# California Prison Health Care Services:

Improper Contracting Decisions and Poor Internal Controls

January 2009 Report I2008-0805

CALIFORNIA STATE AUDITOR

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# CALIFORNIA STATE AUDITOR
## Bureau of State Audits

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January 22, 2009 Investigative Report I2008-0805

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

Dear Governor and Legislative Leaders:

Pursuant to the California Whistleblower Protection Act, the Bureau of State Audits presents its investigative report concerning acquisitions of information technology (IT) goods and services by California Prison Health Care Services (Prison Health Services) with the assistance of the Department of Corrections and Rehabilitation (Corrections). When Prison Health Services discovered that some of its IT acquisitions had been made with a single vendor in 2007 and 2008 without complying with either the state contracting process or the alternative contracting processes established by a federal court, they requested that we investigate the matter.

This report concludes that staff at Prison Health Services ignored state contracting laws, as well as the alternative contracting requirements established by a federal court, when it acquired $26.7 million in IT goods and services in a noncompetitive manner from November 2007 through April 2008. Specifically, Prison Health Services used 49 purchase orders to acquire $23.8 million worth of IT goods from a single vendor when it should have sought competitive bids. It also contracted with the same vendor to provide $2.9 million in IT services again without using a competitive process. Further, staff at Corrections helped to execute the purchase orders for Prison Health Services after initially questioning the propriety of the process used. Consequently, the State cannot be certain that Prison Health Services spent $26.7 million in public funds prudently or that it received the best value for the money spent.

Respectfully submitted,

Elaine M. Howle

ELAINE M. HOWLE, CPA
State Auditor

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# Investigative Results

## Results in Brief

The California Whistleblower Protection Act empowers the Bureau of State Audits (bureau) to investigate and report on improper governmental activities by agencies and employees of the State.[1] As the entity exercising the powers vested in the secretary of the Department of Corrections and Rehabilitation (Corrections) to manage the State's prison medical health care delivery system, California Prison Health Care Services (Prison Health Services) and its employees are subject to the bureau's investigative authority in their exercise of those powers.

When Prison Health Services discovered that some of its information technology (IT) acquisitions had been made with a single vendor in 2007 and 2008 without complying with either the state contracting process or the alternative contracting processes established by a federal court, they requested that we investigate the matter.

We found that staff at Prison Health Services ignored state contracting laws, as well as the alternative contracting requirements, when it acquired $26.7 million in IT goods and services in a noncompetitive manner from November 2007 through April 2008. Specifically, Prison Health Services used 49 purchase orders to acquire $23.8 million worth of IT goods from a single vendor when it should have sought competitive bids. It also contracted with the same vendor to provide $2.9 million in IT services again without using a competitive process. Further, staff at Corrections helped to execute the purchase orders for Prison Health Services after initially questioning the propriety of the process used. Consequently, the State cannot be certain that Prison Health Services spent $26.7 million in public funds prudently or that it received the best value for the money spent.

## Background

In April 2001 in the United States District Court for the Northern District of California, prisoners filed a class action lawsuit against the State alleging that Corrections engaged in cruel and unusual punishment by providing them with inadequate medical care in the State's prisons. In June 2002 the State settled the lawsuit, *Plata vs. Schwarzenegger*, and in the settlement the State agreed to implement in its prisons comprehensive new medical care policies and procedures that would elevate prison medical care to meet

***Investigative Highlights . . .***

*California Prison Health Care Services' (Prison Health Services) staff violated legal requirements and bypassed internal controls by noncompetitively acquiring $26.7 million in information technology (IT) goods and services. Specifically, Prison Health Services:*

- *Used 49 purchase orders to aquire $23.8 million of IT goods from a single vendor without inviting competitive bids.*
- *Contracted with the same vendor to provide $2.9 million in IT services without using a competitive process.*

*Staff at the Department of Corrections and Rehabilitation ultimately executed purchase orders after initially questioning the propriety of the process used.*

[1] For more information about the bureau's investigative authority, please refer to the Appendix.

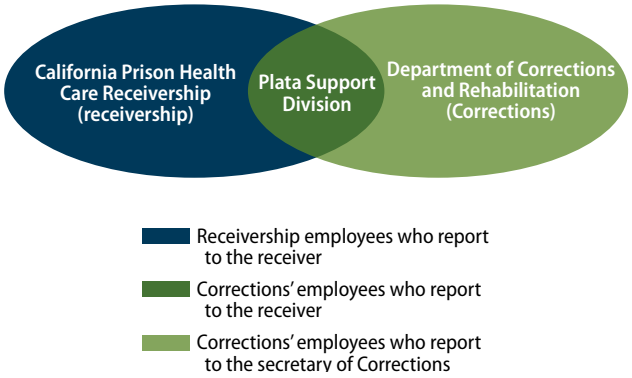
acceptable standards. Under the settlement, the court has the authority to enforce the agreement. The State attempted to fulfill this agreement from 2003 through 2005. However, in October 2005 the court found that the State "failed to achieve even a semblance of compliance." The court therefore appointed a receiver the following year to provide leadership and executive management of Corrections' prison health care system with the goals of restructuring day-to-day operations and developing, implementing, and validating a new system that provides adequate medical care to prisoners in state facilities as soon as practicable. To help achieve these goals, the court gave the receiver all powers vested by law in the secretary of Corrections as they relate to the administration, control, management, operation, and financing of California prisons' health care system. These powers encompass the authority to hire and fire Corrections' employees and to acquire and dispose of property and equipment, including IT goods and services.

To carry out this mission, the receiver established a nonprofit corporation called the California Prison Health Care Receivership Corporation (receivership) to provide executive management for the delivery of medical care in California's prisons. The Plata Support Division within Corrections, consisting largely of Corrections' employees, provides administrative support for the implementation of the receiver's projects.[2] The receiver recently began using the name Prison Health Services to describe collectively both the receivership and the Plata Support Division. Although Prison Health Services has an organizational structure independent of Corrections' management, it nonetheless relies on Corrections' employees who have remained under Corrections' management structure to perform many administrative functions, including business services and accounting.

To acquire goods and services that are needed to administer and improve California's prison health care system, Prison Health Services, with the assistance of Corrections, generally uses the established state contracting process. However, as will be discussed in greater detail later in this report, the federal court has also given Prison Health Services the authority to bypass the state contracting process and instead use certain alternative contracting processes expressly approved by the federal court for specified projects. Figure 1 illustrates the organizational relationship between the receivership, the Plata Support Division, and Corrections as it relates to acquiring goods and services.

[2] Plata is the name of the complainant in the class action lawsuit alleging that Corrections provided inadequate medical care in the State's prisons and thus failed to ensure prisoners' constitutional rights.

**Figure 1**
**The Relationship Between California Prison Health Care Receivership and the Department of Corrections and Rehabilitation**




Source: Bureau of State Audits.

As the entity exercising the powers vested in the secretary of Corrections, Prison Health Services generally must comply with state laws, regulations, and administrative policies that govern state contracting practices except to the extent that the federal court exempts it from doing so. The California Public Contract Code, sections 12100 through 12113, govern the acquisition of IT goods and services. In particular, Section 12100 requires that the Department of General Services (General Services) make or supervise the creation of all contracts for acquiring IT goods and services. Section 12104 requires that the *State Contracting Manual* (contracting manual) set forth all policies, procedures, and methods for state agencies to use when seeking bids for IT acquisitions. Further, Section 12101(c) authorizes General Services to delegate purchasing authority to those state agencies that demonstrate, to General Services' satisfaction, an ability to conduct value-effective acquisitions of IT goods and services. For fiscal year 2007–08, General Service had delegated to Corrections only the authority to purchase IT goods and services costing less than $5,000, unless the purchase was being made under an existing statewide contract.

Chapter 3 of the contracting manual describes the requirements for conducting competitive solicitations for IT goods and services and specifies that acquisitions exceeding $5,000 must be competitively bid. The contracting manual prescribes various processes to achieve competitive bidding that are dependent on the value of the contract. For IT acquisitions less than $100,000, state agencies are required to invite competitive bids by soliciting at least two responsive bids from potential vendors. For IT acquisitions exceeding $100,000, state agencies are required to solicit competitive bids by advertising the proposed acquisition through an invitation for bid or a request

for quote process and base their selection of the winning bidder on specified criteria. An invitation for bid is a request by an agency for potential vendors to submit bids on what they would charge to supply goods and/or services that will satisfy a known and detailed requirement. In a request for quote, state agencies identify a specific need and ask potential vendors for proposals to satisfy that need including the price for doing so. For IT acquisitions exceeding $500,000, state agencies are required to solicit competitive bids by advertising a formal request for proposal in which the agency puts forward a document that describes in general terms some problem to be solved or goal to be achieved, and asks for proposals that will solve the problem or achieve the goal and specify a price for doing so. Once an invitation for bid, request for quote, or request for proposal is advertised to potential vendors, bidder participation is not controlled; thus, there is no requirement regarding the minimum number of bidders that must participate before an agency may award a contract. As shown in Table 1, to comply with state law, Prison Health Services is required to seek competitive bids for any acquisition over $5,000.

**Table 1**
**Requirements for Obtaining Competitive Bids to Provide Information Technology Goods and/or Services Under the State Contracting Process**

| DOLLAR VALUE OF ACQUISITION | BID SOLICITATION METHOD | EVALUATION METHOD | ADVERTISEMENT |
|---|---|---|---|
| $5,000 to $100,000 | Informal | Oral or written response from two responsive bidders | Not required* |
| $100,000.01 to $500,000 | Informal | Invitation for bid or request for quote | Required |
| More than $500,000 | Formal | Request for proposal | Required |

Source: State Contracting Manual, Chapter 3.

* Acquisitions of IT services that exceed $4,999.99 are required to be advertised. Advertisement is not required for acquisitions of IT goods that are less than $100,000.

However, there is an exception to the competitive bidding requirements under state law for the purchase of goods and services that are available for acquisition from a vendor having an existing statewide contract. General Services has established statewide contracts for the provision of particular goods and services to state departments at a set or specified maximum price. As statewide contracts have already been competitively bid by General Services when established, and the contracts are structured to comply with California procurement laws, policies, and guidelines, state departments may purchase items identified in the contracts by simply issuing a purchase order for the items without engaging in the more cumbersome bidding processes otherwise required of state departments.

Although Prison Health Services is generally required to comply with the state laws, regulations, and administrative policies previously described that govern state contracting practices, it also has been given special authority by the federal court to bypass those requirements when acquiring goods and services for certain projects, provided that it complies with an alternative set of requirements intended to be more expeditious than normal state contracting requirements while still preserving essential elements of transparency and competitive bidding.

Specifically, in June 2007, the federal court concluded that the state contracting process adversely affected the receiver's ability to implement necessary, timely remedial measures that would provide adequate medical care in the State's prisons. Consequently, the federal court issued a waiver of state contracting laws for specific projects. The federal court approved the receiver's request for a waiver in order to expedite institutional and medical reform. In granting the waiver, the federal court recognized the receiver's need to act promptly and effectively while preserving the fundamental purposes of the State's contracting laws, such as preventing fraud and corruption, ensuring transparency and procedural fairness, and protecting the public interest. The federal court therefore ordered that when he does not follow state contracting rules, the receiver must nonetheless follow one of three alternative contracting processes: expedited formal bid, urgent informal bid, or sole source.

Table 2 describes the relevant requirements of each of these alternative contracting processes. Most noteworthy, both the expedited formal bid and urgent informal bid processes require the receiver to follow a competitive bidding procedure. The sole-source process allows Prison Health Services to select a single vendor to meet its needs without seeking other bids, but the use of this process is limited to when only one vendor can provide the goods or services required for the project.

**Table 2**
**Alternative Contracting Processes Approved by the Federal Court for the Purchase of Goods and Services for California Prison Health Care Services**

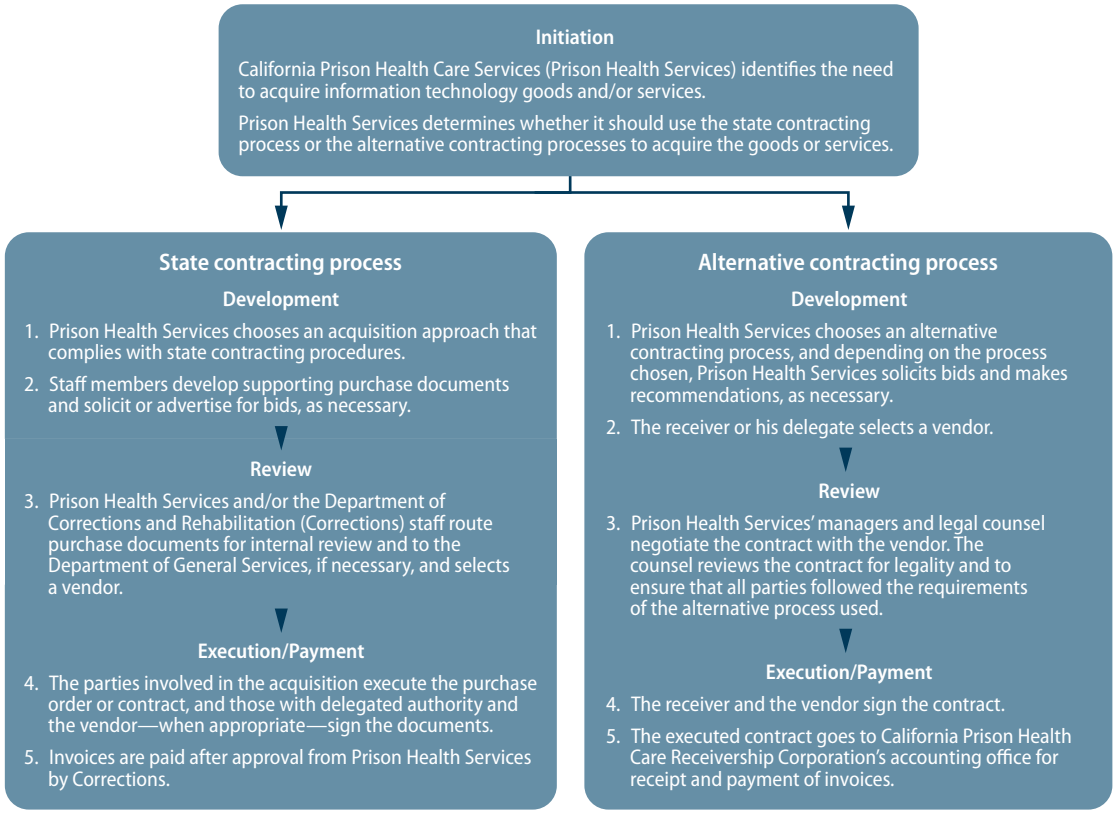
| ALTERNATIVE CONTRACTING PROCESS | VALUE OF ACQUISITION | IS COMPETITION REQUIRED? |
|---|---|---|
| Expedited formal bid | $750,000 or more | Yes—must formally solicit three bids |
| Urgent informal bid | $75,000 to $750,000* | Yes—make reasonable effort to obtain three proposals |
| Sole-source bid | No dollar limits | No—only one source can reasonably supply the need |

Source: United States District Court for the Northern District of California, No. C01-1351.

* The federal court stated that the expedited formal bid process shall also apply to contracts whose total contract price is estimated to be valued from $75,000 to $750,000, unless the receiver determines that urgent circumstances do not permit sufficient time to use the expedited formal bid process. The federal court stated the receiver may also use the urgent informal bid process for any contract whose estimate value is less than $75,000.

With the advent of the alternative contracting processes approved by the federal court, Prison Health Services began acquiring goods and services using both the state contracting process and the alternative contracting processes, depending on the circumstances of the acquisition. Figure 2 provides an illustrative overview of the contracting procedures available to Prison Health Services for the acquisition of IT goods and services under the state contracting process and the alternative contracting processes instituted by the federal court.

**Figure 2**
**California Prison Health Care Services' Contracting Processes for Acquiring Information Technology**




Sources: Bureau of State Audits' interviews with employees from Prison Health Services and Corrections.

## Facts and Analysis

Staff at Prison Health Services, with assistance from Corrections' staff, improperly acquired IT goods and services worth $26.7 million without seeking competitive bids. Specifically, between November 2007 and April 2008, Prison Health Services paid $23.8 million for IT goods. In addition, between December 2007 and February 2008, it paid more than $2.9 million

for IT services. However, in acquiring these goods and services, Prison Health Services failed to comply with applicable state laws or the alternative contracting processes approved by the federal court that require competitive bids to be sought.

Between November 2007 and April 2008, Prison Health Services executed 49 purchase orders for IT goods with one vendor and one of the vendor's subcontractors at a cost of $23.8 million. Although purchase orders could have been used to acquire these goods if the vendor and the subcontractor had a statewide contract to provide such goods, the goods described in the 49 purchase orders were not covered by a statewide contract. Therefore, these IT goods should have been acquired through a competitive process rather than by improperly using purchase orders. Under state law, Prison Health Services was required to solicit bids from other vendors before making these acquisitions by advertising what it needed through either an invitation for bid, a request for quote, or a request for proposal, depending on the value of each acquisition. Table 3 provides a general description of the IT goods that were acquired with the purchase orders and their cost.

**Table 3**
**The 49 Purchase Orders Executed by Prison Health Care Services for Information Technology Goods From November 2007 Through April 2008**

| PURPOSE OF PURCHASE ORDERS | NUMBER OF PURCHASE ORDERS | COST OF PURCHASE ORDERS |
|---|---|---|
| Back-up power supply | 34 | $671,121 |
| Network infrastructure | 11 | 10,401,764 |
| Equipment | 4 | 12,715,838 |
| **Totals** | **49** | **$23,788,723** |

Source: California Prison Health Care Services.

Similarly, between December 2007 and February 2008, Prison Health Services entered into a noncompetitively bid contract for IT services from the same vendor, which it subsequently amended three times on the same day, for a total cost of approximately $2.9 million. Because the original cost of the contract, prior to the amendments, was approximately $45,300, the original contract well exceeded the $5,000 threshold at which state agencies must seek competitive bidding, yet Prison Health Services did not solicit any competitive bids. With the nearly $2.9 million in contract amendments that soon followed, the contract also exceeded the $500,000 threshold at which state agencies must advertise a request for proposal in order to seek competitive bids; however,

this requirement was also ignored. Table 4 provides a description of the original IT services contract along with its amendments, including the execution dates and costs.

**Table 4**
**The Contract and Three Amendments for Information Technology Services Executed by Prison Health Care Services From December 2007 Through February 2008**

| | AMOUNT | DATE SIGNED | PURPOSE |
|---|---|---|---|
| Original contract | $45,277 | December 7, 2007 | House back-up data equipment through a lease contract |
| Amendment 1 | 11,365 | February 15, 2008 | Provide help-desk services |
| Amendment 2 | 443,100 | February 15, 2008 | Provide infrastructure design and build consulting services |
| Amendment 3 | 2,430,000 | February 15, 2008 | Provide information security services |
| **Total** | **$2,929,742** | | |

Source: California Prison Health Care Services.

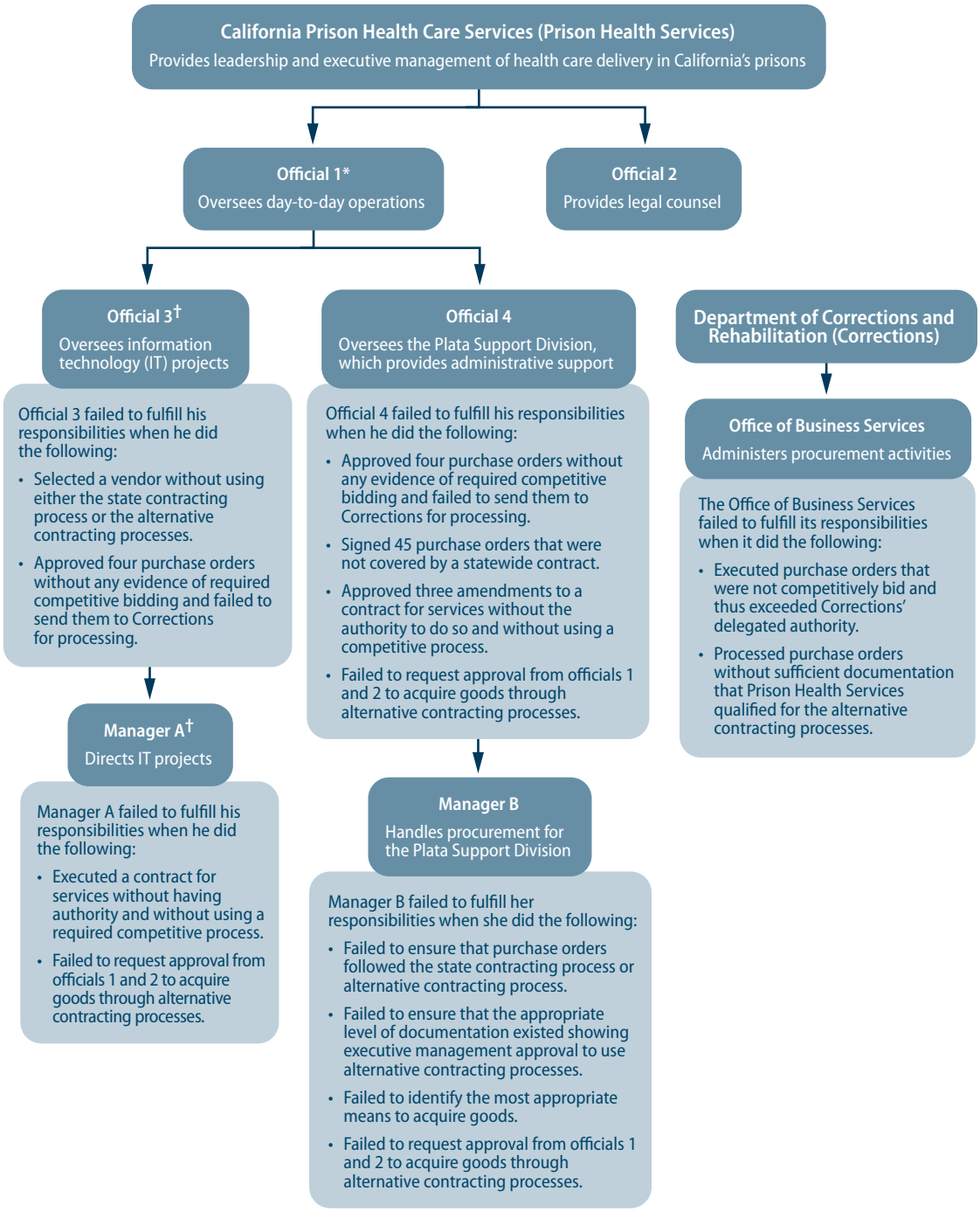
## The Means Used by Prison Health Services to Acquire the IT Goods and Services Violated Legal Requirements and Bypassed Internal Controls

Our investigation determined that Prison Health Services acquired IT goods and services using various procedures that did not comply with either state contracting laws or the alternative contracting processes approved by the federal court. Prison Health Services' staff also bypassed certain internal control procedures that were intended to prevent such noncompliance from occurring. Figure 3 illustrates the control failures of Prison Health Services and Corrections as they relate to the acquisition of IT goods and services.

### *Prison Health Services' Staff Incorrectly Determined That They Could Completely Avoid Competitive Bidding Requirements When Acquiring Needed Goods and Services for a Proposed IT Network*

The failure by Prison Health Services' staff to comply with competitive bidding requirements apparently began with an incorrect determination that statewide contracts and the alternative contracting processes authorized by the federal court provided a convenient means for avoiding all competitive bidding requirements.

**Figure 3**
**Employees at California Prison Health Care Services and the Department of Corrections and Rehabilitation Failed to Fulfill Their Contracting Responsibilities**




Sources: Bureau of State Audits' interviews with employees from Prison Health Services and Corrections.

* Official 1 did not oversee day-to-day operations for IT projects until February 2008 when the current receiver was appointed. The former receiver provided day-to-day oversight for IT projects prior to February 2008.

† Official 3 left his employment with Prison Health Services in February 2008. Manager A was terminated from employment in June 2008.

Soon after Official 3 assumed responsibility for overseeing Prison Health Services' IT projects, he decided that Prison Health Services needed to establish an IT network for the transmission of prisoners' health care information throughout Corrections' prison facilities. He therefore started planning for the creation of such a network.

***An official selected a vendor to provide the IT goods and services without making any effort to solicit competitive bids.***

In April 2007 a vendor learned that Prison Health Services wanted to establish an IT network and contacted Official 3 about addressing this need. According to the vendor, it indicated that it had been awarded a statewide contract to provide IT goods and services at a competitive price and that it was interested in providing the goods and services that Prison Health Services needed under this contract and the statewide contracts of its subcontractors. As a result, Official 3 selected the vendor to provide the IT goods and services for the IT network without making any effort to solicit competitive bids. According to both Official 3 and the vendor, Official 3 intended to use existing statewide contracts to the extent possible to build the IT network. However, according to the vendor's representative, for any IT goods and services not available under existing statewide contracts, Official 3 and the vendor agreed that the acquisition would be made by using one of the three alternative contracting processes approved by the federal court. Over the course of several months, Official 3 and Manager A, who managed Prison Health Services' IT projects for Official 3, met with this vendor and its subcontractors numerous times to discuss Prison Health Services' IT network needs. According to the vendor's representative, the vendor informed Official 3 and Manager A throughout the course of the meetings about which IT goods could be purchased under the vendor's statewide contract and which could not. However, Official 3 stated that based on his discussions with the vendor, he believed that all of the IT goods needed for the project that are the focus of this report could be purchased under existing statewide contracts, so he authorized the use of purchase orders to acquire these items. Statements made by Official 3 and Manager A to staff within Prison Health Services document their understanding that all of these items were available under existing statewide contracts, though we were unable to resolve how they could develop this understanding if the vendor's representative had told them otherwise.

In contrast to the goods discussed above, Official 3 and Manager A correctly understood that the IT services they needed for the network project were not available under the vendor's existing statewide contract. Official 3 and Manager A therefore determined that they would enter into a separate contract with the vendor for the provision of these services using one of the alternative contracting processes. However, the process Prison Health

Services used to acquire IT services was not consistent with the requirements of any of the alternative contracting processes approved by the court.

### *Prison Health Services Violated Legal Requirements and Bypassed Internal Control Procedures in the Way It Used Purchase Orders*

As previously noted, Prison Health Services' officials incorrectly determined that they could acquire $23.8 million in IT goods through the issuance of purchase orders. Based on that determination, they made those acquisitions in violation of state competitive bidding requirements. In November 2007 Official 3 and Official 4 began the acquisitions by signing two purchase orders with the vendor worth approximately $12.1 million to provide equipment for the proposed IT network. As each of these purchases exceeded $500,000, the officials were required by state law to develop a request for proposal and advertise the request to vendors before making the acquisition, but they did not.

Two months later, in January 2008, Official 3 and Official 4 signed two more purchase orders with a subcontractor to the vendor for data servers and other IT-related equipment worth more than $479,100 and $102,200, respectively. Because both purchase orders totaled between $100,000 and $500,000, and were not included as items in the vendor's statewide contract, the officials should have sought competitive bids through an invitation for bid or a request for quote before making these acquisitions.

***During March and April 2008, an official signed 45 purchase orders, totaling $11.1 million, rather than using a competitive bid process as required.***

Finally, during March and April 2008, Official 4 signed 45 more purchase orders with the vendor, each exceeding $5,000 and together totaling $11.1 million. Since all the purchase orders were signed within a short period of time—one week—and the total purchases exceeded $500,000, and were not included as items in the vendor's statewide contract, Prison Health Services should have developed a request for proposal and advertised the request to vendors before making these acquisitions.

When they issued the first four of these purchase orders, Official 3 and Official 4 failed to ensure that Prison Health Services' staff sent the four purchase orders to Corrections' Business Services for processing, which under Corrections' normal procedures entails the creation of appropriate accounting records and a review of the transaction by accounting personnel to determine whether the transaction is proper. Instead, Official 3 and Official 4 apparently returned the signed purchase orders directly to the vendor without processing them through Corrections' Business Services. Several months later, the vendor sent an invoice to Corrections' Business Services for payment. Because Corrections' Business Services did

not process the purchase orders, neither Prison Health Services' accounting office nor Corrections' Business Services had an official record that these purchase orders had been executed. Moreover, no one having familiarity with state contracting rules had an opportunity to scrutinize the purchase orders to evaluate whether the items being acquired were eligible for acquisition by a purchase order.

*Even though Corrections' staff initially rejected the purchase orders, they later approved them, convinced that an authorized alternative contracting process was being used.*

In contrast, when Official 4 issued the remaining 45 purchase orders for IT goods, those purchase orders were routed to Manager B at Prison Health Services who then sent the purchase orders to Corrections' Business Services for processing. Having the opportunity to review these purchase orders, Corrections' Business Services determined that the goods listed on the purchase orders were not covered by a statewide contract with the vendor, and therefore the use of the purchase orders was improper under state law. Consequently, Corrections' Business Services rejected the purchase orders and returned them to Manager B. However, according to Manager B, after speaking with Manager A, Manager B was under the impression that the IT goods and services were being acquired under one of the alternative contracting processes authorized by the federal court. Manager B then resubmitted the purchase orders to Corrections' Business Services even though Corrections' Business Services would not normally be involved in acquisitions under an alternative contracting process. According to Manager B, she did this because Corrections' Business Services was normally the entity that processed purchase orders issued by Prison Health Services for items covered by statewide contracts, and lacking any guidance on how the purchase orders should be processed, felt that their involvement as the processing agent was necessary. Corrections' Business Services processed the purchase orders for Official 4's signature based on Manager B's representation that the purchase orders were proper under the authority granted to the receiver by the federal court. Neither Manager B nor anyone at Corrections' Business Services confirmed the accuracy of the representation with executive management at Prison Health Services. In actuality, Prison Health Services' executive management did not authorize the use of any of the alternative contracting processes to acquire the IT goods listed in the purchase orders. Moreover, Prison Health Services' staff made no effort to use any of the alternative contracting processes for these transactions.

For his part, Official 4 stated that while he signed all of the purchase orders on behalf of Prison Health Services, he did so without questioning them and simply assumed that the purchase orders related to a properly approved contract between Prison Health Services and the vendor that had already been vetted with the appropriate staff at Prison Health Services. Significantly,

as Prison Health Services had neither requested nor received delegated purchasing authority at the time of the purchase order acquisitions, Official 4 did not have the delegated authority from General Services to sign the purchase orders on behalf of Prison Health Services. Although General Services delegated to Prison Health Services the authority to purchase up to $1 million in IT goods and services in September 2008, prior to that authorization, any purchases under state contracting law should have been approved by Corrections, which had delegated purchasing authority up to specified dollar limits, or by General Services. Had this requirement been followed, the purchase orders would have been subject to greater scrutiny.

### *Prison Health Services Also Violated Legal Requirements and Bypassed Internal Controls in Its Contract for IT Services*

As we discussed previously, when Prison Health Services entered into a contract with the vendor for IT services worth approximately $2.9 million between December 2007 and February 2008, it violated state competitive bidding requirements applicable to the contract and each of its three amendments. Specifically, because the original cost of the contract was nearly $45,300, Official 4 and Manager A were required to informally solicit at least two responsive bids before entering into a contract for the services. Moreover, before they could amend the contract to acquire nearly $2.9 million in additional services, Official 4 and Manager A were required to advertise a request for proposal seeking competitive bids for the provision of these services.

However, as justification for not adhering to state contracting requirements for these acquisitions, Official 3 and Manager A provided the impression that they were using one of the alternative contracting processes authorized by the federal court. But just as the contract violated state law by not complying with applicable competitive bidding requirements, it similarly failed to comport with the requirements of the alternative contracting processes, which also required competitive bidding. In particular, as the value of the original contract was less than $75,000, the federal court authorized Prison Health Services to use the urgent informal bid process as an alternative to using the state contracting process, but this process required Prison Health Services to make a reasonable effort to identify and solicit proposals from three vendors. Further, the three subsequent amendments to this contract were signed on the same day and exceeded $750,000 in total. Due to the amount of these amendments, under the federal court order, Prison Health Services was required to engage in an expedited formal bid process before executing the three contract amendments. This

***Not only did a $2.9 million contract for IT services violate state law, it also failed to comport with requirements for alternative contracting processes.***

process obligated Prison Health Services to develop and advertise a request for proposal and to formally solicit three bids. Yet, Prison Health Services did not take these actions.

In addition, use of the alternative contracting processes authorized by the federal court was not sought or properly approved by Prison Health Services' executive management for these acquisitions. Official 1 stated that he established a rule that any time staff at Prison Health Services intended to use any of the alternative contracting processes, he must approve such a use. Similarly, Official 2, also a member of Prison Health Services' executive management, asserted that if Prison Health Services purchased goods or services under the federal court's alternative contracting processes, Prison Health Services' use of the process would be subject to his review as well. However, both of these officials have asserted that they were completely unaware that Official 3 and Manager A intended to use an alternative contracting process for these acquisitions, and we found no evidence to indicate that they were ever advised of this intention.

***Had an official questioned the amendments to an IT contract, he would have found that only a manager had signed the original contract.***

Official 4 was the official who signed the amendments to the contract, but he stated that he signed them without asking questions because he assumed the original contract had been properly approved by Prison Health Services' executive management. Had Official 4 questioned the amendments, he would have found that only Manager A, who was not a member of executive management, had signed the original contract.

By neglecting to advertise or to seek requests for proposals from other vendors, Prison Health Services not only violated state contracting rules and the rules approved by the federal court that require competition, but it also failed to ensure that it used public funds prudently or that the State received the best value for the money spent.

### Prison Health Services and Corrections Failed to Establish Systems to Ensure That Staff Conducted IT Procurement Appropriately

Our investigation identified several factors that led to Prison Health Services and Corrections paying one vendor and its subcontractor $26.7 million for IT goods and services without competitive bidding as required by state law and the processes prescribed by the federal court. In particular, key Prison Health Services' personnel, such as Official 3 and Manager A, did not understand or disregarded the fact that they were unable to use purchase orders to acquire the $23.8 million in goods that they needed for the proposed IT network because those goods were not covered under a statewide contract with the vendor. In addition, Prison Health Services

failed to adequately educate its own staff and staff at Corrections about the effect of the June 2007 federal court order that waived state contracting laws for specified projects so that they would understand the correct impact of that order on the contracting process. Further, Prison Health Services lacked formal policies and procedures to follow when creating and processing contracts. Moreover, Prison Health Services as well as Corrections lacked adequate internal controls to effectively ensure compliance with applicable contracting rules. Finally, Prison Health Services fostered a working environment that discouraged its own staff and staff at Corrections from raising concerns about Prison Health Services' contracting practices.

***Prison Health Services lacked formal policies and procedures as well as adequate internal controls to ensure compliance with contracting rules.***

### *Key Staff at Prison Health Services Either Did Not Understand or Disregarded That They Could Not Properly Use Purchase Orders to Acquire $23.8 Million in IT Goods*

As we discussed earlier, Official 3 stated that he believed all of the IT goods that are the focus of this report were covered by a statewide contract with the vendor so it was proper to acquire the items from the vendor by simply issuing a purchase order for them. In addition, e-mails authored by Official 3 and Manager A appear to document that they shared an understanding that the items were covered by a statewide contract. However, a representative of the vendor asserted that he regularly informed Official 3 and Manager A throughout the acquisition process that certain IT goods and services were not available under its statewide contract. Although our investigation was unable to resolve this conflict in the evidence regarding what Official 3 and Manager A actually knew about the propriety of using the purchase orders, we have been left to conclude that the initial cause for the noncompetitive acquisition of over $23 million in IT goods was a lack of understanding or appreciation by these key officials regarding the wrongfulness of using purchase orders for the acquisitions.

### *Prison Health Services' Officials Failed to Adequately Educate Staff About the Federal Court Order Waiving State Contracting Rules*

Prison Health Services' officials failed to adequately educate all staff involved in the contracting process about the meaning and impact of the federal court's order waiving state contracting rules for certain projects and how this waiver affects the process of acquiring goods and services. Official 1, who is part of Prison Health Services' executive management, told us that management did not need to communicate to staff concerning the impact of the federal court's order because Prison Health Services did not allow its staff to enter into contracts.

*Staff at various levels had little, if any, understanding about the competitive bidding requirements imposed by the federal court.*

As a consequence, it became apparent during the investigation that Prison Health Services' staff at various levels had little, if any, understanding about the competitive bidding requirements imposed by the federal court when obtaining goods and services via the waiver. Although Official 4 acknowledged that he had regular meetings with Official 2, another member of Prison Health Services' executive management, he also stated that he was unaware of any communication with Prison Health Services' staff about the federal court's order. According to Official 4, he knew only that the court order was available for review on Prison Health Services' Web site. Moreover, until we commenced our investigation, key staff at Prison Health Services stated that they were not aware that the waiver could only be invoked with the approval of Official 1 and review by Official 2.

The clearest illustration of the risks associated with not educating staff about the various requirements of the federal court's order regarding the alternative contracting processes occurred when Corrections' Business Services initially refused to process 45 improper purchase orders because the goods being acquired were not available under a statewide contract. Even though Manager A and Manager B had no authority to enter into contracts on behalf of Prison Health Services under the alternative contracting processes, their lack of information about the meaning of the court order caused them to override Corrections' rejection of the purchase orders based on an incorrect assumption that the court order somehow authorized use of the purchase orders. Thus, they incorrectly assured Corrections' Business Services that the purchase orders were proper due to the federal court order. Staff at Corrections' Business Services then proceeded to process the purchase orders for Official 4's signature because they too lacked a sufficient understanding to dispute this assurance. Had staff at Prison Health Services and Corrections been adequately educated about the impact of the court order on the contracting process, the improper use of these purchase orders could have been avoided.

### *Prison Health Services Lacked Written Contracting Procedures*

As a consequence of not issuing any written procedures concerning the processes to follow when creating and processing contracts, executive management at Prison Health Services provided staff with insufficient guidance about what they needed to do to comply with state law, the federal court's order, and management's expectations. Official 4 and his subordinate, Manager B, confirmed that Prison Health Services has no written contracting policies and procedures in place to advise staff of their responsibilities concerning contracts entered into under either state law or the alternative contracting processes authorized by the federal court. In the absence of such

procedures, the investigation revealed numerous instances in which staff made improper decisions about how to handle the acquisitions they were making.

Examples of this mishandling regarding the purchase orders are the failure of Official 3 and Official 4 to have the purchase orders signed by persons with proper authority and the failure to route four of the purchase orders to Corrections' Business Services for its accounting and review processes. As for the contract for IT services that Official 3 and Manager A apparently intended to be handled under the alternative contracting processes, two examples of their being mishandled are the failure of these officials to obtain executive management approval for use of the alternative contracting processes and their failure to seek any competitive bids for the contract and its amendments. If Prison Health Services had written procedures in place concerning how these acquisitions were supposed to be made, staff would have been in a much better position to avoid engaging in the improper practices we discovered or to detect them when they occurred.

### *Prison Health Services and Corrections' Business Services Lacked Adequate Internal Controls Over Contracting*

Prison Health Services has no mechanism in place to ensure that when its staff identifies a need to acquire some good or service, the proper process—state or alternative—will be instituted for the acquisition. As we previously described concerning both the purchase orders for IT goods and the contract for IT services, Official 3 and Manager A decided, apparently on their own, the processes to follow for the acquisition of goods and services for the IT network, even though they seemingly lacked any clear understanding of contracting requirements. Had they been required to obtain the approval of someone else, particularly in executive management, before they moved forward with their acquisition plans, their improper acquisition of the IT goods and services might have been thwarted.

***Managers responsible for acquiring the IT goods and services seemingly lacked any clear understanding of contracting requirements.***

Similarly, Prison Health Services and Corrections have no mechanism in place to ensure that when contracts and purchase orders are being processed for execution, someone with knowledge about the contracting process reviews the documentation for these transactions and has the power to abort a transaction if it does not appear to be in compliance with state and alternative contracting requirements. This was clearly illustrated by the failure of Manager B and Corrections' Business Services to stop the processing of the 45 improper purchase orders that Corrections' Business Services had initially identified to be improper, at least as measured against state contracting requirements. If Manager B

and Corrections' Business Services' staff had been armed with a sufficient understanding of the state and alternative contracting requirements to determine that what Prison Health Services was attempting to do was improper, and they had the authority to halt the processing of these purchase orders upon discovering their impropriety, the State may have avoided the unlawful expenditure of more than $11 million for 45 of the 49 purchase orders for IT goods that we discuss in this report.

### *Prison Health Services' Work Environment Discouraged Staff From Raising Concerns About Contracting*

We observed that Prison Health Services created an environment that discourages Corrections' staff working both inside and outside of Prison Health Services from raising concerns about its contracting practices. Specifically, we observed a sense of trepidation among staff about slowing any of Prison Health Services' projects even when acquisitions for the projects did not appear to adhere to state policies or procedures. For example, Manager B asserted that when she was advised by Corrections' Business Services that although the 45 purchase orders were improper under state law because they were for IT goods that were not covered by a statewide contract, she was also told by Manager A that the goods being sought were related to one of Prison Health Services' time-sensitive projects and she should do whatever she could to expedite them as acquisitions made pursuant to the federal court order that waives state contracting rules. Consequently, Manager B did not question the explanation given concerning these purchase orders and expedited them as directed. However, had she raised concerns about the need to abide by state contracting laws or had a thorough understanding of the court-approved alternative contracting processes, Prison Health Services may not have acquired the IT goods in a noncompetitive manner, in violation of state law and the requirements of the federal court.

### Recommendations

To ensure the consistent application of proper contracting procedures for acquiring IT goods and services, Prison Health Services should do the following:

- Require employees with procurement and contracting responsibilities to attend training at regular intervals regarding state contracting processes.

- Formally communicate to purchasing and contracting staff at Prison Health Services and Corrections the meaning of the federal court's waiver order and the correct procedures that must be followed to use the alternative contracting processes approved by the court.

- Develop and document contracting procedures for staff to follow when acquiring IT goods and services under existing state processes.

- Develop and document the contracting procedures for staff to follow when acquiring IT goods and services under each of the three alternative contracting processes approved by the federal court.

- Specify in writing who at Prison Health Services has authority to sign contracts and purchase orders under the state and alternative contracting processes, and distribute this information to employees who have responsibilities regarding procurement.

- Establish internal procedures to ensure there is documentation of approval from the receiver or his designee to make an acquisition under each of the three alternative contracting processes.

- Ensure that prior to staff selecting a method for acquiring an IT good or service, the proposed acquisition is reviewed by an appropriate staff member to evaluate whether the method of acquisition is proper.

- Ensure that when contracts and purchase orders are being processed by staff at either Prison Health Services or Corrections for IT goods and services, an appropriate staff member will evaluate the proposed acquisition to determine whether it is proper and has the authority to halt the acquisition until any suspected impropriety has been resolved.

To ensure that the State follows applicable contracting laws, Corrections should establish a protocol for communicating with Prison Health Services' executive management when it becomes aware of any potential violations of state contracting laws.

We conducted this review under the authority vested in the California State Auditor by Section 8547 et seq. of the California Government Code and pursuant to applicable investigative standards.

Respectfully submitted,

Elaine M. Howle

ELAINE M. HOWLE, CPA
State Auditor

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| Date: | January 22, 2009 |
| Investigative Staff: | Russ Hayden, CGFM, Manager<br>Siu-Henh Canimo, CFE |
| Legal Counsel: | Steven Benito Russo, JD |

For questions regarding the contents of this report, please contact Margarita Fernández, Chief of Public Affairs, at 916.445.0255.

# Appendix

## THE INVESTIGATIONS PROGRAM

The California Whistleblower Protection Act (Whistleblower Act) contained in the California Government Code, beginning with Section 8547, authorizes the Bureau of State Audits (bureau), headed by the state auditor, to investigate allegations of improper governmental activities by agencies and employees of the State. The Whistleblower Act defines an *improper governmental activity* as any action by a state agency or employee during the performance of official duties that violates any state or federal law or regulation; that is economically wasteful; or that involves gross misconduct, incompetence, or inefficiency.

To enable state employees and the public to report suspected improper governmental activities, the bureau maintains a toll-free Whistleblower Hotline: (800) 952-5665 or (866) 293-8729 (TTY). The bureau also accepts reports of improper governmental activities by mail and over the Internet at www.bsa.ca.gov.

Although the bureau conducts investigations, it does not have enforcement powers. When it substantiates an improper governmental activity, the bureau reports confidentially the details to the head of the state agency or to the appointing authority responsible for taking corrective action. The Whistleblower Act requires the agency or appointing authority to notify the bureau of any corrective action taken, including disciplinary action, no later than 30 days after transmittal of the confidential investigative report and monthly thereafter until the corrective action concludes.

The Whistleblower Act authorizes the state auditor to report publicly on substantiated allegations of improper governmental activities as necessary to serve the State's interests. The state auditor may also report improper governmental activities to other authorities, such as law enforcement agencies, when appropriate.

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*(Agency response provided as text only.)*

California Prison Health Care Receivership Corp.
501 J Street
P.O. Box 4038
Sacramento, CA 95812-4038

January 15, 2009

Elaine M. Howle, CPA
California State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300

Re: January 2009 Investigative Report No. 12008-0805 Regarding California Prison Health Care Services and Department of Corrections and Rehabilitation

Dear Ms. Howle:

I want to thank you and your staff for your evident professionalism in investigating and documenting the IT contracting concerns which I brought to your attention shortly after my appointment in late January, 2008.

As you know, back in 2002, Governor Gray Davis called on me to assume the State CIO role in the aftermath of the Oracle contracting problem. Within a few months of my appointment back then, it was clear that the problems with IT contracting were broader than just Oracle. Among other things, I discovered that the e-government project, which was responsible for establishing a state "portal" early in the Davis Administration, had been implemented through a series of utterly inappropriate, serial short-term sole source contracts that had been strung together over a period of years with a single vendor at an overall cost to the State in the millions. Working with key executives in the Davis Administration, we shut down those contractual relationships and put IT procurement and project management back on sound footing.

After several years of effort, we were even able to junk the old, improperly-procured portal in favor of a portal implemented entirely by a small team of state employees, proving that we don't always need expensive consultants to make significant progress in state IT matters. That new portal is garnering national attention, as noted by the Little Hoover Commission in a recent report:

"Due in large part to the efforts of the state's previous chief information officer [i.e., the current Receiver], who created a strategic plan for California information technology, the state's reputation for technological sophistication has improved. In a few years, California has gone from the back of the pack to near the front. The Center for Digital Government placed California in the No. 5 position in its most recent ranking of tech-savvy states. The state's Web site also hs improved dramatically, earning recognition and awards for its customer-service features." Little Hoover Commission, "A New Legacy System: Using Technology to Drive Performance," p. ii (November 2008).

My experience as State CIO made me quite sensitive to process issues in IT procurement. That is why, when it came to my attention, shortly after my appointment, that some of the IT contracts executed during my predecessor's tenure may not have followed appropriate state laws and policies, I immediately contacted your office to conduct an audit. At about the same time, I was able to replace the Receivership's former CIO – who had no prior state government experience – with a CIO, Jamie Mangrum, who had decades of

state IT experience, and I directed Mr. Mangrum to immediately begin reviewing our processes to ensure compliance with state law. As previously found by the federal court in *Plata v. Schwarzenegger*, not only was the clinical side of the prison medical system broken prior the Receivership, but the administration of the contracting system was also in shambles. *See generally* March 30, 2006 Order re State Contracts and Contract Payment Relating to Service Providers for CDCR Inmates. While progress has been made in this regard, for better or for worse, the greater balance of the resources of the Receivership under my predecessor were applied to addressing the abhorrent clinical conditions on the ground in the prisons. This, as found by Mr. Mangrum and made clear by your report, may have been at the expense of the need to focus a greater degree of effort on much needed administrative controls. Mr. Mangrum, for example, discovered that policies and procedures had simply not been implemented. Subsequently, we began to establish those polices as soon as possible. In addition, we have also worked closely with the Department of General Services to ensure that the continuing use of services from the IT vendor at the center of your investigation is appropriate and in the best interest of the state. To that end we have sought and obtained an appropriately justified approval for an NCB for the ongoing use of the services.

The results of your audit confirm my fears that the one bad IT contract I had seen was but the tip of an iceberg. Your audit also confirms that Mr. Mangrum's quick actions to establish policies resulted in immediate improvements. Recent actions since the completion of your investigation, for example, the adoption of a formal policy governing use of the federal court's waiver of state contracting laws, will also lead to further improvements. Achieving perfection in processing IT contracts remains a challenge under the state's overly complex IT procurement rules, but I am heartened at our improvements and confident that, with the information provided to us by your audit, we can do even better.

Sincerely,

(Signed by: John Hagar for)

J. Clark Kelso

*(Agency response provided as text only.)*

Department of Corrections and Rehabilitation
Office of the Secretary
P.O. Box 942883
Sacramento, CA 94283-0001

January 14, 2009

Ms. Elaine Howle, State Auditor
California State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Dear Ms. Howle:

Thank you for providing us a copy of your draft report concerning your investigation into the California Prison Health Care Services' (Receiver) improper contracting decisions and poor internal controls.

We agree with the factual findings in your report regarding improper contracting. In fact, it was California Department of Corrections and Rehabilitation (CDCR) employees who correctly identified many of these concerns in the first place. In each instance regarding the 45 purchase orders that your report deems improper, it was CDCR employees who correctly identified these improprieties, raised their concerns to the Receiver's office and refused to execute these purchase orders. We agree with the suggestion in your report that our managers must continue to review contract documentation and abort any transactions that violate applicable contracting requirements. We also appreciate your recommendation to improve our communication with the Receiver's office to ensure our continued future compliance in this regard. We look forward to doing so.

Thank you for your work in this area. If you have any questions or need additional information, please contact me at (916) 323-6001.

(Signed by: Matthew L. Cate)

MATTHEW L. CATE
Secretary

cc: Members of the Legislature
Office of the Lieutenant Governor
Milton Marks Commission on California State Government Organization and Economy
Department of Finance
Attorney General
State Controller
State Treasurer
Legislative Analyst
Senate Office of Research
California Research Bureau
Capitol Press