



A REPORT
TO THE
MONTANA
LEGISLATURE

PERFORMANCE AUDIT

Contract Management

Department of Military Affairs

JUNE 2011

LEGISLATIVE AUDIT
DIVISION

11P-06

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We conducted this performance 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 that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Members of the performance audit staff hold degrees in disciplines appropriate to the audit process. Areas of expertise include business and public administration, journalism, accounting, economics, sociology, finance, political science, english, anthropology, computer science, education, international relations/security, and chemistry.

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LEGISLATIVE AUDIT DIVISION

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June 2011

The Legislative Audit Committee
of the Montana State Legislature:

This is our performance audit of the Department of Military Affairs' management of contract related activities. The report presents audit findings and makes recommendations for improving the department's contract related documentation, compliance, and overall contract management.

The department's written response to the audit recommendations is included at the end of the audit report. We thank the Adjutant General and his staff for their assistance.

Respectfully submitted,

/s/ Tori Hunthausen

Tori Hunthausen, CPA
Legislative Auditor

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APPOINTED AND ADMINISTRATIVE OFFICIALS

Department of Military Affairs

Brigadier General John Walsh, Adjutant General

Karen Revious, Administrator, Centralized Services Division

Ed Tinsley, Administrator, Disaster and Emergency Services Division

Janice Thomson-Rouse, Director, Montana Youth ChalleNGe Academy

Dan Hubber, Deputy Construction and Facility Maintenance Officer,
Montana National Guard


 MONTANA LEGISLATIVE AUDIT DIVISION

 PERFORMANCE AUDIT
 Contract Management
 Department of Military Affairs

JUNE 2011

11P-06

REPORT SUMMARY

The Department of Military Affairs spends millions of dollars per year for contracted goods and services; however, overall contract management does not assure compliance with procurement law and accountability for contracting activities.

Context

The mission of the Department of Military Affairs is to provide for the safety and well being of the citizens of Montana through the maintenance of mission ready forces for federal and state activations, emergency services as directed by the Governor, and services to Montana veterans. In carrying out its duties, the department manages a significant amount of contracts. Based on our review, we estimate the department enters into more than 100 new contracts each fiscal year. These contracts are for a wide variety of goods and services, ranging from lawn care and other facility maintenance services to equipment, training, and work related to unexploded ordnances. For fiscal years 2006 through 2010, the department expended \$15.1 million on consulting and professional services alone.

Contract management activities are spread throughout the department. Thirty-one employees who have been delegated purchasing authority handle procurement under \$5,000. For purchases exceeding that amount, staff coordinate with the department's Contracts and Purchasing Officer to execute the needed contract. All procurements for services or goods exceeding \$100,000 are referred to the Department of Administration's State Procurement Bureau.

Upon execution of a contract, a contract liaison is designated. The liaison serves as the department's representative for the duration of the contract and is the primary contact for contractors. As part of their duties as a contract liaison, these employees are responsible for oversight of the provision of the services or goods by the contractor, approval of contractor payments, and assurance of compliance with contract terms. In addition, contract liaisons identify when contract amendments are necessary and if contract renewals are warranted and appropriate based on the department's need and the contractor's performance thus far.

Our audit sought to determine if the Department of Military Affairs' contract activities assure compliance with Montana procurement requirements and ensure accountability for goods and services provided. In order to meet our objective, we reviewed contract procurement and monitoring files, observed contract related processes, and interviewed staff and contractors.

Results

We reviewed a sample of 50 contracts and found the department has not developed controls over its contract management. We noted weaknesses related to the documentation

(continued on back)

of contract related activities, noncompliance with procurement law and policy, and a lack of overall oversight of department contracting.

We noted the department has limited contract related information, which hinders its ability to determine the number of contracts in which it is engaged and funds associated with those contracts.

In addition, we found instances in which the use of sole source procurement was not appropriate or justified for contracts worth \$256,944. In one case, an existing contract was amended to add \$118,500 for a subcontract. Sole source procurement was used on the basis this subcontractor was the only one able to complete the work; however, interviews suggested the work could have been completed by other vendors.

During the course of the audit, we found instances of inappropriate contractor payments. The department paid a contractor for invoices exceeding the total amount allowed by the contract. This represents an overpayment of \$1,487. The department also paid invoices totaling \$14,058 for services provided outside of contract specified timeframes. Further, we identified one contract in which the contract liaison had approved payments of over \$23,000 to a contractor, but the department was unable to locate any documentation to indicate any services had been provided.

We found in nearly 44 percent of the contracts we reviewed, an employee whose purchasing authority had been limited to \$5,000 had signed contracts worth more than that amount. These contracts totaled nearly \$5.3 million.

To address these concerns and others, our audit made several recommendations to improve the department’s contract management.

Recommendations issued related to:

- ◆ Developing a management information system
- ◆ Documenting contracting activities
- ◆ Processing of contractor invoices
- ◆ Clarifying purchasing authority of employees
- ◆ Complying with sole source procurement requirements
- ◆ Distinguishing between employees and contractors
- ◆ Defining the role and responsibilities of contract liaisons
- ◆ Centralizing overall contract management

Recommendation Concurrence	
Concur	9
Partially Concur	0
Do Not Concur	0
Source: Agency audit response included in final report.	

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Chapter I – Introduction

Introduction

The Montana Procurement Act serves as the general policy for state procurement activities, including obtaining contracted services. It exists to clarify the law governing procurement; provide for increased public confidence in procurement; ensure the fair and equitable treatment of all persons who deal with the procurement system; and maximize to the fullest extent practicable the purchasing value of the state's public funds. The Act also places responsibility on the Department of Administration (DOA) to procure all supplies and services needed by the state and authorizes DOA to delegate day-to-day procurement activities to other state agencies. The Department of Military Affairs (department) is authorized to purchase all noncontrolled supplies or services with a total contract value of not more than \$100,000. Due to concerns regarding the department's management of its contracts, an initial audit assessment was conducted and it was determined further audit work was warranted.

Audit Objectives

The objective of this performance audit was to determine if the department's contract activities assure compliance with Montana procurement requirements and ensure accountability for goods and services provided.

Audit Scope

The scope of this audit focused on the department's management of contract related activities. Contract management is a two stage process. The first stage is procurement, which includes activities associated with identifying the need for a contract, using a process to obtain the needed item, conducting the procurement, issuing a contract, and acquiring the good or service. The second stage is contract monitoring, which includes a variety of steps taken to ensure the department receives what the contractor has promised to deliver under the terms of the contract. During the course of this audit, we reviewed the department's activities in both stages of the contracting process.

We focused our review on contracting activities carried out by specific divisions and programs within the department. These divisions were the Centralized Services Division, Disaster and Emergency Services Division, Montana Youth Challenge Academy, and Construction and Facilities Maintenance Office within the National Guard. In addition, the scope of our audit generally focused on contracting activities occurring during fiscal years 2009 through 2011. The contracts reviewed range in value from a few thousand dollars to several million dollars. Our audit did not evaluate procurement activities conducted by DOA for the department or contracts related to construction.

Audit Methodologies

To address the audit objective, we conducted the following work:

- ◆ Reviewed applicable statutes, administrative rules, and department policies and procedures to identify guidance available to department staff.
- ◆ Obtained criteria for contract management and accountability measures from other Montana state agencies, other states, the federal government, and professional organizations.
- ◆ Interviewed department staff regarding contract management activities.
- ◆ Interviewed individuals from organizations which provide contracted services to the department.
- ◆ Examined department procurement file documentation related to the type of procurement method used, specifications required, and the criteria used to evaluate bids and proposals for 50 contracts.
- ◆ Reviewed contract file documentation related to the receipt of goods and services, evaluation of contractor performance, contract renewals, and communication with vendors for 50 contracts.
- ◆ Examined invoices submitted to the department for contracted services and goods.

Areas for Further Study

During the course of the audit, we identified two areas for consideration for future performance audit work.

Disaster and Emergency Services Division

The Disaster and Emergency Services Division is responsible for the coordination, development, and implementation of emergency management planning, mitigation, response, and recovery statewide. This includes the disbursement of federal Homeland Security and Emergency Management funds to eligible political subdivisions and tribal nations across the state. It is anticipated the division will receive \$12.4 million in federal funds during the 2013 biennium. Future audit work could examine the division's management of these funds and policies and procedures in place for handling local or statewide emergencies.

State Procurement Bureau

Section 18-4-221 (1), MCA, gives DOA the authority to audit and monitor the implementation of its rules and the requirements of the Montana Procurement Act. The State Procurement Bureau within DOA procures or supervises the procurement of all supplies and services, and provides technical assistance to government agencies and the public to ensure compliance with the Montana Procurement Act. Future

audit work could examine the bureau's efforts to ensure compliance with the Montana Procurement Act through auditing and monitoring of state agency contracting activities.

Additional Audit Work Required

We found weaknesses in the department's overall contract management. Because the department receives a significant amount of federal funding, there may be federal questioned costs. Additional audit work will be completed by the Legislative Audit Division and, if necessary, reported on in the Montana Single Audit Report (#10-02).

Report Contents

The remainder of this report includes a background chapter followed by chapters detailing our findings, conclusions, and recommendations in the following areas:

- ◆ Chapter III discusses needed improvements in the documentation of contract related activities.
- ◆ Chapter IV provides recommendations to improve the compliance of contracting activities.
- ◆ Chapter V describes strengthening the department's oversight of contract activities.

Chapter II – Background

Introduction

The mission of the Department of Military Affairs (department) is to provide for the safety and well being of the citizens of Montana through the maintenance of mission ready forces for federal and state activations, emergency services as directed by the Governor, and services to Montana veterans. To this end, the department, through the Army and Air National Guard, manages a joint federal state program which maintains trained, equipped military organizations for the Governor in the event of a state emergency and the President in the event of a national emergency. The department also plans for and coordinates the state's response in disaster and emergency situations. The department is administered by the Adjutant General and his staff and is composed of eight divisions. The department had 192.66 FTE and a total budget of \$72.4 million for the 2011 biennium, with \$11.4 million in the General Fund and \$58.5 million in federal funds.

The department manages a significant amount of contracts. Based on our review, we estimate the department enters into more than 100 new contracts each fiscal year. These contracts are for a wide variety of goods and services, ranging from lawn care and other facility maintenance services to equipment, training, and work related to unexploded ordnances. For fiscal years 2006 through 2010, the department expended \$15.1 million on professional and consulting services alone.

The remainder of this chapter describes the department's organizational structure and provides general information on the department's contracting processes.

Department Organizational Structure

The department is composed of the Adjutant General's Office and eight additional divisions.

- ◆ The Centralized Services Division (CSD) is the primary provider of administrative support for the department and its duties relate to financial management, budgeting, personnel, labor relations, and procurement and property management oversight.
- ◆ The Montana Youth ChalleNGe Academy is a volunteer program for youth ages 16 to 18 who have stopped attending secondary school prior to graduation. The program provides an opportunity for "at risk" youth to enhance their life skills and increase education and employment potential.
- ◆ The Army National Guard provides administration, construction, maintenance, and support for military facilities and training areas throughout the state. The Construction and Facility Maintenance Office which includes the Unexploded Ordnance Program, is located within this division.

- ◆ The Air National Guard provides firefighting personnel, maintenance, and support for Air National Guard facilities in Great Falls.
- ◆ The Montana National Guard Scholarship Program assists the National Guard in recruiting and retaining personnel by providing scholarships to eligible personnel enrolled as undergraduate students in Montana colleges, universities, and training programs.
- ◆ The Montana STARBASE Program is a program for elementary school aged children and is meant to raise interest and improve knowledge and skills of youth in math, science, and technology by exposing them to real world applications of math and science through experimental learning, simulations, experiences in aviation and space related fields as it deals with a technological environment, and by using the positive role models found on military bases and installations.
- ◆ The Disaster and Emergency Services Division is responsible for the coordination, development, and implementation of emergency management planning, mitigation, response, and recovery statewide. This division is also responsible for the administration and disbursement of federal Homeland Security and Emergency Management funds to eligible political subdivisions and tribal nations across the state.
- ◆ The Veterans Affairs Division assists discharged veterans and their families, cooperates with state and federal agencies, promotes the general welfare of veterans, and provides information on veterans' benefits. The division also administers the state's veterans' cemeteries.

Department Contracting Processes

Contract management activities are spread throughout the department. The specific need to contract for goods or services may be identified by individual employees within any division. If the purchase will be under \$5,000, it is processed internally within the division by employees to whom the department has delegated purchasing authority. For fiscal year 2011, the department delegated this authority to 31 staff members. Staff coordinate with the department's Contracts and Purchasing Officer (CPO), located within CSD, to determine the best procurement method. The CPO also assigns a contract number to the procurement and reviews contract language prior to execution in order to ensure the inclusion of standard contract language. In instances where the purchase amount exceeds \$5,000, division staff submit a requisition form to the CPO, who determines the appropriate procurement method and conducts the procurement. All procurements for services or goods exceeding \$100,000 are referred to DOA's State Procurement Bureau. Prior to execution, all contracts over \$5,000 undergo a basic legal review.

Contract Liaisons

All contracts designate a contract liaison. The liaison serves as the department's representative for the duration of the contract and is the primary contact for contractors. The liaison is normally an employee who, during the course of their normal job duties, has regular contact with the contractor and is in the best position, both based on their job and their physical location, to judge the performance of the contractor. As part of their duties as a contract liaison, these employees are responsible for oversight of the provision of the services or goods by the contractor, approval of contractor payments, and assurance of compliance with contract terms. In addition, contract liaisons identify when contract amendments are necessary and if contract renewals are warranted and appropriate based on the department's need and the contractor's performance.

Chapter III – Improving Contract Documentation

Introduction

Government contracting for goods and services often involves a substantial amount of funds—it is because of this that safeguards over procurement are important to ensure quality and integrity of contracting activities. Contract procurement is an area subject to vendor protests and litigations and, as such, is an area of high risk for the state. It is essential for agencies to have a strong system of documenting their contracting activities to:

- ◆ Provide a complete background of the transaction as a basis for informed decisions at each step of the procurement process.
- ◆ Support actions taken.
- ◆ Provide information for reviews and investigations.
- ◆ Furnish essential facts in the event of litigation or other inquiries.

Based on our audit work, we identified areas where the Department of Military Affairs (department) can enhance its controls over the documentation of its contracting activities to better ensure a complete history of each transaction is maintained. Audit findings and recommendations discussed in this chapter relate to the following areas:

- ◆ Improving information regarding department contracting activities
- ◆ Strengthening documentation to support contracting activities
- ◆ Enhancing controls over contract related invoices
- ◆ Improving contract amendment procedures

Improvements in Contract Information Needed

Despite having millions of dollars worth of contracts, the department does not know how many contracts in which it is currently engaged. This is due to the fact the department does not have an information system tracking its contracts and the current status of those contracts. The department also does not maintain a comprehensive list of contract liaisons and the contracts monitored by those liaisons. Finally, the department does not have an effective method of maintaining proof of insurance documents it receives from contractors. We noted two contractors who had engaged in contracts with the department in the last year and for which the department was unable to provide any documentation of proof of insurance.

Contract Information Should Be Available

The ability to access and analyze contract information is vital to agency management for making key decisions. Management relies on program information for reporting on agency activities to the legislature, oversight agencies, federal grantors, and the public. Best practices recommend agencies have controls in place to ensure contract information is accessible and accurate. Further, state policy requires each state agency to have a system in place to monitor its contracts.

Department Lacks Contract Information

During the course of our audit, we found the department has limited information regarding its contract activities. Failure to maintain contract related information hinders the department's ability to effectively manage its contracts. The department has no efficient means for identifying the number of contracts currently in effect and the amount of funds associated with those contracts. In addition, not maintaining a list of contracts monitored by each contract liaison has weakened the department's ability to ensure liaisons are appropriately monitoring contracts because the department is unable to readily determine which contracts are monitored by which liaisons. This also obstructs the department's ability to ensure department staff are not entering into contracts without the proper approval. A lack of management information reduces the department's accountability for its contracting activities.

Implementing an information system to track contract activities would enable the department to accurately ascertain its contract commitments, as well as identify contracts monitored by specific liaisons for the purpose of providing oversight of contract monitoring activities. It would also enable the department to ensure it has secured proof of insurance from contractors. Off the shelf information systems for tracking contract activities can be purchased for approximately \$4,000.

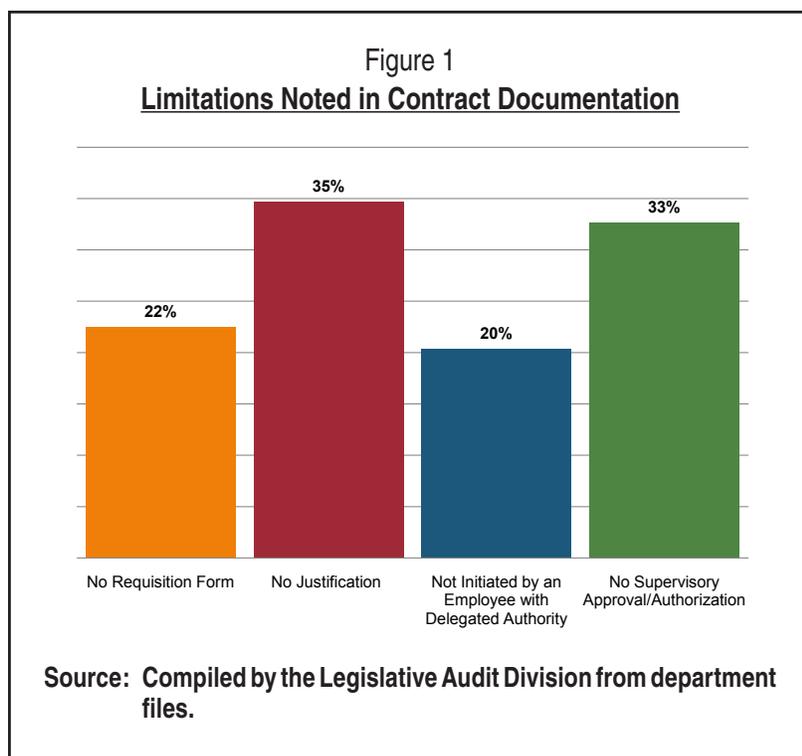
RECOMMENDATION #1

We recommend the Department of Military Affairs develop a contract management information system, which documents at minimum:

- A. *A list of department contracts and the status of those contracts.*
 - B. *A list of contract liaisons and the specific contracts monitored by those liaisons.*
 - C. *Proof of insurance documents provided by vendors engaged in contracts with the department.*
 - D. *Key department contracting activities.*
-

Strengthening Documentation of Contracting Activities

When the need for a good or service is identified and a contract is anticipated, department staff submit a requisition form to the Contracts and Purchasing Officer (CPO). This form serves as the primary method for documenting program management's approval of a purchase, the statement of need for procurement, the desired specifications of the good or service, availability of funds, and authorization for the expenditure of those funds. In the 50 files reviewed, we found the department did not always properly justify or authorize purchases and noted weaknesses associated with the use of the department's requisition form. The following examples are shown in Figure 1:



- ◆ The requisition form was not present in the contract procurement file in 22 percent of the files we reviewed.

- ◆ There was no documentation justifying the need for the procurement in 35 percent of the files we reviewed.

- ◆ There was no documentation an employee who had been delegated purchasing authority had initiated the procurement in 20 percent of the files we reviewed.

- ◆ There was no documentation of approval or authorization of the procurement by a division or program supervisor in 33 percent of the files we reviewed.

The department's internal policy regarding procurement requires

the use of a requisition form. Circumventing this control increases the risk to the department that purchases are not properly justified or authorized.

Evidence of Debarment Searches not Always Present

The suspension or debarment of a vendor from contracting with the state indicates the vendor has acted in a manner which violates state or federal law or has failed to perform or has performed unsatisfactorily in accordance with the terms of one or more contracts. It is a violation of federal law to enter into contracts with these vendors. The department's internal procurement policy requires documentation showing the debarred vendor lists (both state and federal) have been consulted is included in a contract's procurement file. During our review of contract procurement files, we found that in 31 percent of the files, there was no evidence of a debarment search. This

increases the risk to the department of entering into contracts with vendors who have failed to act in accordance with previous contracts or state or federal law.

Summary

These are two areas in which department policy exists; however, there are no review processes in place to ensure these policies are followed by staff. Instituting formal review processes to ensure requisition forms are used to initiate procurement activities and documentation of debarment searches is maintained would enable the department to guarantee purchases are properly authorized and contractors have not been debarred.

RECOMMENDATION #2

We recommend the Department of Military Affairs develop a review process to ensure compliance with federal law and department policy.

Enhancing Controls Over Contract Related Invoices

During the course of this audit, we reviewed the department's processing of contract related invoices. Because of department limitations in contract information, our review was limited to 123 invoices for 21 contracts. We found the following:

- ◆ Fifteen percent of invoices did not contain the contract number assigned by the department. These invoices totaled \$36,084.
- ◆ Nearly 5 percent of invoices charged the department for services provided outside of the contract timeframe. The total value of the amount paid for these services is \$14,058.
- ◆ Twelve percent of invoices did not contain documentation of approval for payment by either the designated contract liaison or their supervisor. These invoices totaled \$187,953.
- ◆ For one contract, the contract clearly states the total contract value was not to exceed \$4,900; however, the department paid invoices totaling \$6,387 for this contract. This equals an overpayment of \$1,487.

State accounting policy states "invoices should be signed when approved for payment. The approver should ensure that goods or services billed under the invoice were provided." A significant portion of a contract liaison's duties relate to ensuring the state receives the goods or services for which it is billed. Documentation of a liaison's written approval of an invoice for payment certifies the goods or services billed for were actually received. In addition, best practices for processing invoices holds that contract

payments should only be made within the term of a contract and department assigned contract numbers should be included on all invoices to ensure an invoice can be tied to a specific contract, which aids in tracking the funds associated with contracts.

We found the department has limited controls for processing contract related invoices. Each individual division within the department has developed its own process. This has led to inconsistencies and the weaknesses noted.

RECOMMENDATION #3

We recommend the Department of Military Affairs comply with state accounting policy by:

- A. *Ensuring assigned contract numbers are included on all invoices.*
 - B. *Verifying billed services were provided within the term of a contract.*
 - C. *Requiring documented approval of payment by either the designated contract liaison or their supervisor.*
 - D. *Ensuring contract payments do not exceed the limits stated in the contract.*
-

Improving Contract Amendment Procedures

Contract amendments become necessary in the event the department or the contractor identify needed changes to the contract. Amendments are handled much in the same way as the original contract request. Department staff coordinate with the CPO to determine the need, which is then formalized in a contract amendment. Amendments do not undergo any type of legal review and are frequently used to renew a contract by extending the term of the contract and increasing funding.

Weaknesses Noted in the Contract Amendment Process

During the course of our audit, for the contracts in our sample which had been amended, we found 15 percent had amendments which were not signed by the contractor. State policy indicates all adjustments and modifications should be well documented. In addition, department policy required all amendments be signed by all parties named in the original contract. This ensures all parties of the contract are clear on their responsibilities under the contract.

We also identified contracts for which executed amendments were unclear. In one instance, an amendment was meant to extend the term of a contract; however, the finalized amendment listed the same termination date as the original contract. An

invoice for \$2,458 was submitted and paid for services provided during the intended contract extension. Because the amendment did not actually extend the contract, this represents a payment outside of the contract term. In another instance, an amendment was meant to change the duties of the contractor under the contract. The amendment states “compensation amount is unchanged,” however, lists additional expenses of \$14,600. It is unclear whether these charges were actually added to the cost of the contract.

In our review of contracting activities, we also identified one instance in which a contract worth nearly \$1.6 million was modified without a formal contract amendment. The contract clearly delineated the project milestones and associated payments. We found the contract liaison allowed the contractor to be paid for partial completion of a milestone. When questioned, the liaison reported a formal amendment was not necessary to modify the contract in this manner because the payment milestones were “subjective.” However, as noted, department policy states contract modifications must be in writing.

By not ensuring contract amendments are agreed upon by both parties, language is clear, and are formalized in writing, the department is not assuring the responsibilities under the contract are apparent and that payments are not made outside the term of contracts. Compliance with existing policy and a formalized process of reviewing contract amendments would mitigate these problems.

RECOMMENDATION #4

We recommend the Department of Military Affairs comply with department policy by implementing a formal review process over contract amendments to document:

- A. *Amendments are signed by both parties.*
 - B. *Contract changes are clearly defined.*
 - C. *All contract modifications are formally documented through the use of written amendments.*
-

Chapter IV – Improving Compliance of Contracting Activities

Introduction

Achieving positive contract outcomes in terms of timeliness, quality, completeness, and cost of deliverables depends on the contracting rules and procedures used, how well department employees implement them, and ultimately on the actual performance of the contractor. As part of our audit, we reviewed the department's policies and procedures for managing contracts to ensure compliance with law and state policy. We found the department's contract management could be improved. Audit findings and recommendations related to the following areas are discussed in this chapter:

- ◆ Department delegation of purchasing authority to employees
- ◆ Sole source procurement
- ◆ Differentiation between contractors and employees

Delegation of Purchasing Authority

In its procurement delegation agreement with DOA, the department is granted authority to further delegate its procurement authority within the agency as it deems appropriate. To this end, the department has delegated purchasing authority to 31 employees. Delegation of purchasing authority allows these employees to handle procurements up to \$5,000 and to initiate larger procurements with the department's Contracts and Purchasing Officer (CPO). We reviewed the delegation of purchasing authority for half of those employees authorized to conduct procurement. Through our review and interviews with department and DOA staff, we identified weaknesses in the department's policies, procedures, and documents related to the further delegation of purchasing authority. These include:

- ◆ Ambiguous timeframes for which the purchasing authority is in effect.
- ◆ Lack of documented CPO approval in instances where program or division administrators request further delegation for specific employees.
- ◆ Unclear limits on the purchasing amount for which employees are authorized.

In addition, we found that in nearly 44 percent of the 50 contracts we reviewed, an employee whose purchasing authority had been limited to \$5,000 had signed contracts worth more than that amount. These contracts totaled nearly \$5.3 million.

Delegation of Purchasing Authority Should Be Formalized

According to federal guidance, contract outcomes are more positive when agencies formally delegate procurement authority to employees. In addition, those authorized

to conduct procurement should receive clear instructions, in writing, regarding the limits of their authority. Because of this, the delegation of purchasing authority to department employees should be carefully documented. The documentation should clearly denote the time period for which the purchasing authority is in effect and any limitations of that authority. Additionally, DOA staff recommend delegation of purchasing authority not be indefinite. Purchasing authority confined to a specific time period creates a regular opportunity for the department to review it and determine if it is still necessary and appropriate. In the forms used by the department for program or division administrators to request the further delegation of authority to other employees, it is required the request be approved, in writing, by the CPO before the authority becomes valid.

In its own internal procurement policy, the department has specifically limited the purchasing authority of employees delegated that authority to \$5,000. According to federal guidance, employees may bind the government only to the extent of the authority delegated to them.

Failure by the department to ensure the limits associated with the purchasing authority of employees are clearly defined has resulted in department staff committing the department to contracts beyond their authority. As noted, we identified over \$5 million worth of contracts for which this had occurred. Because department staff indicated it is common practice for staff to sign contracts above the limit of their purchasing authority, the total value of department contracts entered into by staff without the proper authority may be significantly higher.

RECOMMENDATION #5

We recommend the Department of Military Affairs:

- A. *Clarify policy to include timeframe limits associated with the contracting authority of employees.*
 - B. *Establish a review process to ensure employees are abiding by their delegated contracting authority.*
-

Ensuring Sole Source Procurement Complies With Statutory Requirements

Sole source procurement is the award of a contract for goods or services to the only known capable vendor. This type of procurement occurs without the benefit of competition and is governed by statute. Section 18-4-306, MCA, requires sole source purchases to meet one of these requirements:

- A. There is only one source for the supply or service item.
- B. Only one source is acceptable or suitable for the supply or service item.
- C. The supply or service item must be compatible with current supplies or services.

Further, the department's policy related to sole source procurement requires purchases over \$5,000 have written documentation of the justification of the purchase and be approved in writing by the division or program administrator and the department authorized purchasing personnel. Our review of 50 purchases included 21 sole source purchases conducted by the department since July, 2008.

Sole Source Procurement not Always Justified or Approved

We found the department did not always justify or approve the sole source procurement of goods and services without the use of competitive measures. Specifically, we noted the following:

- ◆ The procurement files for four purchases worth a total of \$140,473 did not contain documentation justifying the use of sole source procurement.
- ◆ The procurement files for nine purchases worth a total of \$248,194 did not contain documentation of oversight approval.
- ◆ The procurement file for one purchase worth \$8,750 indicated disapproval of sole source procurement; however, the procurement was carried out anyway. Department staff indicated, upon reconsideration, the procurement was found to meet the criteria for sole source but the procurement file did not contain any documentation of this later approval.

Sole Source Procurement not Always Appropriate

During the course of the audit, we also noted two purchases in which the use of sole source procurement may not have been appropriate. In one instance, sole source procurement was used to secure database services from a contractor at the rate of \$100 per hour. The purpose of the contract was to transfer data from another contractor's system to a department system. The sole source justification indicated this vendor possessed unique knowledge of the type of information to be transferred and the other contractor's data system. Work on this contract ceased when the contractor became

ill and was unable to complete the work. When staff was asked what would happen if the original contractor was unable to complete the work, department staff indicated an alternative contractor could complete the work. This contradicts the original sole source justification, which indicated this contractor was the only one who could complete the work.

In the second instance, sole source procurement was used to add a subcontract for a strategic long-term management plan to a current contract. The original contract was amended to add \$118,500 for this plan. Department staff, the prime contractor, and the subcontractor indicated that the sole source procurement was used because this subcontractor was the only one able to complete the work. Additional interviews indicated the work could have been completed by other vendors.

Impacts of Inappropriate Sole Source Procurement Are Significant

Failure to ensure sole source procurement is properly justified not only represents noncompliance with state law, but also with administrative rule and department policy. In addition, the department did not acquire these goods and services using competitive measures and did not appropriately justify the procurement method. The department has not formalized a process for division or program administrators or other department authorized personnel to review and approve all sole source procurement to ensure compliance with statute. While our audit focused on contracting activities in four divisions, we believe this issue exists departmentwide.

RECOMMENDATION #6

We recommend the Department of Military Affairs comply with state law governing sole source procurement by establishing a process of review and approval.

Distinguishing Between Contractors and Employees

The Internal Revenue Service (IRS) provides guidance regarding the treatment of contractors versus employees. In general, an individual is an independent contractor if the agency or organization for which the services are provided has the right to control or direct only the result of the work and not the means or methods for accomplishing the result. In addition, the IRS states contractors generally use their own supplies for completing work. Further, if a contractor provides services which are a key aspect of an organization's regular business activity, it is more likely the organization has the right

to direct and contract the contractor's activities, which indicates an employer employee relationship.

In our review of the department's contracting activities, we found one contract in which the department appeared to be treating the contractor as an employee, rather than as a contractor. The contractor worked primarily at the department, using department equipment (telephone, computer, etc.). In addition, department staff reported a significant amount of staff time was spent training the contractor on the work to be completed. The contractor was paid on a monthly or bi-monthly basis, rather than a flat fee or on a time-and-materials basis for the job. Finally, the contractor was hired to perform services which are a key aspect of the regular business of the division for which the contractor was working.

Not properly distinguishing between contractors and employees increases the department's risk for lawsuit from the contractor for failing to provide Workers' Compensation protection. In addition, there is increased risk of liability for tax penalties for not withholding federal income taxes, withholding and paying social security and Medicare taxes, and paying unemployment tax on wages paid. The department should take steps to minimize the risk to it and the state in this area by clearly differentiating between contractors and employees.

RECOMMENDATION #7

We recommend the Department of Military Affairs assure compliance with Internal Revenue Service requirements.

Chapter V – Strengthening Department Oversight of Contract Activities

Introduction

Given the extent of department contracting, it is important the department promote effective contract management and ensure accountability for contracting activities. As a result of this audit, we found the department’s current contract management could be strengthened. This chapter includes recommendations for improvement both at the program level and departmentwide.

Contract Oversight Responsibilities at the Program Level

The role of a contract liaison is extremely important in ensuring the interests of the state are met during the term of a contract. According to the department’s policy regarding procurement, “on a day-to-day basis, [department] contract liaisons need to be monitoring contract performance since early detection and correction of nonperformance is critical for the success of the contract.” This requires the liaison ensure the needed goods or services are received according to the standards set forth in the contract and that payment is not issued for unsatisfactory performance. Because of this, department staff indicated the contract liaison should be the staff member in the best position to monitor the contract, based on their job description and/or physical location. In addition to actively monitoring contracts, the Federal Acquisition Regulation (FAR), provides guidance regarding the establishment of contract files which contain records of all contractual actions. Further, “the documentation in the files...shall be sufficient to constitute a complete history of the transaction.”

Department Designation of Contract Liaisons Could Be Improved

As part of our audit, we reviewed contracts to determine which staff were designated as contract liaisons and the duties completed by those staff as part of their role as a contract liaison. We found instances in which the employee designated as the liaison in the contract a) was not an employee in the best position to judge contract performance or make contract decisions or b) was not completing key contract monitoring duties.

We noted eight contracts in which the employee designated as the contract liaison did not appear to be the most appropriate person for that role. In some cases, a liaison, who had no authority to make decisions regarding the contract based on the scope of the contract and that employee’s job position, had been designated. In other instances, the employee listed as the contract liaison was physically located in another town than where the contract services were provided, which obstructed the liaison’s

ability to accurately judge performance. In addition, we noted contracts for which the liaison maintained no documentation related to the contract, was not responsible for approving contractor invoices, and generally had no duties related to the contract.

Limited Documentation of Contract Liaison Monitoring

We also reviewed contract files maintained by liaisons to determine the level and type of contract monitoring activities taking place. We identified wide variations in the types of contract monitoring files kept. In some instances, we found contract liaisons who maintained a large amount of contract documentation, including formal contract documents, correspondence, communication logs, invoices, meeting summaries, and deliverables. However, for others, the contract monitoring file was limited to the formal contract documents only. We found no documentation of communication with contractors or observation of performance. Finally, we also noted instances in which contract monitoring files were reported as missing or had never existed. Specifically, we identified one contract in which the contract liaison had approved payments of over \$23,000 to a contractor, but the department was unable to locate any documentation to indicate any services had been provided. The department is currently in the process of terminating this contract.

Federal Guidance Is Available

The FAR specifically notes the responsibilities associated with contract monitoring. These include developing and implementing quality assurance actions to ensure goods and services adhere to contract requirements; reviewing and approving or disapproving contractor requests for payment; and maintaining performance records of the contract. In addition to requiring sufficiency of contract documentation, the FAR specifically notes which types of documents should be included in contract files. These include copies of the contract and all modifications; documentation of insurance; quality assurance records; and property administration records.

Formal Policy Regarding Contract Liaisons Should Be Developed

Overall, we found department policy does not specifically address the designation, role, and responsibilities of contract liaisons, including the documents required for inclusion in contract monitoring files. In addition to the fiscal impact to the department, this has also resulted in:

- ◆ Liaisons not in a position to make necessary management decisions regarding contract activities.
- ◆ Employees listed as liaisons who have no duties related to the contract.
- ◆ Employees monitoring contracts who have no knowledge of the requirements included in the contract or are unable to judge performance or verify contract work was completed.

Implementing specific policies regarding contract liaisons and their duties would benefit the department by ensuring the right employees are assigned to monitor contracts and that these liaisons clearly understand the duties associated with contract monitoring. It will also ensure liaisons are documenting contract monitoring activities, which provides the department the ability to review contract files and ensure policy is being followed and the interests of the state are being met.

RECOMMENDATION #8

We recommend the Department of Military Affairs establish formal policy which:

- A. Identifies the criteria for designating contract liaisons.*
 - B. Defines the role and responsibilities of contract liaisons, including those related to the maintenance of documentation regarding contract monitoring activities.*
-

Overall Department Contract Management Is Decentralized

Responsibility for contract related duties is spread throughout the department; however, there is currently only one FTE devoted specifically to contracting. This employee is the Contracts and Purchasing Officer (CPO) and is responsible for overseeing and conducting all department procurement. While this employee provides limited guidance to department staff regarding the basic duties associated with serving as a contract liaison, such as receiving deliverables, approving invoices, and monitoring renewals, the employee maintains no responsibility for oversight of contract monitoring activities. No formal review of contract monitoring activities is conducted. We found limited review of contract monitoring files, checking of invoices, or verification of the total amount of funds paid out under a contract.

As noted, other department staff handle various other contract related duties, but no one entity is responsible for overseeing the entire contract process, which includes procurement and monitoring. For example, department accounting staff process invoices received from individual divisions, however assume no responsibility for confirming the existence of a contract, payments are within the terms of a contract, or there are funds remaining in the contract. Additionally, while division administrators do assume some responsibility for ensuring the liaisons within their division are appropriately monitoring contracts, there are no formalized policies or procedures in place to outline how this is to occur. Overall, there is no formal review of contracts within the department.

Centralization of Contract Management Could Help the Department

State policy holds that each state agency should have a system of contract monitoring in place and agencies should place a “tremendous emphasis” on effective contract administration. During this audit, we found the department’s current system of managing contracts has contributed to the lack of controls we noted. These include:

- ◆ Limits of purchasing authority not always followed
- ◆ Lack of management information
- ◆ Inappropriate use and documentation of sole source procurement
- ◆ Designation and role of contract liaisons not identified in policy
- ◆ Failure to appropriately distinguish between employees and contractors

Failure to tighten controls over the department’s management of contracts could have significant fiscal impacts in the future. Contracts executed during fiscal year 2010 totaled over \$4 million, with an unexploded ordnance contract for remedial investigation/feasibility studies at two sites in the state representing \$1.6 million of this total. There is a high likelihood for the department to increase its contract expenditures in the future because work is currently being done at 30 additional sites to determine if work is warranted. Department staff estimate approximately six of these additional sites may qualify. The estimated cost for these sites is unknown and will be based on the sites themselves; however, judging by the cost for the two sites currently under contract, the cost for these additional sites will be in the multi-million dollar range. Because of the high dollar potential of these contracts and the issue of public safety, it is important the department take steps now to improve its contract management.

Centralizing contract management would aid the department in increasing its management information regarding contracts because one specific entity would be responsible for tracking the status of all contracting activities. In addition, the department would be better able to ensure statutory and policy requirements are followed and oversight of contract monitoring is consistent.

RECOMMENDATION #9

We recommend the Department of Military Affairs designate one specific entity to oversee all contracting activities and assure compliance with state and federal law and policy.

DEPARTMENT OF
MILITARY AFFAIRS

DEPARTMENT RESPONSE

DEPARTMENT OF MILITARY AFFAIRS



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June 7, 2011

Tori Hunthausen
Legislative Auditor
PO Box 201705
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RECEIVED

JUN 07 2011

LEGISLATIVE AUDIT DIV.

Dear Ms Hunthausen,

In reply to the Performance Audit Report on Contract Management received by this office June 1, 2010, we are submitting the following comments:

Recommendation #1:

We concur with your recommendation. The department will develop a contract management information system which documents:

- A. A list of department contracts and the status.
- B. A list of contract liaisons and the specific contracts monitored by those liaisons.
- C. Proof of insurance documents.
- D. Key department contracting activities.

Recommendation #2:

We concur with your recommendation. The department will develop a review process to ensure compliance with federal law and department policy.

Recommendation #3:

We concur with your recommendation. The department will comply with state accounting policy by:

- A. Ensuring assigned contract numbers are included on all invoices.
- B. Verifying billed services were provided within the term of the contract.
- C. Requiring documented approval of payment by either the designated contract liaison or their supervisor.
- D. Ensuring contract payments do not exceed the limits stated in the contract.

Recommendation #4:

We concur with your recommendation. The department will implement a formal review process over contract amendments to documents:

- A. Amendments were signed by both parties.
- B. Contract changes are clearly defined.
- C. All contract modifications are formally documented through the use of written amendments.

Recommendation #5:

We concur with your recommendation. The department will:

- A. Clarify policy to include timeframe limits associated with the contracting authority of employees.
- B. Establish a review process to ensure employees are abiding by their delegated authority.

Recommendation #6:

We concur with your recommendation. The department will comply with state law by establishing a process of review and approval for sole source procurement.

Recommendation #7:

We concur with your recommendation: The department will assure compliance with Internal Revenue Service requirements.

Recommendation #8:

We concur with your recommendation. The department will establish policy which:

- A. Identifies the criteria for designated contract liaisons.
- B. Defines the roles and responsibilities of contract liaisons, including those related to the maintenance of documentation regarding contract monitoring activities.

Recommendation #9:

We concur with your recommendation. The department will designate one specific entity to oversee all contracting activities and assure compliance with state and federal law and policy.

The department anticipates being in compliance with all audit recommendations no later than June 30, 2012.

Sincerely,



Karen Revious
Administrator
Centralized Services Division

