

California Children and Families Commission

Its Poor Contracting Practices Resulted in Questionable and Inappropriate Payments to Contractors and Violations of State Law and Policies

REPORT NUMBER 2006-114, OCTOBER 2006

California Children and Families Commission's response as of October 2007

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits (bureau) review the California Children and Families Commission's (state commission) spending practices, planning efforts, and contracting procedures.

Finding #1: The state commission did not enforce contract terms for one contractor, resulting in overpayments totaling more than \$673,000.

The state commission, in paying invoices totaling \$623,000 in fees and expenses submitted by one of its media contractors, allowed the contractor to circumvent the payment provisions of a contract. The contractor claimed the expenses by representing some of its employees as subcontractors. In addition, the state commission paid the media contractor an added \$50,000 fee that was unallowable per the contract. These payments violated the terms of the contract, which allowed for payments based only on the contractor's own services, in the form of commissions applied to the cost of the advertising it placed; no other services or fees were to be charged.

We recommended that the state commission ensure that both it and its contractors comply with all contract terms.

State Commission's Action: Corrective action taken.

The state commission stated in its 90-day response to our audit that its most concerted efforts have been on staff training to ensure that all staff with any contract management responsibility understand the state's contracting procedures. In its one-year response, the state commission provided a schedule of the training courses that its staff attended between December 2006 and September 2007. It also stated that now that it has completed the Procurement Policy and Procedure Manual (manual), key staff will attend formal, internal training courses during November and December 2007 on topics such as contract concepts and timeline development, contract monitoring, invoice review and approval, and conducting and documenting solicitations. In its 90-day response, the state commission also had indicated that it appointed a specific staff member to track the training status of staff with contract responsibility. Finally, in its one-year response, the state commission pointed to a specific section of the new manual that discusses procedures its staff should follow when contractors do not appear to be complying with contract terms.

Audit Highlights . . .

Our review of the California Children and Families Commission's spending practices and contracting procedures revealed that it:

- » *Allowed one of its media contractors to circumvent the payment provisions of a contract by paying invoices totaling \$673,000 for fees and expenses of some of the contractor's employees that were prohibited under the terms of the contract.*
- » *Did not fully use the tools available to it to ensure its contractors provided appropriate services.*
- » *Could not always demonstrate it had reviewed and approved final written subcontracts and subcontractors' conflict-of-interest certificates.*
- » *Did not always follow state policy when it used a competitive process to award three contracts valued at more than \$47.7 million and failed to provide sufficient justification for awarding one \$3 million contract and six amendments totaling \$27.6 million using the noncompetitive process.*

Finding #2: The state commission did not fully use the tools available to it to ensure that its contractors promptly provided appropriate services.

The state commission did not always include certain important elements when developing some of the contracts we reviewed. Specifically, the state commission's contracts did not always include a clear description of work to be performed, schedules for the progress and completion of the work, and a reasonably detailed cost proposal. Further, it did not always ensure that its contractors submitted adequate work plans, that it received all required work plans, and that it promptly approved them. As a result, the state commission cannot ensure that the resulting contracts clearly established what was expected from the contractor, that the contracts provided the best value, and that its contractors provided the agreed-upon services within established timelines and budgets.

We recommended that the state commission ensure that it fully develops its contracts by including clear descriptions of work, schedules for progress and completion of work, reasonably detailed cost proposals, a requirement for adequate supporting documentation for expenses, and clearly defined types of allowable expenses. We also recommended that it consistently enforce contract provisions requiring contractors to submit complete and detailed work plans before they perform services and incur expenses and to ensure that it promptly reviews and approves work plans.

State Commission's Action: Corrective action taken.

Again, the state commission referred to its 90-day response, which stated that it was sending all staff with any contract management responsibility to various training courses. In that same response, it also indicated that it had developed standard language for all new contracts, which addresses allowable out-of-pocket expenses and requires the contractor to obtain clarification from the state commission in advance of incurring an expense when it is unclear under the terms of the contract whether the expense is authorized. The state commission also stated that it redesigned the work plans it requires its public relations contractors to provide to include a detailed description of services and to identify the deliverables, target audience, and proposed completion timeline, as well as other information. Finally, in its one-year response, the state commission pointed to various sections of its new manual that describes the processes and procedures staff must follow related to the scope of work for a contract, schedules for progress and completion of work, contract budgets, and work plans.

Finding #3: The state commission did not document its oversight of subcontractor agreements and conflict-of-interest certificates.

The state commission could not demonstrate that it had reviewed and approved the final written subcontracts and subcontractors' conflict-of-interest certificates as required. Specifically, our review of a sample of nine contracts and 28 invoices associated with those contracts found that under each contract, the contractors charged for services provided by at least one and sometimes as many as six subcontractors. When we requested these subcontracts and conflict-of-interest certificates, the state commission had to forward our request to its contractors because it did not maintain copies of these documents in its files. Ultimately, it was only able to obtain 19 of a total of 22 requested subcontract agreements. Furthermore, the state commission was only able to obtain either the conflict-of-interest certificate or the conflict-of-interest language embedded within the subcontract for 14 of the 19 subcontracts it obtained. However, it was unable to locate the remaining five certificates. Because the state commission did not maintain these documents in its files, we question whether it reviewed and approved these documents as required before authorizing the use of subcontractors.

Additionally, subcontractors may be unaware of their obligation to preserve records that could be the subject of future audits. The state contracting manual requires contractors to include a provision in subcontracts indicating that the State has the right to audit records and interview staff in any subcontract related to the performance of the agreement. Our review of 19 subcontractor agreements found that five did not contain this language.

We recommended that the state commission establish a process to ensure that it obtains and reviews final written subcontracts and conflict-of-interest certificates before it authorizes the use of subcontractors. Additionally, it should ensure that its contractors include in all their subcontracts a provision indicating that the State has the right to audit records and interview staff in any subcontract related to the performance of the agreement.

State Commission's Action: Corrective action taken.

The state commission's 90-day response indicated that it is ensuring all staff with any contract management responsibility understand contracting procedures by requiring them to attend various training courses. Moreover, in its one-year response, it also pointed out a section in its new manual, which clearly indicates that the state commission must approve in advance final written subcontracts and conflict-of-interest certificates before the subcontractor performs any work. Further, in its 90-day response, the state commission indicated that it uses a Department of General Services' (General Services) form that contains general terms and conditions as a standard part of its contracts. One of the clauses in that document indicates the State's right to audit records and interview staff in any subcontract related to the performance of the agreement.

Finding #4: The state commission sometimes paid unsupported and inappropriate contractor expenses.

Although prudent business practices and some of its contracts include provisions requiring its contractors to include documentation necessary to support the expenses claimed, our review found that the state commission did not always enforce these provisions. Although generally the state commission received documentation to support the expenses claimed in our sample of 62 payments made to its contractors, we found both significant and minor instances in which this was not the case. Even when contractors included supporting documentation, the state commission did not always adequately review it before approving payment.

We recommended that the state commission consistently enforce contract provisions requiring contractors to submit supporting documentation for expenses claimed. Further, it should ensure that it performs an adequate review of such documentation before approving expenses for payment.

State Commission's Action: Corrective action taken.

The state commission's 90-day response indicated that it is ensuring all staff with any contract management responsibility understand contracting procedures by requiring them to attend training courses. In its one-year response, it also referred to a section in its new manual that discusses its invoice review and approval process, including a process for comparing the invoice to various documents, such as the contract and work plans, before approving them for payment.

Finding #5: The state commission inappropriately advanced funds to three contractors.

The state commission provided advance payments to three contractors even though it does not have the authority to do so. According to the state contracting manual, the State is permitted to make advance payments only when specifically authorized by statute, and such payments are to be made only when necessary. In addition, state laws are designed to ensure that public money is invested in and accounted for in the state treasury. Further, other state laws prohibit making a payment until services have been provided under a contract.

However, the state commission inappropriately advanced \$2.5 million to a public relations contractor for the administration of the state commission's regional community-based organization program. The public relations contractor then took between 30 days and six months to disburse the funds to the selected community-based organizations. Our review of 13 other invoices from the same public relations contractor showed that the state commission advanced it funds for the regional community-based organization program totaling \$6.8 million on three other occasions—invoices dated

July 2003, February 2004, and September 2004. Further, the state commission made advance payments in December 2005 and March 2006 to two county commissions totaling more than \$91,500 under memorandums of understanding. When the state commission makes advance payments without the proper authority, it loses the interest it would otherwise earn on these public funds.

We recommended that the state commission ensure it does not make advance payments to its contractors unless it has authority to do so.

State Commission's Action: Corrective action taken.

According to the state commission's 90-day response, the community-based organization program for which it made advances was completed before the bureau raised its concern about these advances. Additionally, the state commission indicated that based on the bureau's recommendation, it cancelled a similar program that was in the pre-disbursement phase. It further stated that it has no current plans to pursue other programs requiring advance payments absent sufficient legal authority to do so. Finally, in its one-year response, it pointed to the section of its new manual that prohibits advance payments unless specifically authorized by statute.

Finding #6: Although it held strategic planning sessions annually, the state commission has not updated its written strategic plan since 2004.

The state commission poorly managed its process for updating its strategic plan, which outlines the current progress of its initiatives and future plans to advance its vision of school readiness. According to the executive director, the state commission annually either develops a draft plan or updates the prior year's plan, and presents it to the commissioners for their review and approval. However, it last updated its strategic plan in 2004. According to the executive director, although the strategic plan was presented and discussed with the commissioners in January 2004 and January 2005, the state commission did not request their formal approval.

In October 2006 the executive director provided us with a draft copy of a commission proceedings manual. The manual includes an annual commission calendar that lists recurring issues the commissioners are required to consider, such as adopting the strategic plan. The executive director hopes to begin using the manual in January 2007 if the commissioners adopt it.

We recommended that the state commission ensure that it updates its strategic plan annually and presents it to the commissioners for review and approval.

State Commission's Action: Corrective action taken.

In its 90-day response, the state commission indicated that the commissioners reviewed and approved the strategic plan in October 2006, which was effective until June 30, 2007. Additionally, in its one-year response, the state commission stated that it had developed and the commissioners adopted the most recent plan in September 2007.

Findings #7: The state commission did not always follow state requirements when awarding competitive contracts and it provided insufficient justification for awarding two contracts and six amendments using the noncompetitive process.

The state commission did not always follow state policies during its process of competitively awarding contracts. For instance, it did not fully justify its reason for awarding three contracts, totaling more than \$47.7 million, when it received fewer than the minimum required number of three bids. Also, the state commission was unable to demonstrate that it had advertised a \$90 million contract in the state contracts register as required by state policy.

Moreover, when awarding some of its contracts and amendments using the State's noncompetitively bid (noncompetitive) contract process, the state commission did not provide reasonable and complete justifications for using the process or for the costs of the contracts awarded. Two of the five noncompetitive contracts we reviewed had insufficient justification of the costs of the contract. For one of these contracts, as well as for six of eight amendments to contracts originally awarded using either a competitive bid or the noncompetitive process, the state commission cited insufficient staff resources or time limitations as its reason for using the noncompetitive process. We do not believe that these circumstances are compelling reasons for avoiding a competitive bidding process.

To ensure that it protects the State's interests and receives the best products and services at the most competitive prices, we recommended that the state commission follow the State's competitive bid process for all contracts it awards, unless it can provide reasonable and complete justification for not doing so. Further, it should plan its contracting activities to allow adequate time to use the competitive bid process.

We also recommended that the state commission fully justify the reasonableness of its contract costs when it receives fewer than three bids or when it chooses to follow a noncompetitive bid process. It should also advertise all nonexempted contracts in the state contracts register.

State Commission's Action: Corrective action taken.

The state commission's 90-day response indicated that it is ensuring all staff with any contract management responsibility understand contracting procedures by requiring them to attend training courses. The state commission also referred to several sections of its new manual—acquisition planning, ensuring a full and open competitive process for formal competitive procurements, noncompetitively bid contracts, and competitive contracts receiving less than three bids, as well as others—where it has addressed some of the issues related to these recommendations. For example, the manual specifically identifies the documentation that staff must prepare when three bids are not received. It also provides guidance to staff related to noncompetitively bid contracts and justification as to the reasonableness of the contract costs.

Finding #8: Documentation for the scoring of competitive proposals was inconsistent.

Inconsistencies in its documentation of the scoring process for contract bids may leave the state commission open to criticism and challenges to its decisions. It uses a consensus method to score proposals it receives on competitively bid contracts. For the nine competitively bid contracts we reviewed, the state commission retained only the consensus score sheet for each proposal submitted in six of the competitive contracts. Without all the individual scoring materials used in discussing and selecting a winning proposal, it is not possible for us or others to independently replicate the results.

To ensure that it promotes fair and open competition when it awards contracts using a competitive bid process, we recommended that the state commission ensure that it fully documents its process for scoring proposals, and that it retains the documentation.

State Commission's Action: Corrective action taken.

The state commission's 90-day response indicated that it is ensuring all staff with any contract management responsibility understand contracting procedures by requiring them to attend training courses. In its one-year response, the state commission also referred to several sections of its new manual that outline its competitive bid process including requirements that all RFPs include the evaluation criteria and selection process and all evaluation and scoring sheets be available for public inspection at the conclusion of the scoring process.

Finding #9: The state commission did not always follow state policies when allowing subcontractors under its interagency agreements and contracts with government agencies.

Of the 24 interagency agreements and four contracts with other government agencies we reviewed, 25 included the services of subcontractors, for a total of at least \$64.6 million. This represents 53.6 percent of the total of \$120.6 million for these agreements and contracts. For 17 of 25 interagency agreements and contracts with other government agencies, the state commission did not always comply with state policies when justifying the use of subcontractors. Three of the 17 appear to have included subcontractors, but the amount of funds subcontractors are to receive is not clear. We also question the justification for the remaining 14 subcontracts totaling \$38.3 million.

To ensure that it follows state policies and protects the State's interest when using interagency agreements and contracts with government agencies, we recommended that the state commission obtain full justification for the use of subcontractors when required and, if unable to do so, deny the use of subcontractors.

State Commission's Action: Corrective action taken.

The state commission indicated that its new manual addresses this recommendation. Our review of the new manual found that it provides guidance related to interagency agreements and contracts with governmental agencies, but more specifically, it states that work performed under a government contract generally must be performed by the contractor agency, not subcontractors. However, it also provides staff the specific provisions that apply if subcontractors are used under these types of contracts.

Finding #10: The state commission agreed to reimburse contractors for indirect costs at higher rates than state policy allows.

The state commission did not always comply with state policies limiting the amount of administrative overhead fees paid to contractors for each subcontract. In fact, the state commission, in its interagency agreements, approved budgets to reimburse its contractors for over \$1.2 million more than the state contracting manual allows.

To ensure that it follows state policies and protects the State's interests when using interagency agreements and contracts with government agencies, we recommended that the state commission limit the amount that it will reimburse its contractors for overhead costs to the rates established in the state contracting manual.

State Commission's Action: Corrective action taken.

The state commission indicated that its new manual addresses this recommendation. Our review of the new manual found that it contains a section that appears to provide appropriate guidance to staff on overhead fees and indirect costs, including establishing limits.

Finding #11: The state commission circumvented contracting law when it used memorandums of understanding to obtain services.

In fiscal years 2004–05 and 2005–06, the state commission awarded five memorandums of understanding (MOUs) and two amendments totaling more than \$595,000. It appears to have intentionally used some of these to avoid having to comply with state contracting requirements, and for at least two MOUs and one amendment the intention was explicit. Although state contracting law allows agencies to enter into contracts with local government entities without competitive bidding, it strictly prohibits agencies from using these contracts to circumvent competitive bidding requirements.

To ensure that MOUs it awards allow for fair and competitive contracting and protect the State's best interests, we recommended that the state commission follow laws and policies applying to contracts when awarding and administering MOUs.

State Commission's Action: Corrective action taken.

Although in its 90-day response the state commission indicated that it had suspended its MOU program pending further review, its new manual provides specific guidance as to those few instances when an MOU can be used.

Finding #12: The state commission consistently failed to obtain approvals for its contracts and amendments on time.

According to state law, all contracts entered into by agencies, except those meeting criteria for exemptions, are not in effect unless and until approved by General Services. The state commission failed to obtain the required approvals before the beginning of the contract term for 43 of 45 of the contracts we reviewed. Similarly, it did not obtain the required approvals for 22 of the 44 amendments we reviewed until after the related contract or prior amendment had ended. Although we did not review all of the contracts to determine whether work began before approval, we noted three instances in which the contractor provided services totaling more than \$7 million before the state commission obtained final approval of the contracts. The state commission also failed to obtain the required approvals altogether on three amendments.

To ensure that it does not expose the State to potential financial liability for work performed before the contract is approved, we recommended that the state commission ensure that it obtains General Services' approval of its contracts and amendments before the start of the contract period and before contractors begin work.

State Commission's Action: Corrective action taken.

The state commission's 90-day response stated that it is ensuring all staff with any contract management responsibility attend training courses related to contracting procedures. In its one-year response, it also referred to several sections in its new manual, one of which clearly states that staff are not authorized to instruct contractors to begin work before a signed copy of the contract is received.

Finding #13: The commissioners may have improperly delegated authority to award contracts.

State law authorizes the state commissioners to enter into contracts on behalf of the state commission. The commissioners adopted a formal resolution in May 2001 delegating their contracting authority to enter into and amend contracts to state commission staff. In this same resolution, the commissioners took action to ratify all prior contracts. It is our understanding that although the commissioners meet in public session to authorize expenditure authority and specify amounts of money for particular purposes, the ultimate decision to enter into contracts and the selection of providers of goods and services is performed by state commission staff. Our legal counsel advised us that it is a well-accepted principle of law that a power given to a public official that involves the exercise of judgment or discretion may not be delegated to others without statutory authority. In this case, no statute authorizes the commissioners to delegate their contracting authority.

To ensure that the state commission staff may lawfully enter into or amend contracts on behalf of the commissioners, we recommended that the state commission seek appropriate legal counsel.

State Commission's Action: Corrective action taken.

The state commission has hired a chief counsel. In its one-year response, the state commission did not address whether the chief counsel had reviewed the bureau's recommendation and advised commission staff regarding the legality of delegating the authority for taking certain actions regarding contracts. However, in a separate letter dated December 5, 2007, the state commission indicated that its chief counsel reviewed this issue beginning in May 2007 and continuing through July 2007, when she rendered her legal opinion to the commission and its staff. However, when we requested a copy of the legal opinion, the chief counsel told us that it was an oral opinion and that she could not provide us any information related to her opinion, asserting attorney-client privilege.

She did, however, provide us with the state commission's current policy related to the approval of contracts and it remains as it was during our audit. Accordingly, it is the continued practice of the state commission to authorize all expenditures in excess of \$150,000, and to delegate to the executive director and his or her designee the authority to award and enter into any contracts that expend those funds.