



HARFORD COUNTY, MARYLAND

Office of the County Auditor

AUDIT OF CONTRACT MANAGEMENT

Report Highlights

Report Number: 2015-A-04

Date Issued: 02/19/2016

Why We Did This Audit

This audit was conducted as part of the County Auditor's risk-based Annual Audit Plan approved by the County Council for FY2015.

What We Found

Payments are occasionally issued without adequate supporting documentation from the vendor.

Payments are occasionally issued for items that are not under contract or at rates other than approved in a contract.

Management cannot readily determine the amount paid on any contractor or for a specific vendor.

What We Recommend

Controls should be improved to ensure all contracts are properly monitored and paid per contract terms.

Council Members and County Executive Glassman:

In accordance with Section 213 of the Harford County Charter, we have performed an audit of Harford County's Contract Management processes. We would like to thank the members of management for their cooperation during the audit.

The audit found that procedures in place to monitor contract compliance can be improved. The Department of Procurement is tasked with contracting for large or County-wide purchases, but must rely on user departments to oversee the use of those contracts. Given the resource limitations, human and technological, of the Procurement Department, it would be difficult to fully monitor all of the contracts without additional support. While user departments were generally aware of contract terms, in some cases, invoices were paid at rates higher than agreed upon. In some cases, vendor invoices did not include enough information to substantiate the purchase. We also noted a number of large or cumulatively large purchases that were not included in a contract.

Further results of the audit, our findings and recommendations for improvement are detailed in the attached report. The audit team is available to respond to any questions you have regarding the attached report.

Sincerely,

Chrystal Brooks
County Auditor

cc: Ms. Karen Myers, Director of Procurement
Mr. Billy Boniface, Director of Administration



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REVIEW RESULTS

We have audited Harford County's Contract Management processes for the period of 7/1/2013 through 6/30/2015. In general, contract management involves the monitoring of awarded contracts to ensure all contract terms are being met, as well as reviewing vendor spending to determine if a contract should be put in place.

Our opinion, based on the evidence obtained, is that current procedures are not adequate to ensure that agreed upon rates are paid by departments and that contracts are not overspent. The audit approach focused on testing the key controls that address management's objectives for the process. Conclusions drawn are below.

Risk	Expected Control	Conclusion
Payments are made to vendors without a contract in place.	Department of Procurement monitors total vendor spending to identify contracting needs.	Unsatisfactory
Invoices are not paid in accordance with the contract terms.	User departments have knowledge of contract terms and review invoices for accuracy.	Needs improvement
Invoices do not provide sufficient documentation to verify the work performed or rates charged.	User departments review all invoices and do not authorize payment unless supporting information is complete and correct.	Needs improvement
Procurement Department approval of large purchases is circumvented by using less restrictive document types within the Procurement System.	All purchases of \$2,500 or more should be entered in the form of a DP (Direct Payment) to ensure they pass through the Procurement Department for approval.	Needs improvement
Change orders are used to increase the total paid to vendor without appropriate procurement approval.	Change orders that increase the contract price by 10% or more go through the Board of Estimates for approval.	Satisfactory

Areas for improvement are described in the Findings and Recommendations section of this report. Management has been provided an opportunity to respond to this report; the response provided follows our findings and recommendations.

FINDINGS AND RECOMMENDATIONS

Finding Number: 2015-A-04.01 Competitive Procurement Process

Purchases were made without formal competitive bidding and contracts in place despite providing goods and/or services in excess of \$25,000.

Analysis: The Procurement Training Guide states that the main department objective is "to provide goods and services to other County departments and agencies at the best possible combination of price, quality, and timeliness consistent with prevailing economic conditions." The Harford County Code generally requires that all supplies and contractual services with an estimated cost of \$25,000 or more be purchased by formal, written contract from the lowest responsible bidder. The County Code also requires Board of Estimates approval for all purchases, contracts, and agreements exceeding \$50,000.

Harford County did not monitor total spending by vendor to determine if purchases exceeded the threshold for stricter procurement guidelines. During the audit period, Harford County made purchases of goods and services exceeding \$25,000 from several vendors without following the required formal competitive bid process or the sole source process. Specifically, 6 vendors tested were paid more than \$25,000 annually without undergoing a formal competitive bidding process. Two (2) of those vendors were paid for individual transactions in excess of \$25,000 despite not having a contract in place. For the remaining 4 vendors, individual transactions were less than \$25,000 but the total annual spending exceeded that amount.

Recommendation: We recommend the County establish a contract monitoring system (or process) to confirm that purchases of goods and services are made in accordance with the Harford County Code. Specifically, we recommend that the Department of Procurement and purchasing departments:

- Consolidate purchases and competitively procure frequently used goods and services;
- Track total vendor spending to determine if contracts should be put in place.

Management Response: Current systems make it a cumbersome task to monitor this information. With the help of Treasury, we were able to pull data from Adpics/Famis and analyzed that information along with purchasing card spend to obtain an overall spend by

vendor. We are validating the spend information by vendor, and our goal is to bid those at \$25K and over. Our newly developed ECMS (Enterprise Contract Management System) went live May 2015. Aaron Hall, Procurement Agent II in charge of this system, projects that all contractual information will be entered into this database by end of fiscal year (6/30/16). This system will help with contract management, but does not address the payment/financial side of business with vendors.

Finding Number: 2015-A-04.02 Rates Charged were not in accordance with the Contract

Payments are being made for goods and services that are not in accordance with the agreed upon contract terms.

Analysis: Contracts put in place by the Department of Procurement establish a fixed price for items and services purchased by the County during a specified time period. This allows the County to adequately project and budget for expected expenses, as well as ensures that the best market rates are being obtained. If the invoices provided by the vendors under contract do not agree with the specified terms, it could result in the County paying more than necessary.

During the audit period, we noted several matters related to incorrect vendor billing. We noted some cases in which vendors under-billed; those invoices have not been noted as exceptions. However, we noted 11 vendors (of 38 total contracts and vendors tested) that billed for services at rates higher than agreed upon, resulting in an overpayment of \$25,302.45. This amount represents a 0.03% error rate.

Additionally, even when a contract was in place, there were several instances where goods or services purchased were not listed in the contract terms. Specifically, we found 9 of the contracts tested included payments to vendors for items not specified in the contract. For one contract, a total of \$93,824 was spent outside of the contract terms.

In some cases, departments approved and paid invoices despite vendors not providing sufficient documentation to verify the correctness of the amounts charged. We had to request additional support for invoices from vendors due to the department not having sufficient support or purchase details on file. As an example, for uniform rentals and purchases, invoices show the number of shirts or pants being billed, but do not provide enough detail to determine the type of shirt, pant or jacket being rented or purchased.

Recommendation: We recommend the Department of Procurement reemphasize to user departments the importance of reviewing contract terms and supporting documentation

when reviewing and approving invoices for payment. We further recommend Procurement periodically review a sample of invoices for contract compliance.

Management Response: Procurement Training has been scheduled where this will be addressed with users. We will reiterate to users what to look for and suggestions for monitoring contracts. We also will reinforce how imperative it is to document vendor performance. In order to help users identify specific details in their contracts, we created a summary cover sheet outlining key elements of their agreements. This cover sheet accompanies each fully executed contract.

Regarding invoice review, we are looking at other possible options to help with this issue.

Finding Number: 2015-A-04.03 Xerox Billing Rates

Monthly billing rates for copiers include unallowed charges.

Analysis: Harford County leases copy and printing equipment from Xerox under the terms of a State of Maryland blanket purchase order. Currently, the County is leasing 139 pieces of equipment, with monthly fees of approximately \$38,500.

The monthly Xerox bill includes a \$550 management fee that appears to be a legacy from the prior contract period. Correspondence indicates that this amount was agreed upon during the prior contract, but never included in an addendum. For the current contract, the fee has not been authorized by the contract, contract extensions, addenda or other correspondence.

The State of Maryland contract details the pricing for each machine model and the additional price for each available accessory. The contract further details the per-page supply (maintenance and toner) charges. When a new machine is leased, the vendor compiles a purchase order detailing the type of machine requested, the accessories included and the monthly color and black and white page allowances. The purchase order also includes the total monthly payment for the machine. The total presented on the purchase order should reconcile to the details in the contract. We contacted the vendor directly for additional information regarding the original lease/purchase agreements for each machine. We reviewed this information for a sample of machines; however, the vendor was not able to provide this information for equipment that was no longer active.

We attempted to reconcile a number of pieces of equipment from the documentation that was provided to the contract terms, but were unable to do so. For our sample of 17 copiers, most did not agree to the contracted rates. We inquired of Xerox regarding these

differences and found that some machines' pricing includes a balance from a prior lease. This effectively means that some departments are paying for two machines, although they only have one. Further, the current pricing may include the residual from a number of prior balances.

The Xerox contract requires payment of any remaining balance when a lease is cancelled. However, this requirement and the future impact of the requirement have not been communicated to the department users who approve the leases. It is also not clear that this was clearly communicated to the Department of Procurement. The purchase order documentation provided by Xerox does not itemize the pricing or indicate that the proposed payment includes a prior balance. When we asked about the lease balance calculations and financing terms for the replaced equipment, Xerox was unable to provide a response other than noting that their systems calculate these figures. We reviewed, with Xerox, the pricing for one machine as an example and based upon the balance and payments, computed a 13.5% interest rate.

For the machines sampled, the total additional billings were \$23,276.64; this amount extrapolated to the entire population of the machines would be approximately \$190,000 overpaid to Xerox for cancelled leases.

Recommendation: We are currently looking at options to address this recommendation.

Management Response: We are currently looking at options to address this recommendation.

Finding Number: 2015-A-04.04 Support for Change Orders

Support for contract change orders was not maintained consistently.

Analysis: After a contract, bid or purchase order has been issued, the purchase may be modified using a change order. Change orders should only be made when the circumstances of the purchase change, requiring additional services or products to be provided. If the change order is more than 10% of a contract that required Board of Estimates approval, a new board approval is required.

We tested a sample of change orders performed during the audit period to confirm that the additional purchase followed the purchasing guidelines and was not included in the original scope of the contract. While change orders in the purchasing system had notes explaining the amount of the change, they generally did not include information explaining the scope of the change. To determine the scope of the change, one would need to review

the original contract and the terms of the proposed change. We found that some change order proposals were maintained in Procurement's electronic files, some were maintained in Procurement's hard copy files and others were maintained by the requesting department. This inconsistent filing makes it difficult to identify each of the components of the change order approval process.

We were able to eventually locate most of the original bid files and change order proposals for the samples tested. However, there was one change order that we could not confirm because documentation was not available for review. Through discussion with Procurement, this may be the case when emailed proposal documents aren't printed for the hard copy file or saved to the network drive.

Recommendation: We recommend the Department of Procurement ensure that documentation is received from departments and maintained in Procurement's files, prior to approving a change order in the purchasing system.

Management Response: We will strive to ensure documentation is received and maintained.

MANAGEMENT RESPONSE

Accessing data is difficult with our current systems. Due to the lack of resources in the Procurement Department, we will continue to search for efficiencies in our processes. Education and training will be stressed within the Procurement Department, as well as with our user departments/agencies. Contract management is paramount; in order to manage contracts, users must understand their contracts. It is essential that analyses be performed periodically and business reviews take place at least annually with top spend vendors. The purpose of these meetings will be to review annual overall spend, breaking out detail by department/agency. These reviews will also create a forum to enforce accountability, and by which opportunities for value adds for the County would be pursued, along with possible cost saving ideas. This meeting would also allow discussion of what is or what is not working in our relationship.

IT procurement is an area where training is needed in the government sector, as well as in private industry. Recently, Stacy Rappold, Procurement Agent III, earned her certification as a CTPS (Certified Technology Procurement Specialist). This designation is known worldwide. Our Procurement Agents have been taking on a stronger role in reviewing and negotiating ALL costs and terms and conditions in our contracts, resulting in substantial savings. Our Department, consisting of three to four Procurement Agents at a time, are responsible for approximately \$180M per year (this amount reflects operational spend only, not construction or capital spend). We are improving practices and strategies and are

focusing on more efficient and logical methods. This is a work in progress. We are revising language to mitigate risk in our bids, proposals and contracts, with the help of our Law Department. We are also currently reviewing our Code for possible revision for improvement and efficiencies.

The County Auditor recommended engaging an external firm for review of capital projects; I propose contracting with an external firm on a wider scale.

Overall, Procurement's approach must entail a proactive, strategic role with contract management, as well as more collaborative engagement with our users and our vendor community. A "valuable purchase" is not one that is solely about low bid.

BACKGROUND INFORMATION

PROGRAM DESCRIPTION AND KEY STATISTICS

The Harford County Code generally requires that all supplies and services with an estimated cost of \$25,000 or more be purchased by formal, written contract from the lowest responsible bidder. In addition, the County Code also requires Board of Estimates approval for all purchases, contracts, and agreements in excess of \$50,000.

After procurement advertises and awards a contract, departments may use the contracted vendor for the work detailed in the contract. The user departments are responsible for reviewing invoices from vendors and ensuring that all work was performed and was within the scope of the contract, as well as confirming the billed rates are correct. This arrangement means the user departments must have knowledge of the contract terms.

Purchases within the scope of this audit totaled approximately \$280 million. This amount, for fiscal years 2014 and 2015, includes only vendors with spending greater than \$25,000 in either year and excludes grants, contributions, appropriations to outside agencies, personnel and employee benefit costs and capital projects. Those purchases relate to 441 vendors. We identified 866 contracts that were active in the period, related to 1,024 vendors.

Contract management and monitoring is more complicated when systems are not designed to provide useful information. In Harford County's case, the purchasing systems cannot readily aggregate purchases by vendor or by contract. To determine the universe for this project, we spent a significant amount of time manipulating data from various systems. It would be impractical for Procurement to perform such analysis routinely, so the data that would be needed for ongoing monitoring is not available.

REVIEW OBJECTIVE, SCOPE AND METHODOLOGY

The objective of this audit was to determine if contracts are being appropriately monitored to ensure compliance with County policies and regulations. The project also sought to determine that amounts paid to vendors were in accordance with contract terms. The scope of the review was limited to vendors that have received payments of more than \$25,000 in each fiscal year.

The audit focused on activity during the period of 7/1/2013 through 6/30/2015. Our audit procedures included interviewing personnel, observation and testing. Specifically, we met with Karen Myers, Director of Procurement, along with the Procurement Agents, to discuss the current contract management process. Based on these initial meetings, we determined that internal controls are not adequately designed. In addition, we noted that the Department of Procurement does not have adequate systems in place to monitor total spending on contracts or for individual vendors without significant manual intervention. Therefore, this audit did not include a complete evaluation of internal control, but instead, relied on substantive testing to support conclusions.

In order to ensure the efficiency of the audit, we selected a sample of 19 contracts and 19 vendors for testing. We reviewed the contracts for each and, where appropriate, tested a sample of transactions related to those vendors and contracts. This methodology provided audit coverage of 28.0% as summarized below.

	<u>Contract testing</u>		<u>Vendor Testing</u>	
	Amount	Transactions	Amount	Transactions
Sample Totals	\$16,596,677	18,728	\$106,733,170	3,932
Invoices Tested	\$5,113,310	1,069	\$73,165,517	358
	Total Spending	Tested	Coverage	
<i>in millions</i>	\$279.3	\$78.3	28.0%	

Our audit intentionally targeted operating contracts for review. Although a number of capital projects were included in our testing, we only confirmed that invoices appeared complete. The comprehensive management of capital contracts requires the additional consideration of overhead rates for engineering firms and retainage rates for construction agreements. We recommend management consider engaging an external audit firm, on a contingency basis, to review the vendors' support for capital project related invoices.

As another example of the complexity involved with monitoring contracts, we noted that one vendor's contract was terminated noting that the vendor would not be able to bid on contracts for 6 months. Within the 6 month exclusion period, however, the vendor was awarded a new contract for \$1,168,460.

The wide variety of the contracts required us to develop unique testing attributes for each contract and vendor reviewed. Consequently, we identified a number of minor, 'one-off' issues that did not warrant inclusion in this report. Those items have been presented to management for resolution. In some cases, it was difficult to obtain the required documentation from vendors, necessitating multiple phone calls and emails and resulting in delays of longer than one month. In our conversations with management, we recommended considering prior communication and customer service issues be considered in future procurement decisions.

Harford County management is responsible for establishing and maintaining effective internal controls. Internal control is a process designed to provide reasonable assurance that objectives pertaining to the reliability of financial records, effectiveness and efficiency of operations including safeguarding of assets and compliance with applicable laws, rules and regulations are achieved. Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected.

The audit was performed in accordance with Generally Accepted Government Auditing Standards (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient 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.

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