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May 18, 1981

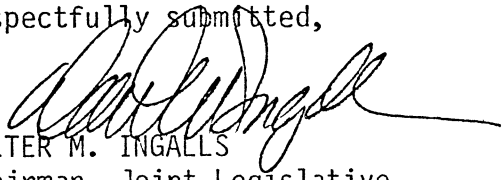
Letter Report 029

The Honorable President pro Tempore of the Senate
The Honorable Speaker of the Assembly
The Honorable Members of the Senate and the
Assembly of the Legislature of California

Members of the Legislature:

Your Joint Legislative Audit Committee respectfully submits
the Auditor General's letter report concerning the contract
management activities of the State Energy Resources
Conservation and Development Commission.

Respectfully submitted,


WALTER M. INGALLS
Chairman, Joint Legislative
Audit Committee



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Thomas W. Hayes
Auditor General

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May 11, 1981

Letter Report 029

Honorable Walter M. Ingalls
Chairman, and Members of the
Joint Legislative Audit Committee
925 L Street, Suite 750
Sacramento, California 95814

Dear Mr. Chairman and Members:

In response to Item 203, paragraph 1 of the Supplemental Report of the Committee of Conference on the Budget Bill of the fiscal year 1980-81, we have reviewed the contract management practices of the State Energy Resources Conservation and Development Commission. We reviewed the existence and sufficiency of systems and procedures within the commission for the award and management of contracts. We analyzed contracts awarded during the 1979-80 fiscal year and investigated such functions as identification of contract needs, selection of contractors, contract supervision, control of progress payments, and use and evaluation of contract results. This review was conducted under the authority vested in the Auditor General under Sections 10527 and 10528 of the Government Code.

STUDY RESULTS

During fiscal year 1979-80, the State Energy Resources Conservation and Development Commission encumbered more than \$9.7 million for over 300 contracts for demonstration projects, research and consulting studies, expert testimony, and other services. Our review found that the commission has developed and implemented an adequate system for controlling and managing contracts. More specifically, the commission has developed this system by planning contract needs so that contract activities coincide with commission objectives.

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Additionally, the commission has implemented adequate procedures for selecting contractors and properly awarding contracts. We also verified that the commission has properly supervised contracts by developing contract manuals, delivering training programs on contracting, and by detailing responsibility for contract monitoring. Further, the commission has adequately controlled partial payments to contractors. And in reviewing contract products, we found that the commission generally uses and evaluates these products. Thus, in our tests of the commission's system, we did not find violations which would indicate significant deficiencies in the management of contracts.

The commission has established its contract management system partly as a result of a comprehensive audit completed in December 1978 by the Auditor General.* The report on this audit concluded that the commission's contract management practices were inadequate and recommended that the commission develop uniform systems and procedures for contract management. In response to this report, the Executive Director of the commission indicated that the Auditor General's recommendations had been implemented.

INTRODUCTION

The commission, which consists of five members appointed by the Governor, is the central state organization responsible for planning and regulating electrical energy production as well as consumption. Under California statutes, the commission is responsible for ensuring a reliable supply of electrical energy to protect public health and safety, to promote general welfare, and to protect environmental quality. In 1979, the commission established these as its priorities:

- Promoting energy conservation by enforcing existing conservation standards, adopting stronger standards for new buildings, and expanding local conservation programs;

* Report P-814.2 entitled Improvements Needed in Controlling Contracts Awarded by the California Energy Commission, was issued December 1978.

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- Developing preferred alternative energy resources in solar, wind, and other resources;
- Improving energy assessment capability in demand forecasting, technology, and planning;
- Approving power plant sites;
- Updating the Energy Contingency Plan.

To implement its programs, the commission was budgeted approximately \$37.5 million and 531 personnel years for fiscal year 1979-80. The following table presents the commission's budget since fiscal year 1979-80:

<u>Source of Funds</u>	<u>Actual 1979-80</u>	<u>Budget 1980-81</u>	<u>Estimated Budget 1981-82</u>
State	\$32,530,084	\$54,183,149	\$29,956,645
Federal	<u>4,986,469</u>	<u>7,133,712</u>	<u>12,495,716</u>
Total	<u>\$37,516,553</u>	<u>\$61,316,861</u>	<u>\$42,452,361^a</u>
 Personnel Years	 531	 547	 552

^a This figure does not reflect a \$6.8 million reduction requested by the Department of Finance because of a cut in federal funds originally anticipated in 1981-82.

The commission funds most of its programs through a surcharge based on kilowatt hours of electricity sold in California. (A surcharge of up to two-tenths of a mill--\$0.0002--per kilowatt hour is allowable.) This rate structure results in larger financial contributions from those who consume the most energy.

The Administrative Services Division, one of five divisions under the Executive Office, is responsible for the administration of contract management. Specifically, the contracts office within this division oversees the development of contracts within state guidelines, the processing and

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approval of proposed contracts, and the maintenance of centralized contract files. Most contract management activities, however, rest with the division staff who monitor ongoing contract activities, receive contract products, and evaluate contracts and the performance of contractors.

Previous Auditor General Report

As noted earlier, the Auditor General completed an audit of the commission's contract management practices in December of 1978. In this report, entitled Improvements Needed in Controlling Contracts Awarded by the California Energy Commission, the Auditor General found that contract management was inadequate, noting instances of noncompliance with sections of the California Government Code and the State Administrative Manual. These instances of noncompliance occurred because the commission's contract procedures were inconsistent and inadequate. Also the report indicated that staff responsible for managing contracts had not been adequately trained.

To alleviate these problems, the Auditor General recommended that the commission develop uniform systems and procedures for managing contracts. The improved system was to include (1) a uniform contract manual; (2) identification of clear lines of authority and responsibility for the development, award and monitoring of contracts; (3) training programs for contract managers; and (4) a contract payment certification process. In responding to the Auditor General's report, the Executive Director of the commission stated that every recommendation had been implemented.

Scope of Work

In conducting our analysis, we interviewed commission personnel; reviewed contract files, accounting records, and contract products; and examined other documents provided by the commission. We conducted a review of all completed contracts let in fiscal year 1979-80. We analyzed 86 contracts which had been let in fiscal year 1979-80, and completed by January 1, 1981. Our analysis evaluated the commission's adherence to procedures required by the State Administrative Manual and the commission's contract manual.

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Further, we conducted a case study analysis of 25 contracts to assess whether the commission used contract products. This analysis involved reviewing commission policies and procedures, interviewing contract managers, and contacting sources outside the agency for verification.

We excluded advisory committee and expert witness contracts from our review. Advisory committee contracts, used to solicit public comments about the commission affairs, were not examined since contract terms are usually for per diem and travel expenses. We also excluded expert witness contracts, used to gain the testimony of certain specialists, since we are unable to judge the qualifications of these experts.

THE COMMISSION HAS DEVELOPED AND IMPLEMENTED AN ADEQUATE CONTRACT MANAGEMENT SYSTEM

Our review found that the commission has developed and implemented a contract management system which adequately controls and manages commission contracts. Generally, we found no weaknesses in the system's identification of contract needs, selection of contractors, contract supervision, control of progress payments, and use and evaluation of contract results.

Identification of Contract Needs

We found that the commission has developed a planning system by establishing broad priorities which are used to identify specific project areas. Such a system helps ensure that contracting activities are directed towards fulfilling the commission's stated objectives. Our review of the project plans revealed that all plans included a listing of contracts expected to be awarded to meet project objectives. Furthermore, the commission justified the objectives of each project by relating them to its established priorities.

The project areas identified within the commission's divisional plans sometimes include activities which cannot be conducted by commission staff. These activities are contracted out to private parties. Section 25218 of the Public Resources Code enables the commission to enter into these professional services contracts as necessary.

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The commission instituted its planning activities partly in response to a previous Auditor General study which concluded that the commission needed to develop a more comprehensive system for planning projects.* The Auditor General recommended that the commission develop a planning process which outlines the complete life of each project, identifies objectives, and specifies deadlines for completing certain tasks. At the time the report was issued, the Executive Director indicated that many of the recommendations had been implemented.

To carry out planning activities, the commission presents broad priorities in the Biennial Report. As the major policy document used in the planning process, this report presents the commission's recommendations for meeting the State's energy needs and establishes priorities which the commission judges will ensure that the State moves toward an acceptable energy future.

Using the priorities from the Biennial Report as guidelines, commission staff determine the specific programs, projects, and contracts to be implemented in achieving the commission's goals. For each budget year, each division submits annual workplans, which detail the projects and contracts that are to be carried out for the coming year. These workplans form the basis of the commission's yearly budget.

To check the effectiveness of the planning process, we reviewed 13 project plans developed by the Development, Conservation, and Assessments Divisions. We found that all of the plans included a listing of contracts expected to be awarded to meet project objectives, a description of project objectives, the means by which these objectives were to be met, and the expected products. Twelve of the 13 plans listed measures to be used for assessing project accomplishments. We also found that all of the 13 project plans addressed project deadlines and milestones.

* This study, issued in November 1978, was entitled Improvements Needed in Planning and Monitoring Research and Development of Alternative Energy Sources, P-814.1.

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Selection of Contractors

The commission has implemented adequate procedures for selecting contractors to ensure the proper awarding of contracts. The commission has identified procedures for selecting contractors through the request for proposal (RFP) process, which assures competitive bidding, and the sole source process, which is noncompetitive. In addition, the commission's system also includes an effective tracking process through which the contract is reviewed by internal offices. We analyzed 86 contracts through all phases of this system and found no indications of significant deficiencies in contractor selection.

The Auditor General's previous report on commission contract management noted numerous weaknesses in the contractor selection system. The audit report recommended that the commission develop procedures identifying clear lines of authority and responsibility for developing and awarding contracts. A commission task force further indicated that the procedures should include greater documentation of contractor selection and development of a contract tracking system.

Our review found no significant problem areas in the commission's RFP or sole source process. In the RFP process, the commission disseminates information to interested parties through the use of a computerized mailing list. A selection committee, usually consisting of commission staff, independently reviews and scores proposals submitted to the contracts office by interested parties. The committee then evaluates the proposals, awarding the contract to the most cost-beneficial proposal. We examined 25 contracts for documentation verifying the use of the commission's established RFP procedures and confirmed that the commission observed these procedures in processing all the contracts analyzed.

Again, in the sole source selection process, we found no significant problem areas. The commission awards sole source contracts to the contractor determined to be best able to perform the designated tasks. The commission's contract manual lists these sample criteria for sole source awards:

- The contractor must be able to provide a unique service;

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- The contractor must own or hold the patent to the service or product; or
- The contractor is performing or has performed similar work.

Sole source contracts must document the special circumstances which existed and should list other individuals contacted to perform the designated tasks.

In our analysis, we reviewed 34 sole source contracts for the required documentation. Of 34 contracts analyzed, 32 detailed adequate justifications of existing special circumstances. The remaining 2 contracts did not contain sufficient documentation. Additionally, 21 of the 34 contracts reviewed contained sufficiently documented efforts to contact other individuals. All but one of the remaining 13 contracts were for amounts below \$1,500. Thus, as with the contracts selected through the RFP selection system, we identified no significant problem areas.

Our review also found that the commission's internal tracking system for monitoring the status of each contract was sufficient. This tracking procedure begins when a division decides to contract for certain services. The division's designated contract manager submits to the Administrative Services Division a contract request memorandum which specifies the relevant contract features, such as the purpose of the contract, contract objectives, and type of selection process to be used. The Administrative Services Division tracks the status of each contract. We reviewed all 86 contracts for documentation of internal tracking activities and found no significant system deficiencies. In conducting each of these activities, division staff complied 93 to 100 percent of the time.

Contract Supervision

Proper contract supervision requires establishing clear and complete contract policies, effectively disseminating the procedures to appropriate personnel, and establishing procedures and controls to identify responsibilities for monitoring the progress of contracts. The commission has ensured proper supervision of contracts by developing a

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contract manual for all staff, by conducting a contract training program designed to inform contract managers about the basic contract process, and by instituting a management system that details the responsibilities for monitoring contracts. Our review of the procedures and controls for contract supervision did not reveal any significant deficiencies that would adversely affect contract management.

The prior Auditor General study on contract management (P-814.2) reported certain problems related to contract supervision. The report found that the commission did not use a current, comprehensive manual and recommended that the commission develop contract policies and procedures to be used by all staff. Further the prior report noted that the commission had not adequately trained staff responsible for managing contracts. It recommended that the commission institute a training program to instruct contract managers in the basic contracting process. Finally, the prior report recommended that the commission develop a contract management system identifying lines of authority and responsibility for monitoring contracts.

Our review found that the commission has acted to implement these contract supervision recommendations from the Auditor General's prior report. For instance, the commission has developed and implemented a contract manual for use by all staff. The commission has also designed a contract manager training program which it delivers an average of twice a year or as needed. All contract managers are required to complete the course. And, when initiating a contract, contract managers must indicate on the contract request memorandum that they have completed contract training. To determine if contract managers had taken this training program, we reviewed 86 contract files and found that 90 percent of the contracts were managed by staff who had completed the training.

Lastly, the commission has implemented a system which details the responsibilities for monitoring contracts. Contract managers are responsible for monitoring day-to-day activities of the contract while contract coordinators work closely with the contract managers to assist in solving problems that may arise. The division chiefs are apprised of contract status through bimonthly status reports.

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Control of Progress Payments

Our review did not reveal any significant instances in which the commission had not complied with established procedures for controlling progress payments to contractors. Progress payments are partial payments of the contract price during the term of the contract. These payments must be controlled to prevent unwarranted payments to contractors.

The commission's accounting office is responsible for making progress payments according to procedures established in the contract manual. The accounting office is allowed to make payments after the contract manager prepares a progress evaluation and after the contract office approves the invoice for payment. The commission's contract manual also does not allow progress payments to be made for contracts less than three months in duration or to exceed 75 percent of the total amount of the contract.

In our review of progress payments, we examined the accounting office's records for 19 contracts to determine if progress payments were made on contracts less than three months in duration or in advance of the approved contract. We also verified that the accounting office was not making progress payments in excess of 75 percent of the approved contract price. Finally, we traced progress payments to progress evaluations to verify that the progress evaluations were prepared for progress payments. Our review of progress payments found no significant instances of noncompliance with the contract manual.

Use and Evaluation of Contract Results

During our review, we found that, in most cases, the commission uses the contract product. We also determined that the commission generally evaluates the contract and the contractor's performance when a project is completed.

The commission awards contracts to fulfill program objectives, to provide information needed for the Biennial Report, or to fulfill legislative mandates. Each contract product should be used in one or more of these areas to assure that all contracting is essential to commission activities.

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We assessed the use of contract results by selecting 25 contracts for case study and by interviewing contract managers to determine how the products or results of these contracts were used. In 20 cases, the commission or other organizations used the contract product or service. Moreover, the objectives of all 25 contracts were found to be justified as contributing to commission objectives.

Contract managers also identified other uses of the contract results. For example, the commission funded several feasibility studies of cogeneration (the joint production of electricity and useful heat). As a result, one private firm and several public institutions, have initiated steps to install cogeneration units in their facilities. The results of another contract, which funded a model energy information and education center at a community college, served as a source of information and role model for other organizations offering similar services.

Although contract results are used for essential commission activities, it is important to determine if the quality of the work performed meets predetermined contract standards. The commission requires that both contract and contractor evaluations be prepared following the submission of the final invoices. Failure to prepare these evaluations may result in improper payments to contractors whose performance did not warrant full or final payments.

The prior audit Report P-814.2 stated that the commission had failed to prepare and file evaluations of contractors' performance for more than 50 percent of the contracts awarded by the commission. The report recommended that the commission develop a system to monitor the preparation of contract evaluations. In response to these recommendations, the commission implemented a system that requires the contract manager to prepare an evaluation after the contractor has submitted the final contract product and the final payment invoice, and after the commission staff has conducted a final review of the contract product. Once the evaluations have been prepared, they are forwarded with the invoices to the contracts office for review and approval. The invoice is then sent to the accounting office for final payment. We found that 47 of the 86 contracts reviewed had final payments. Of these 47 contracts, 85 percent had evaluations in file.

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CONCLUSION

Our review disclosed no significant deficiencies in the State Energy Resources Conservation and Development Commission's system for managing contracts. We analyzed the commission's identification of contract needs, selection of contractors, contract supervision, control of progress payments, and use and evaluation of contract results for completed contracts awarded in fiscal year 1979-80. Our review indicated that the commission has developed a system to adequately manage these contracts.

Respectfully submitted,


THOMAS W. HAYES
Auditor General

Staff: Richard C. Mahan, Audit Manager
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Attachment: Response to the Auditor General's Report
Executive Director
California Energy Commission

CALIFORNIA ENERGY COMMISSION

1111 HOWE AVENUE
SACRAMENTO, CALIFORNIA 95825



May 7, 1981

Thomas W. Hayes, Auditor General
Office of the Auditor General
660 J Street, Ste 300
Sacramento, Ca. 95814

Dear Mr. Hayes

I have reviewed the draft copy of your report on California Energy Commission contract management activities. We are pleased that your staff found our contract management system adequate in all areas examined.

The Energy Commission staff has made an extremely positive effort to assure that our contracting procedures are as complete as possible--from award of contract to ongoing management responsibilities. We will continue to refine and improve these procedures in the future.

Sincerely

A handwritten signature in cursive script, appearing to read "John L. Geesman".

John L. Geesman
Executive Director