STATE AND CONSUMER SERVICES AGENCY

DEPARTMENT OF GENERAL SERVICES

DEPARTMENT OF JUSTICE

AUDIT OF
CONTRACTING PROGRAM
REPORT NO. 8161

OFFICE OF AUDIT SERVICES

OCTOBER 2007

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STATE OF CALIFORNIA

DEPARTMENT OF GENERAL SERVICES

AUDITOR'S REPORT

DATE: May 30, 2008

TO: **JAMES HUMES,** Chief Deputy Attorney General
Department of Justice

This report presents the results of our audit of the Department of Justice's (DOJ) contracting program. On December 9, 2004, the Director of the Department of General Services (DGS) signed Exemption Letter No. 52.3, which granted DOJ's request to process contracts without DGS review and approval. In brief, subject to a number of limitations, the exemption allows various types of contracts under $75,000 to be processed without DGS review and approval during the four-year period of January 1, 2005 through December 31, 2008. As a condition of the exemption, two audits are required to be performed of DOJ's contracting program during the four-year exemption period. Based on DOJ's request, the DGS Office of Audit Services agreed to conduct the first audit required under the terms of the exemption.

The objective of our audit was to determine compliance with the terms and conditions of Exemption Letter No. 52.3. In general, the exemption requires that DOJ maintain an adequate and effective system of internal control over contracting and that the system be sufficient to ensure compliance with the State's contracting laws, policies, and procedures. Our audit was conducted in accordance with U.S. generally accepted auditing standards.

Our review disclosed the following areas of noncompliance with State requirements that should be addressed by DOJ's management. The implementation of the recommendations presented in this report will assist DOJ in improving these areas.

- Policies and procedures are not ensuring that contracts are approved prior to the commencement date shown on the contract.
- The Contracts Unit's quality assurance process is not ensuring full compliance with the State's contracting requirements. The types of exceptions noted during our audit included: (1) contracts not containing clear and concise language related to the scope of work; (2) contracts of an amount of exactly $75,000 not being submitted to the DGS for review and approval; (3) sufficient documentation not being maintained to disclose compliance with a number of contracting requirements; and, (4) janitorial contracts not containing terms requiring the use of janitorial supplies containing recycled paper products only.
- Contract managers are not always adequately performing their responsibility for ensuring that invoiced amounts agree to contractual terms, conditions and payment provisions prior to authorizing payment of the billed costs.
- Although overall we concluded that DOJ's written policies and procedures governing the use of Service Authorizations to procure small dollar value services are adequate, our tests disclosed that, in some instances, awards appeared to have been split to avoid the State's formal competitive bidding limit of $5,000. Further, we developed concerns that some apparent ongoing service needs are being procured as separate undertakings and contracted for through the use of multiple Service Authorizations issued to the same

contractor, instead of through the use of a single contract agreement covering all of the services.

During our review we also identified other matters requiring attention that we discussed with DOJ's management but are not included in this report. These matters included our concern that during most of the 2006/07 fiscal year DOJ was not submitting a non-competitively bid (NCB) contract justification form to DGS for review and approval prior to the award of NCB contracts. Beginning late in the 2006/07 fiscal year, DOJ began transmitting NCB justification forms to DGS for review and approval. Although this condition is a significant violation of the terms of DOJ's exemption and State contracting requirements, since corrective action was taken prior to the start of our audit, this issue is not further discussed in this report.

It should be noted that when advised of areas for improvement during our audit fieldwork DOJ's management took immediate action to begin addressing a number of our concerns. Although we were not able to verify the effectiveness of some of these actions prior to the completion of our audit fieldwork, we were pleased with the commitment shown to improve compliance with State requirements.

Your response to each of our recommendations as well as our evaluation of the response are included in this report.

We greatly appreciated the cooperation and assistance provided by DOJ's personnel.

If you need further information or assistance on this report, please contact me at 376-5058, or Christopher Harris, Management Auditor, at 376-5059.

Rick Gillam

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DEPARTMENT OF JUSTICE
AUDIT OF CONTRACTING PROGRAM

FINDINGS AND RECOMMENDATIONS

The following presents our detailed findings and recommendations developed based on our audit of the Department of Justice's (DOJ) contracting program for compliance with the terms and conditions of Exemption Letter No. 52.3. This report presents information on areas of noncompliance with policies governing the: timely approval of contracts; maintenance of a quality assurance process for contracts; review and approval of contract invoices; and, procurement of small dollar value services.

This information was developed based on our fieldwork conducted over the period July 19, 2007 through October 15, 2007. To determine compliance, we reviewed policies and procedures, tested a sample of contracts awarded during the 2006/07 fiscal year, interviewed parties involved and performed other tests as deemed necessary.

CONTRACTS – TIMELY APPROVAL

Current policies and procedures are not ensuring that contracts are approved prior to the commencement date shown on the contract. Our review of a sample of 55 contracts found that 43 were not processed in a manner that allowed final approval by authorized personnel prior to the commencement date shown on the contract. This included the lack of timely submittal of 14 contracts that required approval by DGS. Further, we determined that actual work started on 28 of the contracts prior to approval.

The significant percentage of late contracts processed by DOJ indicates a weakness in time management. While it was difficult to determine the causes of delays in processing the sampled contracts, we ultimately concluded that many of the late contracts resulted from programs not submitting contract requests to the Contracts Unit in a timely manner.

It should be noted that we did observe that DOJ's contracting policies and procedures contain detailed information on processing timelines. In many instances, we found that programs were not submitting their contract requests in compliance with these timelines.

Public Contract Code Sections 10295 and 10335 provide that contracts are of no effect unless and until approved by DGS (if exempted from DGS approval by SAM, these criteria apply to approval by agency staff with written authority to approve the contract). The State's policies related to the approval and commencement of contracted work are presented in State Contracting Manual (SCM) Section 4.09. The basic State policy is that no contractor should start work until receiving a copy of the formally approved contract.

Recommendation

1. Implement policies and procedures that ensure the approval of contracts prior to the commencement date shown on the contract. As part of this process, program managers should be periodically reminded of the lead-time needed for the timely processing of contracts and their responsibility for ensuring that contract requests are submitted to the Contracts Unit in a timely manner.

QUALITY ASSURANCE PROCESS

The Contracts Unit's quality assurance process is not ensuring full compliance with the State's contracting requirements. For example, we found that 20% (7 of 35) of sampled delegated contracts had at least one instance of noncompliance with State contracting requirements. Since the instances of noncompliance were discussed with and provided to responsible management and staff during our audit fieldwork, they are not detailed in this report. However, the types of exceptions noted included:

- contracts not containing clear and concise language related to the scope of work to be provided (SCM 2.05);
- contracts of an amount of exactly $75,000 not being submitted to the DGS for review and approval. The DOJ's exemption authority only applies to contracts under $75,000.
- sufficient documentation not being maintained to disclose compliance with a number of contracting requirements including: (1) contracting opportunities being advertised in the California State Contracts Register (SCM 5.75); (2) prior to contract award, a verification being made with the Secretary of State to determine that a corporation is in good standing to do business in California (SCM 5.30.D); (3) contracts in excess of $5,000 being reported to the Department of Fair Employment and Housing (SCM 7.15.A.1); and, (4) a low bidder being notified in a timely manner that it was not being awarded a contract (SCM 5.65.B.2).
- janitorial contracts not containing terms requiring the use of janitorial supplies containing recycled paper products only (SCM 7.70.A.1).

The results of our audit testing as discussed above indicates that Contracts Unit management needs to review operating procedures to ensure that quality control processes are functioning as intended.

Recommendation

2. Implement additional quality assurance policies and procedures to assist in ensuring full compliance with the State's contracting requirements. This process should address the issues noted above.

CONTRACT PAYMENTS

Our review of the first payments made for 78 contracts disclosed 13 instances where billed and paid amounts did not agree to the terms, conditions or payment provisions of the applicable contract. For example, we noted 6 paid invoices that contained billed service costs that were outside the term dates of the applicable contract agreement. Further, we noted 3 paid invoices which contained costs calculated in a manner that did not agree with the payment terms of the applicable contract agreement.

At DOJ contract managers have the primary responsibility for verifying the accuracy of and approving contractor invoices for payment. As shown by the results of our tests, these employees are not consistently performing those duties in an adequate and effective manner. SCM Section 9.04.A.9 provides that a typical responsibility of a contract manager is to review and approve invoices for payment to substantiate expenditures for work performed. The

contract manager is the employee designated by a department to ensure compliance with all contract provisions (SCM 9.02.B).

Recommendation

3. Reemphasize to contract managers their responsibility for ensuring that invoiced amounts agree to contractual terms, conditions and payment provisions prior to authorizing payment of the billed costs.

SMALL DOLLAR VALUE CONTRACTS

Our review of DOJ's policies and procedures for awarding small dollar value contracts disclosed a couple areas of concern. The DOJ allows its program units to directly procure small dollar value services. Specifically, DOJ's policies governing these procurements are contained in DOJ Administrative Manual Section 12420. The policies allow a less formal contracting process to be followed to contract for services under $5,000. This includes the use of a Service Authorization form to contract for services, instead of the State's formal STD. 213 contracting form. In general, the Service Authorization process is to be used for one-time service awards which have simple payment provisions.

Although overall we concluded that DOJ's written policies and procedures governing the use of Service Authorizations are adequate, our tests disclosed that, in some instances, awards appeared to have been split to avoid the State's formal competitive bidding limit of $5,000. In fact, our review of 27 contractors that received multiple Service Authorizations during the 2006/07 fiscal year disclosed 7 instances where awards appeared to have been split to avoid the $5,000 limit. For example, we noted two Service Authorizations of $2,600 each totaling $5,200 that were for the same case and services on the same date. We also noted that contracted archive services totaling 220.5 hours of work were split between two Service Authorizations, one for $4,987.50 and one for $2,730. SCM Section 5.03.B provides that services may not be split to avoid the need to advertise or obtain competitive bids.

In addition, we developed concerns that some (five in our sample tests) apparent ongoing service needs are being procured as separate undertakings and contracted for through the use of multiple Service Authorizations issued to the same contractor, instead of through the use of a single contract agreement covering all of the services. For example, we noted 15 Service Authorizations totaling approximately $34,000 for electrical work that were issued to the same contractor during the 2006/07 fiscal year. The amount of the Service Authorizations, which were issued for separate jobs, varied from $300 to $4,987. We also observed 10 Service Authorizations totaling approximately $16,000 for video services that were issued to another contractor. The amount of the Service Authorizations, which were issued for separate jobs, varied from $841 to $4,226. To ensure that the State's interests are adequately protected, ongoing and related services should be combined into one service acquisition process to allow all interested businesses the opportunity to bid on the work.

Recommendations

4. Reemphasize to program unit management their responsibility for ensuring that the Service Authorization process is limited to the contracting for one-time service needs of an amount under $5,000. This should include a reminder that awards must not be split to avoid the $5,000 limit.

5. Periodically review the circumstances where multiple Service Authorizations are being issued to the same contractor during a fiscal year to determine if an annual/single contract agreement should be pursued for any ongoing service needs.

CONCLUSION

Our findings and recommendations are presented to aid DOJ in administering its contracting program. The DOJ should address the reported issues to assist in ensuring compliance with applicable State laws, policies and procedures.

Edmund G. Brown Jr.
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State of California
DEPARTMENT OF JUSTICE

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May 22, 2008

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RE: Response to Draft Audit Report: DOJ Contracting Program

Dear Mr. Gillam:

This letter responds to your audit of the Department of Justice's (DOJ) contracting program. Thank you for the opportunity to include this response in the final report. Although we disagree with the findings, we appreciate the hard work that your staff has put into the review, and we have developed or are developing solutions to strengthen our internal control policies and procedures in all identified areas of concern.

Please be assured that DOJ will take the necessary actions to improve compliance with State contracting laws, policies, and procedures, while continuing the timely provision of essential services that support the law enforcement community, maintain criminal justice operations, ensure public health and safety and provide for mandated legal services on behalf of the State of California.

In response to the findings and recommendations in your May 6, 2008 draft report, I submit the following comments:

1. Contracts - Timely Approval. Recommendation: Implement policies and procedures that ensure the approval of contracts prior to the commencement date shown on the contract. As part of this process, program managers should be periodically reminded of the lead-time needed for the timely processing of contracts and their responsibility for ensuring that contract requests are submitted to the Contracts Unit in a timely manner.

   DOJ concurs that approval of contracts prior to the commencement date shown on the contract is important, and that we should remind program managers of lead times needed. However, in certain litigation and legal investigations, fixed deadlines set by courts, statutes, and court rules do not allow for the current lengthy contract approval process. Expert witness contractors are frequently required to provide testimony or expert information immediately, and must first familiarize themselves with a case prior to providing testimony in court. Likewise, contracts in support of ongoing and active law enforcement missions must, in some cases, begin or continue with little advanced notice. The risk of postponement or stoppage of these services is not reasonable or workable. A 30 to 90 day wait for approval of a contract is not feasible under these circumstances and the provisions of contract services is considered by DOJ to be an emergency

within the meaning of Public Contracts Code section 1102. Therefore, the normal contract approval process must, in some instances, be modified to address this externally-mandated reality.

Significant internal changes to DOJ policy due to fiscal challenges have also occurred, adding to the incident of late approved contracts. DOJ requires a new form to be attached to each contract request over $1,000, and that the requests be reviewed by our Budget Office, the Administrative Support Director, and in some cases by myself. This adds significant time to the approval process, in return for better fiscal accountability. During the current tough budget times, this process will remain in place for service contracts.

Of the eight late contracts identified by contract number, two were legal services contracts awaiting funding for ongoing litigation, one involved a critical hazardous waste removal and destruction contract that was delayed by bid protest problems, and one was delayed by Department of General Services (DGS) pending emergency approval to California Highway Patrol for the renewal of the unarmed security Master Service Agreement. Services in all these instances could not be delayed.

Still, we will comply with your recommendation to remind program managers of the need for adequate lead times in the submission of contract requests. In addition, we will strengthen the language in our service contracts that instruct the contractor to not begin services until the contract is fully approved. A study will be conducted to identify and eliminate any process related barriers to timely approvals of contracts. Training of staff involved in the contracts process will emphasize the need for adequate lead times, and managing vendor's expectations as to when services can begin.

In a meeting with the DGS Director and the DGS Deputy Director of Legal Services on the issue of late contracts, it was agreed that including a letter of engagement dated before the commencement of services could serve as notice that there is an agreement, and that the ensuing contract documents would be ratified back to that date. DOJ will continue to use this letter of engagement, when needed, to mitigate the risk of starting services prior to the approval of the contract.

2. Quality Assurance Process. Recommendation: Implement additional quality assurance policies and procedures to assist in ensuring full compliance with the State's contracting requirements. This process should address the issues noted above.

   DOJ does not believe that the missing documentation asserted in this finding is material, or that a few anecdotal instances amount to a quality assurance issue.

   The contracts of the amount of exactly $75,000 were not submitted to DGS for review consistent with our long-standing interpretation of our exemption authority. We now understand that our delegation authority only applies to contracts in the amount of $74,999.99 or less. Our interpretation of our delegation was not a quality assurance issue. In any event, from now on, any contract of $75,000 or more will be submitted to DGS for review and approval.

   The exceptions noted in the report include two contracts that contain "clear and concise language related to the scope of work." These were both contracts with Lexis-Nexis that identified specific databases needed, specific number of users, at a specific price. Furthermore, they both used the terms and conditions in the DGS-awarded Master Services Agreement with that vendor.

Although three contract files did not contain copies of the California State Contracts Register (CSCR) advertisement, they all had evidence that the advertisement did occur, and included a published bid package and vendor responses. One of these contracts, Royal Janitorial, was a second place bidder that was awarded the contract because the apparent low bidder failed to comply with security background requirements. This was also the one apparent low bidder that the audit identified as not having been notified that it was not being awarded a contract. Since the vendor was non-responsive and not responsible, it was notified that a contract could not be awarded, and no other written notification was necessary. The contract advertisement was merely not moved from the denied vendor file to Royal Janitorial.

One contract was identified as not having Secretary of State verification of corporate good standing. This firm, NEC solutions, is in good standing, and evidence of that is included in other contract files with the same vendor. Likewise, the one contract that did not include a copy of the STD 16 contract notification to the Department of Fair Employment and Housing (DFEH) was included in the transmittal letter to DFEH at the time of award, and that transmittal letter was produced.

Taken as a whole, these should be a discussion item based on materiality and significance. Notwithstanding the comments above, DOJ concurs that proper file documentation is important. The DOJ Contracts Unit has developed a new checklist to be completed prior to the submittal of all service contracts for final approval. Procedures have been changed to increase quality control checks, including final review and verification by the assigned contract analyst using the new checklist. This new procedure will help confirm the inclusion of all necessary documentation required for ensuring compliance with State contracting rules, including but not limited to those mentioned in this audit. In addition, new standard language has been added to require the use of recycled paper products in janitorial contracts. Finally, contracts of exactly $75,000 will be sent to DGS for review and approval.

3. Contract Payments. Recommendation: Reemphasize to contract managers their responsibility for ensuring that invoiced amounts agree to contractual terms, conditions, and payment provisions prior to authorizing payment of the billed cost.

   DOJ concurs with the above recommendation. To improve the quality of contract management and to verify invoices at the time of payment, we will implement four separate initiatives. First, the DOJ Contracts Unit will develop a brochure on the role and responsibility of the contracts manager, which will be included in the distributed program copy of each contract. Second, those individuals designated as contracts managers will be asked to attend the DGS Cal-PCA class on service contracting, where the topic of contract management is covered. Third, internal DOJ contracts training will emphasize steps necessary for proper invoice approval. Finally, in conjunction with the actions taken by the DOJ Contracts Unit, the DOJ Accounting Office has implemented written procedures and provided additional training to their staff. This secondary review will help mitigate the risk of invoice payments being made outside the contract parameters. We are confident that each of these initiatives will help ensure improved contract management and approval of invoices.

4. Small Dollar Value Contracts. Recommendations: Reemphasize to program unit management their responsibility for ensuring that the Service Authorization process is limited to the contracting for one-time service needs of an amount under $5,000. This should include a reminder that awards must not be split to avoid the $5,000 limit. Periodically review the circumstances where multiple Service Authorizations are being issued to the same contractor during a fiscal year to determine if an annual/single contract agreement should be pursued for any ongoing service needs.

DOJ's Service Authorization process is in place to allow for simple one-time services under $5,000. It has been successful in this, and is an important part of DOJ's contracting strategy. We recognize the need to ensure that the process is limited to these one-time services or for services where an ongoing single contract is impractical. Examples of these are auto repairs and printing jobs approved for outside contracting by the Office of the State Publisher. Other valid uses of Service Authorizations include litigation related services, small equipment or facility repairs, and rentals of training or conference rooms.

We concur with the recommendation that program management be reminded that the Service Authorization is for one-time services, and that multiple Service Authorizations with the same vendor is indication that a single contract agreement for that service may be needed. Prior to this audit, we had begun identifying areas that needed larger, competitively-bid contracts rather than Service Authorizations. For instance, large contracts have recently been awarded in the areas of legal reprographics services, messenger and courier services, subpoena service, and court filing services. In addition, we now require additional reviews and pre-approvals for Service Authorizations of $1,000 or more. This will help identify areas where larger contracts or no contract at all, is needed. Finally, and most importantly, the DOJ Contracts Unit has created a team to work on updating all aspects of the Service Authorization process. This is a collaborative effort including contracts, accounting, program management, and training personnel. The outcome of this effort will be a new process, forms, and management review structure that will address all of your concerns identified here.

In conclusion, I would like to again thank you and your staff for the hard work performed in the compliance review of our contracting program. If you have any follow up questions, please contact me at (916) 322-9036.

Sincerely,

Andrew Kraus III

Andrew Kraus III
Acting Director Office of Program Review and Audits

For EDMUND G. BROWN JR.
Attorney General

cc: Jim Humes, Chief Deputy Attorney General
Sue Johnsrud, Director, Division of Administrative Support, DOJ
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William Holtz, Manager, Office of Departmental Services, DOJ
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DEPARTMENT OF JUSTICE
AUDIT OF CONTRACTING PROGRAM

EVALUATION OF DOJ'S RESPONSE

We have reviewed the response by the Department of Justice (DOJ) to our draft report. The response to the recommendations is satisfactory. We appreciate the efforts taken or being taken by DOJ to improve its contracting program.