

**UNIVERSITY OF CALIFORNIA, DAVIS
INTERNAL AUDIT SERVICES**

**Finance and Resource Management
Business Contracts
Internal Audit Services Project #15-24**

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Finance and Resource Management Business Contracts

MANAGEMENT SUMMARY

Background

As part of the Internal Audit Services (IAS) audit plan for fiscal year (FY) 2014-2015, IAS conducted an operational review of the Business Contracts (Business Contracts) office, a unit within University of California, Davis Contracting Services (Contracting). In fiscal year (FY) 14, Contracting managed approximately \$597 million in goods and services, and Business Contracts handled over \$73 million in purchasing agreement transactions, compared to \$68 million in FY12. The largest and more complex agreements have been primarily driven by UC-wide and campus initiatives, including *The Campaign for UC Davis*, solar farm, sustainable construction, Shared Services Center activity, and the new financial system implementation, among others.

Business Contracts develops, negotiates and executes complex business arrangements resulting in personal and professional services agreements, consulting, revenue agreements, no cost agreements, and other contracts and agreements. The Business Contracts team comprises three personnel including portions of the Director and Associate Director positions.

Over the last decade, the Business Contracts function has evolved significantly due to the complexity of changing needs of a growing innovative university. Vast technological advancement, cutting-edge research and increasing partnership collaborations have had a unique impact on the UC Davis business environment, placing a special demand on contracting professionals. Business Contracts personnel are expected not only to thoroughly understand the campus business environment, but to negotiate the appropriate contracting methods to adequately protect the interests of UC Davis and individual departments. In FY14, the campus-wide transition to Quali/Quali Financial System for contract processing initially presented additional challenges to Business Contracts staff and campus departments.

Throughout the period of our review, Contracting has been undergoing many organizational changes, including hiring additional staff and restructuring its operations to build capacity in various specialty groups including: (1) strategic sourcing, complex projects and commodities, (2) technology solutions and training, (3) program management, and (4) business and revenue contracts. As part of the reorganization efforts, Business Contracts unit is planning to add two analysts in FY15.

Purpose and Scope

The audit objectives were to assess internal controls and practices in place to ensure that business contracts are executed in accordance with relevant UC policies in a timely manner, and that awarding of contracts is properly authorized.

To meet the audit objectives, we reviewed the pertinent rules and regulations, gathered Business Contracts operational data, analyzed existing procedures, conducted process walk-throughs, interviewed appropriate management and staff, reviewed a sample of 30 business agreements, and evaluated internal controls. Additionally, we conducted a campus-wide on-line survey to determine the overall level of client satisfaction with Business Contracts and explored issues and concerns raised by survey respondents into the scope of the review.

Conclusions

As of October 2014, Business Contracts is in the process of restructuring and revamping its existing contracting processes. While some improvements have been already made (e.g., streamlining the requisition process by developing process guides and developing template agreements to accommodate departments with higher volume transactions), additional efforts are needed to establish better contracting oversight controls and procedures to allow for transparency and accountability in the decision-making process.

Our review identified the following areas where improvement is necessary:

1. Performing risk assessments to help revamp business processes and incorporating risk assessment into business agreement process practices;
2. Policies and procedures need to be revised to reflect new business processes to ensure proper monitoring of day-to-day activities;
3. Better oversight of professional services agreements over \$15,000 and all contracts over \$100,000;
4. Contract amendments and change orders require monitoring; and
5. Developing meaningful performance measures.

Regarding our on-line survey, 38 recipients responded. The overall results showed mixed opinions, as 55% answered that their needs were met “well” (52%) or “very well” (3%), while 23% answered “not well” (13%) or “not well at all” (10%).¹

Our observations and recommendations are presented in the body of this report along with corresponding management corrective actions.

¹ 22% of the respondents who answered this question selected the “no comment” option.

OBSERVATIONS, RECOMMENDATIONS, AND MANAGEMENT CORRECTIVE ACTIONS**A. Business Contracts does not sufficiently incorporate risk assessments into its processes and practices.**

Incorporating risk assessments into business operations is a widely-accepted best practice. In the highly-regulated area of public contracting, risk assessment procedures represent a prerequisite to adequately addressing campus-wide reputational, legal, and financial risks. In evaluating the operations of Business Contracts, we concluded that the office could improve its effectiveness and efficiency by making better use of risk assessments throughout its contracting processes and management practices. Without establishing a risk review, Business Contracts is not able to prioritize the workload and engage appropriate stakeholders early enough in the contracting process. For example, contracts are signed based on last minute requests submitted through KFS from departments without proper consideration of contracting options, business risks and alternatives.

First, Business Contracts has not established a formal risk assessment framework to track, monitor, and manage contracts based on risk factors such as complexity, materiality, and contract agreement type. For instance, no process exists to isolate contracts that could be considered higher risk, such as those subject to competitive bidding, those over a certain dollar value, those from departments that typically submit complex agreements, and/or those requiring change orders/amendments, as discussed further in Observation D.

Second, with regard to the actual processing of contracts, Business Contracts uses a transaction-based approach, as all purchase requisitions are initiated by departments via the Kuali Financial System (KFS). Once initiated in KFS, all contracts are processed in a uniform manner, regardless of services type, scope of the agreement, competitive bidding requirements, or dollar value. This transaction-level approach to contract development does not seem to sufficiently address the full spectrum of issues and challenges on each agreement. For example, two professional services contracts of equal dollar amounts may require disparate levels of effort and support from Business Contracts staff and represent different levels of risk. However, currently the level of effort and inherent contract risks are not assessed at the contract requisition level.

Third, contract progress monitoring is limited to review of manual records of transactions processed by assigned staff, as well as ad-hoc meetings requested by initiating departments. For example, there may be a significant lag between the time when the requisition is submitted to the Business Contracts coordinator and contract review by Business Contracts management. As a result, not enough time is allowed for risk management consideration and the appropriate stakeholders are not part of the contract development process. Reviewing potential contract risks, such as prior known issues, project complexity, departmental needs and financial impact could help improve the quality of services being provided as well as help save cost. Without a risk assessment structure, Business Contracts will likely continue managing contracts primarily in response to a KFS transaction request, rather than proactively by alternative means such as communicating with campus leaders about initiatives that will require significant contracts.

Finally, our observations were consistent with comments from some of the survey respondents who remarked that Business Contracts lacked a risk-based approach to contracting, particularly spending time on perceived “unnecessary” paperwork rather than focusing on higher risk or value-added issues. Management has acknowledged that they have been aware of the need for incorporating risk assessments into its processes, but has been hindered by resource constraints.

Recommendations

1. Establish a contract oversight function, i.e., an individual or group of individuals responsible for proactively overseeing high risk contracting activity.
2. Conduct a risk assessment to determine areas of primary risks for Business Contracts, such as identifying departments with a history of contracts with issues, changes in department personnel and inherent skill set, contract dollar level and type, and projects of highest complexity.
3. Incorporate risk assessment into the contracting business cycle process.

Management Corrective Actions

1. By 7/15/2015, Business Contracts management will establish contract oversight procedures to ensure that high risk contracting activity is reported monthly to the Business Contracts Director and Associate Vice Chancellor for Finance/ Controller.
2. By 7/15/2015, Business Contracts management will conduct a risk assessment to determine areas of primary risks for Business Contracts, including identifying departments with history of contracts with issues, changes in department personnel and inherent skill set, contract dollar level and type and projects of highest complexity.
3. By 7/15/2015, Business Contracts will establish a process to risk rank (High/Medium/Low) contracts at the requisition stage and will incorporate risk assessment into the contracting business cycle process to help prioritize workload and engage appropriate project stakeholders.

B. Policies and procedures, including documentation requirements, need to be revised.

As part of the review, we assessed contracting files for a sample of 30 contracts for compliance with the existing UC policies, state and federal requirements, and UC Davis Business Contracts written procedures. Overall, we found inconsistencies between written procedures and actual practices, as well as varying levels of documentation maintained in the contract files. Business Contracts has been relying on the Electronic Document Management System (EDMS) for storing electronic files and as a data repository; however, no formal process exists to require that certain documents, such as records of advertising, request for proposal (RFP) scoring criteria, or evaluation committee conflict of interest forms are retained in full.

Currently, the existing process guidelines posted on Contracting's website still refer to legacy DaFIS documents and haven't been updated to reflect the process requirements in KFS. The online guides refer to outdated paper forms and requisition requirements that have been superseded by an updated process. Additionally, various policies refer to procedures that were no longer adhered to by Business Contracts. For example, Policy and Procedure Manual (PPM) section 380-70, *Consultant Agreements*, states that the Business Contracts office is responsible for obtaining three quotes from vendors on professional services contracts. However, according to Business Contracts management, the requesting departments are actually expected to complete this task. In our survey, certain respondents expressed a level of frustration regarding unclear expectations on completing specific procurement tasks such as these.

Additionally, since the transition from DaFIS to KFS, Business Contracts has not yet scanned all FY14 files into EDMS as they've been considering a standardized approach to document filing. No decision has been made regarding the specific documentation requirements to include within the "permanent file" record of a contract. The "permanent file" records are subject to the California Public Records Act (CGC6250) intended "to safeguard the accountability of government to the public." As such, establishing standards for document retention for each contract type helps demonstrate that procurement steps are fair, open and unbiased throughout the contract award process.

Recommendations

1. Revise policies and procedures to reflect current business practices and ensure that policies are consistent with the applicable rules and regulations.
2. Clarify documentation requirements to ensure sound risk management and internal controls over awarding and administration of contracting.
3. Develop a communication strategy to ensure that the updated requirements are properly communicated to departments and training materials are readily available.
4. Establish documentation requirements for "permanent file" records in the data repository to promote compliance.

Management Corrective Actions

1. By 9/15/2015, Business Contracts management will revise policies and procedures to reflect current business practices and ensure that policies are consistent with the applicable rules and regulations.
2. By 9/15/2015, Business Contracts management will clarify documentation requirements for each contract type, as applicable, to ensure risk management and internal controls over awarding and administration of contracting.
3. By 9/15/2015, Business Contracts management will develop a communication strategy to ensure that the updated requirements are properly communicated to departments and training materials are available to interested parties.
4. By 9/15/2015, Business Contracts management will establish documentation requirements for "permanent file" records in the data repository to promote compliance.

C. Business Contracts is lacking sufficient oversight for contracts over \$100,000 and professional services agreements over \$15,000.

Fundamental to a strong public contracting function is the establishment of policies and procedures that demonstrate a fair, open, and unbiased process for awarding contracts. The practices of competitive bidding of contracts and maintaining appropriate process documentation are designed to prevent actual and potential vendors from influencing UC employees in contract award decisions.

Public Contract Code (PCC) 10507.7 requires competitive bids on contracts for goods and services over \$100,000, except for personal and professional contracts². Professional services agreements generally have less stringent requirements, PCC 10508 requiring that the expenditure amount be reasonable. According to the Business Contracts Manual (Manual), "Professional services contracts are not legally required to be competitively bid so long as the price is justifiable ...however, competitive bidding is strongly encouraged." Specific rules apply to consulting contracts, a subset of professional services, and PPM 380-70 requires vendor solicitations from three qualified consultants for contracts over \$15,000.

In our review of nine contracts over \$100,000, we found that generally, the competitive procurement process was not documented consistently, and the Business Contracts process guides and procedure manual contained instructions regarding competitive advertising that were unclear and ambiguous. Four of the nine contracts were not competitively bid, and rationale for sole sourcing was not documented consistently.

In reviewing the documentation for these contracts, as well as the contents of the manual, we concluded that the procedures to document sole source justification could be improved to foster a more transparent contracting process (especially if a contract award was ever questioned or appealed). For example, in one instance, a \$490,000 professional services contract was awarded without advertising, and the associated sole source justification form was incomplete and ambiguous. In another example, although a contract that was publicly bid, the documentation in the file supporting the procurement process, the bid scoring, and the evaluation criteria development process was not clearly documented. While Business Contracts Management stated that the "permanent" file documentation for this contract was being finalized, there is no sufficient oversight process to ensure that all contracts over a certain threshold go through the level of scrutiny to ensure fairness and transparency.

Recommendations

1. Establish procedures for oversight of contracts over an established threshold amount to ensure that the procurement process is fair and open and the contract award is justifiable and unbiased.
2. Clarify the RFP development process, RFP requirements and the evaluation process to ensure that UC Davis can demonstrate an open, fair and objective contracting process.
3. Clarify requirements for documentation of fair and reasonable pricing for all professional service and consulting agreements that are not competitively bid and ensure complete documentation is included in the "permanent" contract file.

Management Corrective Actions

1. By 7/15/2015, Business Contracts management will require a monthly reporting of contracts over \$100,000 to the Associate Vice Chancellor – Finance/Controller, by contract type, along with explanation of sole sourced agreements and pricing justification for professional service and consulting agreements that are not competitively bid.

² Per BUS-43, examples of professional services include medicine and the medical arts, architectural and engineering services, management and systems consultation, research, and the performing arts.

2. By 4/15/2015, Business Contracts management will clarify the RFP development process, RFP requirements and the evaluation process to ensure that UC Davis can demonstrate an open, fair and objective contracting process.
3. By 4/15/2015, Business Contracts management will ensure that complete sole sourcing and pricing documentation is included in the “permanent” contract file.

D. Contract change orders and amendments require proper review and oversight.

Inconsistent documentation and lack of transparency around executing amendments and change orders pose further questions about risk management and the propriety of use of public funds. Two of 11 contracts over \$100,000 that we reviewed included increasing costs resulting from contracts that were extended through contract amendments and change orders, without consideration for rate renegotiation or re-advertising for services.

In one example, a professional services time and materials (T&M) contract showed a substantial cost increase within a short time frame as a result of continuous use of amendments at the initially agreed-upon rates. The work of the consultant in question was governed by a UC Davis letter of intent based on a UC Office of the President established rate agreement. Business Contracts management indicated that the contract was unique and was requested by a department that was working under pressure to address broader UC-wide risk considerations; nonetheless, the cost implications were not considered as part of the contract monitoring process. In retrospect, a fixed price contract could have been considered to help mitigate the risk of growing cost and scope. Going forward, considering department needs, the project scope, and cost implications should be reviewed and monitored on an ongoing basis.

Although Business Contracts personnel represented that they had many discussions with the department about the numerous amendments, there doesn't appear to be sufficient overall contracting oversight to ensure that high dollar value projects (and projects that are deemed high risk) receive appropriate review and approval by a designated group of stakeholders. Specifically, decisions to increase scope and time on a high risk T&M contract should not be made without consideration of alternative contracting solutions.

PPM 380-70 requires that the Materiel Manager ensure that if sole sourcing is used, the rates be reasonable. It doesn't appear that the project was managed with regard to the overall reasonableness of project cost, and no documentation was available to help identify other risk factors that may have justified the decision to significantly increase costs without renegotiating contract terms. Better oversight is needed to ensure that contracts are managed with regard to scope, time, cost, business unit's objectives and UC-wide priorities.

Recommendations

1. Identify high risk projects and develop processes to ensure proper contract monitoring and oversight.
2. Develop a process to ensure ongoing reporting and contract performance monitoring of contract amendments and change orders.

3. Develop a process for ongoing reporting on contracts over \$15,000 for professional services and \$100,000 for all contracts to an oversight committee.

Management Corrective Actions

1. By 7/15/2015, Business Contracts management will identify high risk projects and develop processes to ensure proper contract monitoring and oversight.
2. By 10/15/2015, Business Contracts management will develop a process to ensure ongoing reporting and contract performance monitoring of contract amendments and change orders.
3. By 10/15/2015, Business Contracts management will develop a process for ongoing reporting on contracts over \$15,000 for professional services and \$100,000 for all contracts to an oversight committee.

E. Developing meaningful performance measures

Business Contracts has limited processes to capture agreement processing activity.

Currently, all purchase requisitions are initiated in KFS and are subject to at least two levels of review at the Contracting office prior to being converted into a contract that is ready for execution and approval. First, the submittal is reviewed by the Contracting Services Control Desk, which ensures that the transaction meets the basic document requirements based on a commodity code. Incomplete requisitions are returned to the requesting department through KFS or set aside manually (pending receipt of further information from the initiating department).

After the Control Desk is satisfied that the transaction meets the basic requirements, the requisition is forwarded to the Business Contracts lead personnel for a second level of review, including document verification. If the Business Contracts staff deems the request to be incomplete, she/he may cancel the purchase requisition entirely and require a new submission from the department. However, if all necessary documents are in place, the Business Contracts staff drafts a contract and ensures that appropriate signatures are obtained, and a purchase order (PO) is created in KFS based on an executed agreement.

While generally, Business Contracts management tracks PO processing time and requisition processing time for each transaction, the initial Control Desk processing time is tracked separately, and there is no reporting practice to capture the entire contract cycle time, from the first contract requisition to contract execution. Also, while process times vary based on agreement types -- with no cost agreements showing shortest process times (up to 20 days) and professional and consulting services the longest (up to over 50 days) -- Business Contracts does not track operational performance by contract type.

The external consultant's report, which is consistent with contracting best practices, states, "Effective contracting metrics should be tied to order complexity, communicated to customers, and published for customer view." Currently, Business Contracts does not report contract workload based on complexity, and does not have custom reports. The consultant recommended that Business Contracts implement a balanced scorecard, which should include key metrics within Contracting Services. Although the new overall KFS reporting Balance Scorecard was developed in FY14, this KFS tool does not capture business agreement performance metrics.

Recommendations

1. Develop a comprehensive approach to measuring contracting performance to capture such elements as procurement processing time, meeting customer needs and business objectives, meeting strategic considerations, and meeting business flow milestones.
2. Establish reporting requirements to capture risk-based performance metrics, i.e., procurement activity for contracts by type, contracts over \$100,000, professional services, etc.

Management Corrective Actions

1. By 10/15/2015, Business Contracts management will develop comprehensive performance measures to capture procurement processing time, meeting customer needs and business objectives (i.e. conducting customer surveys), meeting strategic considerations, and meeting business flow milestones.
2. By 10/15/2015, Business Contracts management will establish reporting requirements to capture risk-based performance metrics, i.e., procurement activity for contracts by type, contracts over \$100,000, professional services, etc.