

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 September 2010

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).¹ 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.² 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 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.

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.

¹ 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.

² *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.

- 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.

Board's Action: Pending.

The board stated that all of its future decisions disapproving a contract will include a deadline for when the contract should be discontinued and a requirement that the affected department submit written confirmation of the discontinuation of the contract to it and the interested labor organizations.

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 but—as of November 2010—its instructions as to how its contract managers would identify contracts as high risk had only been verbal. Health Care Services added that it is in the process of developing training for its contract managers regarding Section 19130 of the California Government Code requirements and what types of contracts need review by 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: 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: Partial corrective action taken.

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 moved all of the individuals identified by the audit out of temporary-help positions and into newly authorized positions and provided us with a report indicating the same.

However, we requested that Health Care Services provide this report for the department as a whole and found—as of November 2010—other permanent full-time employees in temporary-help positions. Four of these employees had been in these positions for more than one year. Health Care Services stated that it will endeavor to limit the use of temporary-help positions to those instances that meet the definition in the *State Administrative Manual*.

Finding #3: 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 completed an assessment of the feasibility of creating a new contract database, but determined that it is not economically feasible at this time. Health Care Services also stated that it provided training and instructions to staff on the importance of entering accurate information into the General Services database and that a supervisor regularly reviews reports from the database to ensure the accuracy and completeness of the data.

Public Health's Action: Partial corrective action taken.

Public Health stated that it plans to fully implement its new contract database by December 2010. Public Health added a reminder for entering information into General Services' database to its procurement checklists and indicates that it has and will continue to regularly conduct reviews to ensure staff enter the information appropriately.

Finding #4: 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: Corrective action taken.

Public Health processed an August 2009 amendment to remove noncovered printers from its Visara contract and, after working with General Services to add these printers to its Visara master agreement, executed a January 2010 amendment to add these printers back into its Visara contract.

Finding #5: 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.³ The best-value

³ 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.

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.

Health Care Services' Action: Corrective action taken.

Health Care Services 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 November 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 #6: 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: 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 in February 2010 it provided specific instructions to staff regarding the disclosure categories related to offer evaluators. Health Care Services provided documents showing that its contracts management unit added language to its user guides stating that disclosure requirements apply to all persons involved in contractor selection.

Public Health's Action: Corrective action taken.

Public Health revised its IT Manual and provided us with training material demonstrating its efforts to make procurement staff aware of the IT approval policies.

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. To its procurement checklists, Public Health added a reminder that each member of the evaluation team must complete conflict-of-interest and confidentiality statements.

Finding #7: 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.

