

To ensure that departments are exercising the authority to purchase consulting services effectively, DGS should promptly follow-up with those departments that have not submitted their internal audit reports.

Chapter 4

California State University: Deficiencies in Awarding and Managing Consultant Contracts

Chapter Summary

We reviewed four sole-source contracts at a California State University (CSU) campus and found the campus failed to comply with certain requirements of the State University Administrative Manual. For example, none of the four contracts contained evidence that they were exempt from the competitive bidding requirements in the State University Administrative Manual, nor did the contracts contain a justification for only considering a sole-source for services or a statement explaining why the State's interests were better served by approving a sole-source contract. In addition, one of the four contracts did not have the appropriate approval before the contractor started work.

As part of our review, we compared the policies and guidelines for consulting contracts in the State University Administrative Manual to the policies in the State Administrative Manual to determine if the campuses had adequate guidance to conduct contracting practices in the best interest of the State. We concluded that the State University Administrative Manual does not provide guidance in several areas that in our view are important to ensure the campuses are awarding and managing contracts in a prudent manner. For example, this manual does not require CSU to justify the costs of sole-source contracts. However, the manual does require CSU to provide information in sufficient detail to justify the approval of a sole-source for services or a statement explaining why the State's interests are better served by an exemption from competitive bidding.

Except for specified types of contracts that require the CSU Chancellor's Office's approval, such as sole-source contracts over \$100,000, the State University Administrative Manual does not require that CSU contract amendments be in writing. One of the four contracts we reviewed was amended, but there was no documented evidence of the amendment in the contract file. The manual also does not require the review of negative contractor evaluations prior to awarding new contracts. Finally, the manual does not require campuses to prepare an annual report of their consulting contracts identifying the type of bidding used and the sole-source contracts entered into during the year.

Background

CSU is not required to comply with the Public Contract Code for consultant contracts.

CSU is not required to comply with sections of the California Public Contract Code that apply to consultant contracts. Instead, it complies with the policies and procedures of its State University Administrative Manual. Generally, the State University Administrative Manual policies and guidelines mirror those of the State Administrative Manual. However, we found certain sections of the State University Administrative Manual related to awarding and managing contracts were deficient when compared to the laws and policies in the California Public Contract Code and State Administrative Manual governing other state departments.

Before January 1994, the Department of General Services' (DGS) oversight responsibility for CSU was to review and approve contracts of \$100,000 or more. As of January 1994, CSU is no longer required to submit any of its contracts to DGS. CSU's Chancellor's Office does, however, require the campuses to submit contracts not competitively bid and worth \$100,000 or more, as well as other specific types of contracts, to its office for review and approval.

Lack of Sole-Source Justification and Appropriate Contract Approval

We reviewed four sole-source contracts entered into during the calendar year at one CSU campus. The campus could not provide evidence that any of the four contracts were exempt from competitive bidding requirements in the State University Administrative Manual, nor did the contract file contain a justification for restricting the selection to a sole-source, or an explanation why the State's interests were better served by approving a sole-source contract.

The State University Administrative Manual, Section 2530, provides a list of the types of contracts that are exempt from competitive bidding requirements. For example:

- Cases of emergency where a contract is necessary for the immediate preservation of public health, welfare or safety, or protection of state property;
- To obtain expert witnesses for litigation; and
- When the campus has determined there is but a single source for the service or an exemption is in the best interest of the State.

To receive approval for a sole-source contract, the campus must explain why there is but a single source for the service or why the State's interests are better served by the exemption.

Without sufficient justification for the use of sole-source contracts, CSU could be restricting competition for contracts. Because the State University Administrative Manual does not require campuses to justify the costs of sole-source contracts, the State could be paying more for services than necessary, and the services rendered may not be the best available.

The State University Administrative Manual, Section 2510.03, requires that work shall not commence until the contract has been approved by the appropriate authority, except in cases of emergency to protect human life or state property. However, one of the four contracts we reviewed was not approved before the contractor started work. CSU's failure to obtain contract approval before the contractor begins work exposes the State to potential financial liability for work performed if the contract is never approved.

Inadequate Guidance in the State University Administrative Manual

We reviewed the policies and guidelines in the State University Administrative Manual for consulting contracts and compared them to the policies in the State Administrative Manual to determine if the campuses had adequate guidance to conduct contracting in the best interest of the State. We concluded that the State University Administrative Manual is deficient in several important areas that in our view would aid the campuses in awarding and managing contracts in a prudent manner.

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The State University Manual does not require written contract amendments.

Except for specified types of contracts that require the CSU Chancellor's Office's approval, such as sole-source over \$100,000, the State University Administrative Manual does not require that CSU contract amendments be in writing. The scope of work for one of the four contracts we reviewed was changed without any written amendment. A letter from the contractor indicated that a change in the scope of work occurred. Furthermore, a campus official admitted that she verbally agreed to a change in the contract performance requirements. However, the contract file did not contain a written amendment authorizing the change to the contract.

Prudent business practices require that contract amendments be in writing. By not requiring this, CSU may not be clear on the terms and conditions of any new agreement it has established with the contractor. This in turn could expose CSU to financial losses by paying for contract work never performed.

—◆—
The University Manual also does not require review of negative contractor evaluations.

The State University Administrative Manual also does not require that campuses review negative contractor evaluations prior to the awarding of new contracts. This could result in CSU contracting with parties whose prior performance was substandard. By way of comparison, the State Administrative Manual requires that no consultant contractor be awarded a contract totaling \$5,000 or more unless the department has reviewed any negative contractor evaluation on file with DGS.

Finally, the State University Administrative Manual does not require campuses to prepare a report of consulting contracts entered into during the year. As a result, oversight of campus contracting practices by the Chancellor's Office is limited. For example, the Chancellor's Office cannot determine whether the number of contracts awarded without competition is reasonable or justified, or whether campuses are contracting with firms or individuals whose prior work was substandard. As discussed in Chapter 1, state laws and regulations require other departments to prepare an annual report that includes a list of the consultant contracts entered into during the fiscal year, identifies all sole-source contracts entered into, and indicates the type of bidding used for other consultant contracts.

Conclusion

Although the State University Administrative Manual does not require that campuses justify the costs, the manual does require justification for the use of sole-source contracts. However, the CSU campus we reviewed failed to comply with this requirement. In addition, CSU did not always comply with the requirement to obtain contract approval before work started. Finally, CSU does not provide adequate guidance in its State University Administrative Manual to help ensure the campuses are awarding and managing contracts in the best interest of the State.

Recommendations

To ensure that state funds are protected from misuse, to stimulate competition in a manner conducive to sound state fiscal practices, and to avoid favoritism, fraud, and corruption in the awarding of state contracts, CSU should comply with the requirements in the State University Administrative Manual regarding adequate justification of contracts that are exempt from competitive bidding requirements.

Further, CSU should obtain approval of contracts before the contractor begins work.

Finally, to ensure that CSU campuses have sufficient guidance when procuring consultant services, CSU should address the deficiencies in its State University Administrative Manual.

We conducted this review under the authority vested in the state auditor by Section 8543 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 of this report.

Respectfully submitted,

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State Auditor

Date: September 12, 1995

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