



INTERNAL AUDIT

Contract Administration Audit

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Authorization

The City Auditor has conducted a Contract Administration audit. This audit was conducted under the authority of Resolution #2013-51, Section 2-233, Powers and Duties, Subsection (b)(8) and (c), and in accordance with the Annual Audit Plan approved by the League City, City Council.

Objective

The objective of this audit according to the Annual Audit Plan was to evaluate the process and determine if accountability is in place.

The sub-objectives were as follows:

- 1) Determine if general controls are sufficient and appropriate.
- 2) Verify compliance with Big League Dreams Contract

Scope and Methodology

The City Auditor conducted this audit in accordance with Generally Accepted Government Auditing Standards except this audit function has not had an external peer review. Those standards require planning and performing the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. The City Auditor believes that the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objectives.

The sampling methodology is discussed in Exhibit A and the reliability and integrity of information is discussed in Exhibit B.

To adequately address the audit objectives and to describe the scope of work on internal controls, the City Auditor has:

- Inquired with the Purchasing Department regarding general accountability over Contract Administration.
- Read State Law and the City's Purchasing Policy and the Signatory Policy.
- Reviewed best practices on Contract Administration and another cities Contracting Policy.
- Used the Texas State Auditor's Contract Administration Model
- Reviewed the Maintenance and Operations agreement along with all amendments for Big League Dreams (BLD).
- Met with General Manager and toured the BLD facility.

The deficiencies in internal control that are significant within the context of the audit objective and based upon the audit work performed are stated in the Opportunities for Improvement section starting on page 6.

Background

General Controls over Contracts

The business of the city goes through the contracts the city has with other entities. Contracts account for a large amount of expenditure for the city. Because of this the city needs to ensure that:

- Contractor Selection – Best-qualified contractors are selected
- Payment/Reimbursement Methodology – Reasonable price is paid for the quality of services
- Contract Establishment – Contract provisions hold contractor accountable
- Contract Oversight – Contract terms are monitored and enforced

are handled prudently.

This audit reviewed that there was some type of selection process for each contract in the sample; that a reasonable price was paid for the good or service; that the contractor was held accountable and contract oversight was in place. Since this audit's objective was to review general controls, no in-depth or specific analysis was done on each of the above.

Big League Dreams

BLD is near the intersection of 646 and IH45. One of the features and main attraction to BLD is its replicas of major league stadiums. One can find the Green Monster of Fenway Park and the Vines of Wrigley Field all in a Little League setting.

The city owns the property and has a maintenance and operations agreement with BLD. Currently BLD pays the City a fixed payment of approximately \$250,000.

Starting in the January 2014 timeframe the City's management had some maintenance issues with BLD. It should be noted that the Auditor did not pursue those compliance Issues.

The word contract is used throughout this audit report. It can refer to agreements, memorandums of understanding or any other arrangement between parties regarding a course of action.

Overall Conclusion

The Contract Administration process for the city needs improvement as accountability is not in place.

- 1) General controls are not sufficient
- 2) The Big League Dreams contract has compliance issues previously addressed by management. This audit found a potential problem with insurance coverage

A summary of issues found is as follows: (Note 1: Each sampled item may not be all-inclusive of all that was lacking)(Note 2: All of these have been discussed with management)

- Sample Item 3 – Not receiving reports as required
- Sample Item 4 – Certificate of Insurance (COI) not checked and shows expired dates for insurance/Quarterly Financials not requested
- Sample Item 6 – Grant - Not all documents submitted in Laserfiche
- Sample Item 7 – Not latest information in Laserfiche
- Sample Item 8 – Did not go through Purchasing
- Sample Item 9 – Did not go through Purchasing
- Sample Item 10 – Did not go through Purchasing
- Sample Item 11 – Did not go through Purchasing
- Sample Item 12 - Did not go through Purchasing
- Sample Item 14 – No COI found/Not in Laserfiche/Did not go through Purchasing
- Sample Item 15 – No COI found/All information not found in Laserfiche/Can't determine if this went through Purchasing/Expired Contract
- Sample Item 16 – Renewal after due date
- Sample Item 17 – Can't determine if this went through Purchasing
- Sample Item 18 – Should have gone through City Council/Did not go through Purchasing
- Sample Item 19 – No contract for services portion of contract
- Sample Item 20 – Contracts not executed properly
- Sample Item 21 – Agreement not in Laserfiche/Did not go through Purchasing
- Sample Item 22 – COI does not match bid
- Sample Item 23 – No COI found
- Sample Item 24 – No COI found/Not in Laserfiche
- Sample Item 25 – Expired Term/City not listed as additional insured/Not in Laserfiche
- Sample Item 26 – Federal and State Law compliance issues
- Sample Item 27 – No contract found/Not in Laserfiche
- Sample Item 28 – Not in Laserfiche
- Sample Item 29 – Not in Laserfiche
- Sample Item 30 – Not in Laserfiche

- Sample Item 31 – No contract found
- Sample Item 32 – No contract found
- Sample Item 33 – No contract found
- Sample Item 34 – No contract found
- Sample Item 35 – No COI found
- Sample Item 36 – Not all provisions adhered to in agreement
- Big League Dreams – Insurance Coverage is not per the contract

Opportunities for Improvement

During our audit we identified certain areas for improvement. Our audit was not designed or intended to be a detailed study of every relevant system, procedure, and transaction. Accordingly, the Opportunities for Improvement section presented in this report may not be all-inclusive of areas where improvement might be needed.

Management is in a unique position to best understand their operations and may be able to identify more efficient and effective approaches to the following recommendations:

Finding #1 – Contracting Policies

Condition (The way it is)

The several Purchasing related policies are fragmented and do not clearly define accountability and responsibility for each of the parties involved in the procurement process and is not as comprehensive as it needs to be.

Criteria (The way it should be)

One Contracting Policy that includes guidelines for all phases of the Contract Administration Model.

Effect (So what?)

Confusion and noncompliance with current policies may not allow the city to properly select a contractor, develop reasonable contract rates and performance metrics, and provide for proper monitoring of the contract.

Cause (Difference between condition & criteria)

Due to turnover of personnel, a holistic approach to contracting policy did not develop.

Recommendation

Create a one-stop shop for acquiring the know-how to properly administer contracts. Examples of additional items to be included in the policy are as follows:

- High Technology Purchases
- Conflict of Interests
- Renewal Options
- Construction Contracts
- Risk Management/Insurance
 - Compare COI to contract/bid
 - City listed as additional insured
 - Provision for 30 days notice for material changes
- Contract Monitoring
- Sales Taxes
- Purchase Order vs. Contract
- Change Orders
- Grants
- Memorandum of Understanding
- Parks & Cultural Services Agreement and Leases - Contracts
- Interlocal Agreements – City as an additional insured
- Right-to-Audit Clause – (Ordinance 2013-51, Sec. 2-215 (a))

- Performance Metrics – All attributes of an agreement must be measurable with a reasonable effort. Examples are as follows:
- Certain % off of list price
 - Number of spray applications
 - Response Time
 - Mean Time to Repair
 - Schedule Compliance
 - Backlog
 - Performance Objectives

Management Response

Concur

Action Plan

Management clearly agrees that there are “opportunities for improvement” and have begun by updating the Purchasing Policy and Procedure Manual that will include guidelines for contract administration. As a part of this need to improve the process, Purchasing will develop a working group of managers and employees to serve as a “User Group” and develop clear and concise procedures for Contract Administration.

Implementation Date

October 1, 2014

Finding #2 – Training

Condition (The way it is)

During the audit it became apparent that responsible parties were not aware of their tasks to carry out the Contract Administration Model.

Criteria (The way it should be)

Any individual responsible for any phase of contract administration should be trained on their responsibilities

Effect (So what?)

Important aspects of contract administration will be lacking. For example, if the contractor does not carry the proper amount of insurance, the city's risks will increase. If there is no knowledge for the proper selection of a contractor the taxpayer may not get the best deal. If a right to audit clause is missing the city may not have the ability to verify the activities of the contractor.

Cause (Difference between condition & criteria)

There must be a priority for identifying what the city needs training on and then develop the curriculum to satisfy the needs.

Recommendation

Create a needs assessment for training in the city and develop the means to provide the training.

Management Response

Concur

Action Plan

Upon completion of the aforementioned Policy and Procedures Manual and working with the User Group, both comprehensive, high level, and end user training programs will be developed and presented to employees.

Implementation Date

January 15, 2015

Finding #3 – Proper Initial Review of Contracts

Condition (The way it is)

Proper initial reviews of contracts are not always being made. Numerous sampled contracts had no City Attorney review or did not go through Purchasing.

Criteria (The way it should be)

Contracts should be approved as to form by the City Attorney. The Purchasing Department has been established to assist each department to procure necessary goods and services at the best possible price. Purchasing can assist by: 1) Keeping the city in compliance with state law. 2) Providing segregation of duties over the Purchasing Process. 3) Observing what is being purchased and by whom to isolate any purchases that may indicate the potential for quantity discounts. 4) Ensuring the city is aware of all arrangements the city has entered into. This is especially important during a crisis situation or when employees leave employment.

Effect (So what?)

Without the proper review of the City's contracts, the City's ability to reach its objectives may be compromised.

Cause (Difference between condition & criteria)

A lack of training and an assigned responsible party for each contract.

Recommendation

Establish a responsible person and backup for each contract in the city to facilitate the review process. A check-off sheet may be an enabler. Provide training for good contract administration.

Management Response

Concur

Action Plan

- Working with the City Attorney, Purchasing has developed standard contracts for use.
- Going forward, all contracts, regardless of value, that are processed through the Purchasing Department will require both a responsible contact and backup person. This data will be maintained on the Contract Listing that has been developed and is managed in Purchasing.
- All contracts will have City Attorney approval.
- All city developed contracts will be included as a sample document in solicitations (bids, RFPs, etc.) and signed by the provider before City Council approval.

Implementation Date

Immediately

Finding #4 – Monitoring

Condition (The way it is)

Seven out of 36 contracts were not readily found or found at all. In 19 out of 36 contracts there was a lapse in monitoring. Eight of those lapses dealt with the Certificate of Insurance.

Criteria (The way it should be)

A contract is only as good as its monitoring and enforcement

Effect (So what?)

If the city or responsible person does not have the contract in possession that's readily available monitoring will not take place. Lapses in contract monitoring increases risk to the city. Risks may be in the form of:

- Not being able to evaluate the financial solvency of the other party
- Contract may not be executable
- Financial risks from a:
 - Lack of the appropriate insurance
 - Lack of naming the city as an additional insured
 - Lack of a 30-day notice for material changes not found in COI

Cause (Difference between condition & criteria)

Accountability has not been assigned; Guidelines are not in place and training is lacking

Recommendation

Assign Accountability, Put the Guidelines in place; Provide training for the responsible parties.

Management Response

Concur

Action Plan

- Accountability for the contract lies with the Director most closely related to the contract. The Director has the responsibility to deliver executed contracts to Purchasing and to the City Secretary.
- The City Manager has reinforced that assignment of responsibility at Director's meetings.
- That directive will be reinforced in the updated purchasing policy.
- Purchasing will develop comprehensive training for Contract Administration to include, but not limited to, overview; procurement process; tracking; monitoring, etc.

Implementation Date

January 15, 2015

Finding #5 – Central Repository

Condition (The way it is)

The Central Repository (Laserfiche) was not used in 21 out of 36 contracts examined. Four out of the 21 either had partial information or not the latest information. Additionally, the majority of departments reporting contracts did not have them housed in Laserfiche.

Criteria (The way it should be)

An inventory of contracts needs to be stored in a readily available storage application to provide efficiency of contract utilization. From the effectiveness standpoint, the entire relationship established by a contract as it evolves over time is housed in one place.

Effect (So what?)

One cannot monitor a contract if it is not readily available. Without the electronic means one can only rely on memory and a paper filing.

Cause (Difference between condition & criteria)

There is a lack of information regarding a requirement that all contracts be given to the central repository

Recommendation

Require that all contracts be housed at the central repository. Explore the possibility of using Laserfiche for all contract approvals and expiration ticklers.

Management Response

Concur

Action Plan

- The office of the City Secretary shall be the central repository for contracts for the City.
- Directors will be again reminded, via the updated purchasing policy and training, to provide all contracts to Purchasing for transmittal to central repository (City Secretary).
- Currently IT, Purchasing and the City Secretary are exploring opportunities to use Laserfiche technology for contract approvals, etc. In the meantime, Purchasing has developed a Master Contract List, for those contracts that are routed through our department. This listing includes a 90-day tickler for contract end or renewal.

Implementation Date

Ongoing, to be complete by January 15, 2015

Finding #6 – 4B Industrial Development Corporation

Condition (The way it is)

No evidence of training for certain city officials.

The city performs administrative functions for the 4B but is not reimbursed.

A determination has not been made of what exemption status applies to the 4B and if necessary submit paperwork requesting the exemption. This is for federal tax exemption.

Criteria (The way it should be)

A) Texas Local Government Code Section 502.101 - Certain Section 4B economic development and city officials are required to complete a training seminar. The officials must complete a seminar once every 24 months.

B) A city cannot provide anything of value to the 4B without due consideration. AG Opinion no. JC-0109 states: "Thus, in answer to your question, section 21 of article 5190.6 prohibits a city from giving money or services to a development corporation it has established. We note, however, that the Act does not preclude a city and development corporation from entering into a contract pursuant to which the city provides the development corporation with services in exchange for consideration from the development corporation."

C) Section 501(c)(3) requires Form 1023 to be filed with the IRS requesting this exemption.

Effect (So what?)

Non-Compliance with Federal and State laws

Cause (Difference between condition & criteria)

Management Oversight

Recommendation

Revisit the laws that affect 4B Industrial Development Corporations

Management Response

Management Concur

Action Plan

A) The training requirement includes both representatives of the 4B and of the City. The 4B representative has been trained. The designated City officials have not. Section 502.001(a) (1) requires training at least once in each 24-month period for "the municipal attorney, administrator, or clerk of the municipality". The City Manager will attend qualified training within the next six months.

B) City Staff is working to develop an interlocal agreement with the 4B to provide for the reimbursement of administrative costs incurred by the City on behalf of the 4B.

C) Staff is in the process of filing for exempt status recognition

Implementation Date

January 15, 2015

Finding #7 – Automatic Renewals

Condition (The way it is)

7 out of 36 contracts had automatic renewals.

Criteria (The way it should be)

Prudent business practices require due diligence in the acquisition of products and services.

Effect (So what?)

Automatic renewals may not always provide the city with the best alternatives to purchasing. An excessively long-time for automatic renewals may not keep up with the dynamic business environment.

Cause (Difference between condition & criteria)

Automatic renewals are a convenient way of purchasing as they save administrative costs from the continuous time-consuming task of getting quotes or re-bidding a product or service.

Recommendation

Put limits on the duration of automatic renewals.

Management Response

Concur

Action Plan

All new contracts issued through the Purchasing Department will have term limits and limited (if any) renewal options with a defined escalation clause. Incorporated in the revised policy, renewals will be limited to provide a total term of no longer than three (3) years in most cases. All renewal provisions will include defined pricing.

Implementation Date

Immediately

Finding #8 – Big League Dreams

Condition (The way it is)

General Liability coverage according to the contract should be \$2,000,000 per occurrence. Certificate of Insurance states \$1,000,000.

Criteria (The way it should be)

Contract Insurance Amount must equal Actual Insurance Coverage.

Effect (So what?)

The City could take on additional risk (\$\$\$) if there was an occurrence between \$1,000,000 - \$2,000,000. Insurance is meant to share risk.

Cause (Difference between condition & criteria)

No accountability was assigned to monitor this contract. No policy or training exists to educate an employee on what to look for on a COI

Recommendation

Contact Big League Dreams and inform them of the shortfall and ensure that it gets corrected.

Management Response

Concur

Action Plan

- 1) Training on Certificate of Insurance requirements will be a part of the contract administration training planned for the upcoming fiscal year.
- 2) The Deputy City Manager and City Attorney are working toward resolution of the insurance and other issues with the contractor

Implementation Date

January 15, 2015

EXHIBIT A

Sampling Methodology

The contracts in this audit were either picked from:

- Laserfiche – City Secretary’s database of contracts
- Purchasing Storage Directive – Where all Purchasing Bids, Contracts, Request for Proposals, Request for Qualifications are stored electronically
- Departments – Inquiry was made with departments asking for all contracts they are involved with.

A sample of 36 contracts was reviewed for this audit. The sample was judgmentally chosen. The sample included 14 different departments. Different types of contracts were selected. They included competitively bid, non-profit, interlocal, grants, and department quotes.

Analysis was performed to determine if contracts originating in the departments made their way to Laserfiche, the central repository.

It is noteworthy to state that a complete population of contracts in existence is not possible since not all contracts made their way to Laserfiche or even the Purchasing Department.

EXHIBIT B

Reliability and Integrity of Information

As related to the objectives of this audit, the reliability and integrity of data sources is inadequate. This is because all data sources (contracts) were not located in their appropriate places. (See Opportunities for Improvement #5, Page 11).