



Long Beach City Auditor's Office

Contract Administration Audit Limited Scope Review Report 4 of 10

The International Center for Management & Organization Effectiveness, Inc.

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Executive Summary

This is Report 4 of 10 in a series of limited scope audits of City contracts.

This report includes the results of a limited scope review of contract #HD-IC-01831 between the City of Long Beach's Harbor Department (Harbor or Department) and The International Center for Management & Organization Effectiveness, Inc. (CMOE or Contractor). It is the fourth of ten contract audits reporting on the adequacy of the City's monitoring procedures and internal controls over the administration of contracts. A summary report that compiles the results of the ten individual contract audits will be issued separately.

In April 2015, Harbor entered into a two-year, \$192,000 contract to assess and identify core competencies of key leadership, and to deliver team-building and leadership training in support of its strategic goal to enhance organizational development. In December 2015, the contract was amended to increase the amount by \$218,000, add eight months to the term and allow for continued training for additional Harbor staff.

Summary of Results

The Harbor has established procedures and an organizational structure that strengthen the control environment and reduce the risk of liability surrounding contracting activities.

Recognizing the importance and liability associated with having good contract oversight, the Harbor established the Contract Compliance Section (CCS) in its Finance Division and developed a comprehensive Contracting Procedures Manual (Manual). The CCS and Manual collectively serve as an excellent resource to Harbor staff, communicate procedures to ensure consistency and provide guidance on best contracting practices. Other areas of the City could benefit using Harbor's approach to overseeing contracts.

While reviewing the CMOE contract, we did note a few exceptions from policy that occurred during the procurement process. While each exception on its own may be considered minor, taken together they can create the perception that a conflict-of-interest may exist. These exceptions highlight the importance of complying with the Harbor's Manual, which was established to ensure an equitable and transparent practice in contracting, and to minimize risk exposure to the Harbor.

We want to thank the Department's staff for their assistance, patience and cooperation during this audit.

Results & Recommendations

Strong contract oversight policies and procedures can minimize risk exposure and provide increased transparency.

The Harbor Department (Harbor or Department) contracted with The International Center for Management & Organization Effectiveness, Inc. (CMOE or Contractor) to assess and identify core competencies of key leadership, and to deliver a series of team building and leadership training workshops. This two-year contract, initially valued at \$192,000, was in support of the Harbor's organizational development goals included in their 2016 Strategic Plan Update. The Harbor's Human Resource and Team Development Division (HR) is responsible for contract oversight. Eight months into the contract term, an amendment increasing the contract by \$218,000, or 114%, was approved to expand the training to additional Harbor employees.

The Harbor has millions of dollars in contracted goods and services and recognizes the importance of establishing good processes and controls regarding contract administration. In 2010, the Harbor established the Contract Compliance Section (CCS) to provide appropriate policies and procedures for contract oversight. The CCS developed a comprehensive Contracting Procedures Manual (Manual) in February 2011, which provides guidance and best practices over contracting activities. This Manual is an excellent resource for Department staff and reduces the Harbor's risk exposure due to inconsistent or poor processes.

While auditing the CMOE contract, we did find exceptions with the Manual's prescribed processes that, when taken collectively, could be perceived as a conflict-of-interest. The CMOE contract, while not significant in size relative to many initiated by the Harbor, is still nearly half a million dollars. Regardless of the contract amount, best contracting standards should be followed in all situations.

Finding 1. The Harbor recognized the necessity of providing adequate contract oversight and established a Contract Compliance Section (CCS) and developed a comprehensive Contracting Procedures Manual (Manual). However, training was not mandatory for those employees involved in contracting activities.

The CCS and the Manual serve as resources to Harbor staff involved in contracting activities, help to minimize risk exposure and maximize the value received for expended funds.

- A. The Harbor has a decentralized procurement function where each division is responsible for the entire process from pre-solicitation and evaluation of bid proposals, to contract administration and contract close-out. To address the inherent challenge of this structure, such as inconsistency in procedures, the Harbor established the CCS. The CCS provides continuous monitoring and oversight of contract activities to strengthen the control environment.
- B. The Manual is based on Public Contracting Code and contracting best practices. It creates a system of checks and balances and helps to ensure that an equitable, consistent, transparent and streamlined procurement process is followed.
- C. Voluntary training on the Manual was initially provided to many Harbor employees soon after it was adopted and subsequent training has been held since. The Manual is posted on the Harbor's intranet and is accessible to all staff.

Recommendation:

1.1 The Harbor should expand the training on the Contract Procedures Manual, making it mandatory for all employees involved in contract activities, including procurement and oversight responsibilities. Periodic refresher training should occur.

Finding 2. Certain procedures outlined in the Contracting Procedures Manual were not followed, which can lead to the perception of a conflict-of-interest.

Disregarding the adopted policies and guidance of the Manual can result in inconsistent procurement and oversight procedures and practices, which can lead to a lack of transparency and incorrect assumptions regarding contract oversight.

- A. The request-for-proposal (RFP) for the training workshops was appropriately advertised through PlanetBids. There were nine proposals received. Due to the original contract amount being less than \$200,000, it did not require Board of Harbor Commissioners (BHC) approval. One of the members of the CMOE contract selection committee had a prior working relationship with the firm ultimately selected. According to the Contractor, they learned of the RFP through this committee member. While we are not stating actual preference was given to this Contractor, the following procedural exceptions could be interpreted as a conflict-of-interest. There was no documentation available stating why the exceptions occurred.
 - i. The Manual states that at least three individuals with requisite knowledge of the given project should make up the selection committee. However, bid proposals were evaluated by a two member team rather than a three member team.
 - ii. The Manual requires each selection committee member to certify that they do not have any conflict-of-interest with any of the proposed bidders. However, a selection committee member that had a prior working relationship with the Contractor failed to complete a conflict-of-interest form included with the proposal evaluation forms.
- B. A substantial amendment of \$218,000, more than doubling the original contract amount (\$192,000), was awarded to extend the training to additional staff throughout the Harbor. This amendment was approved by the BHCs.
 - i. The pricing for the additional services in the contract amendment was negotiated by management and not open to bid.
 - ii. The contract originally covered training to be delivered to approximately 85 Managing Directors, Directors, Assistant Directors, Managers and key lead/supervisory personnel. The amendment covered the cost to expand training to a second group of approximately 160 supervisors, professional and paraprofessional administrative personnel, with curriculum designed to meet the needs of the group. However, the original RFP does not have clear language indicating that additional substantial work could be awarded, nor did the RFP request pricing proposals for potential additional training.

While we understand the desire and necessity to have consistency in the training and curriculum for all employees, the policy exceptions and awarding of significant additional work not covered in the initial RFP could be interpreted as favoritism based on the prior working relationship of the selection committee member.

Recommendation:

2.1 The Harbor should adhere to the adopted procedures set out in the Contracting Procedures Manual. Any exceptions or deviations should be explained and documented.

2.2 The scope of work in RFPs should address potential additional services that may result in a future amendment to the contract and request pricing proposals from all vendors.

Finding 3. Based on the time and money involved with the training provided under this contract, management should ensure that qualitative, as well as quantitative, processes are in place to measure the value of the training going forward.

According to the Harbor's HR Director, while the value of CMOE's service can be measured on a quantitative and qualitative basis, the full benefit and value will not be seen for one to three years. Currently, Management measures the attendance rate and a cost per-employee per-day to attend CMOE workshops and reviews the workshop feedback provided by the attendees. Going forward, Management plans on assessing other variables, such as improved leadership skills, staff commitment and employee turnover. However, there is not an established plan or process for how or when this will be done. In addition, there are no immediate plans to link this training with performance evaluations.

Monitoring and measuring the long-term outcomes resulting from the Contractor's services (workshops) will allow the Harbor to ascertain whether the services provided were worth the amount paid and time committed.

Recommendation:

3.1 The Harbor should develop criteria and monitor, measure and report on the benefits and effectiveness of the Contractor's services toward their mission of developing staff.

Finding 4: The contract's right-to-audit clause lacks a time limit and is different from the City contract templates.

During the audit, we reviewed the CMOE contract terms and conditions. We also looked at other contract language, City contract templates and contract language developed by the Association of Certified Fraud Examiners.¹ Although we did not compare all terms and conditions of the contract to others, we did find that the right-to-audit (RTA) clause in the CMOE contract is different from RTA clauses of other contracts reviewed under the Contract Administration series of audits.

- A. The City's contract templates contain RTA clauses that state the City can audit all books, records, accounts and other documents of the contractor during the term of the contract and for a period of five years after termination or expiration of the contract.
- B. The CMOE contract includes a RTA clause that states the City can audit all books, accounts, reports, etc. of the contractor and its subcontractors, but lacks a specified time period for when the audit may occur.

Recommendation:

4.1 The Harbor should work with the City Attorney's Office to develop consistent and thorough right-to-audit language for contracts. The audit clause should include a time frame of at least five years after termination or the expiration of the contract.

¹ Appendix B is an example right-to-audit clause from the Association of Certified Fraud Examiners and can be used by organizations to develop their own clause, or to update an existing clause.

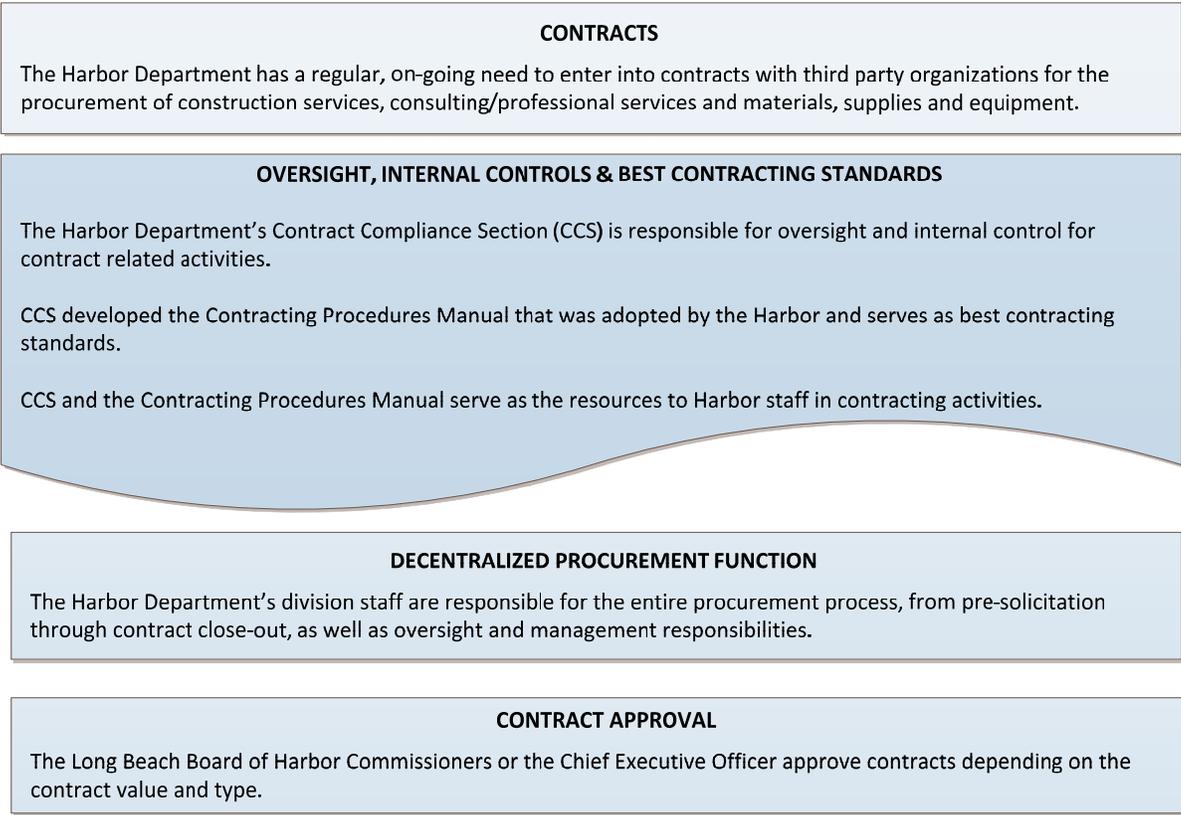
Background

Organization & Governance

The City’s Harbor Department (Harbor or Department) is governed by the Board of Harbor Commissioners (BHC). Among other responsibilities, the BHC must approve contracts over \$200,000 and contracts over \$100,000 when less than three proposals are received or are sole source procurements. In addition, the Harbor’s Chief Executive Officer is granted authority to issue contracts in an amount not exceeding \$200,000 and without BHC approval.² All contracts must be competitively bid and awarded to the lowest responsible bidder, except as otherwise provided in the City of Long Beach Charter (section 1801) or by general law.

As shown in Figure 1, the Harbor handles their own purchasing function which is supported by the Contract Compliance Section (CCS) located in the Finance Division. The CCS serves as a resource to staff and strengthens the control environment surrounding contracts.³

Figure 1
Harbor Purchasing Structure



² Municipal Code (section 2.84.01) and Ordinance HD-2159 provides this authority when the contract is based on an Invitation to Bid or a Request for Proposal, which results in at least three bids or proposals.

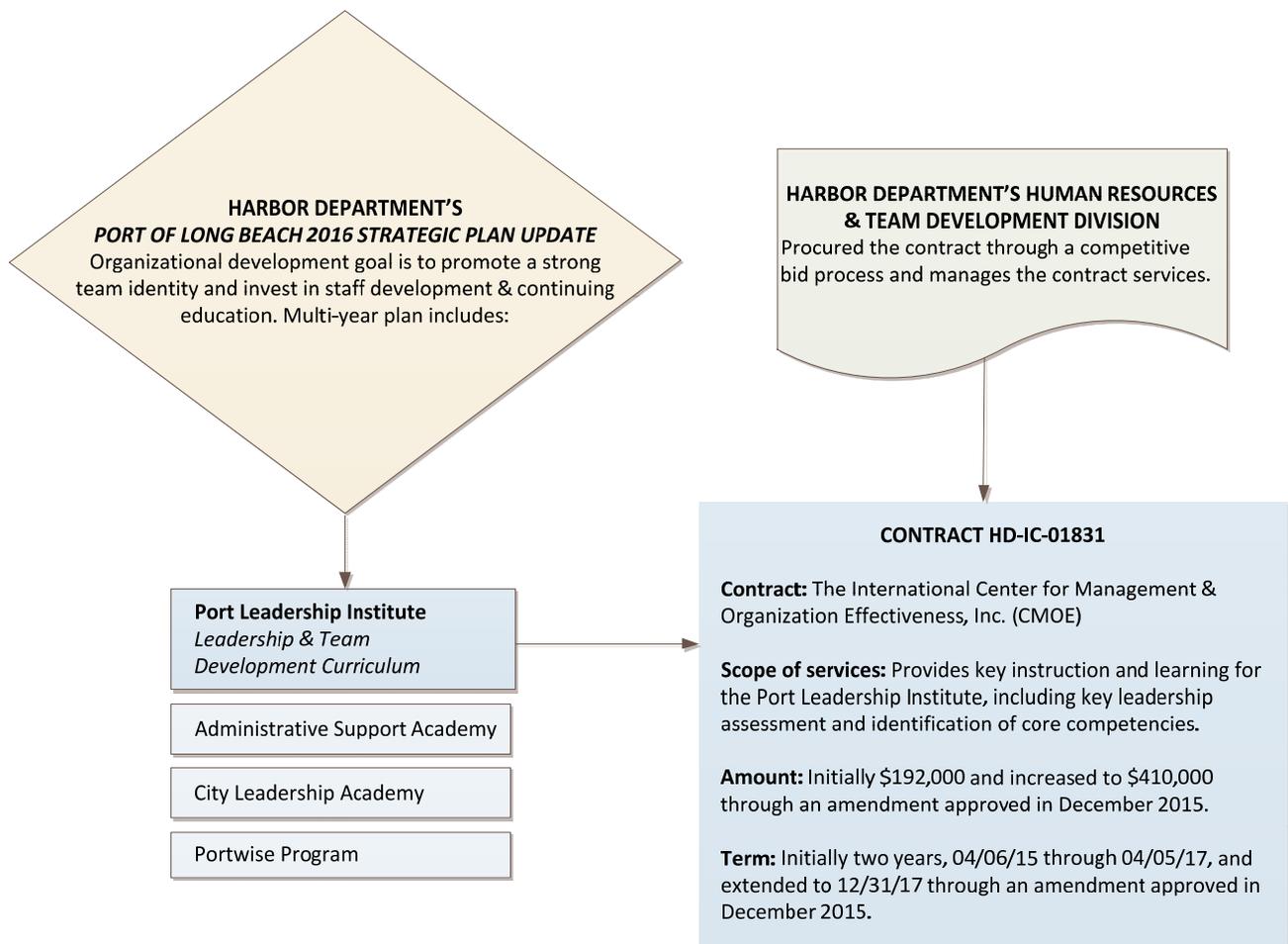
³ The Contract Compliance Section was established based on an organizational assessment of the Harbor and the consulting firm’s recommendation.

The Harbor's Contract Procedures Manual (Manual) sets out the policies and guidance regarding procurement matters, and creates a system of checks and balances to help ensure that the contracting process is well-controlled. Based on statutory law (Public Contracting Code) and contracting best practices, the Manual was approved by the BHC's Finance and Administration Committee in February 2011.

Harbor Strategic Plan

The Harbor updated its Strategic Plan (Plan) in 2016 to articulate its vision. The goal of the Organizational Development section of the Plan is to foster a safe, well-trained and collaborative organization that integrates people, process and technology, and promotes a team-oriented culture with professional and personal growth. As shown in Figure 2, this goal is supported by a number of programs, including the Port Leadership Institute. Working toward this goal, the Harbor's HR Division issued a request-for-proposal in October 2014, to seek a contractor who would provide curriculum development consulting services.

Figure 2
Harbor Organizational Development Goal



Contract

Initially approved at \$192,000, it was increased to \$410,000 in December 2015 to provide services to more Harbor staff

In April 2015, the Harbor entered into a contract with the International Center for Management & Organization Effectiveness, Inc. (CMOE) to provide key instruction and learning in support of the Port Leadership Institute Program. The amount of the contract was \$192,000 and the term was the two-year period from April 6, 2015 through April 5, 2017. The contract scope-of-work was based on an assessment, which identified core values shared by the Harbor leadership team.

CMOE was to deliver a series of workshops covering leadership and team development curriculum. The participants included in this training were Harbor's senior management team, including Managing Directors, Directors and Assistant Directors. It also included Managers and key lead/supervisory personnel. In December 2015, the contract was amended to expand the training to a second group of participants, including Harbor's supervisory, professional and paraprofessional administrative staff. The amendment increased the contract amount by \$218,000 for a new total of \$410,000, and extended the term eight months to December 31, 2017.

Contractor

The firm has provided learning, consulting and organizational-research services for leaders in a variety of industries such as aerospace, insurance and technology; their clients include AT&T, FedEx and Honda.

CMOE was founded in 1978 by Steven J. Stowell, PhD. and is headquartered in Sandy, Utah. The company's goal is to create high-impact performance solutions and to build a sustainable, performance-oriented culture for organizations. CMOE has offices around the world, including Africa, Asia, Europe and North and South America.

After the contract is executed, the Harbor is responsible for managing the contract to ensure the Contractor completes the required scope of services with quality. This contract is managed by staff in the Harbor HR Division. Appendix A provides additional information related to contract administration, including best practices and components of effective contract monitoring.

Objective, Scope & Methodology

This audit assesses whether the Department employed sound contract monitoring procedures to ensure the Contractor complied with key terms & provisions.

The objectives for this audit were to evaluate the adequacy of the Harbor Department's (Harbor or Department) monitoring procedures and internal controls over the contract administration, examine related payments and to review the Contractor's compliance with key contract provisions. The audit scope was the nine month period from April 2015 through January 2016.

We reviewed the contract's terms and conditions along with related records, including procurement documents, legislative text, contract amendments, purchase orders, and change orders. We also reviewed regulatory criteria including the City Charter Article 1800, *Contracts*; and the Harbor's procurement policies. In addition, we used best practices and principles in public procurement and contract monitoring to evaluate the adequacy of the Harbor's oversight responsibilities.⁴

To perform the work we conducted the following procedures:

- I. Procurement Method – Reviewed the method used to purchase the contract, including competitive bid documents where applicable, and the executed contract to determine whether the contract and accompanying purchase order complies with the Harbor's purchasing guidelines. We also verified that the contract was properly approved by the Board of Harbor Commissioners.
- II. Risk Assessment & Control Environment – Performed a review of contract-related data to assess the contract risk. Interviewed Department employees to gain an understanding of the activities they perform in managing the contract and monitoring the Contractor's performance, as well as to assess the internal control environment. We also verified the Contractor's compliance with key contract terms and conditions.
- III. Payment Processing – Compared Contractor payments to the original invoice and supporting records where available to verify accuracy, appropriateness and proper approval. We also evaluated the timeliness of payment processing.

We conducted this audit in accordance with Generally Accepted Government Auditing Standards (GAGAS), which 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 the audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

⁴ *Principle and Practices of Public Procurement*, Sept. 2013, by The National Institute of Government Purchasing, Inc. and The Chartered Institute for Purchasing and Supply; and *Components of an Effective Contract Monitoring System*, July 2003, by the State of Georgia Department of Audits and Accounts Performance Audit Operations Division.

Appendix A

In its simplest terms, contract monitoring provides the City with assurance that it is receiving the services or goods for which it has paid. But taken further, active contract monitoring mitigates risk, with risk defined as the probability of an event or action having an adverse effect on the City.⁵ Proper oversight and monitoring creates a strong control environment that can deter fraud, waste, and abuse. As shown in Figure 3, components of an effective contract monitoring system include an ethical tone that starts at the top of the organization, ongoing monitoring, and thorough recordkeeping.

Figure 3
Best Practices in Contract Management

TONE AT THE TOP	
<p>I. Establish a consistent, high quality contract monitoring & compliance system across the organization.</p> <p>II. Publish, communicate and implement written policies.</p>	<p>III. Provide training in contract compliance & monitoring to those with the responsibility for contract oversight.</p> <p>IV. Limit contract risk by requiring disclosure of conflicts of interest.</p>
CLOSE OVERSIGHT and GOOD ADMINISTRATION	
<p>V. The contract scope-of-work (SOW) often is the City’s primary means of communicating these expectations. Ensure the SOW includes:</p> <ul style="list-style-type: none"> • Clear expectations & deliverables that are defined and specific. • A plan that considers all significant issues that may affect the success of the project. • A contingency plan to address how the agency would respond in the event of an interruption of service delivery. • A dispute resolution procedure that requires timely resolution. <p>VI. Use standard project schedules to document project progress, responsibilities, timing, and problems.</p> <ul style="list-style-type: none"> • Hold regular meetings to discuss the information in the schedule and agreement on changes. Agree to the frequency of updates. <p>VII. Perform onsite monitoring to ensure the contractor’s compliance.</p> <ul style="list-style-type: none"> • Visits can verify actual performance against scheduled or reported performance and ensure the contractor is dedicating sufficient resources and appropriate personnel. 	<p>VIII. Evaluate the contractor's performance and provide feedback.</p> <ul style="list-style-type: none"> • Focus on outputs and outcomes that assess some aspect of the effect, result, or quality of the service. <p>IX. Contract files are organized and complete. Records are critical should any contract dispute occur. Items to include:</p> <ul style="list-style-type: none"> • Method of evaluation and award. Maintain a copy of the contract, modifications, and amendments; as well as insurance records. • All contract activities, including meetings, communications, issues, and agreed-upon changes or resolution. <p>X. Contractor invoices are accurate, complete & sufficiently supported. Records regarding any change to payment schedules, pricing, or timing should be maintained.</p> <p>XI. Payments are linked to satisfactory performance, properly reviewed, and approved.</p>

⁵ *Components of an Effective Contract Monitoring System*, July 2003, by the State of Georgia Department of Audits and Accounts Performance Audit Operations Division.

Appendix B

A right-to-audit clause in a contract can help to control fraud and abuse by affording discovery devices in examinations. Below in Figure 4 is an example right-to-audit clause from the Association of Certified Fraud Examiners (ACFE) that organizations may use to develop their own clause, or to update an existing clause. The ACFE's sample language, however, is not intended to represent legal advice, and we do not make a recommendation to use this specific language. It is included solely as a reference.

Figure 4
ACFE Example Right to Audit Clause

Right to Audit

[Contractor] shall establish and maintain a reasonable accounting system that enables [Company] to readily identify [Contractor]'s assets, expenses, costs of goods, and use of funds. [Company] and its authorized representatives shall have the right to audit, to examine, and to make copies of or extracts from all financial and related records (in whatever form they may be kept, whether written, electronic, or other) relating to or pertaining to this [Contract or Agreement] kept by or under the control of the [Contractor], including, but not limited to those kept by the [Contractor], its employees, agents, assigns, successors, and subcontractors. Such records shall include, but not be limited to, accounting records, written policies and procedures; subcontract files (including proposals of successful and unsuccessful bidders, bid recaps, etc.); all paid vouchers including those for out-of-pocket expenses; other reimbursement supported by invoices; ledgers; cancelled checks; deposit slips; bank statements; journals; original estimates; estimating work sheets; contract amendments and change order files; backcharge logs and supporting documentation; insurance documents; payroll documents; timesheets; memoranda; and correspondence.

[Contractor] shall, at all times during the term of this [Contract or Agreement] and for a period of ten years after the completion of this [Contract or Agreement], maintain such records, together with such supporting or underlying documents and materials. The [Contractor] shall at any time requested by [Company], whether during or after completion of this [Contract or Agreement], and at [Contractor]'s own expense make such records available for inspection and audit (including copies and extracts of records as required) by [Company]. Such records shall be made available to [Company] during normal business hours at the [Contractor]'s office or place of business and [subject to a three day written notice/without prior notice]. In the event that no such location is available, then the financial records, together with the supporting or underlying documents and records, shall be made available for audit at a time and location that is convenient for [Company].

Right to Audit (continued)

[Contractor] shall ensure [Company] has these rights with [Contractor]'s employees, agents, assigns, successors, and subcontractors, and the obligations of these rights shall be explicitly included in any subcontracts or agreements formed between the [Contractor] and any subcontractors to the extent that those subcontracts or agreements relate to fulfillment of the [Contractor]'s obligations to [Company].

Costs of any audits conducted under the authority of this right to audit and not addressed elsewhere will be borne by [Company] unless certain exemption criteria are met. If the audit identifies overpricing or overcharges (of any nature) by the [Contractor] to [Company] in excess of one-half of one percent (.5%) of the total contract billings, the [Contractor] shall reimburse [Company] for the total costs of the audit. If the audit discovers substantive findings related to fraud, misrepresentation, or non-performance, [Company] may recoup the costs of the audit work from the [Contractor]. Any adjustments and/or payments that must be made as a result of any such audit or inspection of the [Contractor]'s invoices and/or records shall be made within a reasonable amount of time (not to exceed 90 days) from presentation of [Company]'s findings to [Contractor].

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Management Comments

Management's response begins on the following page.

MANAGEMENT RESPONSE AND ACTION PLAN

Harbor Department

Contract Administration Audit: CMOE

No.	Recommendation	Priority	Page #	Agree or Disagree	Responsible Party	Action Plan / Explanation for Disagreement	Target Date for Implementation
1.1	The Harbor should expand the training on the Contract Procedures Manual, making it mandatory for all employees involved in contract activities, including procurement and oversight responsibilities. Periodic refresher training should occur.	H	3	Agree	POLB/Contract Compliance Section	This effort is currently underway with the Contracting Procedures Manual training for Executives scheduled in March 2016 and the remainder of staff by December 2016. Periodic refresher training sessions will be scheduled on a reoccurring basis.	Dec-16
2.1	The Harbor should adhere to the adopted procedures set out in the Contracting Procedures Manual. Any exceptions or deviations should be explained and documented.	H	3	Agree	POLB/Contract Compliance Section	Contract Compliance Section will continue to advise staff of documenting exceptions or deviations and ensure appropriate approvals are obtained.	Feb-16
2.2	The scope of work in RFPs should address potential additional services that may result in a future amendment to the contract and request pricing proposals from all vendors.	H	3	Agree	POLB/Contract Compliance Section	Contract Compliance Section will continue to advise staff to define scope in a measurable and comprehensive way and account for possible future amendment scope needs, to the extent possible.	Feb-16
3.1	The Harbor should develop criteria and monitor, measure and report on the benefits and effectiveness of the Contractor's services toward their mission of developing staff.	M	4	Agree	POLB/Human Resources	Through surveys or focus groups, Harbor will monitor the impact or effectiveness of the training as it relates to the achievement of Harbor Department goals.	Dec-16
4.1	The Harbor should work with the City Attorney's Office to develop consistent and thorough right-to-audit language for contracts. The audit clause should include a time frame of at least five years after termination or the expiration of the contract.	M	4	Agree	POLB/Contract Compliance Section	Contract Compliance Section will work with the City Attorney's Office and advise their Office on the recommended enhancement.	Feb-16

Priority

H – High Priority - The recommendation pertains to a serious or materially significant audit finding or control weakness. Due to the seriousness or significance of the matter, immediate management attention and appropriate corrective action is warranted.

M – Medium Priority - The recommendation pertains to a moderately significant or potentially serious audit finding or control weakness. Reasonably prompt corrective action should be taken by management to address the matter. Recommendation should be implemented no later than six months.

L – Low Priority - The recommendation pertains to an audit finding or control weakness of relatively minor significance or concern. The timing of any corrective action is left to management's discretion.

Yellow areas - to be completed by the department