



CONSENT CALENDAR  
July 13, 2010

**To:** Honorable Mayor and Members of the City Council  
**From:** Ann-Marie Hogan, City Auditor  
**Subject:** Audit: Efficiency and Transparency of Contract Fiscal Management Needs Improvement

RECOMMENDATION

Request the City Manager to report back on or before January 18, 2011 on the implementation status of each of the City Auditor's recommendations in the attached report. Report back no later than every six months, thereafter, until all recommendations have been fully implemented.

SUMMARY

Our performance audit was conducted to determine:

- Whether procedures, processes, and practices involving contract review include controls that mitigate the risks associated with contract overspending.
- If project managers attempted to exceed their Council/City Manager authorized spending limits via a purchase order change.

Our sub-objective was to disclose contract preparation and execution weaknesses that came to our attention.

The good news is that project managers generally did not exceed their authorized limits. However, the cost of ensuring compliance might be excessive. Significant resources and multiple stand-alone systems are used to monitor contracts. None of these systems is integrated with the City's financial software, Sungard HTE. Improved fiscal management guidance, especially written guidance, is also needed to reduce wasted staff time.

We also noted that the stated balance in the Public Liability Fund Chapter of the Berkeley Municipal Code is not consistent with current practices. The City Attorney has proposed new language that appears to more clearly express current funding practices.

FISCAL IMPACTS OF RECOMMENDATION

It is important to the City's financial health that contract expenditures and performance are monitored. Expenditure contracts executed in fiscal year 2009 totaled more than \$70 million<sup>1</sup>.

We did not perform an analysis of the staff time wasted due to the lack of written procedures and a centralized contract-monitoring database. It appears likely that this waste is more costly than overspending. The short-term cost to Finance and to the operating departments for creating or enhancing written procedures should be minimal compared to the ongoing cost of inefficiencies. Once responsibilities and roles are documented and clarified, Finance can more easily determine whether the current costs in wasted staff time justify future investment in software improvements.

RATIONALE FOR RECOMMENDATION

Implementing our recommendations would help staff manage contract expenditures more efficiently and effectively.

POSSIBLE FUTURE ACTION

Contract software improvements could require future Council action to allocate funding.

CONTACT PERSON

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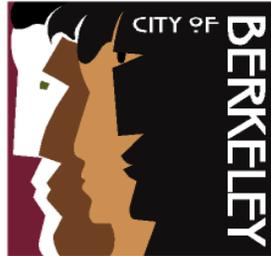
Attachments:

- 1: Audit: Efficiency and Transparency of Contract Fiscal Management Needs Improvement

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<sup>1</sup> The \$70+ million does not represent expenditures for one fiscal year: The contracts executed vary in term length and the contract not-to-exceed amounts represent expenditures over the life of the contract, e.g., 10 years.

# City of Berkeley



## Efficiency and Transparency of Contract Fiscal Management Needs Improvement

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Presented to Council July 13, 2010

**Efficiency and Transparency of  
Contract Fiscal Management Needs Improvement**

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## I. Executive Summary

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Transparency in spending helps ensure appropriate use of City funds.

### ***Citywide Written Guidance is Needed***

The City has extensive written procedures for contract preparation, but little guidance for fiscal management after the contract is approved. This results in errors and inefficiencies that waste City resources.

There is little guidance for monitoring contracts after they are signed.

### ***Department Specific Written Guidance is Important***

We asked City departments for their written contract management procedures. Many lacked sufficient guidance for fiscal and performance monitoring.

Written procedures, even in a simple format such as a checklist, help avoid mistakes and allow someone who is unfamiliar with operations to perform the duties effectively.

### ***Automated Systems Could Help with Transparency and Fiscal Oversight***

“The key problem with tracking contract[s]... is that the data is kept in multiple databases.”  
- Public Works Analyst

City staff use a variety of stand-alone systems to monitor contracts. None of these systems is integrated with the City’s financial system, Sungard/HTE. This is extremely inefficient. It also increases the risk of overspending and lapsed terms.

Sungard/HTE offers a contract module that might make the fiscal management of contracts more transparent and efficient. While it might not meet all of the City’s needs, it could be a cost effective way to improve current systems. The option of using the contract module has not been fully explored.

## II. Audit Objectives and Results

### *Objectives*

- Determine whether procedures, processes, and practices involving contract review include controls that mitigate the risks associated with contract overspending.
- Determine if project managers attempted to exceed their Council/City Manager authorized spending limits via a purchase order change.

Our sub-objective was to disclose contract preparation and execution weaknesses that came to our attention.

### *Results*

Accurate and clearly written contract procedures result in consistent performance.

Project managers generally did not exceed their authorized limits. In three of seventy-two (4%) instances, project managers attempted to request more money than their contract allowed. In only two instances, totaling \$44,674, did project managers actually spend more than their contract allowed.

A need for improved fiscal management guidance appears to be the cause for the contract overspending. Establishing clear, written procedures will assist project managers and support staff in monitoring contract expenditures. As an added benefit, the procedures could be used to document business processes and identify opportunities to streamline work. Well-documented procedures could also be used to identify and design software solutions.

Improvements needed:

Written procedures may be the first step to streamlining work.

1. Provide clear contract fiscal management guidance (Finding 1).
2. Explore the use of Sungard/HTE's contract module (Finding 2).
3. Execute contracts timely (Finding 3).
4. Update contract review procedures (Finding 4).
5. Amend the Public Liability Chapter of the Berkeley Municipal Code (Finding 5).

City resources are not used efficiently when staff spend time to identify, research, and resolve problems associated with contract management.

### III. Auditee Accomplishments

The Finance Department/General Services Division reported the following accomplishments. In fiscal year 2010, the Division:

- Conducted three (3) training classes on contract preparation.
- Assisted City staff in executing six hundred and ten (610) contracts (as of June 8, 2010).

On an ongoing basis, the General Services Division reviews contracting procedures for efficiencies and effectiveness.

### IV. Background

#### Contracts

In fiscal year 2009, the City executed 442<sup>1</sup> expenditure contracts totaling more than \$70 million.<sup>2</sup>

Contract preparation is a multi-departmental effort that requires coordination among a number of contract reviewers. [Exhibit C](#) illustrates the contract approval workflow.

Contract spending is limited to the not-to-exceed (NTE) amount stated in the contract. [Exhibit B](#) provides more information on fund availability, Council approval, and contract NTEs.

Contract expenditures are limited to the contract not-to-exceed amount. This is true even if there are funds in the budget and/or Council approved a larger sum.

#### Contract Administrator

Contract administration is centralized in Finance.

According to the authorized job description, the Contract Administrator<sup>3</sup> is responsible for assisting in the development and monitoring of City contracts. The Contract Administrator is to serve as a single point of contact for City project managers.

<sup>1</sup> Includes 259 new contracts and 183 contract amendments. Excludes revenue contracts.

<sup>2</sup> The \$70+ million does not represent expenditures for one fiscal year: The contracts executed vary in term length and the contract not-to-exceed amounts represent expenditures over the life of the contract, e.g., 10 years.

<sup>3</sup> The City established the Contract Administrator position in November 2005. The position was proposed by the Director of Finance and reports to the General Services Manager in the Finance Department.

## Project Managers

Project managers are responsible for managing their contracts; this includes fiscal management.

City project managers are responsible for ensuring that contracts are properly authorized, accurate, and complete. This includes ensuring budgeted funds are available before initiating a contract.

Once contract work begins, City project managers are responsible<sup>4</sup> for ensuring that expenditures do not exceed the contract amount. This requires them to monitor contract expenditures and determine whether it will be necessary to seek City Manager or Council approval to increase the contract not-to-exceed amount.

## Contracts Online

[Contracts Online](#) is a guide for City project managers and support staff to prepare, authorize, and execute contracts. [Contracts Online](#) includes:

- general information and an overview of the contract process;
- instructions on how to complete the forms and prepare the contract package;
- contract review forms, boilerplates and certifications; and
- links to other required forms, related procedures, and legislation.

The Contract Administrator maintains [Contracts Online](#).

## **V. Findings and Recommendations**

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### **Finding 1: Little Guidance Available for Monitoring City Contracts**

#### Staff Need Improved Guidance from Finance for the Fiscal Management of Contracts

Contract spending terms require clarification.

Contracts Online does not provide adequate guidance for monitoring contract spending. Some operating units appear confused about the difference between Council authorization, the contract not-to-exceed amount, and budgeted funds (see [Exhibit B](#)). Result: A total of \$44,674 was spent beyond contract limits<sup>5</sup>.

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<sup>4</sup> City project managers are also responsible for monitoring the quality of work performed. Previous reports about performance monitoring include [Public Works Contract Monitoring \(September 2010\)](#); [Public Works Construction Contracts \(June 2000\)](#); [Public Works Construction Contracts – Follow Up \(February 2007\)](#); and [City Monitoring of Community Agency Contracts \(June 2000\)](#).

<sup>5</sup> Corrective action has been taken.

There is also confusion about when staff may increase the amount<sup>6</sup> of a contract purchase order. Result: Three departments attempted to increase purchase orders before having an amended contract in place. A purchase order is the mechanism for paying a contract. Staff may add funds to a purchase order only after the City Manager signs and the City Auditor registers the contract. This helps reduce the risk of unauthorized spending.

### Lack of Written Procedures in Operating Departments

The Auditor's Office requested that 20<sup>7</sup> City departments/divisions submit their contract monitoring procedures. Nine departments responded. Of those departments:

Written contract monitoring procedures could help determine certain contract software needs.

- Seven did not include guidance for monitoring performance after a contract is signed.<sup>8</sup>
- Seven did not explain the difference between Council authorization, contract not-to-exceed amounts, and budgeted funds.
- Four lacked sufficient guidance for how expenditures are monitored and by whom.
- Two<sup>9</sup> did not maintain any contract monitoring procedures.
- Two had outdated procedures.

Clear, concise, detailed, and up-to-date written procedures reduce the risk of confusion and help ensure staff perform their duties as intended.

<sup>6</sup> When a contract purchase order is increased, contract funds are *encumbered*. Encumbrances are funds set aside for a purchase(s) but not expended. To clarify, staff may *pre-encumber* funds during contract preparation, but they may not *encumber* funds until the contract is executed (i.e., signed by all parties to the agreement).

<sup>7</sup> City component units are included in this count.

<sup>8</sup> It is possible that some departments have separate written procedures for contract performance management. The wording of the request for procedures may have led departments to believe they needed to submit for review only procedures pertaining to fiscal management.

<sup>9</sup> Audit is included in this count. In February 2010, Audit developed procedures for monitoring contract expenditures. In May 2010, the procedures were updated to include performance monitoring.

## City Manager's Response to Finding

*Agree.*

## Recommendations and City Manager Responses

- 1.1 **Finance** should define in Contracts Online the difference between Council authorization, contract spending limits, and budgeted funds. **Finance** should also clarify when City project managers may increase the amount of a contract purchase order.

*Agree. Recommendation partially implemented June 7, 2010 and will be fully implemented by June 30, 2010.*

- 1.2 The **City Manager** should direct all City departments to develop or update written contract management procedures. The procedures should specify how and by whom spending is monitored, and how performance is monitored. The procedures should be clear, concise, and sufficient to meet the particular needs of each department.<sup>10</sup>

*Agree. Recommendation will be implemented by July 31, 2010.*

- 1.3 **Finance** should clarify in Contracts Online that departments are responsible for establishing written contract management procedures (see recommendation 1.2).

*Agree. Recommendation implemented June 7, 2010.*

## Finding 2: Option of Using Sungard/HTE's Contract Module Has Not Been Fully Examined and the Results Documented

### The City Lacks Adequate Citywide Contract Monitoring Software<sup>11</sup>

Staff use a variety of stand-alone systems to monitor contract spending limits, balances, and terms. These systems are not integrated with the City's financial system. Multiple updates are required to ensure the various stand-alone systems are correct and consistent. If each system

The City needs "a central easy-to-access online location to [view a contract's] current processing status, its location, and whether it is yet actionable."

- Library Director

<sup>10</sup> Departments with few contracts may not need the same degree of documentation as departments that execute a large number of contracts. Brief and less detailed procedures may be sufficient.

<sup>11</sup> For more information, see [Audit: Leases: Conflicting Directives Hinder Contract Oversight](#) Findings 8 and 9.

is not updated, staff may inadvertently rely on incorrect information. This increases the risk of overspending and lapsed terms.

“The functionality of the [contract module] would still deliver a great deal of value....”

- Information Technology

Sungard/HTE<sup>12</sup> offers a contract module that could simplify contract monitoring. The module links to the general ledger, manages approvals, and includes an expiration date notification. The estimated start-up cost is approximately \$35,000 with annual recurring costs estimated at approximately \$5,000.

Use of the module could provide a citywide view of contracts and provide a more efficient way to monitor contract spending and expiration dates. While the module may not meet all of the City’s contract monitoring needs, it could still provide value. For a small cost, it could be an improvement to current systems. However, the option of using this module has not been fully examined and the results documented.

### City Manager’s Response to Finding

*Agree.*

### Recommendation and City Manager Response

2.1 **Finance**, with input from contract reviewers, user departments, and Information Technology, should look into the possible use of the Sungard/HTE contract module. **Finance** should furnish a written report to the City Manager that clearly documents reasons for acceptance or rejection of the module.

*Agree. Recommendation will be implemented by December 31, 2010.*

### Finding 3: Contract Not Executed Timely

One department rushed an amendment through the contract review process to pay overdue invoices totaling \$43,632. The project manager did not adequately monitor the contract expenditures: Four months before the project manager prepared an amended contract, the available contract balance was only \$69. The amendment was to pay for prescription psychiatric medications.

The [Citywide Contract Compliance Audit Report \(May 2004\)](#) found that 95% of all contracts were executed (signed) after the planned start date and 58% of sampled contracts had invoices for work performed prior to contract execution (see finding three of the report).

<sup>12</sup> The City’s financial and work management system.

A rushed transaction should be a signal to slow down and closely review documentation.

To provide uninterrupted services to clients, departments should ensure a contract is in place before purchasing goods or services. Although no evidence was found to indicate fraudulent activity, transactions that are rushed or performed outside the normal process are universally recognized as a red flag for possible fraud.

#### **City Manager's Response to Finding**

*Agree.*

#### **Recommendation and City Manager Response**

3.1 The **City Manager** should remind all City Departments of the City's policy to ensure an executed contract is in place prior to purchasing goods and services.

*Agree. Recommendation will be implemented by July 31, 2010.*

#### **Finding 4: Update Contract Review Procedures**

The City Attorney's Office lacked adequate written contract review procedures. According to the City Attorney, only attorneys with legal education, practical knowledge, and years of experience perform contract reviews. Therefore, detailed contract review procedures are unnecessary. The City Attorney also stated that the nature of the work makes it impossible to predict what specific terms the attorneys must review.

The auditors agree that the amount of detail included in written procedures will vary according to the size of the department, the professional experience of the employees, and the nature of the task. However, written procedures help to ensure that work is performed as intended.

#### **City Manager's Response to Finding**

*Agree.*

## Recommendation and City Manager Response

- 4.1 The **City Attorney** should update their contract review procedures to provide reviewers additional guidance.

*The City Attorney implemented the recommendation in March 2010.*

## Finding 5: Amend the Public Liability Fund Chapter of the Berkeley Municipal Code

The [Public Liability Fund Chapter](#)<sup>13</sup> of the [Berkeley Municipal Code](#) gives the City Attorney authority over the Public Liability Fund (Fund). The purpose of the Fund is to pay for costs associated with claims against the City<sup>14</sup>.

When the City established the Fund in 1972, it identified an initial balance of \$175,000. Today the annual Fund balance is established based on budgets approved by the City Council and is much higher than the balance deemed appropriate over 35 years ago. The stated balance of \$175,000 in the [Public Liability Fund Chapter](#) is not consistent with current practices.

The City Attorney has proposed new language for the [Public Liability Fund Chapter](#) of the [Berkeley Municipal Code](#). It appears this new language more clearly expresses current funding practices.

## City Manager's Response to Finding

*Agree.*

## Recommendation and City Manager Response

- 5.1 The **City Manager** should submit the proposed update to the [Public Liability Fund Chapter](#) of the [Berkeley Municipal Code](#) to Council for approval.

*Agree. Recommendation will be implemented by September 21, 2010.*

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<sup>13</sup> [Chapter 7.12](#)

<sup>14</sup> The General Fund is also a funding source for some litigation-related costs (see [Exhibit D](#)).

## VI. Fiscal Impact

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Expenditure contracts executed in fiscal year 2009 totaled more than \$70 million<sup>15</sup>. It is important to the City's financial health that contract expenditures and performance are monitored.

Lack of procedures and software wastes time.

Project managers spent \$44,674 beyond contract limits. Improved written guidance will help prevent contract overspending.

With an estimated initial investment of approximately \$35,000 and annual recurring costs of approximately \$5,000, the City **might** be able to improve staff's ability to monitor their contracts.

Although the auditors did not perform an analysis of the staff time wasted due to the lack of written procedures and a centralized contract-monitoring database, it appears likely this cost is more significant than the overspending.

## VII. Conclusion

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Effective contract management is important for successful City operations.

Contracts represent a significant portion of City expenditures yet there is little guidance for monitoring expenditures and performance. In fact, a recent audit found that the City is at risk of overpayments due to inadequate contract monitoring and a lack of monitoring procedures.<sup>16</sup> It is vital to City operations that staff have the tools to monitor expenditures and performance throughout the life of the contract.

Implementing our recommendations would help staff manage contract expenditures more efficiently and effectively.

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<sup>15</sup> The \$70+ million does not represent expenditures for one fiscal year: The contracts executed vary in term length and the contract not-to-exceed amounts represent expenditures over the life of the contract, e.g., 10 years.

<sup>16</sup> [Public Works Contract Monitoring: Risk of Overpayments / Lack of Inventory Control \(February 9, 2010\)](#)

## Appendix A

### Scope and Methodology

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This report is based on a preliminary survey of citywide purchase order increase requests and contract preparation and execution. It was planned as part of a series of contract oversight reports. Survey and fieldwork were performed between February 9, 2009 and December 10, 2009. Objectives were met by:

- Reviewing 72 purchase order increase requests (from various departments / divisions) between August 1, 2009 and September 30, 2009.
- Reviewing 67 contracts executed (from various departments / divisions) between August 1, 2009 and September 30, 2009.
- Reviewing Contracts Online and the City's Purchasing Manual.
- Reviewing contract review/management procedures used by oversight and initiating departments, and holding meetings and discussions with key contract review staff.
- Surveying and communicating with staff involved with initiating contracts and/or processing purchase order increases.
- Performing Sungard/HTE inquiries.
- Reviewing Sungard/HTE contract module documentation and discussing the module with Information Technology staff.

The results of the reviews, discussions, meetings, Sungard/HTE inquiries, surveys, and communications are the basis for the findings in this report.

The Auditor's Office is not responsible for making management decisions related to contract administration and management. [Section 2.24.050](#) of the Berkeley Municipal Code only requires the City Auditor to review, countersign, number, and register all contracts. Current practice is that Audit staff verify contract payment history before notifying Finance/General Services that a contract purchase order may be increased. Audit work included a review of procedures used by Audit staff to review, countersign, number, and register all contracts, and the procedures used to verify contract payment history. An auditor not involved with this audit, or the non-audit services<sup>17</sup>, read the procedures for the Auditor's Office and no significant omissions or concerns came to his attention. The contracts and purchase order increases included in our test sample were reviewed during the normal course of our non-audit work. We did not audit the work performed by our office. We believe this did not impair our compliance with Generally Accepted Government Auditing Standards for auditor independence.

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<sup>17</sup> Generally Accepted Government Auditing Standards state: "in non-audit services, audit organizations perform tasks... that directly support the entity's operations. Non-audit services (1) are generally performed for the sole use and benefit of the entity requesting the work or (2) provide information or data to a requesting party without providing verification, analysis, or evaluation of the information or data and, therefore, the work does not usually provide a basis for conclusions, recommendations, or opinions on the information or data. The nature and scope of a non-audit service is generally determined by agreement between an audit organization and an audited entity or by the requesting party. In contrast, the nature and scope of an audit is determined by an audit organization in order to satisfy the audit objectives."

We conducted this performance audit in accordance with *Generally Accepted Government Auditing Standards (GAGAS)*. Those standards require that we plan and perform our audit to obtain sufficient and appropriate evidence that provides a reasonable basis for our findings and conclusions, based on our audit objectives. We believe that the evidence obtained provides reasonable basis for our findings and conclusions, based on our audit objectives.

This performance audit was initiated by the Auditor's Office and scheduled as part of the fiscal year 2010 Audit Plan presented to Council on June 23, 2009.

## Appendix B

### **Contract Funding and Authorization Terms**

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Understanding the difference between budgeted funds, Council authorization, and contract not-to-exceed amounts is necessary for monitoring contract balances and ensuring the timely execution of contract amendments.

#### *Budgeted Funds*

These are estimates of proposed expenditures. Money must be in the budget prior to contract execution.

Having money in the budget does not mean Council has approved contract spending or that work may begin.

#### *Council Authorization*

By resolution, Council approves how much of budgeted funds a department may use for a service contract over \$50,000 or a construction contract over \$200,000. (The City Manager may approve service contracts for \$50,000 or less and construction contracts for \$200,000 or less.)

Approval by Council does not mean that work may begin on a project. This approval only allows a department to use the money for the stated purpose and move forward with the contract. The contract is not valid until after the City Manager (or, for litigation, the City Attorney) signs the contract.

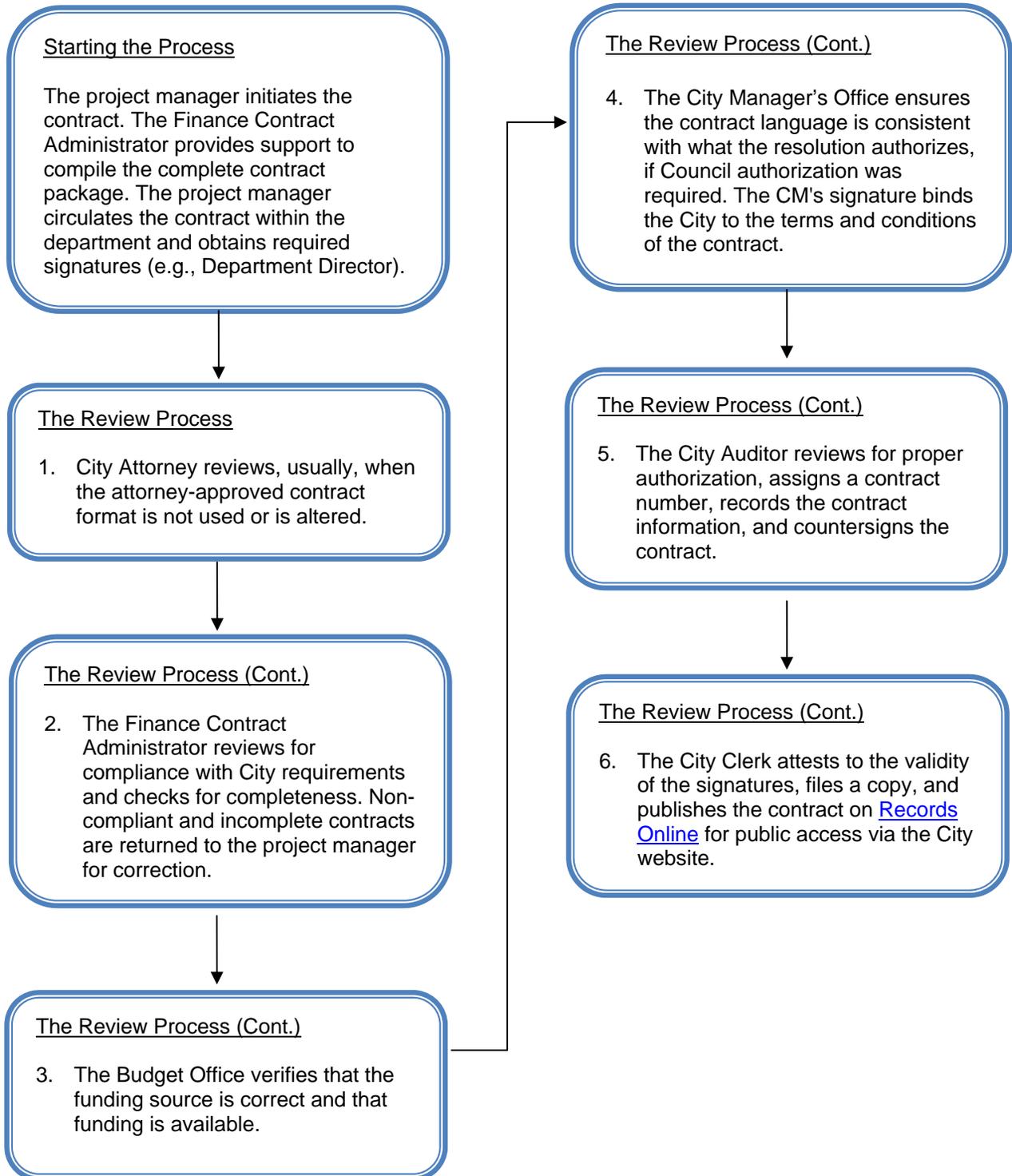
#### *Contract Not-To-Exceed (NTE) Amount*

The NTE is the maximum amount that may be paid out over the entire term of the contract. The amount must be less than or equal to the Council approved amount.

Spending is limited to the NTE stated in the contract. If Council approved an NTE of \$500,000, but the City Manager signs a contract for \$300,000, the spending limit is \$300,000. This is true even if the other \$200,000 is in the budget. Using the remaining \$200,000 requires a contract amendment. Execution of the amendment must take place before any additional work begins or services are rendered.

## Appendix C

### Contract Review / Approval



## Appendix D

### City Attorney Spending Authority

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The City Attorney provided the following opinion for litigation-related costs from sources other than the Public Liability Fund:

“The City Attorney has independent authority under [Section 113](#) of the Berkeley Charter to enter into contracts for litigation-related expenses, subject to the amounts budgeted for such expenses in the budget adopted by the Council. To the extent this authority extends to litigation in which the City is a plaintiff, it flows from and is dependent on either the City Attorney’s independent authority to initiate litigation or from express Council direction to initiate litigation as set forth in [Section 113](#).”

[Section 113](#) of the City Charter states:

“The City Attorney shall prosecute, in behalf of the people, all criminal cases arising from violations of the provisions of this Charter and the ordinances of the City, and shall attend to all suits and proceedings in which the City may be legally interested; provided, the Council shall have control of all litigation of the City and may employ other attorneys to take charge of any litigation or to assist the City Attorney therein.”

