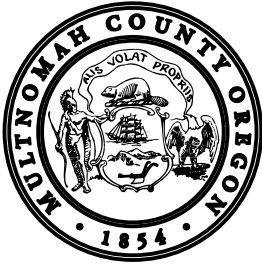Large Contracts
Audit Follow Up

March 2016

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Multnomah County Auditor

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Date: March 1, 2016

To: Deborah Kafoury, Multnomah County Chair
        Commissioners Bailey, Smith, Shiprack, and McKeel

From: Steve March, Multnomah County Auditor
Re: Large Contracts, Audit Followup

Contracts and contracting represent a significant portion of the County's annual expenditures, particularly for the provision of human services. To ensure the effective and efficient management and monitoring of those contracts, the contracting process itself requires the commitment of upper management; this is governance. Governance can provide leadership and enhance the operation of the organization through continuous improvement. We are hopeful that the timing and commitment of management is there at this time.

In response to our 2008 Audit of Large Contracts, a redesign of the contracting process was started; however, momentum was lost as leadership at the highest levels changed and departments returned to the old way of doing business. The old way was a semi-siloed approach to contracting with a number of our non-profit providers having multiple contracts with multiple departments, with each department going through all of the same required contracting, oversight, and monitoring steps, to ensure delivery of measureable outcomes.

In a previous audit on Financial Health Monitoring, we noted some strengths we do have located within the Department of County Management. However, there are opportunities for additional efficiencies, if the County can come together to better manage our contract-related risks through stronger governance, performance management, and continuous improvement. There are also opportunities for better training and information sharing.

We are encouraged that management and the COO recognize the potential for improvement and have shown a willingness to undertake incorporating our recommendations going forward. We would like to thank the staff and management of several departments, but in particular that of the Department of County Management, for their assistance and cooperation with this follow-up. We would also like to thank the COO for her willingness to continue to look for ways to improve County operations

C: COO Madrigal, CFO Campbell, and Department Directors

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Executive Summary

Partly in response to our 2008 Audit of Large Contracts, the County undertook the ambitious project of redesigning its contracting processes. Unfortunately, over time, much of the initial progress made toward implementing the Audit's recommendations was lost. Without the active participation of an executive leader, like the Chair or the Chief Operating Officer (COO), we have found it to be extremely difficult for any County initiative that crosses departmental boundaries to succeed. Initiatives like the contract redesign process have even more difficulty succeeding because their success depends on sustained levels of commitment.

Because contracting plays such an important role in the County fulfilling its mission, it is important that the organization continue to improve in this area. A high performing contracting process can help the County manage contract-related risks, such as poor performance or contractor insolvency, provide for sharing information, and promote continuous improvement. Specifically, we recommend that the County develop a governance structure to oversee continued and sustained improvements, develop and apply an appropriate training curriculum for all staff involved in the contracting process, and ensure that staff across departments and divisions are able to share information as they manage contracts.

Objective

We initiated this follow-up audit to determine if the work that went into the contract system redesign led to the development of a structure to address issues of governance, procedures, risk, and performance management as outlined in the recommendations of the 2008 Audit of Large Contracts.

Background   The County is, in many respects, a contracting organization, and it is important that it has a high performing contracting process in place to reduce risks and monitor performance. To varying degrees, every County department relies on contracts to fulfill or facilitate the completion of its mission. Nowhere is the involvement of contracts and contractors more prevalent than in the area of human services, where the County contracts for services rather than provides them directly.

Risk in contracting comes in many forms, such as the risk that poor contractor financial health may lead to clients receiving inadequate or unsafe care, the potential that contractor non-compliance with federal or state laws could put clients and the County at risk, or the risk that contractor failure means that services must be interrupted while an alternative provider is found.

We completed the most recent full-scale audit of contracting in 2008 and a follow-up on vendor financial health monitoring in 2015 and we can report that some progress has been made with respect to financial health monitoring.

The County spent over $1 billion on contracts over the last 3 years

Exhibit 1 shows the total dollar amount of contract related spending and the amount of contract spending on human services for fiscal years 2013 - 2015. Human services contracts include spending for addiction or mental health treatment, housing services, and services for seniors. Other large dollar contract purchases include those for County roads and bridges, County computers and technology projects, large capital projects such as the Health Department Headquarters, and employee benefit coverage. FY 2015 County expenditures were nearly $1.1 billion. Approximately one-third of all County expenditures involved contracts. In a typical year, we have more than 1,000 active contracts and serve thousands of clients.

**Exhibit 1: Spending on Contracts Compared to
Total County Spending (dollars in millions)**

	FY 2013	FY 2014	FY 2015
Total Expenditures	$990.3	$1,062.0	$1,071.2
Contracts	$321.4	$371.1	$370.2
Contracts as a Percent of Expenditures	32%	35%	35%
Human Services* Contracts	$122.0	$136.4	$135.6
Human Services as a Percent of Contract Spending	38%	37%	37%

Source: Multnomah County consolidated financial statements and the
County's financial system
*An approximation of human service contract spending, based on contracts
from the Departments of County Human Services and Community Justice

Partly in response to the recommendations in the 2008 Audit, the County started an initiative to redesign the contracting system, as shown in Exhibit 2 below.
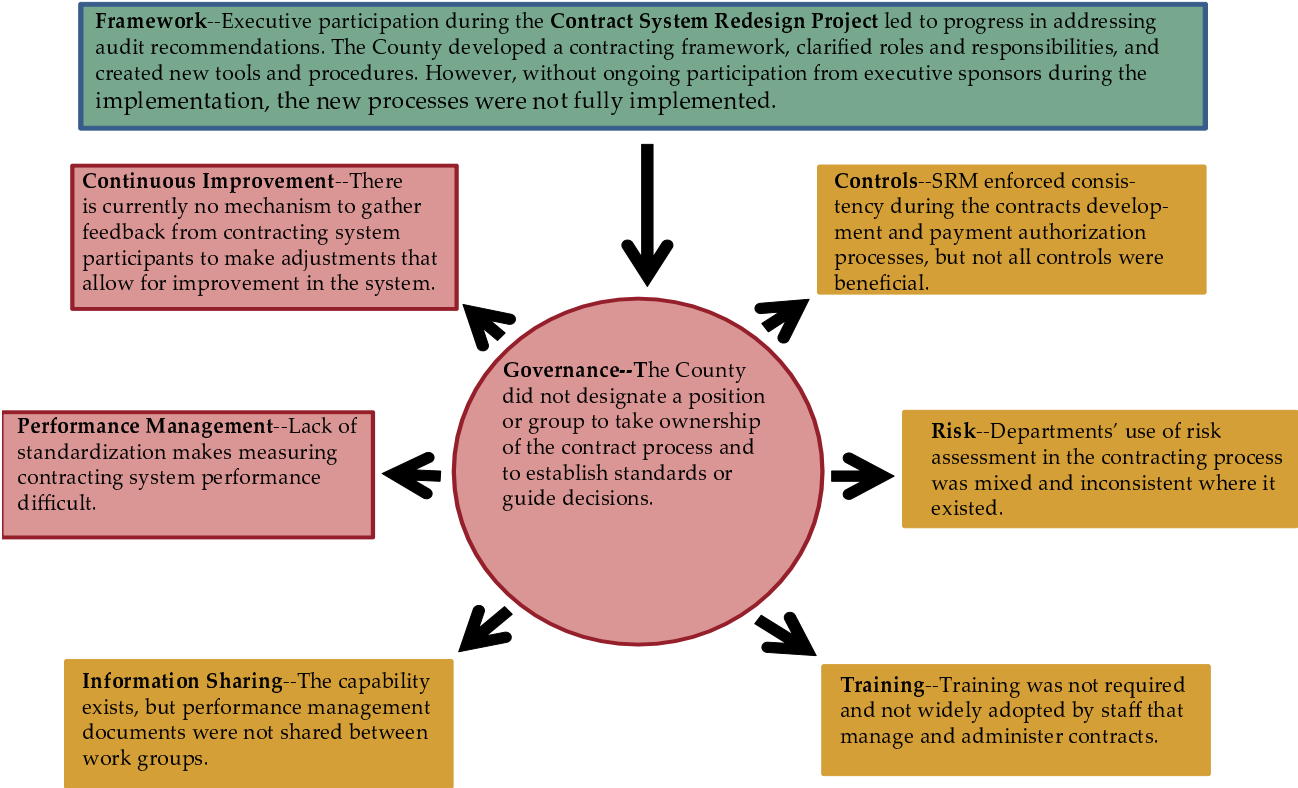
Exhibit 2: Contract Redesign Chronology

- **July 2008 – Audit of Large Contracts released.** The Audit recommended the County build a contracting framework focused on issues of governance, procedures, risk and performance management.
- **July 2008 – Board of County Commissioners adopted a resolution** to evaluate the county contracting process and make recommendations for improvements.
- **January 2009 – The Contracts Action Team report**, adopted for implementation by the Board of County Commissioners, recommended a contracting framework designed to clarify roles, responsibilities, and accountability and standardize a risk-based approach to implementing contracts County-wide. The report called for an electronic data system for procurement, contracting, and data sharing activities as well as a governance structure to monitor compliance and promote best practices.
- **2009 – 2011 – The Contract System Redesign Team** was formed to move the contract improvement process forward. The team developed manuals, checklists, and tools for new processes and procedures.
- **2009 – A Technology Solution Team** researched the feasibility of implementing an SAP module to serve as an electronic data system for procurement and contract processing as well as information sharing.
- **2011 – Central Purchasing** developed and delivered training based on new procedures manuals.
- **2012 - SRM:** The County went live with a Supplier Relationship Management system (SRM) in April 2012. SRM is an electronic procurement, contracting, and records management system.
- **March 2015 – Auditor's Letter to Management on Contractor Financial Health Monitoring released.** The letter reiterated the importance of keeping track of the financial health of vendors with high risk contracts.

Source: Auditor's Office

Findings   The 2008 Audit recommended the County build a contracting framework focused on governance, procedures, risk, training and performance management. Exhibit 3 summarizes the recommendations and the results of the County's attempts to implement them.

Exhibit 3: The Status of the Recommendations from the 2008 Audit of Large Contracts

Framework--Executive participation during the **Contract System Redesign Project** led to progress in addressing audit recommendations. The County developed a contracting framework, clarified roles and responsibilities, and created new tools and procedures. However, without ongoing participation from executive sponsors during the implementation, the new processes were not fully implemented.

Continuous Improvement--There is currently no mechanism to gather feedback from contracting system participants to make adjustments that allow for improvement in the system.

Controls--SRM enforced consistency during the contracts development and payment authorization processes, but not all controls were beneficial.

Governance--The County did not designate a position or group to take ownership of the contract process and to establish standards or guide decisions.

Performance Management--Lack of standardization makes measuring contracting system performance difficult.

Risk--Departments' use of risk assessment in the contracting process was mixed and inconsistent where it existed.

Information Sharing--The capability exists, but performance management documents were not shared between work groups.

Training--Training was not required and not widely adopted by staff that manage and administer contracts.

Source: Auditor's Office

Framework   **The System Redesign teams developed a risk-based strategic contracting framework that clarified roles and responsibilities.**

Recommendation: Develop a risk-based strategic framework for planning, developing, and monitoring contracts.

Result: *Implemented* – With support from executive leadership, redesign teams developed processes and procedures that span the life of the contract and aligned with the three phases in the Contracting Framework developed by the Contract Action Team. The *Contract Planning, Development and Administration Guide* clarified roles and responsibilities in the contracting process. The guide listed step-by-step tasks with clearly defined roles and responsibilities for both program and central purchasing staffs. Responsibilities were assigned as follows:

- Phase I – contract planning. In this phase, the *department or program* conducts planning activities, program design, and risk assessments and develops specifications for the solicitation and contract documents.

- Phase II – contract development. In this phase, procurement is completed and the contract is negotiated; both the *department and central purchasing* have responsibilities in the contract development phase.

- Phase III – contract administration. This final phase is often in place for multiple years with large human services contracts. It is solely under the direction and authority of *departments* to manage.

Governance

The County did not designate a position to take ownership of the contract process and to establish standards or guide decisions.

Recommendation: The 2008 Audit of Large Contracts and the Contract Action Team Report both called for a centralized standard setting, policy development, and enforcement function.

Result: *Not Implemented* – The County never created a sustainable governance structure to manage the contracting system. With no one to manage the procedures outlined in the framework, departments moved away from the adopted procedures and developed their own.

During the early stages of the redesign project, under the direction of the chair, the Chief Operating Officer (COO) acted as the project sponsor. While the COO position is a natural fit to oversee the contracting system, neither the Chair nor the Board of County Commissioners specifically identified that role for the COO. The lack of a dedicated sponsor, combined with turnover in leadership positions and competing priorities, meant the contract system lost much of its direction.

Without active executive participation, it is difficult for cross-departmental initiatives to succeed. Initiatives like the contract redesign process have even more difficulty succeeding because they generally have a life span that exceeds the average term of a Chair or tenure of a COO.

Controls

SRM enforced consistency during the contract development and payment authorization processes, but not all controls were beneficial.

Recommendation: Increase controls over exceptions to the traditional procurement and contracting processes.

Result: *Partially Implemented* – Without a governance structure to make sure departments followed the new processes and procedures, compliance with the new process was limited to those parts of the process that could be controlled by Central Purchasing via SRM. These controls over procurement, contract development, and payment helped to build consistency in contracting, but some proved to be more burdensome than beneficial.

The SRM controls meant Purchasing was better able to ensure that contracts:

- Included the most up-to-date language that met changing state and federal requirements;
- Included up-to-date administrative requirements, such as insurance certifications; and
- Were signed by both the County and vendor and recorded in the system before they authorized any payments on the contract.

These controls are consistent with the recommendations of the 2008 Audit, but until the County is better able to complete contracts on time, some of the controls create problems for contractors without providing the County any real protection. For example, continuous service delivery is critical to the needs of many of the County's most vulnerable clients. County departments frequently do not get new contracts in place when old contracts expire, which means we need the contractors to continue to work without a valid contract in place. The SRM controls prevent the County from paying contractors for services until a new contract is completed and signed. In these cases, withholding payment until a contract can work its way through the administrative process provides little protection to the County and places a burden on our contractors. We found a number of examples where contractors appeared to be providing services several months before contracts were signed, working without pay until the contract was released for payment.

With no governance structure specifically responsible for the contracting system as a whole, there is nobody to make decisions about the balance between the benefits and costs of these controls, nor is there any formal mechanism for dealing with disputes that may arise in the process.

Risk **Departments' use of risk assessment in the contracting process was mixed and inconsistent where it existed.**

Recommendation: There should be a risk-based approach to planning, developing, and monitoring contracts.

Result: *Partially Implemented* – Starting with the Contract Action Team recommendations in early 2009, the County developed processes and tools for assessing and monitoring risk in contracts and contractors. However, programs that are performing risk assessments and incorporating risk into planning and monitoring activities are not using these tools or processes.

We reviewed procurement and contracting documentation for 109 contracts – 74 of which were human services contracts – created using the SRM system. We reviewed these contracts to gauge the extent to which programs were using the new contracting process and tools.

- We found only two contracts where a program used the Human Services Risk Assessment tool and none of the human services contracts included any documentation of planning activity related to risk.
- The redesigned process also calls for a pre-contract information form to be completed by the vendor getting the contract – the form is designed to provide information the County can use for risk assessment

purposes. We did not find any of these forms in the contracting system.
- The County is doing a better job of monitoring contractor financial health, an important part of assessing and managing risk, but is primarily focusing on those contractors that receive non-Medicaid federal funding through the County. This leaves some important vendors out of the process.

Training

Training was not required and not widely adopted by staff that manage and administer contracts.

Recommendation: Train contracting staff to ensure dissemination and adoption of new contracting processes and procedures.

Result: *Partially Implemented* – Training is important in order to develop skills, reinforce changes and build consistency in contracting practices. Central Purchasing, in collaboration with the redesign teams, developed and offered a range of training classes based on the new procedures and tools. However, no central entity required contract managers and administrators to take the training and most did not. While some gave the training positive reviews, it clearly did not meet departments' needs as they have been independently developing their own training programs.

Central Purchasing developed and offered the following trainings to facilitate the roll out the new approach to contracting.

- Contracting Business Basics
- Establishing Performance Measures in Contracts
- Contract Monitoring
- Contract Sanctions

While the training covered important topics, it wasn't necessarily reaching the right people. Few department staff responsible for contract planning, assessing risk, or contract monitoring attended the 2011 trainings. Further, trainings tapered off in early 2012, providing few opportunities to reinforce new procedures. Although the Contract Action Team report called for mandatory training, training was not required and not well-attended by program staff.

The lack of high level executive ownership and direction of the contracting process had a large impact on training.

- Central Purchasing took on the role of training by default, even though they did not have the specific budget or training expertise to take it on.
- There was no mechanism in place to ensure contract training met the needs of program staff responsible for planning and managing contracts.
- The County's training unit did not have an active role in the development or delivery of contract training.

Information Sharing

The capability exists, but performance management documents were not shared between work groups.

Recommendation: To increase the focus on contractor performance, develop and support a County-wide contractor performance information repository.

Result: *Partially Implemented* – During the contract redesign process, management believed that an electronic database implemented with SRM would provide a method of sharing contractor performance and monitoring information. In this way, the entire County could benefit when individual workgroups were able to improve on

processes or tools. However, departments were not using the system. For example, of the 109 contracts we reviewed in SRM:

- None of the contracts included any documentation of compliance or monitoring activities and
- Only about 5 percent of those contracts included documented communication with the contractor.

Without a governance structure to stress the importance of information sharing, departments are on their own to decide the extent to which they participate beyond the minimum that is required with SRM. The new procedures leave contract performance and monitoring activities completely to the discretion of departments. The recommendations of the contract process redesign teams and the contract administration manuals are offered as "best practices" and not required. Contractors that work with multiple County programs are more likely to face different expectations regarding contract monitoring, which increases the administrative burden on these contractors.

Performance Management

Lack of standardization makes measuring contracting system performance difficult.

Recommendation: Monitor contracting system goals and performance.

Result: *Not Implemented* – The standardization envisioned in the Contract Action Team recommendations should have facilitated better measurement and management of both system performance and vendor performance. But with very little standardization across departments, system-wide performance is difficult to measure.

The County's contracting system involves many interrelated components – centralized work units such

as Purchasing, the County Attorney's Office, and Risk Management have roles, as well as departmental program and business services staffs. Making an adjustment in one component is likely to affect other pieces and unless the County can measure the entire process, it is difficult to know whether an adjustment improved the process as a whole. For example, SRM streamlined standardized parts of the procurement development and contracting process, but added to the workload of department business services staff.

With no governance structure in place, we are moving further away from standardization. Departments and divisions are developing processes in isolation and the risk assessment and contract administration process is becoming less, not more consistent.

Continuous Improvement

There is currently no mechanism to gather feedback from contracting system participants to make adjustments that allow for improvement in the system.

Recommendation: While not an explicit recommendation in the 2008 Audit, the importance of focusing on continuous improvement should be a goal for every County process. The Contract Action Team recommended that a continuous improvement process be used to maintain and upgrade the contracting framework. A formalized system for gathering information on how processes or tools are working that then turns the information into refinements in the processes and tools is a central feature of the continuous improvement cycle. The County does not have anything like this for the contracting system. The structure that was in place to redesign the contracting process dissolved without leaving a system for incorporating feedback and refinements. Without a governance structure, there is no way to successfully rebuild it.

Recommendations

The establishment of a **Governance Structure** is the most important step in addressing the weaknesses in the County's contracting system that we have identified in both previous audits and the current audit.

Once in place, the Governance Structure can:

- Create a continuous improvement process to ensure that refinements to processes, controls, and tools are made when needed.
- Develop and establish a mandatory comprehensive contracting training curriculum for both administrative staff, who process contracts through the system, and program staff, who are generally responsible for administering the contracts once they are in force. This can best be done in collaboration with departments, Central Purchasing, and the Training Unit. Training should be available online to ensure that staff can access it when they need it.
- Ensure that consistent processes are followed, particularly in conducting risk assessments and monitoring performance.
- Identify an efficient means of sharing risk assessments and performance management documents.
- As part of a continuous improvement process, create a mechanism to review the costs and benefits of SRM controls and refine processes as appropriate.

Scope and Methodology

Our work included reviewing contracting policies and procedures, diagramming the contracting life cycle, interviewing staff involved in the contracting process, and reviewing meeting notes from the Contract System Redesign project. We reviewed the Supplier Relationship Management (SRM) system, and examined a sample of County contracts within SRM to determine whether they followed County contracting processes. We focused on

contracts valued at more than $1 million and looked at contracts with vendors that did more than $1 million worth of business with the County. We analyzed SAP data and SRM data and reviewed reports from the SRM system. Data analysis focused on a time period one year after the launch of the SRM system, fiscal years 2013 through 2015.

We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives

Response

February 29, 2016

Auditor Steve March
501 SE Hawthorne Blvd., Ste 600
Portland, OR 97214

Re: Large Contracts Audit Follow-up

Dear Auditor March:

Thank you for the opportunity to review and respond to the Large Contracts Audit Follow-up. Our contracting system is very complex. We recognize the importance of balancing the service needs of our clients with ensuring efficiency and compliance with our laws and rules.

Thank you for presenting the findings of this audit to the Direct Report Managers (DRM) at their February 10 meeting. Because contracting plays such an important role in the county's fulfillment of its mission, we agree that the governance function must be at an organizational level high enough to maintain focus over time. In order to ensure sustained effort, we are exploring ways to incorporate it into an existing cross-departmental committee. We will be cataloging and reviewing county committees and workgroups to determine the best place for a contract administration subcommittee. Integrating governance issues into the bi-monthly DRM meetings is one potential outcome. Additionally, we will ask our existing Purchasing Leaders and Financial Management Forum groups to identify how they might address and escalate governance issues to the DRMs.

We will also reexamine the work that was done as part of the Contract System Redesign to clarify the standards of contract administration with the Department Directors. We will identify appropriate trainings to support the staff in meeting those standards. We are developing policies and procedures to implement mandatory staff training and to ensure that they are audited regularly. We will also look at ways of leveraging the capabilities of the County's ERP system to improve transparency and consistency across departments.

In the meantime, we are committed to more regular monitoring of system performance. We will be working with Purchasing and the departments to ensure that regular system monitoring is occurring both at the department and system level. In addition, we will develop communication protocols to alert central Finance and the departments when contract performance or financial risk concerns are raised. This fits in well with the overall DCM goal of continuous process improvement and enhanced communication within the organization. Communication with the Department Directors and other key stakeholders will be critical to securing their buy-in as we move to implement the governance and training recommendations.

Thank you again for the time and effort taken to compile this report and make recommendations to improve our contracting system.

Sincerely,

Marissa Madrigal
Chief Operating Officer

Mark Campbell
Chief Financial Officer