State of California:

Unnecessary Administrative Fees Increase the State’s Cost of Contracting With California State Universities

November 2000

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November 21, 2000

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

Dear Governor and Legislative Leaders:

As part of our annual financial and compliance audit of the State of California for the fiscal year ended June, 30 2000, required by Section 8546.3 of the California Government Code, the Bureau of State Audits presents its audit report concerning the State’s interagency agreements with the Board of Trustees of the California State University (board) and standard agreements with California State University (CSU) foundations.

This report concludes that contracts with CSU entities appear appropriate; however, some state departments have unnecessarily paid or agreed to pay the university system about $3 million in fees to administer these contracts. This is occurring because, rather than contracting directly with the foundation providing the needed services, some departments contract with the board, which acts as an intermediary. In addition, some departments pay higher fees because they negotiate rates for administrative fees without sufficient knowledge of the cost the CSU entities actually incur for administrative activities. Finally, we found departments pay more in fees because CSU foundations hire subcontractors and purchase goods for them, although the departments could procure these services and goods more cheaply themselves or seek to avoid the amount of administrative fees tacked on to the cost of these items.

Respectfully submitted,

Elaine M. Howle

ELAINE M. HOWLE
State Auditor
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Health and Human Services Agency, Department of Health Services

Resources Agency
SUMMARY

RESULTS IN BRIEF

State departments (departments) contract for billions of dollars of services every year. To obtain needed services, departments do not always look to the private sector to identify contractors; sometimes they contract with entities in the California State University (CSU) system for the expertise of the faculty, staff, and students at the various CSU institutions. From July 1998 to February 2000, state departments had contracts worth $143 million with the CSU system. We reviewed a sample of 183 contracts worth $93 million and found CSU faculty and students appropriately performed the majority of the work. Furthermore, when the university needed to hire subcontractors for some portion of the work, the subcontractors were properly selected through a competitive bid process, if bidding was required.

While the contracts with CSU entities appear appropriate, we did find that some state departments have unnecessarily paid or agreed to pay fees to administer these contracts.

State departments will pay the board $1.5 million to act as intermediary between the State and the CSU foundations.

State departments could have saved $1.4 million in administrative fees had they negotiated the average 15 percent rate.

By allowing CSU foundations to purchase goods and services for them, state departments paid $102,000 more than necessary.

Audit Highlights . . .

Our review of the State’s contracts with the California State University (CSU) system revealed that:

☑ While the contracts with CSU entities appear appropriate, state departments have unnecessarily paid or agreed to pay fees to administer these contracts.

☑ State departments will pay the board $1.5 million to act as intermediary between the State and the CSU foundations.

☑ State departments could have saved $1.4 million in administrative fees had they negotiated the average 15 percent rate.

☑ By allowing CSU foundations to purchase goods and services for them, state departments paid $102,000 more than necessary.

Another factor contributing to higher fees is that some departments negotiate rates for administrative fees without sufficient knowledge of the cost the CSU campuses actually incur for administrative activities. This leaves the departments ill-equipped to bargain for more competitive rates. In our sample of 183 contracts, fees generally ranged from 8 percent to 25 percent of the contracts’ direct costs and covered expenses for administrative support as well as for managing personnel, finances, and facilities. The average administrative fee for the contracts reviewed was 15 percent of total direct costs. However, state departments often paid more than 15 percent. Taking into account only those 36 contracts not brokered by the board in
which the administrative fee exceeded 15 percent, the State could have saved $1.4 million had the contracting department negotiated the average 15 percent fee.

In other situations, departments pay more in fees because CSU campuses hire subcontractors and purchase goods for them, although the departments could procure these services and goods more cheaply themselves or seek to avoid the amount of administrative fees tacked on to the cost of these items. We identified eight contracts in which campuses entered into large subcontracts for printing services and training materials that the departments could easily have procured themselves—and saved the State $102,000 in administrative fees. Since contracts between state departments and CSU entities are exempt from competitive bidding, it is important for department managers to adequately understand and carefully scrutinize all contract costs to determine that charges are reasonable and necessary.

RECOMMENDATIONS

To ensure they are receiving the best value when contracting with the CSU system, state departments should limit administrative fees by these actions:

- Avoid contracts using fiscal intermediaries, such as the board, that add little value.

- Negotiate rates for administrative fees based on a fuller understanding of the actual costs comprising the rate.

- Contract directly with third parties for goods and services when it is more cost-effective, or avoid payment of the administrative fees tacked on to the cost of goods and services state departments could procure at reduced costs on their own.

AGENCY COMMENTS

The agencies that responded to our report generally agreed with our findings and recommendations. The Business, Transportation and Housing Agency and the Department of Transportation indicated some comments regarding why they pay higher rates for administrative fees in federally funded contracts with the CSU system than they do in similar state funded contracts.
INTRODUCTION

BACKGROUND

The California Public Contract Code and the State Contracting Manual establish basic guidelines for state departments entering into contracts and interagency agreements with the California State University (CSU) system. The State Contracting Manual exempts from competitive bidding contracts between state departments and the Board of Trustees of the California State University (board) or CSU foundations. A foundation is a nonprofit corporation established to support the educational, research, and community service objectives of a CSU campus. To achieve these goals, the foundation manages the campus’ grants and contracts and fosters relationships with other public and private entities. Subcontracting and purchases under agreements with the foundations should still be competitively bid.

Many state departments contract with the CSU system to take advantage of the expertise of its faculty, staff, and student resources. For example, departments look to the CSU campuses to develop the content for various publications and to assist with research by conducting field studies. State departments can obtain services by entering into interagency agreements with the board, which then contracts with campus foundations. The board functions as a resource broker to match the research, education, training, and service needs of state departments with the expertise of the CSU faculty, staff, and students. In other cases, departments contract directly with a foundation.

In either case, administrative fees are written into the contract to cover the costs of managing a contract and include such items as personnel management, financial management, facilities management, and other administrative support.

SCOPE AND METHODOLOGY

As part of our annual financial and compliance audit of the State for the fiscal year ending June 30, 2000, the Bureau of State Audits reviewed the State’s interagency agreements with the board and standard agreements with CSU foundations. To
evaluate the State’s compliance with the laws, regulations, and policies governing contracts, we reviewed the California Public Contract Code and the Government Code, the State Administrative Manual, and the State Contracting Manual; from these sources, we identified policies governing interagency and standard agreements.

To determine whether contractual agreements that state departments have with the board and CSU foundations meet the standards outlined in state laws and regulations, we obtained a listing of all of their contractual agreements with terms effective from July 1998 to February 2000. We reviewed all contracts of $100,000 or more but excluded those between the CSU system and other state educational institutions, such as the University of California and the California Community Colleges. In addition, we visited the following CSU campuses, which had at least 12 contracts with state agencies of $100,000 or more:

- Chico
- Fresno
- Long Beach
- Pomona
- Sacramento
- San Diego

In reviewing these contracts, we determined whether using the board or a CSU foundation was in the best interest of the State and whether the state department received good value in return. We also reviewed the extent to which the CSU campuses used subcontractors to determine if the process of hiring of subcontractors circumvented the State’s competitive bidding requirements.

Our review included agreements with 33 different state agencies. In addition, we met with contract managers at the Commission on Peace Officer Standards and Training, the Department of Health Services, and the Department of Parks and Recreation to discuss their contracting practices and to obtain their perspectives on certain agreements, as necessary.
AUDIT RESULTS

CONTRACTS WITH CALIFORNIA STATE UNIVERSITIES APPEAR APPROPRIATE

We reviewed 183 contracts worth $93 million and found that California State University (CSU) faculty and students performed the majority of the work contracted for. In 170 of these contracts, faculty and students performed 75 percent or more of the work. When subcontractors completed some portion of the work, we found that they were appropriately selected through a competitive bidding process, if required.

CONTRACTING WITH THE BOARD OF TRUSTEES OF THE CALIFORNIA STATE UNIVERSITY IS MORE COSTLY TO THE STATE

Although contracts appear appropriate, we found that many state departments pay more than necessary for administrative fees when contracting with the CSU system. Many departments are paying more fees because they are contracting with the Board of Trustees of the California State University (board) instead of negotiating contracts directly with the campuses. The board acts as an intermediary for the state department and the CSU foundation that provides the services. It establishes master agreements with the CSU foundations, enters into an interagency agreement with a state department, and then issues work authorizations to the foundation that will provide the contracted services.

Currently, various departments have over 240 agreements totaling $35 million with the board. Based on the terms of these agreements, the board will receive about $1.5 million. Although on average this amount represents about 5 percent of direct costs, the board will receive 10 percent of the 25 percent fee in about half of the agreements while the foundation will retain the remaining 15 percent. By contracting directly with CSU foundations, state departments could avoid these costs. Although one state manager noted that contracting with the board is beneficial if a department is not familiar with the
expertise of CSU faculty and staff, three other state managers have found little benefit in contracting with the board. When they contracted directly with a campus foundation, they paid only a 15 percent administrative fee.

We found that five different state departments had 15 individual contracts of $100,000 or more with the board in which the total administrative fee was 25 percent. For example, one contract between the board and the Department of Health Services (DHS) called for the California State University Sacramento (CSUS) Foundation to research, produce, and distribute educational material and to conduct various trainings and workshops. Contracting through the board cost the DHS an additional $124,000 in administrative fees. The DHS could have avoided this cost because its program manager already knew this foundation could provide the services and therefore did not need the resource brokering services of the board.

In addition to paying the board an administrative fee as part of the initial contract, departments also pay the board the administrative fee for amended contracts. This additional fee is unnecessary because the board had already identified the foundation to do the work at the time of the initial agreement. For example, the DHS’ agreement mentioned above was initially for $952,000, including $76,000 in administrative fees for the board. Later amendments increased the amount of the agreement by $600,000. The DHS paid the board an additional $48,000 in administrative fees on the amended amount, even though it received little value for this expense.

UNDERSTANDING THE ACTUAL COSTS UNDERLYING ADMINISTRATIVE FEES COULD ENABLE DEPARTMENTS TO NEGOTIATE LOWER RATES

State departments may be paying more for administrative fees than necessary because they are negotiating fees without sufficient knowledge of the cost CSU foundations actually incur for administrative activities. Many times an administrative rate is negotiated based on the rate in other agreements that a CSU foundation has with other government entities. For instance, many agreements with federal agencies specify a rate for administrative fees at about 40 percent of the direct labor costs. In fact,
representatives of two foundations told us that they seek to obtain rates similar to federally allowed rates when contracting with state departments.

The foundations do incur administrative costs, such as time keeping and processing payroll for faculty and staff working on projects and preparing invoices to the state department for payment. However, the fees negotiated in these agreements do not appear to be based on the actual cost of the administrative activities that are necessary to carry out each individual agreement. Instead, state departments and the foundations simply negotiate an overall fee to generally support the foundations’ administrative efforts.

We noted a wide range of rates for administrative fees in the 183 agreements we reviewed of $100,00 or more between state departments and CSU entities, as shown in Table 1.

**Table 1**

<table>
<thead>
<tr>
<th>CSU Campus</th>
<th>3-10%</th>
<th>11-15%</th>
<th>16-24%</th>
<th>25% or Greater</th>
<th>Totals</th>
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<td></td>
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<td>4</td>
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<tr>
<td>Chico</td>
<td>5</td>
<td>3</td>
<td>6</td>
<td></td>
<td>14</td>
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<tr>
<td>Fresno</td>
<td>9</td>
<td>6</td>
<td></td>
<td></td>
<td>15</td>
</tr>
<tr>
<td>Hayward</td>
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<td></td>
<td></td>
<td></td>
<td>2</td>
</tr>
<tr>
<td>Long Beach</td>
<td>1</td>
<td>2</td>
<td>2</td>
<td>1</td>
<td>6</td>
</tr>
<tr>
<td>Monterey Bay</td>
<td>1</td>
<td>1</td>
<td></td>
<td></td>
<td>2</td>
</tr>
<tr>
<td>Northridge</td>
<td>4</td>
<td></td>
<td></td>
<td></td>
<td>4</td>
</tr>
<tr>
<td>Pomona</td>
<td>5</td>
<td>3</td>
<td>3</td>
<td></td>
<td>11</td>
</tr>
<tr>
<td>Sacramento</td>
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<td>6</td>
<td>3</td>
<td>34</td>
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<tr>
<td>San Bernardino</td>
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<td>2</td>
<td></td>
<td></td>
<td>5</td>
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<tr>
<td>San Diego</td>
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<td></td>
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<td>Sonoma</td>
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<td>8</td>
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<td>Subtotals</td>
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<td>55</td>
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<td>13</td>
<td>15</td>
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<td>Totals</td>
<td>63</td>
<td>56</td>
<td>32</td>
<td>32</td>
<td>183</td>
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</tbody>
</table>
Of the 183 agreements sampled, 119 had administrative fees constituting 15 percent (the average rate) or less of direct contract costs. For the majority of the agreements, CSU entities were satisfied when they were paid rates of 15 percent or less. However, state departments paid more than 15 percent for 28 of the 31 agreements that went through the board. As described above, payments of administrative fees to the board will cost state departments about $1.5 million. In addition, 36 of the 152 contracts negotiated directly with CSU foundations had rates exceeding the 15 percent average with 17 at 25 percent or greater. Had departments negotiated the average rate of 15 percent for the 36 agreements, they could have saved $1.4 million. In the Appendix, we provide a list of state departments and the administrative fees they agreed to pay to CSU entities.

To provide a better understanding of how foundations use administrative fees, we profiled an agreement between the Sonoma State University Academic Foundation and the Department of Transportation to perform archaeological studies. We found that the administrative fee rate for this $950,000 agreement was 42 percent of personnel costs or nearly $239,000, which equates to 34 percent of the total direct costs. This rate was based on the administrative fees that the foundation was allowed to charge in its agreements with federal agencies. The Figure on the following page shows how the administrative fees were allotted in this agreement.

The Anthropological Studies Center (center), a part of the foundation at the time, performed the work related to this agreement. However, only half of the administrative fees were used to cover the center’s costs. Of the remainder, 10 percent, or $24,000, was allocated to the School of Social Science for project administration and 40 percent, or $96,000, to the University Administration and Finance Division, which provides overall administrative support to all campus entities. This allocation does not seem to be based on the costs that the various campus groups would actually incur to carry out this agreement. In this and similar instances, it would be appropriate for state contracting officers to ask foundations to justify the rate in terms of actual costs the campus expects to incur. Equipped with this information, state contracting officers would be in a better position to negotiate a competitive rate.
DEPARTMENTS MAY PAY FEES UNNECESSARILY IF CALIFORNIA STATE UNIVERSITIES PROCURE GOODS AND SERVICES FROM SUBCONTRACTORS

Departments may pay more in unnecessary fees when they allow the foundations to purchase goods and services from external vendors and subcontractors instead of contracting with these parties directly. For 13 of the 183 contracts of $100,000 or more, the foundations used subcontractors to perform more than 25 percent of the work. In six cases, the departments could have easily avoided additional fees by procuring the goods and services directly. In one example, the DHS entered into two contracts with the CSUS Foundation, one directly with the foundation and one through the board as described above, to
design and print educational brochures. The foundation designed the brochures but used a subcontractor to print them. If the DHS had contracted directly with the printer, it could have saved $71,000.

In another example, the Department of Parks and Recreation (DPR) contracted with the CSUS Foundation to design and produce public relations and marketing documents. For the printing of two newsletters and other booklets and brochures, the DPR contracted directly with printing companies, thus saving $8,700 in fees. However, it had the foundation subcontract the printing of other items under this contract, such as reply cards, posters, and banners. If the DPR had contracted directly with private companies for these items, it could have saved an additional $1,900 in fees.

The remaining contracts we identified with unnecessary fees were between CSU foundations and the Commission on Peace Officer Standards and Training (commission) for leadership and management training courses. When we reviewed all of the foundations’ contracts with the commission, we identified two additional contracts with similar scopes of work. The commission paid $29,000 more than necessary in administrative fees for these five agreements because the commission had the CSU foundations purchase training materials for about 1,100 students, including books, course completion certificates, notebooks, office supplies, videotapes, and printed handouts. In addition to being reimbursed for the actual costs of these purchases, the foundations also received over $29,000 in administrative fees simply for acting as purchasing agents for the commission. By using one of its own staff to arrange for these purchases, the commission could have saved these funds. We calculated that the $29,000 in administrative fees paid by the commission would pay the salary and benefits of a purchasing agent for over five months, which far exceeds the amount of effort needed to purchase the training materials in these agreements. Alternatively, the commission could have negotiated an administrative rate that excluded the cost of these training materials in the calculation of administrative fees. In our review of other contracts, we noted multiple instances in which items like subcontractor costs were excluded from the calculation of administrative fees.

Departments could have saved at least $102,000 by purchasing goods and services directly from vendors rather than having the CSU make the purchases.
In summary, if departments had not contracted through the board, they could have saved about $1.5 million in administrative fees over the terms of the existing multiyear agreements. In addition, for the 36 agreements with rates in excess of 15 percent that were negotiated directly with CSU foundations, departments could have saved $1.4 million if they had negotiated the average rate of 15 percent instead. Finally, departments could have saved at least $102,000 by procuring goods and services directly from vendors rather than having the foundations make the purchases. Since contracts between state departments and CSU entities are exempt by state law from competitive bidding, it is essential that state contract managers carefully scrutinize all costs to avoid paying unnecessary fees or other costs and ensure the State is receiving the best value for its money.

RECOMMENDATIONS

To ensure they are receiving the best value when contracting with the CSU system, state departments should limit administrative fees by these actions:

- Avoid contracts using fiscal intermediaries, such as the board, that add little value.

- Negotiate rates for administrative fees based on a fuller understanding of the actual costs comprising the rate.

- Contract directly with third parties for goods and services when it is more cost-effective, or avoid payment of the administrative fees tacked on to the cost of goods and services state departments could procure at reduced costs on their own.
We conducted this review under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,

ELAINE M. HOWLE
State Auditor

Date: November 21, 2000

Staff: John F. Collins, CPA
      Matthew Liu
      Bryan Beyer
      Preston Hatch
APPENDIX

State Agencies Pay Varying Rates for Administrative Fees When Contracting With California State Universities

As described in our report, state departments that contract with California State Universities pay varying rates for administrative fees. Table 2 lists the 183 agreements we reviewed of $100,000 or more by state agency and groups them into various ranges of administrative fee rates.

TABLE 2
State Agencies Pay Varied Administrative Fee Rates To CSU Entities

<table>
<thead>
<tr>
<th>State Agency</th>
<th>3-10%</th>
<th>11-15%</th>
<th>16-24%</th>
<th>25% or Greater</th>
<th>Totals</th>
</tr>
</thead>
<tbody>
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<td>Air Resources Board</td>
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<td>4</td>
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<td>1</td>
<td>11</td>
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<tr>
<td>California Coastal Commission</td>
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<tr>
<td>California Integrated Waste Management Board</td>
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<td>1</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>California Postsecondary Education Commission</td>
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<tr>
<td>California Trade and Commerce Agency</td>
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<tr>
<td>Commission on Peace Officer Standards and Training</td>
<td>2</td>
<td>1</td>
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<td>3</td>
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<tr>
<td>Department of Boating and Waterways</td>
<td>1</td>
<td></td>
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<td></td>
<td>1</td>
</tr>
<tr>
<td>Department of Fish and Game</td>
<td>1</td>
<td>4</td>
<td></td>
<td></td>
<td>5</td>
</tr>
<tr>
<td>Department of Consumer Affairs</td>
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<tr>
<td>Department of Corrections</td>
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<td>2</td>
</tr>
<tr>
<td>Department of Health Services</td>
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<td>10</td>
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<td>5</td>
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</tr>
<tr>
<td>State Agency</td>
<td>3-10%</td>
<td>11-15%</td>
<td>16-24%</td>
<td>25% or Greater</td>
<td>Totals</td>
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Agency’s comments provided as text only.

California State University
Office of the Chancellor
401 Golden Shore
Long Beach, CA  90802

November 2, 2000

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

Dear Ms. Howle:

Thank you for your October 30, 2000 letter regarding draft audit number 2000-001.4, which reviews state departments’ expenditures made through agreements with the California State University. In general, I agree with your recommendations encouraging state agencies to contract directly with our campuses and auxiliary organizations rather than using a fiscal intermediary. Eliminating the intermediary, in our case the University Services department of the CSU Institute, should indeed reduce contract overhead. In fact, effective September 30, 2000, I eliminated University Services in an effort to streamline state agency contracting. Campuses have been delegated authority to contract directly with state agencies. In addition, as your audit recommended, campuses have been delegated authority to negotiate rates for administrative fees with state agencies.

Thank you for the opportunity to comment on the audit. If you require any additional information, please contact Mr. Larry Mandel, University Auditor at 562-951-4441.

With kind regards,

Sincerely,

Charles B. Reed

(Signed by: Charles B. Reed)

Charles B. Reed
Chancellor
Dear Ms. Howle:

We are in receipt of your letter to Commission Chairman, Ted Hunt, and excerpts from your draft report. We appreciate the opportunity for review and input.

The draft includes the assertion, “The Commission paid $29,000 more than necessary...” We believe the point at issue is more problematic or conditional than this positive assertion connotes.

If the Commission had chosen to purchase the materials directly, the Commission would have incurred costs not yet calculated. We would also have experienced workload/staffing difficulties perhaps not recognized by the auditors. While it is not certain that we could have negotiated the same indirect charge if we had excluded materials purchased from the indirect calculations, we take this observation seriously and will address the matter in future contract negotiations.

The draft asserts that the Commission was charged $5.00 each for 631 blank video tapes that could have been purchased for $1.64 each. Actually, the contract at issue includes a budget item for 432 video tapes at $5.00. This was a budget amount only, and our records reflect that the Commission actually paid $2.16 each for these video tapes. The tapes purchased are slightly higher quality than those available at $1.64 each.

*California State Auditor’s comments appear on page 19.
Finally, the draft observes that savings might be found in quantity discounts for textbooks. We agree that this matter should be evaluated.

Thank you for the opportunity to comment.

Sincerely,

(Signed by: Glen Fine)

GLEN FINE
Acting Executive Director
California State Auditor’s Comments on the Response From the Commission on Peace Officer Standards and Training

To provide clarity and perspective, we are commenting on the response to our audit report from the Commission on Peace Officer Standards and Training (commission). The numbers below correspond to the numbers we have placed in the commission’s response.

1. We recognize that if the commission had made the purchases we describe on page 10 itself, it would have incurred some limited additional cost. However, this additional cost would have been much less than the $29,000 it paid to the universities.

2. Because the commission reports that it ultimately paid $2.16 for each videotape, instead of the $5 it had agreed to pay in the contract budget, we have removed the example from our text. However, the commission put itself at risk of paying inflated prices by approving a price of $5 per tape in the contract budget.
Blank page inserted for reproduction purposes only.
Agency’s comments provided as text only.

Business, Transportation and Housing Agency  
980 9th Street, Suite 2450  
Sacramento, CA 95814  

November 3, 2000  

Elaine M. Howle*  
State Auditor  
Bureau of State Audits  
555 Capitol Mall  
Sacramento, CA 95814  

Dear Ms. Howle:  

Attached is the Department of Transportation’s (Caltrans) five-day response to your draft report State of California: Unnecessary Administrative Fees Increase the State’s Cost of Contracting With California State Universities (#2000-001.4). Thank you for the opportunity to respond to the draft report.  

We believe that it is incumbent upon any state agency to ensure that they are receiving the best value when contracting with the California State Universities system or any other entity. Part of accomplishing that objective requires that negotiated administrative fee rates are reasonable and supportable. To that end, the established process for the negotiation of administrative fee rates in federally funded contracts with the California State Universities places the negotiation responsibilities with the federal government. Specifically, the federal Office of Management and Budget Circulars A-87 and A-21, which establish the principles and standards for determining costs for federal awards carried out through cost-reimbursement contracts (A-87 for state and local governments, and A-21 for educational institutions), require that administrative fee rates be reviewed, negotiated and approved by the federal cognizant agency.  

In the case of such contracts, Caltrans carries out its responsibilities by performing pre-award audits to ensure that the federally negotiated rates are used, and periodically conducts post-award audits to ensure that the administrative fees actually charged are supportable. We believe these actions constitute a reasonable effort given the requirements for federally funded contracts.  

If you need additional information, please do not hesitate to contact me, or Michael Tritz, Chief of the Office of Internal Audits within the Business, Transportation and Housing Agency, at (916) 324-7517.  

Sincerely,  

(Signed by: Al Lee for:)  

MARIA CONTRERAS-SWEET  
Secretary  

Attachment  

*California State Auditor’s comments begin on page 25.
November 2, 2000

MARIA CONTRERAS-SWEET, Secretary
Business, Transportation and Housing Agency
980 - 9th Street, Suite 2450
Sacramento, CA 95814

Dear Secretary Contreras-Sweet:

I am pleased to provide our response to the Bureau of State Audits’ (BSA) report on the State’s cost of contracting with California State University (CSU) foundations. The report recommended that state departments, including the Department of Transportation (Caltrans), ensure that they are receiving the best value when contracting with the CSU system. To do this, the BSA stated that state departments should negotiate rates for administrative fees based on a fuller understanding of the actual costs comprising these rates.

The BSA auditors stated that some state departments, including Caltrans, are paying more for administrative fees than necessary. BSA further states that this is because these departments do not always negotiate for administrative fees that are based on actual costs.

The BSA report profiled an agreement between Caltrans and Sonoma State University Academic Foundation to illustrate its finding. This was a contract for archaeological studies to be performed by this foundation. The auditors stated that the administrative fee rate charged to Caltrans under this agreement was 42% of personnel costs, or $239,000. This was based on the rate allowed the foundation by federal agencies for indirect costs. However, according to the BSA, the allocation of costs did not seem to be based on costs that the campus would actually incur to carry out the agreement. The BSA stated that only half of the administrative fees were used for the indirect costs of the foundation’s Anthropological Studies Center. Of the remainder, 10% was allocated to the School of Social Science for project administration, while 40% went to the University’s Administration and Finance Division, which provides overall support to all campus entities.
The report also tabulated the range of rates charged by CSU foundations in agreements with Caltrans.

Caltrans acknowledges that there are a variety of administrative rates charged in its agreements with CSU foundations. However, Caltrans would like to point out the following:

- Caltrans accepts the federal rate (42% in the above example) for administrative costs in cases where the agreements are financed by federal funds. The federal government reviews the indirect cost rate proposals of CSU campuses and campus foundations and approves the use of a negotiated rate for billing on all federal contracts. The rate is developed by the campus and negotiated and approved by its federal cognizant agency (U.S. Department of Health and Human Services). The negotiated indirect cost rates are based on federal cost principles covering the allowability of costs. The indirect cost negotiation agreement covering this specific contract, Section IID, states “The rates in this agreement were approved in accordance with the authority in Office of Management and Budget Circulars A-122, A-21, or HHS (Health and Human Services) hospital cost principles, as appropriate, and should be applied to grants, contracts and other agreements covered by the appropriate regulation...” In other words, these are the indirect cost rates that HHS expects the foundation to use in its federally funded contracts.

- Caltrans performs pre- and post-award audits on contracts with CSU foundations. These audits help ensure that the indirect cost rates charged by the foundations are reasonable. For this specific contract, Caltrans performed a pre-award audit and ensured that the correct federally negotiated indirect cost rate was used in the contract. In addition, Caltrans’ Office of Audits and Investigations performs periodic post-audits of completed contracts involving CSU campuses and their foundations.

- BSA should consider the cost of implementing its recommendation on a contract by contract basis versus the benefits derived. Relying on the federally approved rate, performing pre-award audits to determine the reasonableness of the costs, and performing periodic post audits are all current steps that Caltrans takes to ensure all costs, including indirect, billed on contracts are reasonable. To request that Caltrans obtain a fuller understanding of the actual costs comprising the rate would require we duplicate the federal indirect cost rate negotiation process. We believe it would be more beneficial for BSA to address this specific issue to the campus if they believe their rates are not a reflection of their actual costs to administer the contract. It should be noted that section IIC of the indirect cost rate negotiation agreement states “If a fixed rate is in this agreement, it is based on an estimate of the costs for the period covered by the rate. When the actual costs for this period are determined, an adjustment will be made to a rate of a future year(s) to compensate for the difference between the costs used to establish the fixed rate and actual costs.” In other words, the CSU foundation is responsible to make any needed adjustment between the negotiated rate and its actual costs.
BSA should consider that the CSU foundation incurs costs to support the contract that must also be recovered for the work of the School of Social Science and the work of the Administrative and Finance Division. According to the federal government, these are reasonable allocations to recover costs incurred in the administration of a federal contract.

BSA should consider that the indirect cost rates vary depending on the campus, the campus department or foundation, and whether it is an on-campus or off-campus function. There are several rates for every CSU campus and several foundations at each CSU campus. In some cases, the campus foundation may be a subcontractor. As such, the 15% average identified in the BSA audit report may not be meaningful.

In conclusion, Caltrans believes its current process of relying on the federal indirect cost rate setting process, pre-award, and periodic post-audits ensures that indirect costs charged on contracts are reasonable. To obtain a more complete understanding of the actual costs constituting the rate would be duplicative and unnecessarily costly.

If you have any questions, or require further information, please do not hesitate to contact Gerald Long at (916) 323-7122.

(Signed by: Jeff Morales)

JEFF MORALES
Director
California State Auditor’s Comments on the Response From the Business, Transportation and Housing Agency

To provide clarity and perspective, we are commenting on the responses to our audit report from the Business, Transportation and Housing Agency (agency) and the Department of Transportation (Caltrans). The numbers below correspond to the numbers we have placed in the respective responses.

1. The agency and Caltrans are incorrect when they assert that it is solely the federal government’s responsibility to negotiate the administrative fee rates in federally funded contracts. State departments that spend federal money have a responsibility as well. According to a representative from the Division of Cost Allocation of the federal Department of Health and Human Services, the federal cognizant agency for Caltrans, the federal indirect cost rate represents a maximum administrative fee rate that an entity such as a California State University (CSU) can charge in federally funded contracts. There is no prohibition for an organization to negotiate a lower administrative fee rate when appropriate. In fact, federal guidelines recognize there are instances in which a single indirect cost rate for all activities of a grantee department or agency or for each major function of the agency may not be appropriate. A single rate may not take into account those different factors which may substantially affect the indirect costs applicable to a particular program or group of programs. The factors may include the physical location of the work, the level of administrative support required, the nature of the facilities or other resources employed, the organizational arrangements used, or any combination thereof.

In our view, the fact that the department pays significantly lesser rates for administrative fees in its other agreements with CSU campuses that are state funded should cause it to question the higher rates the campuses charge in federally funded agreements. Clearly, the sources of funds used to pay for an agreement should not dictate the rate for administrative fees.
For federally funded contracts, it appears that Caltrans prefers to rely on the federally approved indirect cost rate. However, this rate represents the maximum allowable rate that can be charged in federally funded contracts. We believe that as the contracting department, Caltrans should not simply agree to pay the maximum allowable rate. Rather, contracting departments should negotiate an indirect cost rate based on an understanding of the actual administrative costs.

Our report recognizes that CSU foundations incur administrative costs for managing a contract including such items as personnel management, financial management, facilities management, and other administrative support. However, since the Anthropological Studies Center performed the work related to the agreement we profiled, we question that half of the administrative fees went to other campus groups, such as the School of Social Science and the University Administration and Finance Division, who were only incidentally involved with the agreement. In addition, since this agreement included anthropological field studies conducted at an off-campus location, the need to utilize campus facilities and equipment was limited. In fact, the federally approved indirect cost rate for Sonoma State University identifies a lower maximum rate of 19.8 percent for activities conducted off campus, which is 22.2 percent lower than the 42 percent Caltrans paid.

We are well aware that campus foundations have several indirect cost rates. However, our essential point is expressed on page 8 of our report where we point out that for 119 of the 183 agreements we sampled, CSU entities were satisfied when they were paid rates of 15 percent or less. The 15 percent average indirect cost rate is indeed meaningful.
Agency’s comments provided as text only.

Health and Human Services Agency  
1600 Ninth Street, Room 460  
Sacramento, CA 95814  

November 3, 2000

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

Dear Ms. Howle:

Thank you for forwarding for my review and comment a draft copy of the Bureau of State Audits’ report titled, “State of California: Unnecessary Administrative Fees Increase the State’s Cost of Contracting With California State University.” I am forwarding to you the attached Department of Health Services’ (DHS) response to the review findings and recommendations, and understand that DHS has begun taking steps to address the issues raised in the Bureau’s report.

Sincerely,

(Signed by: David Maxwell-Jolly for:)

GRANTLAND JOHNSON

Attachments
Dear Ms. Howle:

Thank you for the opportunity to comment on the draft of your recent review of the Department of Health Services' expenditures made through agreements with the California State University (CSU) auxiliaries for the period of July 1, 1998, to February 29, 2000. We concur with your findings and recommendations.

You recommend that to ensure Department of Health Services (DHS) receives the best value when contracting with the CSU system, we should limit administrative fees by the following actions:

1. Avoid contracts using fiscal intermediaries, such as the Trustees of the California State University (trustees), that add little value.

2. Contract directly with third parties for goods and services when it is more cost-effective, or avoid payment of the administrative fees tacked on to the cost of goods and services that we could procure at reduced cost on our own.

In response to your recommendations, we are in the process of issuing to DHS programs the following policy instructions:

1. Contract directly with individual California State University campuses and foundations to avoid incurring unnecessary administrative costs charged by the trustees. Avoid entering agreements directly with the trustees, whenever possible.

2. Negotiate the lowest possible indirect cost rate and/or administrative fee when contracting directly with any university campus or with the trustees. Avoid the payment of unnecessary administrative fees and overhead in subcontracts and amendments to university agreements.

3. Evaluate the necessity of using subcontracts under university agreements and strive to reduce subcontracts to 25 percent or less of the total agreement amount.
4. Eliminate the use of subcontracts under university agreements whenever it is more practical and cost effective for DHS to directly secure and coordinate the services of a third party.

5. Avoid the use of subcontracts under university agreements unless the nature of the project/service is such that it is impractical for DHS to directly secure and coordinate those services.

We expect these policies to reduce the administrative costs of CSU contracts. If you have additional questions or concerns, please feel free to contact Ms. Peg Gerould, Acting Deputy Director for Administration, at (916) 657-3054. Again, thank you for the opportunity to comment.

Sincerely,

(Signed by: Diana M. Bontá)

Diana M. Bontá, R.N., Dr.P.H.
Director
Blank page inserted for reproduction purposes only.
The Resources Agency of California
1416 Ninth Street, Suite 1311
Sacramento, CA 95814

November 6, 2000

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

RE: Response to Draft Audit

Dear Ms. Howle:

The Department of Parks and Recreation has prepared the following response to the draft audit “Unnecessary Administrative Fees Increase the State’s Cost of Contracting With California State Universities:”

Finding:

DEPARTMENTS MAY PAY FEES UNNECESSARILY IF CSU PROCURES GOODS AND SERVICES FROM STATE CONTRACTORS.

The Department has indicated it concurs with the recommendation to limit administrative fees and will implement improved processes to ensure the most cost effective alternative is used.

We appreciate the opportunity to review and comment on the Draft Report.

Yours sincerely,

(Signed by: Michael Sweeney for:)

Mary D. Nichols
Secretary for Resources
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