

Secretary of State **AUDIT REPORT**

Report No. 2002-43 • November 26, 2002

Department of Human Services: Contracting Practices



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Summary

PURPOSE

The purpose of our audit was to determine if the Department of Human Services' contract procurement and administration practices are adequate and comply with applicable laws and regulations.

BACKGROUND

For the 1999-01 biennium, the department entered into more than 6,000 contracts ranging in value from less than \$1,000 to more than \$6 million. Contracts covered a wide range of goods and services including medical care, foster care, legal services, management consulting, training, translation services, information technology projects, video production, file reorganization, public relations, and mediation services.

RESULTS IN BRIEF

Our review identified opportunities for the department to make improvement in the areas of contract administration and payments, contract solicitation and selection, and record keeping. Specifically, our recommendations address such problems as improper or inadequate: payments, solicitation practices, sole source and short-term contracts, bidder notifications, and file documentation.

OTHER MATTERS

We also noted instances where independent contractors appeared to be employees and a potential issue with the department's 1099 reporting.

RECOMMENDATIONS

We recommend that the department:

- Establish clear policies and procedures regarding contract administration, solicitation, selection and file management. Further, clearly define staff responsibilities, including detailed guidance on how to monitor contracts.

- Provide ongoing training in state contracting requirements to both contract administrators and contract managers. Take steps to ensure understanding and compliance on the part of program managers.
- Improve processes for making, tracking and reporting a contract payment through the various accounting systems.
- Consult with Department of Administrative Services to develop acceptable practices for urgent short-term contracts and clarify solicitation posting requirements.

AGENCY ACCOMPLISHMENTS:

Many of the examples that we cite in this report occurred prior to the reorganization of contracting responsibilities at the department. To the department's credit, we have found it to be very responsive in dealing with the problems we identified and, in many instances, started to institute recommendations prior to the completion of our audit work.

AGENCY RESPONSE

The Department of Human Services generally agrees with the recommendations and has made significant changes in the structure of its organization over the past 18 months. Prior to reorganization, there was no central contacting office, standardized documents nor policies among the previous divisions. The contracts that were audited by SOS were in effect prior to the consolidation of the Office of Contracts and Procurement (OC&P). The consolidation has brought focus to development of department-wide policies, procedures, and documents, and consistency to the agency's practices.

Introduction

The policy of the state of Oregon, as expressed in statute and administrative rule, is to encourage competition and discourage favoritism among potential contractors. The goal of state contracting activity is to foster open and impartial competition with the

aim of obtaining goods and services at a fair and reasonable price.

The contracting process involves determining that goods or services are needed, soliciting and selecting a contractor, negotiating contract terms, executing a contract, receiving contracted goods or services and making payments according to contract provisions. The Department of Human Services

divides these responsibilities between the central Contracts and Procurement (C&P) unit and program employees. The C&P unit generally has responsibility for the creation and implementation of contracts, while program employees are responsible for administering the contracts after the contracts have been signed.

Background

The Department of Human Services is Oregon's health and social services agency. The department is in the midst of a major reorganization. Reorganization seeks to centralize certain department services. As part of that effort, contract procurement services have been gradually moved from the individual programs to the central Contracts & Procurement (C&P) unit.

For the 1999-01 biennium, the department entered into more than 6,000 contracts ranging in value from less than \$1,000 to more than \$6 million. Contracts covered a wide range of goods and services including medical care, foster care, legal services, management consulting, training, translation services, information technology projects, video production, file reorganization, public relations, and mediation services.

Audit Results

During our audit, we identified payment issues with 15 percent of the contracts reviewed and found incomplete file documentation in 28 percent of the contract files. Our testing identified opportunities for improvement in the areas of contract administration and payments, contract solicitation and selection, and contract file record keeping.

Insufficient Contract Administration and Inappropriate Payments

Contract administration is an integral part of the contracting process. The Department of Administrative Services has delegated the authority to the department for contract administration. Agencies receiving this authority are required to assure conformance with the contract terms, conditions, and specifications as well as adequate performance and

accurate expenditures. Without adequate contract administration practices, the state is at risk of not receiving quality products or services at a fair price.

During our review, we found instances in which the department's contract administration and payment practices did not comply with state contracting rules and were not adequate. For example, the department made payments that did not agree to contract terms or were made without valid contracts.

We noted the following:

- One contractor's payments exceeded the not-to-exceed amount of the contract by approximately \$210,000.
- Another contractor was reimbursed for travel expenses totaling approximately \$3,000, even though the contract explicitly stated that travel expenses were not to be paid.
- A nursing facility was paid more than \$2.1 million for services without a valid contract from January 2000 through March 2002.
- A residential care facility was paid approximately \$39,000 from May 2001 through March 2002 for services not included in its contract.
- The department made full payment of \$15,000 in early 2000 to one contractor prior to receiving the contract deliverables. The deliverables were not received until late 2001, over a year later. An additional payment of \$5,266 was made to the contractor after delivery.
- The department routinely uses "exception letters" to authorize payment for services outside the service period defined in the contract. This is an internal department procedure, which is not sanctioned by the Department of Administrative Services for authorizing payments. During 2001, the

department made payments to vendors totaling over \$3.7 million using this method. The final payment of \$5,266 discussed above was authorized by use of an exception letter.

We noted that program employees were typically responsible for contract administration duties. In our interviews with program staff members, they stated that they did not receive sufficient training in contracting rules. Also, our interviews regularly found that program staff mistakenly assumed that the C&P unit was handling some of the administrative responsibilities.

We also noted that control mechanisms to ensure that contract payments agree to contract terms were not adequate. Although the accounting sections processed contract payments, they were not always notified of new contracts or modification of existing contract terms. One of the department's programs appeared to use the contract tracking capabilities of its accounting system. The department's other programs either did not have, or were not consistently using, the contract module component of their accounting system. As a result, payments were not always linked to a contract number, making it difficult to track not-to-exceed amounts and adhere to the appropriate service dates.

We recommend that the department:

- Establish clear policies and procedures defining contract administration responsibilities.
- Provide adequate training for program staff with contract administration responsibilities. Specifically, training should include basic principles of state contracting rules and responsibilities of contract administrators.
- Provide a uniform means of tracking all payments made on

individual contracts in the accounting systems to ensure that payments are not made in excess of contractual amounts or on invalid or expired contracts.

Agency's Response:

We agree with the recommendations.

- ⇒ *OC&P is developing a Contract Administration Training Module for all contract administrators to address roles and responsibilities of contract administration.*
- ⇒ *OC&P is working with the Department of Justice (DOJ) to identify those situations where we have authority to authorize exceptional payments and when we need to consult with DAS or DOJ.*
- ⇒ *OC&P is working with other DHS offices to develop a system that will allow us to track actual expenditures against contracts.*
- ⇒ *We have distributed an informational brochure to assist DHS staff to clarify the roles and responsibilities associated with procurement of goods and services.*

Preferential Treatment of Contractors

We identified practices within the department that did not appear to encourage fair, open, and competitive public contracting. These practices included solicitation limitations, sole source contracts for specialized but not unique services, and inadequate notification of potential bidders.

Lack of Required Documentation

Our review of solicitation and selection practices was limited by lack of adequate documentation in contract files. According to state contracting rules, contract files should contain solicitation and selection documentation, a record of

the negotiation of the contract terms, and executed contracts.¹ Further, while the C&P unit had responsibility for maintaining the master contract files for the department, we found that C&P files usually did not contain all required solicitation, selection, negotiation, and contract documentation.

Since additional contract files were also maintained within the various department programs, we examined those contract files as well, and still found documentation incomplete for 28 percent of the contracts reviewed. The lack of required documentation made it difficult to conclude whether contracts were solicited and awarded appropriately. Allegations of preferential treatment and the pre-selection of some contractors that we had received could not be disproved, but existing documentation and interviews tended to support the allegations. This lack of sufficient documentation puts the state at risk should the contract award process be challenged.

We noted that the department had neither a complete set of written policies and procedures related to contracting nor sufficient initial and ongoing training for C&P and program staff. In addition, there was no consistent file review process in place within the C&P unit to ensure compliance with documentation or solicitation requirements.

We recommend that the department:

- Develop and implement written policies and procedures related to contract solicitation and selection responsibilities. These policies should clearly assign responsibilities between department staff for standard procedures.
- Establish a standard training curriculum for C&P and program staff. Further, there should be regular opportunities for ongoing professional education and

encouragement for contracting staff to pursue professional certifications.

- Establish provisions within the C&P unit for a quality assurance review of files. Consider creating a checklist for each file to ensure that required elements are present. This could be used to aid in staff training.

Agency Accomplishments

The department has drafted and finalized written policies and procedures related to contract solicitation and selection responsibilities.

Agency's Response:

We agree with the recommendations.

- ⇒ *DHS has consolidated all contracting functions to OC&P. This has ensured that all contracting activities are being conducted in a standardized manner.*
- ⇒ *OC&P is developing a Solicitation Training Module to help educate DHS staff in the appropriate procedures for selection of contractors.*
- ⇒ *We have designated a position with quality control responsibilities to randomly look at all contract/solicitation files for complete documentation.*

Improper Solicitation Practices

State rules specify the solicitation and selection process to be used, which varies depending on the contract amount. These rules were established to encourage competition and discourage favoritism. Our audit identified department practices that appeared to be designed to assure that contracts were awarded to pre-selected contractors. At the very least, these practices provided the appearance of an unfair advantage to particular contractors.

¹ OAR 125-020-0510

We noted examples of solicitation and selection practices that apparently were used to award contracts to preferred vendors. The department's own review concluded that some of these contractors were pre-selected.

In one case, a mandatory conference may have unnecessarily limited responses to a solicitation. Administrative rules require potential contractors to attend mandatory conferences in order for their proposals to be considered.² When agencies elect to require mandatory conferences, best practices recommend 10-14-day notice of such conferences; however in this instance, notice was given on Friday for a Tuesday morning conference. Only one contractor attended the conference and the resulting \$368,000 contract was awarded after receipt of only one proposal. This contract was the fourth in a series with a total value of more than \$1 million; all of which had been awarded to the same contractor. The third contract was awarded through the use of a declaration of emergency, which we question. These circumstances combine to give the appearance of pre-selection of the contractor for the fourth contract.

In addition, there was a solicitation for strategic reorganization services. The total of the contracts let for this service was \$100,000. The solicitation process used for this service was informal. The solicitation clearly stated that multiple contractors would not be used for this \$50,000 project; however, two contracts for \$50,000 were awarded. Further, the proposal received from one of the contractors did not appear to be responsive and appeared to have been submitted only after direct prompting from the C&P consultant. These factors, combined with the fact that this contractor was a former department employee, and that the department's

own internal review acknowledged the pre-selection of this contractor led us to conclude that this contractor received preferential treatment and was most likely pre-selected.

Our interviews indicated that staff occasionally felt pressure from management to obtain the services of a particular contractor and to use inappropriate methods to award contracts to those pre-selected contractors.

Unjustified Sole Source Contracts

According to state administrative rule, there are only two allowable reasons to sole source a contract. Sole source is to be used when only one contractor can provide the services because of unique expertise, or when it is unlikely that sole sourcing will substantially diminish competition. Administrative rules require that the department include a written justification supporting the sole source determination in its contract files.³ We found instances in which the department applied sole source rules to acquire specialized, but not unique, services in apparent violation of state contract rules.

For example, the sole source provision was used for a \$25,000 media consultation contract. The services to be provided did not appear to require unique expertise. Contract services included brokering the purchase of appropriate public awareness materials and related media buys, and working with associations to resolve conflicting media purchasing needs.

The sole source justification in another file included only a description of the work to be performed without reference to either of the allowable reasons. The contract was for consultative services pertaining to a request to the federal government to extend the

Oregon Health Plan. While the knowledge necessary to perform the work was specialized, it was not necessarily unique. A \$36,000 management-consulting contract resulted.

We recommend that the department provide a written directive to managers, program staff, and C&P unit staff regarding the improprieties of pre-selecting contractors. Misuse of the system to ensure that contracts are awarded to specified contractors through use of practices such as questionable mandatory bidders conferences and unjustified sole source contracts should be curtailed.

Agency's Response:

We agree with the recommendation.

⇒ *A written communication will be issued to programs regarding the appropriate use of sole source contracts.*

Inadequate Notification of Potential Bidders

State rules define minimum standards for the length of time a solicitation must be advertised. We noted common notification practices within the department that would tend to restrict competition, including:

- Providing minimal time to respond to advertising opportunities, and
- Untimely notification of the Office of Minority, Women and Emerging Small Business regarding contracting opportunities.

VIP Advertising

The Vendor Information Program (VIP) system is an electronic means of advertising state agencies' contracting opportunities. The department's use of VIP to satisfy solicitation requirements did not always appear to meet the goal of open, competitive state contracting.

² OAR 125-030-0009

³ OAR 125-020-0350

Discussion with officials at the Department of Administrative Services indicated that the minimum length of time specified by rule was intended for basic proposals and would not be considered adequate if the requested proposals required more detail. The department appeared to post solicitations for the minimum time allowable, regardless of the detail requested.

In addition, the department has had connection problems with the VIP system such that complete contract proposal requests could not be posted. It has been common to post only a brief summary on VIP for the minimum allowable time. This requires potential contractors to contact the C&P unit directly to obtain a complete copy of the solicitation. While advertising requirements may be met, this process effectively reduces the time available to develop and submit proposals.

OMWESB

The Office of Minority, Women and Emerging Small Business (OMWESB) strives to ensure that minorities, women and emerging small businesses have equal access to contracting opportunities in both the public and private sector. State rules require that OMWESB be notified of state contracting opportunities.³ Notification can be accomplished by posting on VIP or by contacting OMWESB directly. State law is not specific with regard to required timeframes for this notification, stating only that notification should be “timely.”⁴

Our review found little evidence indicating how or when OMWESB was directly notified when necessary. One contract file clearly showed that the contractor was selected prior to notifying OMWESB.

We recommend that the department:

- Better evaluate the length of time proposals are to be advertised. More time than the minimum should be provided for detailed proposals. Further, when complete solicitations are not posted on the VIP system, the department should mandate additional posting time as a standard practice.
- Adequately document notification to OMWESB in all cases. Further, the department should consider consulting with DAS to clarify “timely” notification.

Agency’s Response:

We agree with the recommendations.

- ⇒ *DHS will consult with DAS to clarify their meaning of “timely” notification.*
- ⇒ *All solicitations over \$5,000 are now posted on VIP for the minimum required time of five (5) or fourteen (14) days.*

Inappropriate Short-Term “Bridge” Contracts

The department’s “bridge” contracts are short-term contracts, 30-90 days, to provide services when there is an immediate, urgent need for services without the time available to follow state contracting requirements. This type of contract authorizes a service to begin or continue without soliciting for a contract, the intention being that the needed services would begin or continue while going through the appropriate solicitation process. These contracts do not conform to state contracting rules. There are provisions for exemption and emergency contracting that require DAS approval, but the department rarely uses them. Instead, the department usually uses bridge contracts as the recognized practice in these situations. As such, there are no standard guidelines governing

this practice. In addition, we found “bridge” contracts in effect for periods of up to a year.

Interviews indicated that the department used “bridge contracts” for a number of reasons. In some cases, this use appeared to result from program staff’s not allowing adequate time for a contract to be processed, contract end dates not being tracked adequately, and the C&P unit’s not providing timely notification of expiring contracts to program staff. In still other cases, it appeared that “bridge” contracts were used because of the convenience.

We recommend that the department:

- Consult with Department of Administrative Services to develop acceptable and defined urgent short-term contract practices.
- Provide realistic timelines on contracting practices to contract requestors to help assure that adequate time is allowed for the process to be completed.
- Develop a notification process that allows sufficient lead-time to process contracts for continuing services.

Agency’s Response:

We agree with the recommendations.

- ⇒ *DHS will consult with DAS to review current short-form practices and develop acceptable urgent short-form contract practices if needed.*
- ⇒ *OC&P has developed policies that address the procedures for requesting contracts.*
- ⇒ *The automation of the CSTAT 90-60-30 day expiration notices has significantly reduced the necessity to bridge the gaps between contracts.*

³ OAR 125-020-0310 (5)

⁴ ORS 200.035

Lack of Insurance Documentation

The need for, type, and level of insurance necessary to protect the state's interest should be considered and included in contract terms.⁵ Best practices would seem to mandate that contract files contain any documentation required by the contract, such as proof of insurance.⁶ Failing to ensure compliance with contractual requirements does not provide the state with the intended protection of state assets from damage or liability.

We tested for insurance documentation and found documentation missing in 23 out of 25 files that required insurance. One factor contributing to this situation was the lack of regular review to compare insurance coverage to contract specifications by the C&P unit. Further, the lack of documentation made it difficult to determine if contractors were allowed to begin work without providing insurance documentation. One contract coordinator stated that contracts would not be held up because of a lack of insurance documentation.

We recommend that the department:

- Assign responsibility for tracking insurance documentation to ensure that insurance documentation is received, names the state as an additional insured, and matches the contract in both type and amount of insurance.
- Authorize services to begin on a contract only after receipt of insurance or other required documentation.

Agency's Response:

⁵ Principles of Public Contracting, BA 161, Public Purchasing using the Informal & Formal Process, State of Oregon DAS-TPPS Winter 2001.

⁶ "Best Practices in Contract Administration" DAS Internal Audit January 21, 1999, p. 5.

We agree with the recommendations.

⇒ *One staff member has been assigned the responsibility of entering all of the insurance forms into the CSTAT database.*

⇒ *OC&P is working with DHS internal auditors and program staff to develop a plan and a process for tracking required insurance information.*

Other Matters

Independent Contractors Appear to Be Employees

Guidelines provided by the federal government distinguish between independent contractors and employees. We noted several instances of independent contractors who appeared to be treated as employees. According to state rule, a department may not use personal service contracts to obtain and pay for the services of an employee. Providing space and equipment for contractors to perform contracted tasks and including contractors on organizational charts can contribute to establishing employee relationships with the contractors.

One program provided two independent contractors with office space, supplies, business cards, business telephones, and state email accounts, all at state expense, despite the fact that the contract stated that the department would not provide these items. Also of concern to us in these instances were misleading affidavits provided by a program manager about the contractors' independent working conditions and apparent disregard of concerns raised by the Department of Justice regarding this contractor relationship of more than eight months.

If an employee relationship were found to exist with contractors, the state could be liable for providing state benefits to those contractors. A recent court case involving a private employer found the employer liable

for significant benefits in a situation in which individuals classified as independent contractors were deemed as employees under the common law.⁷

We recommend that the department consult with the Department of Justice and then provide specific guidance to managers regarding the legal distinctions between and proper handling of employees and independent contractors.

Agency's Response:

We agree with the recommendation.

⇒ *The two instances that were noted have been corrected.*

⇒ *Program managers are receiving training regarding the distinction between independent contractors and employees.*

Accounting System Issue

Federal guidelines require amounts paid to workers who are not employees in excess of \$600 in a year to be reported for income tax purposes. In reviewing a sample of payments based on federal 1099 reporting, we noted a risk of misreporting amounts paid to contractors.

We found that several accounting systems in use in the department did not interface with one other. Several of these systems issue 1099s. Contractors may work for more than one department program. If at least one program paid a contractor less than the threshold amount of \$600, it would be possible for that contractor to have the total reported inaccurately on a 1099.

We recommend that the department develop procedures to assure compliance with federal 1099 reporting requirements.

⁷ *Vizcaino v. Microsoft Corp.*, U.S.D.C., W.D. Wash. No. C93-178C ("Vizcaino").

Agency's Response:

We agree with the recommendation.

- ▣ *OC&P is working with DHS accounting office to look at all of the payments systems relating to contracts and to develop procedures to assure compliance with federal 1099 reporting requirements.*

Objectives, Scope and Methodology

We found indications of problems with the department's contracting practices while conducting prior audits. We also received allegations regarding preferential treatment of contractors. As a result, we conducted this audit of the contract procurement and administration practices within the department.

The objective of our audit was to evaluate the adequacy of

department's contracting management and administration practices. We conducted our fieldwork between June 2001 and March 2002. As a part of our audit, we reviewed pertinent state statutes and administrative rules. We researched best practice guidelines for public contracting and interviewed department staff, Department of Justice attorneys, and Department of Administrative Services purchasing staff. We obtained, reviewed, and analyzed information related to contract management and administration in two phases.

During our first phase, preliminary review, we analyzed a judgmental sample of approximately 200 master contract files at the department's C&P unit. We reviewed the files for compliance with state rules.

Because of issues we found in the preliminary review, we selected a

statistical sample of 268 department vendors that had payments reported to the federal government for calendar year 2000 from the various department accounting systems. Approximately 70 percent of the sample was comprised of medical and childcare payments, which did not require contracts. For the 22 vendors that had associated contracts, we reviewed payments made to vendors, compared payments to contract terms, and reviewed the documentation in the contract files. For those payments that did not relate to a contract, we reviewed documentation and determined whether a contract was required.

We conducted our audit in accordance with generally accepted government auditing standards.

This report, which is a public record, is intended to promote the best possible management of public resources. Copies may be obtained by mail at Oregon Audits Division, Public Service Building, Salem, Oregon 97310, by phone at 503-986-2255 and 800-336-8218 (hotline), or internet at Audits.Hotline@state.or.us and <http://www.sos.state.or.us/audits/audithp.htm>

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The courtesies and cooperation extended by the officials and staff of the Department of Human Services were commendable and much appreciated.

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