DHCS

Department of Health Care Services
MEMORANDUM

Date: September 30, 2009

To: Bryan Hobson, Chief
Program Support Branch
Administration
1501 Capitol Avenue, MS 1400

From: Thomas J. Rakela, C.F.E., Chief
Internal Audits
1500 Capitol Avenue, MS 2001
(916) 445-0759

Subject: Contract Exemption Review – Final Report (09003)

Internal Audits has completed the Contract Exemption Review of the Department of Health Care Services (DHCS). This review was performed to comply with the Department of General Services' (DGS) Exemption Letter 55.4 and its amendments. The exemption allows DHCS to authorize contracts under $75,000 without first obtaining DGS' approval.

As part of its operating responsibilities, Internal Audits is responsible for following-up on all inadequacies and weaknesses identified in this review. A corrective action plan, including the status of any action taken as well as any planned action, is due within 30 days from the date of this letter. Also, an update should be provided every six months until all corrections have been completed.

Pursuant to the Governor's Executive Order S-08-09, Internal Audits' reports will be made available to the public within five working days of finalization. Accordingly, this report will be posted to the internet at http://reportingtransparency.ca.gov/.

We appreciate the hospitality and cooperation extended by Program Support Branch, and hope that the recommendations will benefit your future operations.

If you have any questions, please call me at (916) 650-0272.

Attachment

cc: See next page.

cc: Karen Johnson
Chief Deputy Director
Policy and Program Support
1501 Capitol Avenue, MS 0003

John Eastman
Deputy Director
Administrative Division
1501 Capitol Avenue, MS 1000

Richard Gillam, Chief
Office of Audit Services
Department of General Services
707 Third Street, Eighth Floor

Fred Daniels
Audit Supervisor
Office of Audit Services
Department of General Services
707 Third Street, Eighth Floor

Jayna Querin, Chief
Contracts and Purchasing Services
Program Support Branch
Administration
1501 Capitol Avenue, MS 1403

DEPARTMENT OF HEALTH CARE SERVICES

INTERNAL AUDITS

Contract Exemption Review

September 2009

09003

DEPARTMENT OF HEALTH CARE SERVICES
INTERNAL AUDITS

CONTRACT EXEMPTION REVIEW

SEPTEMBER 2009

AUDITOR:
SHEILA GARFIO

THOMAS J. RAKELA, C.F.E.
CHIEF OF INTERNAL AUDITS

ASSIGNMENT NO. 09003

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EXECUTIVE SUMMARY

EXECUTIVE SUMMARY

Internal Audits has completed its review of the Department of Health Care Services' (DHCS) internal controls for the processing of specific contracts. This review is required by the Department of General Services (DGS) in their Exemption Letter 55.4 and its amendment. The exemption allows DHCS to authorize contracts under $75,000 without obtaining DGS approval. Our review concentrated in DHCS' Contract Management Unit (CMU) and applicable programs. The review included testing of contracts, grants, Service Orders, DHCS' CAL Card usage, and contractual agreements written under the Master Service Agreements and the California Multiple Award Schedules.

On July 1, 2007, the California Department of Health Services separated into two distinct departments, the DHCS and the California Department of Public Health. The results of this report pertain to Exemption Letter 55.4, which was granted to DHCS.

The audit report opinion is qualified because contracts are not consistently approved on time (repeat finding) as a result of untimely submission by the programs to CMU.

This report contains a total of two audit findings:

- The majority of the 24 sampled contracts processed and approved were finalized after the start of the contract period. Additionally, work was started prior to contract approval.
- CMU and Program contract files did not include copies or originals Contractors Certification Clauses.

The findings and recommendations were discussed with CMU and applicable program management during the course of our audit. CMU and program management were very receptive to our findings and corrective action was underway on the findings.

AUDITOR'S OPINION

AUDITOR'S OPINION

Internal Audits has conducted a review and evaluation of the system of internal controls for the processing of contracts by the Department of Health Care Services' (DHCS) Administration Division, in effect, as of September 30, 2009. Our examination was conducted in accordance with the auditing standards published by the Institute of Internal Auditors, Inc. Compliance testing was performed in accordance with the approved Department of General Services' (DGS) Audit Guide and requirements found in the State Administrative Manual (SAM), Chapter 1200, and the State Contracting Manual.

The examination included a review to document the system of internal controls for the processing of contracts, to determine if the system of internal controls can be reasonably relied upon, and to test the effectiveness of the internal control system through evaluation of a sample of contracts awarded since the last internal audit.

A sample of contracts was selected for review from each of the following categories as required by the DGS Audit Guide:

- Contracts under $75,000 as specified in DGS Exemption Letter 55.4 and its amendment.
- Contracts including grants exempted from DGS approval by statute, an Attorney General's opinion, or other authority.
- Informal contracts, such as Service Orders.
- Contracts and Services Orders written under the Master Service Agreements.

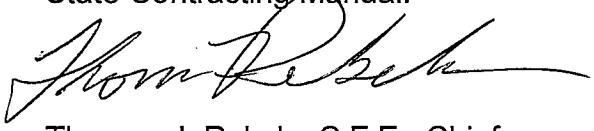
Contract agreements were selected randomly and judgmentally to ensure that a comprehensive variety of contractual agreements were examined for this review. In part, Internal Audits reviewed the contracts to ensure whether:

- Acceptable policy and procedures and adequate separation duties existed.
- Contracts were approved timely.
- The scope of work was clear and payment terms appropriate.
- Services were started after the contract was approved.
- Appropriate components were included in the contracts.
- Résumés were included when appropriate.
- Grants should have been contracts.
- Contracts were properly and adequately monitored, including post evaluations.
- Contracts were not split to avoid approval of DGS.
- Payments were made timely.
- Amendments properly processed through DGS when the amount was over $75,000.

Nothing came to our attention during this review to indicate that any contracts were inappropriately classified as grants.

Our review and evaluation disclosed that the current control system could not ensure that contracts were approved prior to commencement of the contract period and prior to the commencement of contract work.

In our opinion, except for the condition described in the preceding paragraph, the system of processing contracts by DHCS' Administration Division, in effect as of September 30, 2009, taken as a whole, is adequate and sufficient to provide reasonable assurance that contracts are in compliance with the SAM, § 1200 through 1233, and the State Contracting Manual.



Thomas J. Rakela, C.F.E., Chief
Internal Audits

BACKGROUND

BACKGROUND

The Department of General Services (DGS) has been designated by the State Legislature as the lead agency to oversee state contracts. However, the Director of DGS has the authority to exempt certain contract transactions from the legally required DGS approval. The law that established DGS' authority also sets the maximum dollar amount of the exemption, $75,000 beginning January 1, 1995, for the letting of contracts and sets specific requirements that must be met. An audit of the Department of Health Care Services' (DHCS) contracting process is one of those requirements. DHCS is granted an exemption only after a quality control review of this audit is done by DGS to assure that the requirements for exemption were met.

The purpose of this audit is to determine compliance with the conditions of the Exemption Letter 55.4 and its amendment, which include compliance with specific legal requirements. To that end, the DGS Audit Guide was used to conduct this audit. DGS can then conduct a quality control review economically and efficiently.

FINDINGS AND RECOMMENDATIONS

FINDINGS AND RECOMMENDATIONS

Finding 1 The majority of 24 sampled contracts processed and approved were finalized after the start of the contract period. Work was started prior to contract approval.

Condition

Of the 258 contracts processed by the Department of Health Care Services (DHCS), only 77 contracts were less than the exemption amount of $75,000. We sampled approximately one-third of these contracts, or 24 contracts. Sixteen of the contracts sampled were approved after the start date of the contracts. Some contracts were approved as late as six months into the contract period. Furthermore, services were performed prior to the contract being approved for 8 of the 16 approved late.

According to the Contract Management Unit (CMU), they encourage Department staff to submit contract packages timely, but the issue of late contracts is still present. CMU sends out Administrative Memos to the programs regarding timely contract processing and CMU has reduced their processing time in-house. Due to various reasons, program staff continues to submit contracts late or incomplete causing delays in approving contracts. A contributing factor for the late contracts continues to be the chronic delays in passing the state's budget.

Contractors commencing work before an agreement is fully executed run the risk of having the agreement disapproved or payments disallowed or delayed. This, in turn, could cause problems for the programs in achieving their delivery of services. Regardless, CMU has no control over when services are performed. This issue is addressed by the specific program.

Criteria

CMU is required to process contracts in an efficient and timely manner. Health Administrative Manual, § 9-2110 states that contract approval can take between 2 and 14 weeks or longer from the date a final contract package is received by CMU for processing before the agreement is fully executed.

The State Contracting Manual (SCM), § 4.02 states that each state agency is responsible for making sure that its contracts comply with applicable legal requirements and is based on sound business practices. CMU should make every effort to process and approve contracts timely.

SCM, § 4.09 states that the basic state policy is that no contractor should start work until receiving a copy of the formally approved contract. Contractors that begin work before an agreement is fully executed face the risk of having the agreement disapproved or payments disallowed or seriously delayed.

Recommendations

A Programs should make every effort to comply with regulations to ensure that contracts are processed timely.

B CMU should continue to remind program staff of the importance of timely submission of contracts.

Finding 2 Contractor Certification Clauses were unavailable for review.

Condition

Payments were tested for 17 sampled contracts and it was noted that five contract files did not include copies of the Contractors Certification Clauses (CCC). The remaining twelve were not applicable to the requirement.

CMU does not receive the original CCCs unless contracts are competitively bid, but they do keep the original signed contracts on file. CCCs are submitted with bid documentation, but are left with the bid materials and not filed with the contract. The programs that submit the contracts check an area on Agreement Summary Form STD. 215 that confirms the presence of a CCC. However, the program did not have or send a copy of the CCC to CMU with the contract.

The cover letter to collect a contractor's signature on the Standard Contract Agreement on the internet site for DGS' Legal Services detailed the items that were to be submitted for certain contracts. The CCC is a required item that must accompany the completed standard contract when the signed contract is submitted to the department program. Additionally, DGS' example cover letter states that the CCC will be kept on file in a central location and must be renewed every three years and updated as changes occur.

DGS' CCC Form 307 is a certification under the laws of the State of California that allows persons or entities to conduct business with the state. The Certification of compliance must be furnished before the offer is final or the contract is void.

As discussed with CMU's Unit Chief, the CCC number varies and corresponds with a particular General Terms and Conditions (GTC) version cited on the face of an agreement. Not all agreements cite the GTC as some cite the General Interagency Agreement terms (GIA) and, as such, a signed CCC is not required in all instances.

DGS cover letters that appear on DGS' website consist of samples that were posted for permissive departmental use to introduce the standard contract process that began in 1998. The last revision to the DGS Standard Agreement Cover Letter was September 14, 2001. The items to be completed and submitted are included in the Checklist in the body of the cover letter. Item three names the CCC and the requirements associated with its renewal every three years and submission. DHCS' former DGS attorney informed CMU that the CCC certification was good for the duration of the contract if the term of the contract is longer than three years.

Criteria

Public Contract Code, §10295 states that all contracts entered into by any state agency for the performance of work or services by the state agency for or in cooperation with any person, or public body, are void unless and until approved by the department. Every contract shall be transmitted with all papers, estimates, and recommendations concerning it to the department and, if approved by the department, shall be effective from the date of the approval.

SCM, § 9.09 states that each agency is responsible for maintaining all invoices, records, and relevant documentation for three years after the final payment under the contract (Government Code, § 8546.7). The following format is recommended for the maintenance of contract records:

1. Label a file folder for each contract administered.
2. In each file folder include: A log sheet for a diary of activities related to the contract.
3. Each time you speak with anyone about the contract, make a note of the date of the discussion, and the subject matter discussed.
4. A file guide labeled "Invoices." Retain a copy of all invoices in this file guide.
5. A copy of the executed contract and other pertinent documentation, such as a copy of the original contract request and any correspondence related to the contract or contractor.

Recommendations

C Programs should attach a copy of the completed CCC to each applicable contract when it is submitted to CMU. A CCC is not required for each contract. Contracts citing the GIA do not need a signed CCC.

D Program should keep the original CCC on file either in a single location/binder or in the contract file.

E CMU should issue an Administrative Memo to all programs regarding the additional requirement for processes associated with CCC.

AUDITEE'S RESPONSE

Department of Health Care Services

MEMORANDUM

DATE: September 28, 2009

TO: Thomas J. Rakela, C.F.E., Chief
Internal Audits
1500 Capitol Avenue, MS 2001
Sacramento, CA 95814

FROM: Bryan Hobson, Chief
Program Support Branch
1501 Capitol Avenue, MS 1403
Sacramento, CA 95814

SUBJECT: Response to Internal Audit Report

The Department of Health Services' Program Support Branch's Contract Management Unit (CMU) has received and reviewed the Internal Audit findings completed in accordance with Department of General Services' Exemption No. DHCS 55.4 that examined the policies, procedures, and controls exercised in the processing of service contracts.

CMU appreciates the work performed by DHCS' Internal Audit staff and the opportunity to review and respond to the draft report. Below is CMU's response to the audit findings and recommendations.

In addition to CMU's audit response, CMU has included a separate document containing recommended alterations to the "Conditions" in Audit Finding 2 in which some statements are in need of minor revision.

Please contact me at 650-0171 if there are questions or concerns about CMU's response.

Sincerely,

Bryan Hobson, Chief
Program Support Branch

cc: John Eastman, Deputy Director, Administration
Jayna Querin, Chief CMU

Audit Findings, Recommendations, and Responses

Finding 1 The majority of 24 sampled contracts processed and approved were finalized after the start of the contract period. Work was started prior to contract approval.

Recommendations

A Programs should make every effort to comply with regulations to ensure that contracts are processed timely.

B CMU should continue to remind program staff of the importance of timely submission of contracts.

Response CMU concurs with the audit findings and recommendations. This is a historical audit finding. Although a number of efforts have been undertaken over the past years, the timely processing of all contracts is a goal that has yet to be attained.

The Department of General Services (DGS) issued Administrative Orders 06-05 and 06-05.1 in fiscal year 05/06 announcing the policy and requirements for approval/non-approval and acceptance requirements, as well as allowed exceptions for submitting untimely contract documents to DGS for approval.

In a continuing effort to stimulate timely contract initiation by DHCS programs, CMU will issue a CMU Notice/Bulletin reminding DHCS programs to submit their contracts to CMU in a timely manner and to discourage contractors from beginning work prior to receiving a copy of a fully approved and executed contract. In the CMU Notice, program staff will be directed to DHCS' Intranet instructions communicating procedures for compliance with DGS' Administrative Orders. CMU will strive to release the CMU Notice/Bulletin by October 16, 2009 and have it posted on DHCS' Intranet CMU Notice site.

In a continuing effort to discourage contractors from beginning work prior to full contract execution, CMU will continue to make available for Program use contractor signature collection letter templates and model solicitation language instructing contractors not to begin work in advance of notification that all contract approvals have been obtained.

Audit Findings, Recommendations, and Responses

Finding 2 Contractor Certification Clauses were unavailable for review.

Recommendations

C Programs should attach a copy of the completed CCC to each applicable contract when it is submitted to CMU.

D Program should keep the original CCC on file in single location/binder or in the contract file.

E CMU should issue an Administrative Memo to all programs regarding the additional requirement for processes associated with CCC.

Response CMU concurs with the audit findings and recommendations.

CMU agrees to issue an Administrative Information Memo informing DHCS programs of the audit finding and announcing a requirement that applicable contracts submitted to CMU be accompanied by a copy of the completed and signed CCC. CMU will strive to release the memo by October 30, 2009 to begin collecting signed CCCs with applicable contracts beginning November 16, 2009.

CMU will include the following instructions in the memorandum: (a) Reiterate the requirement to collect a completed/signed CCC for applicable contracts citing DGS General Terms and Conditions (i.e., GTC 307 or later), (b) Advise Programs to retain the originally signed CCC on file either in a single location or in a contract file, (c) Require Programs to submit a copy of the signed CCC with the final contract package delivered to CMU for final approval, (d) Instruct Programs to collect a renewed CCC from applicable contractors every three years, and (e) Inform Programs of the availability of a contractor signature collection letter template with instructions related to submission of the signed CCC with the signed contract.

Note [1]: Recommended text addition. A CCC is not required for each contract. Contracts citing the GIA do not need a signed CCC.

AUDITOR'S COMMENTS

AUDITOR'S COMMENTS

Internal Audits is pleased with the efforts made by the Contract Management Unit (CMU). We understand that some of the problems identified by the audit are not within the direct control of CMU, and we acknowledge their willingness to work with other programs to implement our recommendations. Internal Audits believes that CMU is responsible for the procedures they are recommending, such as the issuance of bulletins and revisions to existing processes. The procedures planned in CMU's response should help reduce the problems identified in our audit.