

# Departments of Health Care Services and Public Health

## Their Actions Reveal Flaws in the State's Oversight of the California Constitution's Implied Civil Service Mandate and in the Departments' Contracting for Information Technology Services

REPORT NUMBER 2009-103, SEPTEMBER 2009

### *Responses from the Departments of Health Care Services and Public Health, and the State Personnel Board, as of November 2009*

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits (bureau) examine the use of information technology (IT) consulting and personal services contracts (IT contracts) by the Department of Health Care Services (Health Care Services) and the Department of Public Health (Public Health). The audit committee specifically asked the bureau to review and assess the two departments' policies and procedures for IT contracts to determine whether they are consistent with state law. The audit committee also requested that we identify the number of active IT contracts at each department and—for a sample of these contracts—that we determine whether the departments are complying with California Government Code, Section 19130, and with other applicable laws, rules, and regulations. For the sample of contracts, the committee also requested that we collect various data and perform certain analyses, including determining whether the two departments are enforcing the knowledge-transfer provisions contained in the contracts.

The audit committee also asked us to identify the number, classification, and cost of IT positions budgeted at each department for each of the most recent five fiscal years. In addition, we were to determine the number of vacant IT positions, the turnover rate, and any actions that the departments are taking to recruit and retain state IT employees.

For a sample of contracts under review by the State Personnel Board (board), the audit committee asked us to identify the California Government Code section that the departments are using to justify an exemption from the implied civil service mandate emanating from Article VII of the California Constitution. For the contracts overturned by the board, we were asked to review the two departments' responses and determine whether corrective action was taken. Finally, the audit committee requested that we review and assess any measures that the two departments have taken to reduce the use of IT contracts.

### **Audit Highlights . . .**

*Our review of the personal services and consulting contracts for information technology (IT contracts) used by the Department of Health Care Services (Health Care Services) and the Department of Public Health (Public Health) revealed the following:*

- » *Over the last five years, the State Personnel Board (board) has disapproved 17 of 23 IT contracts challenged by a union.*
- » *Many of the board's decisions were moot because the contracts had already expired before the board rendered its decisions.*
- » *Of the six IT contracts still active at the time of the board's decisions, only three were terminated because of board disapprovals.*
- » *Health Care Services did not comply with state policy regarding the use of blanket positions and was disingenuous with budgetary oversight entities.*
- » *Neither Health Care Services nor Public Health has a complete database that allows it to identify active IT contracts and purchase orders.*
- » *The departments complied with many, but not all, state procurement requirements.*
- » *The departments did not obtain the requisite financial interest statements from half the sampled employees responsible for evaluating contract bids and offers.*

**Finding #1: The board disapproved most of the departments' challenged IT contracts, but these decisions had limited impact.**

Over the last five years, the board has disapproved 17 IT contracts executed by Health Care Services, Public Health, and their predecessor agency—the Department of Health Services (Health Services).<sup>1</sup> The board disapproved the IT contracts because the departments, upon formal challenges from a union, could not adequately demonstrate the legitimacy of their justifications for contracting under the California Government Code, Section 19130(b), which provides 10 conditions under which state agencies may contract for services rather than use civil servants to perform specified work. These conditions include such circumstances as the agencies needing services that are sufficiently urgent, temporary, or occasional, or the civil service system's lacking the expertise necessary to perform the service.

Although the union prevailed in 17 of its 23 IT contract challenges, many of the board's decisions were moot because the contracts had already expired before the board rendered its decisions. This situation occurred primarily because the union raised challenges late in the terms of the contracts and because the board review process was lengthy. The board's former senior staff counsel stated that if the board disapproves a contract, the department must immediately terminate the contract unless the department obtains from the superior court a stay of enforcement of the board decision. However, as the board's executive officer explained, the board's decisions usually do not state that departments must immediately terminate disapproved contracts, and she is unaware of the historical reasons behind this practice. Of the six IT contracts that were active at the time of the board's decisions, only three were terminated because of board disapprovals. For each of the other three IT contracts, the departments either terminated the contract after a period of time for unrelated reasons or allowed it to expire at the end of its term. We found that one contract was not terminated because the department was unaware of the board's decision and another because of miscommunications between the department's legal services and program office managing the contract. Because the board lacks a mechanism for determining whether state agencies comply with its decisions, the departments experienced no repercussions for failing to terminate these contracts.

Additionally, our legal counsel believes that uncertainties exist about whether or not a contract disapproved by the board is void and about the legal effect of a void contract. However, if a court were to find that the disapproved contract violated public contracting laws, the contractor may not be entitled to any payment for services rendered.<sup>2</sup> Because the legal effect of a board-disapproved contract is uncertain, it may be helpful for the Legislature to clarify when payments to the related contractors must cease and for what periods of service a vendor may receive payments.

To create more substantive results from the reviews conducted by the board under California Government Code, Section 19130(b), we recommended that the Legislature specify that contracts disapproved by the board must be terminated and require state agencies to provide documentation to the board and the applicable unions to demonstrate to the satisfaction of the board the termination of these contracts. We also recommended that the Legislature clarify when state agencies must terminate contracts disapproved by the board, when payments to the contractors must cease, and for what periods of service the contractors are entitled to receive payments.

To provide clarity to state agencies about the results of its decisions under California Government Code, Section 19130(b), we recommended that the board explicitly state at the end of its decisions if and when state agencies must terminate disapproved contracts. Additionally, we recommended that the board obtain documentation from the state agencies demonstrating the terminations of disapproved contracts.

<sup>1</sup> Only July 1, 2007, Health Services became Health Care Services, and Public Health was established. All contracts disapproved by the board were originally executed by Health Services. However, the management of these contracts was performed by Health Services, Health Care Services, or Public Health.

<sup>2</sup> *Amelco Electric v. City of Thousand Oaks* (2002) 27 Cal. 4th 228, 234, upholding *Miller v. McKinnon* (1942) 20 Cal. 2d 83, 89, and *Zottman v. San Francisco* (1862) 20 Cal. 96, 101, 105-106.

To vet more thoroughly the Section 19130(b) justifications put forward by the departments' contract managers, to ensure the timely communication of board decisions to the contract managers, and to make certain that disapproved contracts have been appropriately terminated, we recommended that legal services in both departments take these actions:

- Review the Section 19130(b) justifications put forward by the contract managers for proposed personal services contracts deemed high risk, such as subsequent contracts for the same or similar services as those in contracts disapproved by the board.
- Notify contract managers of the board's decisions in a timely manner and retain records in the case files showing when and how the notifications were made.
- Require documentation from the contract managers demonstrating the termination of disapproved contracts and retain this documentation in the case files.

***Legislative Action: Unknown.***

We are not aware of any legislative action at this time.

***Board's Action: None.***

The board's executive officer stated that the board's legal counsel concluded that the board is unable to implement our recommendations without a statutory amendment.

***Health Care Services' Action: Partial corrective action taken.***

Health Care Services stated that its legal services is available to review personal services contracts identified by its contract managers as high risk. However, Health Care Services did not specify how its contract managers would identify contracts as high risk. Additionally, although Health Care Services stated that it revised its request-for-offer template to include evaluation criteria as identified in past board decisions, it did not indicate how this assists the contract managers in identifying those contracts they should forward to legal services.

Health Care Services also stated that notifying contract managers of relevant board decisions is in accordance with its current practices and that it would request notifications from program managers of contract terminations related to board-disapproved contracts and document them in the case files.

***Public Health's Action: Corrective action taken.***

Public Health issued a policy effective November 3, 2009, that requires its program staff to obtain approval from its legal services before entering into personal services contracts. Public Health stated that it has developed procedures to ensure that contract managers receive timely notification of board decisions and to maintain documentation for all notices of contract terminations in legal services' case files.

**Finding #2: The departments have entered into subsequent contracts for substantially the same services as those in contracts disapproved by the board.**

Although not prohibited by law from doing so, the departments entered into numerous subsequent contracts for the same services as those in the contracts previously disapproved by the board. Specifically, we found that for nine of the 17 contracts disapproved by the board, the departments entered into subsequent contracts for substantially the same services as those in disapproved contracts. In one case, the board disapproved an IT contract for the same service from the same supplier that it had already disapproved in an earlier union challenge. Without some limitation on subsequent same-service contracts, board decisions related to Section 19130(b) of the California Government Code

will often affect only contracts with terms that have expired or will soon expire, and the decisions will not preclude similar contracts from immediately replacing those that the board disapproves. As a result, all the effort and resources spent reviewing challenged IT contracts would seem to be an inefficient use of state resources.

To create more substantive results from the reviews conducted by the board under California Government Code, Section 19130(b), we recommended that the Legislature do the following:

- Prohibit state agencies from entering into subsequent contracts for substantially the same services as specified in contracts under board review without first notifying the board and the applicable unions, allow unions to add these contracts to the board's review of the original contracts, and allow the board to disapprove the subsequent contracts as part of its decision on the original contracts.
- Require state agencies that have contracts disapproved by the board to obtain preapprovals from the board before—in a manner similar to the process that occurs for requests under California Government Code, Section 10130(a)—entering into contracts for substantially the same services. Further, if an agency enters into a contract without the board's preapproval, the Legislature should allow the applicable union to challenge this contract and prohibit the agency from arguing that the contract was justified under Section 19130(a) or (b). Instead, the board should resolve only whether the subsequent contract is for substantially the same service as the disapproved contract.

***Legislative Action: Unknown.***

We are not aware of any legislative action at this time.

**Finding #3: Although it saved the State \$1.7 million by replacing IT consultants with state employees, Health Care Services failed to follow budgetary instructions and rules.**

Partly in response to the disapproved contracts, the two departments sought to replace IT contractors with state IT employees. For this purpose, in January 2009, the Department of Finance (Finance) approved the creation of an additional 28 IT positions within the information technology services division (IT division) of Health Care Services and 11 IT positions within the IT division of Public Health. Health Care Services began the process of converting IT contractor positions into state positions as early as October 2006, but it did not clearly disclose this effort in its budget change proposal (BCP) requesting additional positions. Specifically, despite language in Health Care Services' January 2009 BCP stating that the 28 requested positions "will replace contractors *currently* providing IT support functions" and that these conversions will occur over three fiscal years, it had already replaced nine contractors, and the termination dates for the contracts associated with these nine contractors had already expired.

Because permanent positions had not yet been approved in the state budget, Health Care Services funded the new employees—who were hired as permanent civil servants—using temporary-help positions authorized in the budget as *blanket positions*, which are positions in the approved budget that an agency may use for short-term or intermittent employment needs when expressing those needs as classified positions has proven impracticable. According to the *State Administrative Manual*, an agency may not use temporary—help positions provided under its blanket authority to fund permanent employees. Although it did not comply with state policy regarding the use of blanket positions and was disingenuous with budgetary oversight entities, we estimate that Health Care Services saved the State more than \$1.7 million when it converted IT contracts to IT positions. Public Health stated that it will not be able to replace its IT contracts with state employees until fiscal year 2010–11, which is when it anticipates it will be able to hire and train employees who have the appropriate skill sets to make the transition successful.

To ensure that Finance and relevant legislative budget subcommittees are able to assess its need for additional IT positions, we recommended that Health Care Services prepare BCPs that provide more accurate depictions of the department's existing conditions.

To comply with requirements in the *State Administrative Manual*, we recommended that Health Care Services refrain from funding permanent full-time employees with the State's funding mechanism for temporary-help positions.

***Health Care Services' Action: Pending.***

Health Care Services stated that it strives to provide clear and precise BCPs and that it would continue to provide training to staff on the preparation of BCPs, based on guidance from Finance, that are accurate and complete. Health Care Services also stated that it is currently in the process of removing all of the individuals identified by the audit out of temporary-help positions and into newly authorized positions.

**Finding #4: The two departments cannot readily identify active IT contracts.**

Neither Health Care Services nor Public Health has a complete database that allows it to identify active IT contracts and purchase orders. Consequently, the departments cannot readily identify such procurements. The best source of information for the purposes of this audit was the contracts database maintained by the Department of General Services (General Services) and populated with self-reported data from state agencies. However, we found errors in the data reported by Health Care Services and Public Health indicating that the information in General Services' database is incomplete and inaccurate for these departments.

Public Health stated that it is in the process of developing a new database that will identify all contracts that are active and IT-related. The database will include this information for all completed contracts and those in progress. Public Health anticipates implementing its database in October 2009. The chief of its Contracts and Purchasing Support Unit stated that Health Care Services is monitoring the development of Public Health's database, and Health Care Services will consider its options for creating a similar database if the implementation of Public Health's database is successful.

To readily identify active IT and other contracts, we recommended that Public Health continue its efforts to develop and implement a new contract database. Additionally, we recommended that Health Care Services either revise its existing database or develop and implement a new contract database.

To ensure that reporting into General Services' contracts database is accurate and complete, we recommended that both departments establish a review-and-approval process for entering their contract information into the database.

***Health Care Services' Action: Partial corrective action taken.***

Health Care Services stated that it will complete, by March 2010, its assessment of the feasibility of enhancing its contract database. Health Care Services also stated that it reiterated to staff the importance of entering accurate information into General Services' database, provided additional instruction, and performed spot checks of data entered into the system in August and September 2009. Health Care Services indicated that, because the latter activity resulted in the detection of a few errors, it implemented a new procedure that involves the preparation of a data entry form by supervisory or analytical staff. Further, Health Care Services stated it plans to continue to perform spot checks to ensure the accuracy of the data in General Services' database.

***Public Health's Action: Partial corrective action taken.***

Public Health stated that it will complete its new contract database by July 2010. Public Health also stated that it established a new procedure for staff to enter information into General Services' database and will have a staff person conduct a review to ensure the procedure is reliable.

**Finding #5: The departments generally complied with the procurement requirements that we tested.**

The departments complied with many, but not all, state procurement requirements we reviewed. For a sample of 14 contracts, the departments obtained the requisite number of supplier responses, encouraging competition among suppliers. The departments also complied with requirements related to maximum dollar amounts and allowable types of IT personal services, except in one instance. In this instance, Public Health procured some unallowable printer maintenance services under its contract with Visara International (Visara). Visara's master agreement with General Services allows it to provide maintenance on numerous printer types. However, 13 of the 17 printer types listed in Public Health's contract with Visara are not included in General Services' master agreement. Therefore, the prices negotiated between Public Health and Visara for maintenance on these 13 printer types were not subject to the required level of scrutiny that is designed to ensure that Public Health is not paying too much.

To make certain that it procures only maintenance services allowed in the State's master agreement with Visara, we recommended that Public Health either make appropriate changes to its current Visara contract or have General Services and Visara make appropriate changes to Visara's master agreement.

***Public Health's Action: Partial corrective action taken.***

Public Health stated that it processed an amendment to remove non-covered printers from its Visara contract and is working with General Services to add these printers to its Visara master agreement.

**Finding #6: The departments have not provided suppliers with selection criteria.**

The *State Contracting Manual* establishes the requirements for departments to follow when conducting supplier comparisons, and it provides a request-for-offer template. The request-for-offer template states that if departments use the best-value method to select suppliers, they should detail their selection criteria and the corresponding points that will be used to determine the winning offer.<sup>3</sup> The best-value method, which is the basis for all California Multiple Award Schedules (CMAS) contracts, refers to the requirements, supplier selection, or other factors used to ensure that state agencies' business needs and goals are met effectively and that the State obtains the greatest value for its money.

Three of the requests for offer associated with the five CMAS contracts we reviewed contained only brief, vague statements regarding how the departments would determine the winning offers. Further, none of the requests for offer for these five contracts included information on the corresponding points. Without specific selection criteria, potential suppliers are left to guess the criteria and their relative importance using what they can glean from the departments' requests for offer.

To promote fairness and to obtain the best value for the State, we recommended that the two departments demonstrate their compliance with General Services' policies and procedures. Specifically, in their requests for offer, they should provide potential suppliers with the criteria and points that they will use to evaluate offers.

<sup>3</sup> The *State Contracting Manual* provides departments with limited discretion regarding policy requirements prefaced by the term "should." It states that such policies are considered good business practices that departments need to follow unless they have good business reasons for deviating from them.

*Health Care Services' Actions: Corrective action taken.*

Health Care Services indicated that it modified its request-for-offer template to include evaluative criteria that it will use on all CMAS procurements.

*Public Health's Action: Pending.*

Public Health stated that, by January 2010, it plans to develop and distribute to staff a new form they can use to inform potential suppliers of the criteria it will use to evaluate their offers.

**Finding #7: The departments did not obtain some required approvals and conflict-of-interest information for the contracts that we reviewed.**

The departments did not always obtain prior approvals from their agency secretary, directors, and—in the case of Public Health, IT division—as required by state procurement rules and departmental policies. In particular, we found that the departments did not obtain the appropriate agency secretary's or director's approvals for three of the seven CMAS and master agreement contracts for which the requirement was applicable. Additionally, despite a policy requiring its IT division to review all IT contracts, we found that Public Health's IT division did not review two of the 14 Public Health contracts we reviewed.

The departments also did not consistently obtain requisite annual financial interest statements from bid or offer evaluators. Health Care Services failed to obtain this statement from one employee and Public Health failed to obtain the financial interest statement from six of its employees. For three of the six employees, Public Health stated that the employees were not in positions designated in the department's conflict-of-interest code as needing to file the financial interest statement. Our review raised questions about whether Public Health's conflict-of-interest code appropriately designated all employees engaged in procurement. We believe that state employees who regularly participate in procurement activities may participate in the making of decisions that could potentially have a material financial effect on their economic interests. To maintain consistency with the Political Reform Act, state agencies should designate such employees in their conflict-of-interest codes. Without the approvals mentioned earlier and these financial interest statements, the departments are circumventing controls designed to provide high-level purchasing oversight and to deter and expose conflicts of interest.

To ensure that each contract receives the levels of approval required in state rules and in their policies and procedures, we recommended that the departments obtain approval by their agency secretary and directors on contracts over specified dollar thresholds. In addition, we recommended that Public Health obtain approval from its IT division on all IT contracts, as specified in departmental policy.

To make certain that it fairly evaluates offers and supplier responses, Public Health should amend its procedures to include provisions to obtain and retain annual financial interest statements from its offer evaluators. Further, both departments should also ensure that they obtain annual financial interest statements from all designated employees. Finally, Public Health should ensure that its conflict-of-interest code is consistent with the requirements of the Political Reform Act.

***Health Care Services' Action: Partial corrective action taken.***

Health Care Services stated that it would obtain the necessary approvals, as required. Health Care Services did not indicate that any revision of policy or procedure would be necessary. Health Care Services also stated that, during the next period for filing financial interest statements, it would provide specific reminders to staff regarding the disclosure categories related to offer evaluators and it would review each contract to ensure that evaluators have filed statements.

***Public Health's Action: Partial corrective action taken.***

Public Health stated that it would send out, by December 31, 2009, a bulletin reminding staff of its policy for processing IT procurements, which includes obtaining approvals from the division chief, the legal office, and the IT division's chief.

Effective November 3, 2009, Public Health issued a policy that requires each staff member who participates in the procurement process to file a conflict-of-interest and confidentiality statement it created.

**Finding #8: Health Care Services could not always demonstrate fulfillment of contract provisions requiring IT consultants to transfer knowledge to IT employees.**

Health Care Services and Public Health did not always include specific contract provisions in their contracts with IT consultants to transmit the consultants' specialized knowledge and expertise (knowledge transfer) to the State's IT employees because these knowledge-transfer provisions were not always applicable. However, when its IT contracts included knowledge-transfer provisions, Public Health was generally able to demonstrate that the department met these provisions, while Health Care Services had difficulty doing so for all three of its contracts in our sample that contained knowledge-transfer provisions.

To verify that its consultants comply with the knowledge-transfer provisions of its IT contracts, and to promote the development of its own IT staff, we recommended that Health Care Services require its contract managers to document the completion of knowledge-transfer activities specified in its IT contracts.

***Health Care Services' Action: Corrective action taken.***

Health Care Services stated that it would remind all managers and supervisors who are responsible for managing IT contracts to document the completion of knowledge-transfer activities. Health Care Services did not indicate that any revision of policy or procedure would be necessary.