California State Auditor

BUREAU OF STATE AUDITS

# California Children and Families Commission:

*Its Poor Contracting Practices Resulted in Questionable and Inappropriate Payments to Contractors and Violations of State Law and Policies*


October 2006
2006-114

The first five copies of each California State Auditor report are free. Additional copies are $3 each, payable by check or money order. You can obtain reports by contacting the Bureau of State Audits at the following address:

**California State Auditor**
**Bureau of State Audits**
**555 Capitol Mall, Suite 300**
**Sacramento, California 95814**
**(916) 445-0255 or TTY (916) 445-0033**

OR

**This report is also available on the World Wide Web http://www.bsa.ca.gov**

The California State Auditor is pleased to announce the availability of an on-line subscription service. For information on how to subscribe, please contact the Information Technology Unit at (916) 445-0255, ext. 456, or visit our Web site at www.bsa.ca.gov

**Alternate format reports available upon request.**

# CALIFORNIA STATE AUDITOR

ELAINE M. HOWLE
STATE AUDITOR

STEVEN M. HENDRICKSON
CHIEF DEPUTY STATE AUDITOR


October 31, 2006 2006-114

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the Bureau of State Audits presents its audit report concerning the California Children and Families Commission's (state commission) spending practices and contracting procedures. Our review found that the state commission allowed one of its media contractors to circumvent the payment provisions of a contract by paying invoices totaling $673,000 between February 2002 and December 2003 for fees and expenses of some of the contractor's employees that were prohibited under the contract, effectively preventing that money from furthering the allowable contract activities.

This report also concludes that the state commission did not fully use the tools available to it to ensure its contractors provided appropriate services. Further, it could not always demonstrate it had reviewed and approved final written subcontracts and subcontractors' conflict-of-interest certificates. Additionally, the state commission did not always follow state policy when it used a competitive process to award three contracts valued at more than $47.7 million and failed to provide sufficient justification for awarding one $3 million contract and six amendments totaling $27.6 million using the noncompetitive process. Moreover, it did not always ensure that its interagency agreements met the state requirement for using subcontractors, and it failed to follow state policy concerning these agreements that limits administrative overhead when it agreed to pay $1.2 million more than it should have. The state commission also intentionally used some memorandums of understanding with counties to avoid having to comply with state contracting requirements.

Finally, we found the state commission had clear authority to conduct its advertising campaigns relating to preschool, these advertisements and their timing were consistent with legal restrictions on the use of public funds, and did not contribute any of its public funds to campaign accounts used to support the various ballot measures. However, the state commission could not demonstrate that payments it made for a period of almost four months in 2004 to three individuals who worked for both a media contractor and campaign committees were appropriate.

Respectfully submitted,

Elaine M. Howle

ELAINE M. HOWLE
State Auditor

# CONTENTS

# SUMMARY

*Audit Highlights . . .*

*Our review of the California Children and Families Commission's spending practices and contracting procedures revealed that it:*

- ☑ *Allowed one of its media contractors to circumvent the payment provisions of a contract by paying invoices totaling $673,000 for fees and expenses of some of the contractor's employees that were prohibited under the terms of the contract.*
- ☑ *Did not fully use the tools available to it to ensure its contractors provided appropriate services.*
- ☑ *Could not always demonstrate it had reviewed and approved final written subcontracts and subcontractors' conflict-of-interest certificates.*
- ☑ *Did not always follow state policy when it used a competitive process to award three of the contracts valued at more than $47.7 million and failed to provide sufficient justification for awarding one $3 million contract and six amendments totaling $27.6 million using the noncompetitive process.*

*continued on next page . . .*

## RESULTS IN BRIEF

The California Children and Families Commission (state commission) contracts with media and public relations companies to conduct mass media campaigns related to various issues involving early childhood development and school readiness. We found a number of problems with the way it awards and manages these contracts. For example, the state commission allowed one of its media contractors to circumvent the payment provisions of a contract by paying invoices totaling $673,000 between February 2002 and December 2003 for fees and expenses of some of the contractor's employees. These payments violated the terms of the contract, which stated that payment was to be based solely on commissions applied to the cost of advertising placed by the contractor and prohibited the charging of other services or fees. As a result, the state commission paid for services it had not contracted for, effectively preventing that money from being used to further the other activities allowed by the contract, namely purchasing printed ad space or broadcast media time.

Additionally, the state commission did not fully use the tools available to it to ensure that its contractors provided appropriate services. For example, it did not always include some important elements in its contracts, such as a clear description of work to be performed and detailed cost proposals. Further, it did not always ensure that its contractors submitted adequate work plans, that it received all required work plans, and that it promptly approved them. As a result, the state commission cannot ensure that the resulting contracts clearly established what was expected from the contractor, that the contracts provided the best value, and that its contractors provided the agreed-upon services within established timelines and budgets.

Moreover, the state commission could not always demonstrate that it had reviewed and approved final written subcontracts and subcontractors' conflict-of-interest certificates. When the state commission fails to review these documents before authorizing contractors to use a subcontractor, it cannot ensure that it protects the State's interests or identifies potential conflicts of interest. Also, although the state commission's contracts typically include provisions requiring its contractors to

- ☑ *Did not always ensure that its interagency agreements met the state requirement for using subcontractors.*
- ☑ *Agreed to pay $1.2 million more than it should have for administrative overhead because it did not follow state policy that limits such payments.*
- ☑ *Intentionally used some memorandums of understanding with counties to avoid having to comply with state contracting requirements.*
- ☑ *Had clear authority to conduct its advertising campaigns relating to preschool, these advertisements and their timing were consistent with legal restrictions on the use of public funds and did not contribute any of its public funds to campaign accounts used to support the various ballot measures.*
- ☑ *Its payments to three individuals who worked for the media contractor were generally consistent with the restrictions related to the use of public funds for political purposes. However, for a period of almost four months in 2004, the state commission could not demonstrate that these payments were appropriate.*

document the expenses claimed, it did not always enforce these provisions and sometimes accepted inadequate documentation. This failure to properly develop and manage its contracts caused the state commission to make some questionable payments to contractors for items such as laptop computers valued at $10,000, food catering costs, and monthly parking fees.

In addition, the state commission did not always follow state policies during its process of competitively awarding three of the nine contracts we reviewed. For example, it failed to provide adequate justification that contract costs totaling more than $47.7 million were reasonable when it competitively awarded three contracts that received fewer than three bids. Also, it did not consistently document its scoring of proposals received from potential contractors and was unable to demonstrate that it had advertised one contract, totaling $90 million, in the state contracts register as required.

When we looked at the state commission's use of noncompetitive contracts, we noted that it failed to follow state policies that require sufficient justification for awarding such contracts. For example, in its justifications the state commission cited insufficient staff resources or time limitations as its reasons for awarding one contract and six amendments using the noncompetitive process. We do not believe that these circumstances are compelling reasons for avoiding a competitive bidding process.

Further, the state commission did not always ensure that its interagency agreements met the requirements for using subcontractors, and the agreements regularly included budgets that allowed the payment of administrative overhead fees at amounts higher than state policy allows. Its failure to follow state policy in these instances resulted in the state commission agreeing to pay $1.2 million more for these agreements than it should have. In addition, the state commission intentionally used some memorandums of understanding with counties to avoid having to comply with state contracting requirements.

When the state commission does not fully comply with established laws and policies designed to promote competition, fairness, and value, it cannot ensure that the State is receiving the best value for its money or that the State's interests are being protected.

Between 2000 and 2006 the state commission used four media and public relations contractors to conduct mass media campaigns related to various issues, including promoting the value of preschool. During this time, the Office of the Attorney General received three ballot proposals that either related to preschool or that, if enacted, would have affected the work of the state commission. Two of these proposals ultimately qualified for the ballot. Because of the timing of the state commission's publicly funded media campaigns and the ballot proposals, concerns arose as to whether the state commission inappropriately spent public funds on campaign activities or on political advocacy. Our review determined that the state commission had clear legal authority to conduct its public advertising campaigns related to preschool. We also found that the content of these advertisements and their timing were consistent with applicable legal restrictions related to the use of public funds for political purposes and confirmed that the state commission did not contribute any of its public funds to campaign accounts used to support the various ballot measures.

Finally, although three individuals who worked for a media contractor also worked for the campaign committees supporting certain ballot measures, we were generally able to determine that the state commission's payments to these individuals were consistent with the restrictions on the use of public funds for political purposes. However, for an almost four-month period in 2004, we cannot determine whether public funds were spent appropriately to pay for the services of these three individuals because the state commission did not have adequate records. So that we might learn what services these three individuals were paid to perform during this time, we contacted each of these individuals as well as the former chair of the state commission. We were able to talk with two of the three individuals and with the former chair of the state commission. All of the individuals we talked to indicated that they did not perform any campaign activities during this period.

## RECOMMENDATIONS

To ensure that it acts in the State's best interest by properly managing contracts and approving payments only for appropriate expenses, the state commission should take the following steps:

- Ensure that both it and its contractors comply with all contract terms.

- Fully develop its contracts by including important elements such as a clear description of the work to be performed and a reasonably detailed cost proposal.

- Consistently enforce contract provisions requiring contractors to submit supporting documentation for all claimed expenses and ensure that it adequately reviews all documentation before approving expenses for payment.

- Establish a process to ensure that it obtains and reviews final written subcontracts and conflict-of-interest certificates before it authorizes the use of subcontractors.

- Consistently enforce contract provisions requiring contractors to submit complete and detailed work plans for the state commission's review, and ensure that it receives all required work plans and promptly approves them.

To ensure that it protects the State's interests and receives the best products and services at the most competitive prices, the state commission should do the following:

- Follow the State's competitive bid process for all contracts it awards, unless it can provide reasonable and complete justification for not doing so. Further, it should plan its contracting activities to allow adequate time to use the competitive bid process.

- Fully justify the reasonableness of its contract costs when it receives fewer than three bids or when it chooses to follow a noncompetitive bid process.

- Advertise all nonexempted contracts in the state contracts register.

To ensure that it promotes fair and open competition when it awards contracts using a competitive bid process, the state commission should ensure that it fully documents its process for scoring proposals, and that it retains the documentation.

To ensure that it follows state policies that protect the State's interest when using interagency agreements and contracts with government agencies, the state commission should fully justify the use of subcontractors when required and, if it is unable to do so, deny the use of subcontractors.

## AGENCY COMMENTS

The state commission believes that the majority of our recommendations regarding Chapters 1 and 2 result from the state commission's lack of updated training programs and procedures for contracting. Further, the state commission states that it is deeply committed to making itself a model for state contracting practices, and has already begun to implement new policies and practices and improve staff training. ■

Blank page inserted for reproduction purposes only.

# INTRODUCTION

## BACKGROUND

In November 1998 voters passed Proposition 10, the California Children and Families Act of 1998 (Children and Families Act) to create an integrated, comprehensive, and collaborative system of information and services to enhance optimal early childhood development and to ensure that children are ready to start school.[1] The Act established the California Children and Families Program (Children and Families Program) to promote, support, and improve the early development of children, prenatal to age five. The Children and Families Program aims to fulfill this mission by developing standards, resources, and programs that emphasize community awareness, education, nurturing, child and heath care, social services, and research. To fund the Children and Families Program, the Act added a tax of 50 cents per pack on cigarettes and an equivalent tax on other tobacco products. It also created the California Children and Families Commission (state commission), also known as First 5 California, and allowed each county to create its own commission (county commission) to administer its programs. Counties may also create joint county commissions.

**The Children and Families Act requires the state commission to spend its 20 percent share of the Proposition 10 tax revenues as follows:**

- 6 percent for mass media communication to the general public.
- 5 percent to ensure that children are ready to enter school and for programs relating to education.
- 3 percent to ensure that children are ready to enter school and for programs relating to child care.
- 3 percent to ensure that children are ready to enter school and for research and development of best practices and standards for early childhood development programs and services.
- 1 percent for administrative costs.
- 2 percent for any activity other than administrative costs.

Source: California Health and Safety Code, Section 130105(d).

## THE STATE COMMISSION'S ROLE

Under the Children and Families Act, the state commission serves as lead agency, receiving 20 percent of the Proposition 10 tax revenues to provide technical assistance to the county commissions, conduct research and evaluations, manage public media campaigns, develop infrastructure, and administer statewide initiatives. The county commissions receive 80 percent of the Proposition 10 tax revenues to administer their programs. The state commission must spend its 20 percent share in accordance with requirements imposed by the Act (see the text box). In defining these responsibilities,

[1] Since its passage, the Children and Families Act has been amended. Thus, when we refer to the Act throughout this report, we are referring to the amended version.

the Act requires the state commission to adopt guidelines for an integrated and comprehensive statewide program that promotes, supports, and improves early childhood development. It also requires the state commission to define the results to be achieved by these adopted guidelines and to collect and analyze data measuring progress toward attaining those results.

The state commission comprises seven voting members: Three commissioners, including the chair, are appointed by the governor; two are appointed by the speaker of the Assembly; and two are appointed by the Senate Rules Committee. The secretary of Education and the secretary of Health and Human Services Agency or their designees serve as ex officio, nonvoting members. This audit focuses entirely on the state commission's spending practices and contracting procedures related to the 20 percent of Proposition 10 tax revenues that are directly under its administrative control.

## THE STATE COMMISSION'S GOALS AND RESOURCE ALLOCATION

According to its 2003–2006 strategic plan, the state commission fulfills its responsibilities under Proposition 10 by focusing on advancing its vision of school readiness through efforts that promote the following goals:

- **Early childhood learning and education:** Increase the quality and access to early learning and education for children age five and under.

- **Early childhood health:** Promote the prevention of, identification of, and intervention in health and developmental issues.

- **Parent and community education:** Promote the importance of quality early care and education for young children by providing information and tools to parents, caregivers, schools, and communities.

- **Tobacco cessation:** Contribute to the decrease in the use of tobacco products and other harmful substances by pregnant women, parents, and caregivers of young children.

- **Organizational effectiveness:** Ensure that programs and resources are used and managed in the most effective manner and in accordance with state laws and regulations.

The state commission conducts an annual planning process that consists of receiving input regarding its initiatives and future plans from individual commissioners, state commission staff, stakeholders, and county commissions. During this process, commissioners individually have the opportunity to focus the state commission's efforts on areas they are particularly interested in developing. For example, one commissioner's focus is on ensuring that projects address children with disabilities or special needs, while another commissioner's primary focus is on providing universal preschool.

The result of this planning process is an update to the state commission's strategic plan, with approval by the commissioners. The update presents the goals and objectives of the state commission and forecasts the financial resources that will be available for those purposes. The most recent strategic plan covers the period 2003–2006. The state commission completed the annual planning sessions to update its plan in 2004, 2005, and 2006.

Although Proposition 10 requires the state commission to allocate its resources for specific purposes, the state commission determines how the allocated money will be spent within each category. For example, for the 6 percent of its tax revenues deposited in the mass media communications account, the state commission decides which media campaign is consistent with the goals of the strategic plan and Proposition 10 and funds it accordingly.

During the last four years, the state commission has made school readiness its primary goal. To support this goal, it has allocated resources for a number of programs, including child care, children's health, training of care providers, and public awareness of school readiness issues.

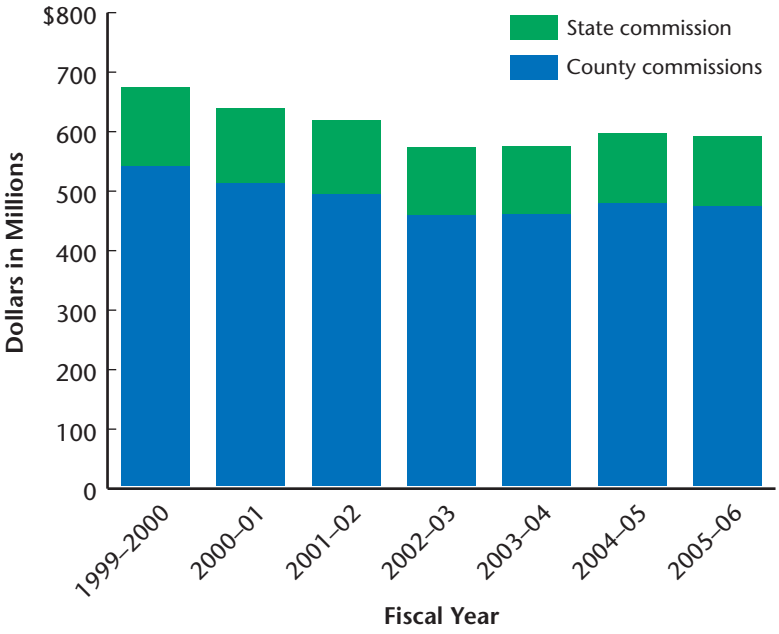
## THE CALIFORNIA CHILDREN AND FAMILIES TRUST FUND

The Children and Families Act created the California Children and Families Trust Fund (trust fund) as the repository for the tax revenues it receives. However, not all of this revenue is available to the programs supported by the state and county commissions. Because additional taxes may reduce tobacco consumption and thus the tax revenue generated, the Act requires the trust fund to reimburse other programs funded with cigarette taxes and established by prior legislation for their projected losses.

According to the state commission's 2004–05 annual report, the State Board of Equalization developed tobacco consumption models that compare actual tobacco consumption levels with levels projected to have occurred without the additional tax. Using these models, the trust fund pays the amounts generated by taxes imposed by the Children and Families Act to the predecessor programs. After this reimbursement, the remaining amount is available for the state commission and the county commissions' early childhood development programs. We refer to the remaining amount as Proposition 10 tax revenues. Figure 1 illustrates the Proposition 10 tax revenues for fiscal years 1999–2000 through 2005–06.

## FIGURE 1

**Proposition 10 Tax Revenues**




Sources: Generated from State Controller's Office accounting reports.

Note: Tax revenues available to state and county commmissions after preexisting programs funded by tobacco taxes are reimbursed for their projected losses.

## THE STATE CONTRACTING PROCESS

The State has established processes for departments to use when acquiring goods and services. Competition is typically at the core of these processes, which are designed to promote fairness, value, and the open disclosure of public purchasing. State law

and the policies of the Department of General Services (General Services)—the State's contracting and procurement oversight department—generally require departments to conduct a competitive bidding process that gives vendors an opportunity to submit price quotes or proposals for purchases of goods and services valued at $5,000 or more, with certain exceptions. California public policy strongly favors competitive bidding, and contracts established without competitive bidding are limited by either statute or state policy.

State law allows limited exceptions to the requirement that departments conduct competitive bidding on contracts. First, when the contracted good or service is needed because of an emergency—that is, when immediate acquisition is necessary for the protection of public health, welfare, or safety—the department can bypass competitive bidding. In addition, on certain occasions, a department may need to contract with a specific vendor whose goods or services are unique in some way. This type of contract is known as a noncompetitively bid (noncompetitive) contract. State policy describes the conditions under which this type of procurement is appropriate, as well as the circumstances that require the approval of General Services. The noncompetitive process requires departments to explain certain information, including the unique nature of the purchase and why it is limited to a certain contractor. They must also provide information that is in sufficient detail to justify the reasonableness of the contract's cost. To ensure compliance with competitive bidding requirements, state policy authorizes a noncompetitive contract only when the requesting department can adequately document that the circumstances of the contract meet one of the two previously described exceptions.

State law also requires General Services to prescribe the conditions under which a contract may be awarded without competition and the methods and criteria used to determine the reasonableness of contract costs. General Services is responsible for exercising its authority based on what it determines is in the "best interest" of the State.

In addition to these exceptions to competitive bidding, a department may enter into an agreement for services with another public entity, such as a state department, university, or local government, without following a competitive process as long as the public entity's employees perform the contracted services. State law clearly prohibits departments from using agreements with other public entities to circumvent competitive

bidding requirements, and state policy sets specific limits on the use of subcontractors and on the overhead charges allowed for each subcontract.

## STATE LAWS RELATED TO THE USE OF PUBLIC FUNDS AND RESOURCES FOR PARTISAN POLITICAL PURPOSES

Various additional laws govern the use of public funds. Public officials, such as commissioners or designated employees of the state commission, are generally prohibited from using public funds for campaign activities.[2] This, however, does not mean that public officials are completely prohibited from using public funds for various activities related to a proposed ballot measure. A public official may generally use such funds to undertake a variety of activities related to a proposal that has not yet qualified for the ballot. The official may use public funds to undertake studies about the value of the proposal, to draft proposed language for the ballot measure, or even to secure a proponent to carry the proposal forward as a ballot measure. A public official may not, however, use public funds to gather signatures to qualify a proposal for the ballot. Even after the proposal has qualified as a ballot measure, a public official may use public funds to provide the public with an impartial presentation of the facts related to the ballot measure or to provide the public with an analysis of how the ballot measure would affect the agency, but the public official must stop short of using public funds to undertake activities that constitute political advocacy—anything that urges the support or defeat of a ballot measure.

The Children and Families Act specifically authorizes the state commission to spend funds for communications to the general public using television, radio, newspapers, and other mass media on subjects related to and furthering the goals and purposes of the Act, including methods of nurturing and parenting that encourage proper childhood development; the informed selection of child care; information regarding health and social services; the prevention and cessation of tobacco, alcohol, and drug use by pregnant women; the detrimental effects of secondhand smoke on early childhood development; and children's readiness to enter school.

[2] The term "public funds" is not limited to money but includes anything of value belonging to a public agency, such as equipment; supplies; compensated staff time; and the use of telephones, computers, or fax machines.

Finally, state law requires each government agency to adopt a conflict-of-interest code approved by a code-reviewing body. The state commission's code-reviewing body is the Fair Political Practices Commission—the oversight body responsible for administering and implementing the Political Reform Act of 1974 (Political Reform Act). The Political Reform Act generally prohibits public officials at any level of state or local government from participating in government decisions that the public officials know or have reason to know will affect their economic interests. In March 2000 the state commission adopted and obtained approval of its conflict-of-interest code, including designating positions that must file statements of economic interests annually and upon assuming or leaving a designated position. The statement of economic interests filed by designated employees must be retained and available for public inspection.

## SCOPE AND METHODOLOGY

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits review the state commission's spending practices and contracting procedures. Specifically, the audit committee asked us to do the following:

- Review the state commission's planning efforts and determine how it sets goals and allocates resources.

- Review and evaluate its policies, procedures, practices, and internal controls for awarding contracts and expending funds received from Proposition 10 tobacco tax revenues and determine whether they comply with applicable laws, regulations, and best practices. This also includes a review of specific criteria used to award contracts and spend funds for advertising and those pertaining to competitive bidding and conflicts of interest.

- Determine whether the state commission's expenses and its recipients' use of funds are appropriate and within the limitations established by Proposition 10.

- Determine whether advertising firms paid by the state commission incurred costs solely for the purposes set out in their contracts.

- Assess the appropriateness of the state commission's expenditures of public funds for the preschool media campaign and for media contracts in fiscal years 1999–2000 through 2005–06 in relation to the state commission's objectives and applicable laws.

- Determine, if possible, whether the state commission and the Proposition 82 campaign or the campaigns for other ballot measures coordinated media purchases, and if the state commission expended other public funds for inappropriate political purposes.

We reviewed and evaluated relevant state laws, regulations, and policies and identified those that were applicable and significant to the audit.

To obtain an understanding of the state commission's planning efforts and process for setting goals and allocating resources, we interviewed state commission staff, reviewed the state commission's strategic plan, and reviewed the minutes of its annual planning sessions.

To assess the state commission's compliance with applicable laws, regulations, policies, and best practices for awarding contracts, we reviewed a sample of 45 contracts.[3] After selecting the original sample of 45 contracts, we selected an additional five memorandums of understanding to review for certain requirements. When we discuss contracts in this report, we are referring collectively to contracts, interagency agreements, contracts with other governmental entities, and memorandums of understanding, unless we specify otherwise. Our sample represented 97.6 percent of the total dollar amount awarded for fiscal years 1999–2000 through 2005–06. We assessed the state commission's compliance with state laws, regulations, and policies for advertising, competitive bidding, and obtaining required approvals. We also determined if the state commission included required language in its contracts and obtained certification forms signed by contractors acknowledging conflict-of-interest laws. Further, we assessed the reasonableness of its justifications for using a noncompetitive bid method when applicable. Finally, we reviewed the state commission's

[3] We were unable to confirm that the state commission's database from which we selected our sample included a complete universe of contracts. We identified 11 instances in which gaps in the sequence of contract numbers assigned occurred and staff either could not explain the reason for the gaps or suggested that the contracts may have been canceled; however, we could not verify their explanations.

conflict-of-interest policy for its commissioners and employees to determine if it met the requirements of state law, and we assessed its compliance with that policy.

To determine whether the state commission's expenditures were within the percentages allowed by Proposition 10, we verified the allocation of revenues to each of the six designated categories and confirmed that its spending was within the allocations.

To evaluate whether the state commission's expenditures were for allowable purposes, we reviewed a sample of 47 expenditures, which we selected in proportion to the total expenditures charged to each of the spending categories during fiscal years 2003–04 through 2005–06. As part of our review, we selected an additional 15 payments the state commission made between 2000 and 2005, most of which related to its public relations and media contracts. We evaluated whether the contractors' invoices were detailed enough for the state commission to determine whether activities performed complied with contract terms and whether costs incurred were solely for purposes outlined in their contracts. Finally, for the 62 sampled expenditures, including 28 related to its public relations and media contracts, we compared the descriptions of expenditures and supporting documentation to the state commission's objectives and assessed the appropriateness of those expenditures.

In reviewing the state commission's effectiveness in monitoring the use of funds to ensure that they are used only for allowable purposes, we interviewed state commission staff to understand its control processes and assessed its compliance with these processes in conjunction with the previously mentioned sample of payments.

To determine whether the state commission coordinated with the Proposition 82 campaign or campaigns for other measures in making its media purchases or other expenditures of public funds, we interviewed key management staff at the state commission, including the former chief deputy director, and reviewed relevant records. Also, we obtained documentation of selected ballot measure campaign expenditures and compared them to the timing and nature of expenditures made by the state commission to assess whether there was a coordinated effort. Additionally, we requested electronic e-mail files for

17 individuals.[4] Finally, to gain an understanding of the activities and services they either directed or provided, we sent registered letters to a former chair of the state commission and selected individuals paid through one of the state commission's media contracts and interviewed those who were able to talk with us prior to the publication of this report. ■

[4] Because of deficiencies the state commission identified with its information technology processes, it provided electronic records for only seven of the 17 individuals we requested. However, because the information technology deficiencies are outside the scope of this audit, we plan to issue a separate management letter to the state commission to ensure that it moves forward in taking corrective action.

# CHAPTER 1

## *Poor Management of Contracts Resulted in Questionable and Inappropriate Payments to Contractors*

### CHAPTER SUMMARY

The California Children and Families Commission (state commission) paid invoices submitted by one of its media contractors totaling $673,000 between February 2002 and December 2003 for fees and expenses of some of the contractor's employees, thus allowing the contractor to circumvent the payment provisions of the contract. The contract contained a payment provision that allowed only commission payments to be made to the contractor based on the cost of the advertising it placed. By ignoring this provision, the state commission paid for services it had not contracted for, effectively preventing these funds from being used to further the other activities that were allowable under the terms of the contract.

Additionally, the state commission did not always include important elements when developing some of the contracts we reviewed. Consequently, it could not ensure that the resulting contracts clearly established what it expected from the contractor and provided the best value. Further, the state commission did not always ensure that its contractors submitted work plans that included all the required elements, that it obtained all the required work plans, and that it promptly approved the work plans.

Further, the state commission could not always demonstrate that it had reviewed and approved the final written subcontracts and subcontractors' conflict-of-interest certificates, as required by contract language.

Moreover, although prudent business practices and some of the state commission's contracts include provisions that require its contractors to include the documentation necessary to

support the expenses claimed, our review found that the state commission did not always adhere to these practices or enforce contract provisions. Although the state commission generally received documentation to support expenses for our sample of 62 payments it made to its contractors, we found both significant and minor instances in which this was not the case.

Finally, the state commission prepares a strategic plan, which outlines the current progress of its initiatives and its future plans to advance its vision of school readiness. Its plans for the next four years, as described in the last approved strategic plan, are aligned with the goals and objectives of Proposition 10 and are updated annually.[5] However, although its annual strategic planning process occurred in 2005 and 2006, the state commission did not present the resulting updated plans to the commissioners for their approval, nor were draft revisions of the plan made available to others.

## THE STATE COMMISSION DID NOT ENFORCE CONTRACT TERMS FOR ONE CONTRACTOR, RESULTING IN OVERPAYMENTS TOTALING MORE THAN $673,000

*Payments totaling $673,000 violated the terms of the state commission's contract with one of its media contractors.*

The state commission, in paying invoices totaling $623,000 in fees and expenses submitted by one of its media contractors, allowed the contractor to circumvent the payment provisions of a contract. The contractor claimed the expenses by representing some of its employees as subcontractors. In addition, the state commission paid the media contractor an added $50,000 fee that was unallowable per the contract. These payments violated the terms of the contract, which allowed for payments based only on the contractor's own services, in the form of commissions applied to the cost of the advertising it placed; no other services or fees were to be charged.

The state commission entered into a contract in 2001 with a media contractor for $90 million to oversee a statewide advertising campaign. The terms of the contract required the contractor to manage all of its employees, its subcontractors, and any vendors, as well as to manage the creative development, production, and media placement of the advertisements. The contract further required the contractor to submit detailed work plans with descriptions of the services and deliverables and specified that the contractor was not authorized to

[5] Proposition 10 is the California Children and Families Act of 1998, which established the California Children and Families Program to promote, support, and improve the early development of children, prenatal to age five.

provide services until the state commission's contract manager approved the work plans. More specifically, the contractor had no authority to begin production of any media advertisement without the state commission's prior approval of the print copy.

The contract also contained various provisions related to what the contractor could charge the state commission. It stated that the contractor could charge the actual out-of-pocket expenses for the costs of the various materials used in the production and development of the advertisements, with no markup. The contract did allow the contractor to charge an 11 percent markup on the cost of purchasing printed ad space or broadcast media time, on either television or radio, but it prohibited the billing of any services or fees. Thus, any costs the contractor might incur by using its employees to develop, produce, and place the advertisements were to be borne by the contractor, and the 11 percent markup on the purchase of ad space and media broadcast time was intended to be the contractor's sole means of covering such costs and generating a profit. Finally, the contract allowed the contractor to subcontract for certain services, but these subcontracts had to have the state commission's prior approval, and the contractor could charge the state commission only for the actual cost of the subcontract.

Rather than enforce the contract's terms, the state commission approved and paid its media contractor more than $623,000 for the salaries, benefits, out-of-pocket expenses for other than material costs, and administrative fees of three individuals employed by the media contractor between February 2002 and December 2003. The invoices the contractor submitted for these three individuals indicated that they were subcontractors when, in fact, they were not. Furthermore, the state commission neither received nor approved the subcontracts for these individuals in advance, as called for in the contract. In fact, correspondence we obtained between the contractor and the state commission clearly indicated that the state commission was aware that these three individuals were employees of the media contractor rather than subcontractors. The provisions of the contract did not allow the contractor to charge the state commission directly for the services of its employees. Thus, by approving these payments, the state commission allowed the media contractor to circumvent the payment provisions of the contract.

***Correspondence we obtained clearly indicated the state commission was aware that three individuals represented to be subcontractors were in fact employees of the media contractor.***

Further, the contractor did not submit work plans that detailed what these three employees would do, nor, when asked, did the contractor provide us with detailed documents

supporting the services they provided. When we asked the state commission's executive director to provide us a written description of the services they performed, she was unable to do so. The executive director explained that, to the extent these three individuals worked directly with the state commission, they worked primarily with commissioners and staff who are no longer with the state commission, making it impossible to provide us with an accurate description of their services. However, we found some evidence suggesting that on a few occasions these three contractor employees performed various activities related to the Improving Classroom Education Act—better known as the California Teacher's Association (CTA) Reiner Initiative. Although these kinds of activities were permissible using public funds, as we discuss in greater detail in Chapter 3, these types of payments were not allowable under the terms of the contract.

Additionally, correspondence we obtained from the state commission between the media contractor and one of these employees indicated that the contractor had concerns about whether these types of charges were appropriate under the terms of the media contract. An e-mail from the media contractor's senior vice president to one of these three individuals, a copy of which was sent to the state commission's former chief deputy director, stated that "running your expenses through our contract is a favor [the media contractor] is doing for [the former chair of the state commission]." In this same e-mail the senior vice president acknowledged that "we are accepting liability for every one of your expenses, many of which are very clearly outside the terms of our agreement with the State."

***In another instance of the state commission making an unallowable payment under its media contract, it paid its contractor $50,000 to develop a Preschool for All Advocacy Plan.***

Further, in July 2003 the state commission paid its media contractor a $50,000 fee to develop a Preschool for All Advocacy Plan (advocacy plan). This is another instance of the state commission making a payment that was unallowable under the contract provisions. When we asked for a copy of the advocacy plan, the state commission provided us a draft document, explaining that, although it never received a final version, it believed the contractor completed all tasks that were required of it. Nonetheless, not only did the state commission inappropriately pay the media contractor a $50,000 fee for the services of its employees to prepare this plan, it also failed to obtain the final product.

Because the state commission approved and paid contractor invoices that violated contract terms, it overpaid the contractor by more than $673,000 and failed to protect the State's interest. Additionally, by making these payments, the state commission and its contractor effectively prevented that money from being used for the legitimate activities allowed by the contract, namely purchasing printed ad space or broadcast media time.

## THE STATE COMMISSION DID NOT FULLY USE THE TOOLS AVAILABLE TO IT TO ENSURE THAT ITS CONTRACTORS PROMPTLY PROVIDED APPROPRIATE SERVICES

The state commission did not always include certain important elements when developing some of the contracts we reviewed and thus did not clearly establish what was expected from the contractor. Additionally, although it required its public relations and media contractors to submit work plans that contained detailed budgets, descriptions of services or deliverables, and established timelines to measure progress and completion of work, it did not always ensure that the work plans submitted included all the required elements, that it obtained all the required work plans, or that it promptly approved the work plans.

### The State Commission Did Not Adequately Develop Some Contracts

Our review of 45 contracts found that the state commission did not always include the following important elements:

- A clear description of work to be performed.
- Schedules for the progress and completion of the work.
- A reasonably detailed cost proposal.

*The state commission awarded two contracts that did not include a detailed description of the work to be performed.*

We reviewed four contracts that the state commission awarded for media communications, two of which it awarded in 2000. These earlier contracts did not include a detailed description of the work to be performed, an element essential to a well-developed contract. The two contracts simply directed the contractor to develop an advertising campaign aimed at ensuring that children under the age of five live in a safe, nurturing, and stimulating environment while increasing the state commission's credibility among Californians. Such vague descriptions of the scope of work contained in these contracts puts the State at risk of not receiving the services it intended to receive.

*The state commission entered into two contracts valued at almost $8.7 million and four interagency agreements totaling $5 million that did not contain schedules for the progress and completion of work.*

Further, the state commission did not develop or include a schedule for the progress or completion of the work for another two of its contracts and for four interagency agreements. It entered into the two contracts in May 2003 and March 2004 for services totaling almost $1.7 million and $7 million, respectively, and it entered into the four interagency agreements between October 2000 and October 2003 for services totaling $5 million. Neither the contracts nor the interagency agreements contained schedules for the progress and completion of work. Without a progress schedule or an expected completion date, the state commission had insufficient means with which to monitor its contractors to ensure that they were on track and would be able to provide the services or products when needed.

Additionally, the state commission did not ensure that four interagency agreements (three that were discussed previously and one other) included reasonably detailed cost proposals. In July 2003 the state commission entered into an agreement with another state agency to procure and administer media and public relations services for the state commission for a maximum amount of $1 million. However, the interagency agreement did not contain a detailed cost proposal showing how the $1 million would be used. The state commission also entered into two other interagency agreements with the same contractor—the first in October 2000 in which the contractor agreed to design, create, assess for appropriateness with a focus group, and produce a parent guide in both English and Spanish, and the second in October 2003 to revise, update, adapt, and produce a parent guide in three Asian languages. The contractor also agreed to be responsible for the printing, storage, and shipping of 620,000 copies of these guides for both agreements. We expected that, for each of these two interagency agreements, we would see a detailed budget that outlined the amount the contractor would spend in categories such as personnel, translation services, travel, and expert reviews. Instead, the budgets in these two agreements simply stated the total cost of $1.5 million for the first agreement and just over $1 million for the second and the total number of copies, as well as a cost per copy. According to program staff, the state commission had internal discussions about whether to require a detailed budget for the agreement entered into in October 2003 but decided against it because it was a product purchase similar to purchasing a book from a publisher. Although we agree that the state commission was purchasing a specified number of copies of the parent guide, it also purchased development in the form of revisions prompted in part by the focus group

assessment, updates, and adaptations to multiple languages. Because this was more than just a product purchase, we would have expected a detailed breakdown of the costs in both of these agreements. Finally, the state commission entered into a fourth interagency agreement in January 2004 for services totaling $3 million requiring its contractor to develop, implement, administer, and evaluate an insurance-based oral health initiative. However, although the cost proposal included categories for personal services and operating expenses and equipment, it did not provide a breakdown of these categories, such as what types of items within the operating expenses and equipment categories the contractor was seeking reimbursement for.

In another example of an insufficiently developed contract, the state commission entered into a contract in June 2002 that contained a fairly detailed cost proposal to support the award of almost $23 million, but it left out one critical element. Although the cost proposal indicated that the contractor planned to apply a rate to labor costs for benefits and overhead, it did not disclose the amount of the rate to be charged. By not ensuring that interagency agreements and contracts contain reasonably detailed cost proposals, the state commission cannot ensure that it is containing costs within reasonable limits.

***For over half of the 45 contracts we reviewed (56 percent), the state commission did not include contract provisions requiring its contractors to provide documentation to support the expenses claimed.***

Additionally, some of the contracts contain language that requires documentation for all expenses claimed, while others do not. We believe that it is reasonable to expect all contracts to contain this language to facilitate an adequate review of the contractor's invoices before approving payment. We would also expect the contracts to describe the types of items that constitute allowable out-of-pocket expenses, for instance, travel and subsistence, communication, materials, and supplies, so that both the contractor and the contract manager are clear as to what is allowable under this category. For 25 of the 45 contracts we reviewed (56 percent), the state commission did not include contract provisions requiring its contractors to provide documentation sufficient to support the expenses claimed. All but two of these contracts were interagency agreements. When we asked why it did not always require this language, the state commission told us that it used standard forms created by the Department of General Services, which did not contain this language. However, the state commission also indicated that it plans to incorporate this provision in the standard contract terms it writes and will provide directions to its staff on this provision in its contracting manual, both of which are currently under development.

In addition, although cost proposals included in five of its most recent contracts with its media and public relations firms contained a line item for out-of-pocket expenses, the contracts did not define the types of expenses that would be reimbursable under this category. This led to some questionable items being charged. For example, several of the invoices billed under these contracts included out-of-pocket expenses for items such as laptop computers totaling $10,000, as well as the costs of catering and monthly parking fees for consultants. None of these charges were defined by the contracts as allowable expenses. Similarly, although one of the public relations contracts established a limit of $50,000 per year for a line item called account administration, it did not define what could be charged to that item. The state commission stated that it communicated with its contractors when issues arose regarding out-of-pocket expenses. The state commission provided one example of such communication. However, we still believe that without consistent, clear written definitions as to the types of charges that are allowable, the state commission's ability to monitor and control contract costs is limited.

### The State Commission Did Not Consistently Take Advantage of the Use of Work Plans

The state commission did not always ensure that its contractors submitted work plans that included all the required elements. Additionally, it approved some work plans late or could not demonstrate that it had ever approved them, and in other instances it was unable to provide them at all.

**The state commission's contracts with its public relations and media firms require a work plan to include the following:**

- A detailed description of the services and deliverables to be provided during completion of the work plan.
- Whether any service or deliverable will be provided by a subcontractor.
- The target audience to which the service or deliverable is directed.
- A timeline for the completion of the service or deliverable.
- A detailed work plan budget estimate, consistent with the contractor's cost proposal, including any markups or commission to be charged.
- An estimate of any ongoing talent costs or expenses necessary to maintain the deliverable and preserve its availability for use.

According to the terms for its public relations and media contracts, work plans approved by the state commission's contract managers are incorporated and made part of the contract. Generally, the contract requires each work plan to include the information found in the text box.

The state commission's contracts with its public relations and media contractors provide a broad description of services in the scope of work section. For example, in one contract with a public relations contractor, the scope of work includes a statement that the contractor is responsible for overseeing a statewide public relations campaign targeting the general public

and diverse communities, but it does not provide the details of how this is to be accomplished. Instead, the contract requires one or more work plans during the course of the contract that provide the detail of the services and deliverables. Because the scope of the work is so broad, it is vitally important that the contractor prepare these work plans and that the state commission review and approve them so that it can monitor the cost, appropriateness, and timeliness of services.

We compared a sample of 28 invoices from public relations and media contractors to the relevant work plans and evaluated whether the work plans contained all of the required elements. However, the state commission was unable to provide eight of the work plans associated with these invoices. Table 1 summarizes the missing plans or elements in the work plans related to the 28 invoices from its public relations and media contractors.

**TABLE 1**

**Public Relations and Media Contractors' Work Plans That Did Not Comply With Contract Specifications**

| | Public Relations Contract | | | Media Contract | | | |
|---|---|---|---|---|---|---|---|
| Missing Work Plan Element | #1 | #2 | #3 | #1 | #2 | #3 | #4 |
| A detailed description of the services and deliverables | | | | | | | 1 |
| The target audience served | | | | | | 1 | 2 |
| A detailed work plan budget consistent with the contractor's cost proposal, including any markups or commission to be charged | 1 | 6 | 2 | | | | 2 |
| A work plan | 1 | 2 | 1 | 1 | 3 | | |

Sources: Contract files at the California Children and Families Commission (state commission)–A sample of 22 work plans prepared by the state commission's current public relations and media contractors during the period October 1999 through October 2005.

Note: Numbers represent the number of work plans for each contract with the identified deficiency. A work plan could have one or more missing elements.

When the state commission does not ensure that contractors submit detailed work plans that include all of the required elements outlined in the contract, it cannot ensure that the services and deliverables provided are consistent with its goals and objectives.

Further, we found problems with the approvals for the work plans associated with some of the invoices in our sample. For example, the state commission approved and paid nine

invoices for services totaling more than $28 million under nine different work plans that showed approvals dated after the contractor had completed some or all of the work. In fact, the state commission approved one work plan in October 2002 for services the contractor had provided during July 2002, and it approved a second work plan in January 2004 for services the contractor had provided during the quarter ending December 2003. Additionally, although the state commission approved and paid 10 invoices for services totaling $5 million, it did not date the associated work plans, making it impossible to determine whether it had approved them promptly. Three work plans we reviewed did not contain any evidence that they had ever been approved. In addition, as we mentioned earlier, the state commission was unable to locate approved work plans for eight invoices totaling more than $2.8 million. When the state commission does not approve the required contractor work plans in advance or fails to obtain or approve work plans, it limits its ability to direct and monitor its contractors' performance and budgets to ensure that it receives the services and deliverables expected within established budgets.

***The state commission was unable to locate approved work plans for eight invoices totaling more than $2.8 million.***

## THE STATE COMMISSION DID NOT DOCUMENT ITS OVERSIGHT OF SUBCONTRACTOR AGREEMENTS AND CONFLICT-OF-INTEREST CERTIFICATES

The state commission could not demonstrate that it had reviewed and approved the final written subcontracts and subcontractors' conflict-of-interest certificates as required. Typically, its contracts include language stating, "The [state commission's] contract manager's acceptance of the subcontractor shall be contingent upon the review and approval of the final written subcontract and the subcontractor's conflict-of-interest certificate." The conflict-of-interest compliance certificate is a form required of both the contractor and subcontractor acknowledging their willingness to comply with the State's conflict-of-interest rules.

Our review of a sample of nine contracts and 28 invoices associated with those contracts found that under each contract, the contractors charged for services provided by at least one and sometimes as many as six subcontractors. When we requested these subcontracts and conflict-of-interest certificates, the state commission had to forward our request to its contractors because it did not maintain copies of these documents in its files. Ultimately, it was able to obtain 19 of a total of 22 requested subcontract agreements. Furthermore,

*We question whether the state commission reviewed and approved final written subcontracts and subcontractors' conflict-of-interest certificates.*

the state commission was able to obtain either the conflict-of-interest certificate or the conflict-of-interest language embedded within the subcontract for 14 of the 19 subcontracts it obtained. However, it was unable to locate the remaining five certificates. Because the state commission did not maintain these documents in its files, we question whether it reviewed and approved these documents as required before authorizing the use of subcontractors.

Moreover, although the state commission obtained copies of most of the subcontracts from its contractors, the three it was unable to provide, along with their conflict-of-interest certificates, were all associated with its current media contractor. As we described in an earlier section, during the period between February 2002 and early December 2003, the state commission inappropriately paid $623,000 for the services and expenses of three of its media contractor's employees in violation of contract terms. During that time, the contractor billed these employees as subcontractors. During a later time period—May 2004 through mid-April 2005—when the media contractor no longer employed these three individuals, it continued to bill for these same three subcontractors, and the state commission paid the contractor $191,000 for their services under its media contract. Although paying these individuals as subcontractors under its media contract was allowable in certain circumstances under the contract's terms, the contractor's inability to provide the subcontracts and conflict-of-interest certificates related to these individuals as subcontractors raises questions as to whether the state commission ever approved and reviewed these documents or whether these documents even existed.

According to our review of its policies and procedures and discussions with management, the state commission does not have a specific procedure to ensure that contract managers review subcontracts and conflict-of-interest certificates before authorizing contractors to use a subcontractor. Thus, when it does not obtain subcontracts and certificates, it cannot ensure that it protects the State's interests, nor can it identify potential conflicts of interest.

Subcontractors may also be unaware of their obligation to preserve records that could be the subject of future audits. The state contracting manual requires contractors to include a provision in any subcontract indicating that the State has the right to audit records and interview staff in any subcontract related to the performance of the agreement. Our review of 19 subcontractor agreements found that five did not contain this language.

## THE STATE COMMISSION SOMETIMES PAID UNSUPPORTED AND INAPPROPRIATE CONTRACTOR EXPENSES

Although prudent business practices and some of its contracts include provisions requiring its contractors to include documentation necessary to support the expenses claimed, our review found that the state commission did not always enforce these provisions. Although generally, the state commission received documentation to support the expenses claimed in our sample of 62 payments made to its contractors, we found both significant and minor instances in which this was not the case. Even when contractors included supporting documentation, the state commission did not always adequately review it before approving payment. Further, the state commission inappropriately advanced funds to contractors.

### The State Commission Did Not Always Require Contractors to Submit Complete Invoice Documentation

The state commission did not consistently ensure that its contractors submitted supporting documentation of the propriety of expenses claimed for reimbursement even though, in many cases, the contracts contained language requiring contractors to do so. Following are some of the more significant deficiencies relating to five contracts, each of which included language requiring supporting documentation for expenses.

*One invoice totaling $3.1 million under a contract with a broadcasting station did not contain documentation to support any of the charges.*

- One invoice dated April 2005 for $3.1 million under a contract with a public broadcasting station did not contain documentation to support any of the charges, which were for personnel costs, legal services, Web site costs, promotional materials, and other purposes.

- Four invoices—two from August and December 2004 and two from October and December 2005—totaling $2.3 million did not contain documentation to support $325,000 in charges from one contractor who, between June 2002 and February 2006, provided the state commission with research and evaluation activities related to the effects of Proposition 10 on California's children. These invoices included charges for labor, travel and subsistence, and materials and supplies. The state commission indicated that it had several processes in place to monitor these invoices including monthly progress reports and weekly conferences with the contractor. However, these do not take the place of supporting documentation for expenses as required by the contract.

- One $272,000 invoice dated October 2005 from a contractor that provides services related to the state commission's First 5 Oral Health Education and Training Project did not contain documentation to support charges totaling $190,283 identified as travel, equipment, supplies, and subcontractors' costs, among others.

- One invoice dated April 2004 for $276,000 related to a contract with a community college district did not provide documentation to support operating expenses totaling $73,805.

- One $600,000 invoice dated October 2005 related to a contract with a county office of education did not contain documentation to support any of the charges and, instead, indicated that all supporting documentation would be on file with the office of education. According to the state commission, the contract manager, a former employee, visited the contractor's office and reviewed the back-up documentation retained by the contractor to verify the charges related to this invoice. Ultimately, the contract manager approved the invoice. However, we do not believe that sending an employee to its contractor's office to review supporting documentation is the most efficient use of an employee's time.

Further, although its current media contractor usually submitted documentation to support charges for the invoices we reviewed, we found certain charges without support even though the contract required it. For example, when we reviewed one invoice for the services of three individuals identified as subcontractors, we found no documentation associated with the invoice, work plan, or contract that identified what services these subcontractors were providing, so we reviewed additional invoices claiming reimbursement for these subcontracting costs. In total, the state commission paid eight invoices between May 2004 and mid-April 2005 that included $191,000 in charges for these three subcontractors, but the contractor never provided any type of documentation explaining what services these three individuals performed and why the services were allowable and appropriate under this contract. Another unrelated invoice from the same media contractor claimed $40,000 for additional casting and overtime for commercials but contained no documentation demonstrating that these additional charges were necessary or that the state contract manager had approved them.

***The state commission paid $191,000 to its media contractor for three subcontractors, but failed to provide any documentation that identified what services these subcontractors were providing.***

Moreover, our review of 14 invoices submitted to the state commission between April 2000 and March 2006 by its current public relations contractor under three different contracts found that, although the contractor generally submitted documentation to support most of the charges included in its invoices, when documentation was missing it involved the earlier years. Typically, in those earlier invoices we found that documentation was missing for charges such as telephone, Internet, copies, and faxes, even though the contract required such documentation. When we reviewed more recent invoices—those occurring in late 2005 and 2006—we did not have the same concern. We believe that this problem will no longer occur because, according to the most recent contract with its public relations contractor, the state commission no longer allows the contractor to charge it directly for such items as faxes and telephone—these charges are now covered by a surcharge.

Finally, our review of three invoices dated November 2003 and May and August 2005 totaling $1.5 million under three interagency agreements—one with a state agency and two with universities—found that the contractors did not provide documentation to support most of their charges. While the provisions of these interagency agreements do not contain a specific requirement for these contractors to submit documentation to support their charges, prudent business practices call for, and we believe it is reasonable to expect, the state commission to ensure that its payments are for appropriate purposes.

***The state commission approved and paid four invoices where the contractor had inappropriately applied a markup to its nonlabor costs totaling about $129,000.***

In addition to deficient documentation, the state commission approved and paid four invoices dated between August 2004 and December 2005 in which the contractor had inappropriately applied a markup totaling about $129,000 to all nonlabor expenses, which included items such as the cost of subcontractors, materials and supplies, report production, and shipping and receiving. Although the contract contained language allowing the contractor to apply a markup to labor categories, it did not contain language allowing it to apply a markup to its nonlabor costs. This contractor applied markups ranging from 8 percent to as high as 87 percent, for an average markup of about 12 percent. According to the contractor, it based these percentages on an agreement it negotiated with the federal Defense Contract Management Agency.

We discovered the markup when we reviewed these invoices and were unable to reconcile the supporting documents with the amounts claimed. When we asked the state commission to explain the differences, it was unable to do so and called the contractor, which then prepared a reconciliation schedule that clearly identified both the costs and the markup. Thus, we question whether the state commission appropriately reviewed these invoices before paying them, especially in light of the fact that the markup allowed by the contract applied only to labor costs and, according to the contractor, its basis for the markup percentages applied was a federal agreement, not a basis for markup approved by the state commission.

When the state commission does not enforce provisions requiring its contractors to submit supporting documentation for expenses, it cannot ensure that it pays only for appropriate and allowable expenses. It may also approve and pay for inappropriate expenses when it does not perform adequate reviews of the supporting documentation it does receive.

### The State Commission Inappropriately Advanced Funds to Three Contractors

The state commission provided advance payments to three contractors even though it does not have the authority to do so. According to the state contracting manual, the State is permitted to make advance payments only when specifically authorized by statute, and such payments are to be made only when necessary. In addition, state laws are designed to ensure that public money is invested in and accounted for in the state treasury. Further, other state laws prohibit making a payment until services have been provided under a contract.

***Without legal authority the state commission inappropriately advanced $2.5 million to a public relations contractor, which then took between 30 days and six months to disburse the funds to selected community-based organizations.***

However, one of the invoices we reviewed dated December 2003 was for an advance of $2.5 million to a public relations contractor for the administration of the state commission's regional community-based organization program. The public relations contractor then disbursed the funds to the selected community-based organizations. Although the state commission disagrees that these funds were an advance, the public relations contractor did not disburse $2.1 million of the funds (84 percent) until more than 30 days after it received the payment. Further, it disbursed more than $1.1 million to the grantees more than 90 days and as much as six months after the State disbursed the funds to the public relations contractor. Our review of 13 other invoices from the same public relations

contractor showed that the state commission advanced it funds for the regional community-based organization program totaling $6.8 million on three other occasions—invoices dated July 2003, February 2004, and September 2004.

Even though the state commission's contract requires the contractor to administer the regional community-based organization program, the state commission could distribute the funds to the contractor after the contractor verified receipt of services from the grantees. Specifically, we would expect the state commission to require the contractor to review grantee invoices and confirm services before requesting funds from the state commission for payment to the grantees. This would allow the state commission to eliminate advance payments that it is not authorized to make as well as earn interest on the funds until they are disbursed.

We also found that the state commission made advance payments in December 2005 and March 2006 to two county commissions totaling more than $91,500 under memorandums of understanding. We discuss these types of contracts further in Chapter 2. When the state commission makes advance payments without the proper authority, it loses the interest it would otherwise earn on these public funds.

## ALTHOUGH IT HELD STRATEGIC PLANNING SESSIONS ANNUALLY, THE STATE COMMISSION HAS NOT UPDATED ITS WRITTEN STRATEGIC PLAN SINCE 2004

The state commission also poorly managed its process for updating its strategic plan, which outlines the current progress of its initiatives and future plans to advance its vision of school readiness. The state commission has a planning horizon that covers four years, as explained in the last updated strategic plan, and its plan is to align with the California Children and Families Act. According to the last version of the strategic plan, covering 2003 through 2006, it is the product of planning sessions, staff meetings, employee surveys, budget exercises, and extensive analysis. The state commission also receives input from stakeholders at its public meetings and discussions at planning retreats with the commissioners. As stated in the plan, such work focuses on "gaining a clear understanding of past and current strategies, as well as developing recommendations as to which strategies should be continued and which new initiatives should be developed." According to the executive director, the state commission annually either develops a draft plan or updates

the prior year's plan using all this input, and presents it to the commissioners for their review and approval. However, it last updated its strategic plan in 2004. According to the executive director, although the strategic plan was presented and discussed with the commissioners in January 2004 and January 2005, the state commission did not request their formal approval.

*According to the executive director, although the strategic plan was presented and discussed with the commissioners in January 2004 and January 2005, the state commission did not present the updated plan to the commissioners for approval.*

Interviews with the executive director revealed that although the planning process occurred in 2005 and 2006, the state commission did not present the updated plans to the commissioners for approval. When we asked about the outdated plans, the executive director initially explained that the draft revisions were not available in either paper or electronic form because staff were unable to locate the updates in a former employee's electronic files. While determining why the strategic plan had not been updated, the executive director uncovered a number of problems in the information technology operations of the state commission, which the state commission has begun taking steps to resolve. Subsequently, in October 2006, the executive director provided us with a paper copy of the revisions for the 2005 plan. Further, the executive director also told us that the state commission is taking steps to formally update its plans. Also in October 2006, the executive director provided us with a draft copy of a commission proceedings manual. The manual includes an annual commission calendar that lists recurring issues the commissioners are required to consider, such as adopting the strategic plan. The executive director hopes to begin using the manual in January 2007 if the commissioners adopt it. Without a formally updated and approved strategic plan, the state commission cannot be sure that its current vision and direction are clear to staff, partners, and the public. Also, without a final plan the state commission cannot ensure that it is providing clear and appropriate guidance in planning and developing its operations and in measuring progress toward its stated goals.

## RECOMMENDATIONS

To ensure that it acts in the State's best interest by properly managing contracts and approving payments only for appropriate expenses, the state commission should take the following steps:

- Ensure that both it and its contractors comply with all contract terms.

- Fully develop its contracts by including clear descriptions of work, schedules for progress and completion of work, reasonably detailed cost proposals, a requirement for adequate supporting documentation for expenses, and clearly defined types of allowable expenses.

- Consistently enforce contract provisions requiring contractors to submit complete and detailed work plans before they perform services and incur expenses. Also, ensure that it promptly reviews and approves the work plans.

- Establish a process to ensure that it obtains and reviews final written subcontracts and conflict-of-interest certificates before it authorizes the use of subcontractors. Additionally, it should ensure that its contractors include in all their subcontracts a provision indicating that the State has the right to audit records and interview staff in any subcontract related to the performance of the agreement.

- Consistently enforce contract provisions requiring contractors to submit supporting documentation for expenses claimed. Further, it should ensure that it performs an adequate review of such documentation before approving expenses for payment.

- Ensure that it does not make advance payments to its contractors unless it has authority to do so.

Finally, the state commission should ensure that it updates its strategic plan annually and presents it to the commissioners for review and approval. ■

# CHAPTER 2

## *The State Commission's Inconsistent Contracting Practices Led to Violations of State Law and Policies*

### CHAPTER SUMMARY

The California Children and Families Commission (state commission) did not always follow state policies during its process of competitively awarding contracts. For instance, it did not fully justify its reasons for awarding three contracts, totaling more than $47.7 million, when it received fewer than the minimum required number of three bids. It also did not consistently document its scoring of proposals received from potential contractors and was unable to demonstrate that it had advertised one contract, totaling $90 million, in the California State Contracts Register (state contracts register) as required by state policy.

Moreover, when awarding some of its contracts and amendments using the State's noncompetitively bid (noncompetitive) contract process, the state commission did not provide reasonable and complete justifications for using the process itself or for the costs of the contracts awarded. In fact, for two of the five noncompetitive contracts we reviewed, as well as for six of the eight amendments to the contracts originally awarded using either a competitive or noncompetitive process, we found insufficient or questionable justifications.

Further, the state commission did not always ensure that its interagency agreements and contracts with other governmental agencies met the requirements for using subcontractors. These agreements regularly allowed for payment of administrative overhead fees at amounts higher than state policy allows. As a result, the state commission approved budgets for roughly $1.2 million more in overhead fees than it should have.

In addition, our review of all five of its memorandums of understanding with counties found that the state commission appears to have used some of these agreements to avoid having to comply with state contracting requirements. For two of these memorandums, this intention was explicitly expressed.

According to state law, all contracts entered into by state agencies, unless specifically exempted, are not in effect until approved by the Department of General Services (General Services). The state commission failed to obtain the required approvals for 43 of the 45 contracts we reviewed before the beginning of the contact term. Similarly, it did not obtain the required approvals for 22 of the 44 amendments we reviewed until after the related contracts or prior amendments had ended. Although we did not review all 45 contracts for work beginning before approval, we noted three instances in which the contractors provided services totaling more than $7 million before the state commission obtained final approval of the contracts. The state commission also failed to obtain the required approvals on three amendments altogether.

Finally, the commissioners may have improperly delegated authority to award contracts to the state commission's executive director and staff. The commissioners approved the funding for projects or contracts but were generally not involved in the selection of contractors or in reviewing and approving contracts. Consequently, many of the contracts were approved outside of an open meeting where the public would have had an opportunity to be fully informed about contractual obligations, making the legal status of the contracts uncertain.

## THE STATE COMMISSION DID NOT ALWAYS FOLLOW STATE REQUIREMENTS WHEN AWARDING COMPETITIVE CONTRACTS

The state commission received fewer than the minimum required number of bids to award three of the nine competitively bid contracts we reviewed, totaling more than $47.7 million. However, it did not fully justify its reasons for awarding these three contracts in spite of the lack of bids. It also did not consistently document its scoring of proposals received from potential contractors, and it was unable to demonstrate that it had advertised a $90 million contract in the state contracts register as required by state policy.

### Some of the State Commission's Justifications for Awarding Competitively Bid Contracts That Received Less Than Three Bids Were Inadequate

The state commission's contract files did not always contain complete explanations and justifications for awarding contracts when it received fewer than three competitive bids. State

law requires at least three competitive bids except in certain circumstances, including when the agency has advertised in the state contracts register and has solicited all potential contractors it knows, or when the contract is with another state agency, local governmental entity, or an auxiliary organization of the California State University or a California community college. The state contracting manual (contracting manual) requires the agency to provide a justification of the reasonableness of the price when there are fewer than three bids and to retain this information in its contract files. Although General Services approved the contracts, it is ultimately the state commission's responsibility to ensure that it provides appropriate justification and to retain the documentation.

***The state commission failed to fully justify the reasonableness of the amounts it awarded for three contracts, totaling more than $47.7 million.***

For three of the nine competitively bid contracts we reviewed, the state commission did not receive three responses, and it failed to fully justify the reasonableness of the amounts it awarded for the three contracts, totaling more than $47.7 million. The state commission indicated that it believed the contract amounts were reasonable because they did not exceed the amounts initially authorized by the commissioners. For example, for the largest contract, which was approved in July 2001, the commissioners set the maximum amount at $36 million, which ultimately was the amount awarded. However, it is not surprising that the bids would be at or below the maximum allowed, which was set in a public meeting and likely known by all interested parties, including bidders. In two other instances, the state commission stated that the winner's cost was reasonable because the two bids submitted were so close in amount to each other.

We would have expected the state commission to take additional steps, such as conducting a market survey of rates for similar services, comparing the contract's price to other contracts with similar scopes of work and services, or some other reasonable and documented basis for justifying the cost. For example, the state commission reported that the cost for designing and implementing a data collection and evaluation system was reasonable because it would be at or below a threshold of 10 percent of the total projected cost of the system. Although its contract file did not contain the documentation to support its claim that the threshold was based on an industry standard, it was able to produce several sources indicating that professional evaluators estimate such costs at between 10 percent and 15 percent. While we would prefer that

the state commission maintain this kind of documentation in its contract files, we believe the basis for its justification of cost in this instance is reasonable.

The documentation for the $36 million contract also stated that although it considered cost as part of the evaluation process, the basis for the award was the highest overall score for expertise, ability to perform, and oral presentation skills. This award method—commonly referred to as the secondary method—focuses primarily on the quality of a contractor's proposal and team and typically weights the cost component at only 30 percent of the total score. Although it used this method to explain why it chose one bid over the other for this contract, the state commission did not explain why it believed the contract amount was reasonable.

***Although it used a recognized method to explain the qualitative aspects of why it chose one bid over the other for a $36 million contract, the state commission did not explain why it believed the contract amount was reasonable.***

Similarly, it did not provide complete cost justifications for awarding the other two contracts—the first, valued at $7 million, was approved March 2004, and the second, valued at $4.7 million, was approved April 2004—using the secondary method of competitive scoring. For these two contracts, the state commission again cited the commissioners' initial approval of the project maximums as a key factor in the reasonableness of the cost. In each of these cases, the state commission received only two proposals and awarded the contracts to the one that received the higher score using the secondary method of competitive scoring. Its justification for the reasonableness of the amount awarded in one contract stated that the two bids were very close and that the winning bidder actually had the lower proposed cost. For the other, its justification stated that the bids were very similar and that their total costs for a program of this magnitude were very close. The winning bid had a higher score on the overall evaluation for quality and cost, which the state commission used to justify the award even though the winning bid was $540,000 more than the other bid. Once again, the state commission did not follow state policy because, although it explained why it chose the winning bid, it failed to explain why the contract amount was reasonable.

When we asked the state commission how it determined the amount of funding for each of these three projects and whether it performed any market surveys or comparisons to determine that the contract bids were reasonable, it provided us with copies of the presentations staff made to the commissioners when requesting the funding for only two of the projects. For

one of these two projects, it also provided a draft copy of a list of other projects staff had reviewed. None of this documentation provided sufficient support or any analyses describing how the state commission determined the amount of funding requested for these two projects.

By not taking the additional steps to justify and document the reasonableness of the bidders' proposed costs through other methods, such as conducting a well-documented market survey of rates for similar services or a comparison to other contracts that have a similar scope of work and services, the state commission may not be taking full advantage of the competitive bid system.

### Documentation for the Scoring of Competitive Proposals Was Inconsistent

*Inconsistencies in its documentation of the scoring process for contract bids may leave the state commission open to criticism and challenges to its decisions.*

Inconsistencies in its documentation of the scoring process for contract bids may leave the state commission open to criticism and challenges to its decisions. It uses a consensus method to score proposals it receives on competitively bid contracts. According to contract unit staff, each evaluator reviews the proposals individually and assigns scores using individual score sheets. Then the group of evaluators meets to discuss the proposals and reaches a consensus on the scores for each component of the proposals. However, after the group determines the consensus score, the individual score sheets typically are discarded. State law requires that all proposals, evaluations, and scoring sheets be available for public inspection after the scoring process is completed. For the nine competitively bid contracts we reviewed, the state commission's documentation of the scoring process was inconsistent. It retained only the consensus score sheet for each proposal submitted in six of the competitive contracts. Without all the individual scoring materials used in discussing and selecting a winning proposal, it is not possible for us or others to independently replicate the results.

For two other competitively awarded contracts, the state commission's files contained a scoring summary that illustrated the individual scores and a final consensus score for the group; however, the files did not contain the individual scoring sheets that supported the scores on the summary sheet. For the remaining competitively awarded contract, the files contained all the necessary documents that allowed us to replicate the state commission's final score.

### The State Commission Could Not Demonstrate That It Appropriately Advertised for a Large Contract

*Although it ultimately received 13 bids for a $90 million contract, because it failed to advertise the contract according to state policy, it may still have limited the number of bids it received.*

In April 2001 the state commission awarded a $90 million contract to an advertising and media consulting firm to oversee a statewide campaign to educate the public on influences affecting young children, but it could not demonstrate that it advertised the contract in the state contracts register. To ensure that all potential contractors are aware of state contracting opportunities, the contracting manual requires departments to advertise contracts of $5,000 or more, unless exempted, in the state contracts register before the process begins. Although the state commission may not have advertised the availability of the contract in the state contracts register, it provided us with documentation showing that it notified more than 250 advertising and public relations companies of the anticipated release of the request for proposal, inviting companies to sign up to receive a copy of the request for proposal when it was available. Ultimately, the state commission received 13 bids. However, because it failed to advertise the contract according to state policy, the state commission may have limited the number of bids it received for this sizeable $90 million contract.

## THE STATE COMMISSION PROVIDED INSUFFICIENT JUSTIFICATION FOR AWARDING TWO CONTRACTS AND SIX AMENDMENTS USING THE NONCOMPETITIVE BID PROCESS

The state commission also did not provide reasonable and complete justifications for the contract costs or for the use of the noncompetitively bid (noncompetitive) process when it awarded some of the noncompetitive contracts we reviewed. Two of the five noncompetitive contracts we reviewed had insufficient justification of the costs of the contract. For one of these contracts, as well as for six of eight amendments to contracts originally awarded using either a competitive bid or the noncompetitive process, we also found insufficient or questionable justification for using the noncompetitive process.

### Explanations of the Reasonableness of Contract Costs Were at Times Inadequate

According to the contracting manual, a noncompetitively awarded contract is one for which only a single business is afforded the opportunity to provide the specified goods or

services. The contracting manual states that a justification for a noncompetitive contract is required unless specifically exempted by statute or policy. Further, it also requires that departments awarding contracts using this process provide a cost justification that addresses the appropriateness or reasonableness of the cost and includes the following information:

- Cost information (budget) in sufficient detail to support and justify the cost.
- Cost information for similar services and explanations for any differences between the proposed services and similar services.
- Special factors affecting the costs of the contract.
- Reasons why the department believes the contract costs are appropriate.

Although these are the specific requirements of the current contracting manual, earlier versions required similar information in sufficient detail to support and justify the cost of the contract.

***We question the reasonableness of the state commission's cost justifications for two noncompetitive contracts we reviewed totaling $5.5 million.***

We question the reasonableness of the state commission's cost justifications for two of the five noncompetitive contracts we reviewed. For one contract totaling $3 million, it based its cost justification on comparisons of the current contract to previous similar contracts either with itself or with another agency. We expected to find in the file for this contract at least an analysis describing why the state commission believed that the scope of the comparison contracts was materially equivalent to the proposed noncompetitive contract, in addition to an analysis describing how the costs compare.

Instead, the state commission's explanation of its cost analysis for the $3 million contract approved in January 2000 was contained in the following sentences: "The [state commission] has determined that the cost is reasonable as compared to a similar agreement between this contractor and [another agency]. [The other agency] contracted the service for approximately $2.5 million for their Tobacco Control Program. The state commission's cost would be $3 million for focusing on Tobacco, Drugs, and Alcohol." Although General Services approved the use of the noncompetitive process for this contract, we do not believe the state commission's explanation

provides sufficient information to show that it performed an appropriate cost analysis to ensure that its contracted price was either fair or reasonable.

The cost justification on the second contract was unclear. The state commission stated that the $2.5 million cost for the contract approved in May 2006 was based on "average expenditures invoiced" for the period of the original contract it replaced. Actually, its calculation used an average monthly cost based on the original contract amount without consideration for amendments, rather than on expenditures invoiced. In fact, had it set the contract's price based on the previous contract's average monthly invoices during the entire period of the original contract and its amendment, the cost would have been $1.8 million, saving it more than $700,000.

### The State Commission Did Not Always Have a Good Rationale for Using the Noncompetitive Process for One Contract and Six Amendments

*Despite the fact that a lack of time is not a basis for forming a contract without competitive bidding, the state commission used this as justification for executing a $3 million sole source contract.*

In addition to finding the justifications of contract costs inadequate, for one of these two contracts we also question the appropriateness of the state commission's justification for using the noncompetitive contracting process rather than a competitive process. In December 1999, shortly after the state commission began operations, it submitted a justification for one contract totaling $3 million to General Services, indicating that it needed to use the noncompetitive process because of time and resource constraints and stating that the competitive process would require three to four months. Despite the fact that a lack of time is not a basis for forming a contract without competitive bidding, General Services promptly approved the request, and in January 2000 the contract was executed.

The state commission also indicated that its mandated task was to communicate subjects relating to and furthering the goals and purposes of Proposition 10 to the general public and that its new and limited staff (seven individuals) and the pressing need to communicate these messages required the use of the noncompetitive process.[6] Although we recognize that General Services approved the use of this process, and we can understand the challenges faced by the new state commission, we believe its reasoning for accelerating the contracting process makes a

[6] Proposition 10 is the California Children and Families Act of 1998, which established the California Children and Families Program to promote, support, and improve the early development of children, prenatal to age five.

better argument for slowing the process down. For instance, for this contract, the state commission stated that "[t]hese communications hold the success of the California Children and Families Commission in their hands. It therefore becomes necessary that public relations take the lead role in increasing the identity, awareness, and credibility of Proposition 10." We do not find it reasonable that, given the state commission's views on the importance of its (and Proposition 10's) public image, it would choose to award this contract without a full, competitive bidding process to ensure that it found the most appropriate and competitive contractor for its projects.

We also reviewed two additional sole source contracts that were entered into by the state commission in 2000. These sole source contracts were challenged in court and the court upheld their validity. In its decision, the court found that although there were technical violations of state contracting laws and policies, the contracts were nonetheless valid and reasonable under the circumstances. Despite the court's ruling, we believe that, according to prudent business practices, in its future contracts the state commission should undertake the kind of cost analysis we described earlier.

***We question the state commission's rationale justifying six of the eight amendments associated with the contracts we reviewed.***

We also question the rationale justifying six of the eight amendments associated with the contracts we reviewed, which were originally awarded using either a competitive bid or a noncompetitive contracting process. One of these amendments was approved in November 2000, while the other five were approved between February 2004 and March 2006. All six of the state commission's justifications focus on its lack of time. However, these time constraints arose during routine circumstances, with no legitimate external factors that imposed additional, unanticipated work or shortened time frames. For example, its justification for using the noncompetitive process when amending its $90 million media contract in February 2004 for an additional six months and $12 million stated that it would not be able to complete its competitive bid process before the existing contract ended. The state commission indicated that, due to a Department of Finance budget letter limiting the frequency of meetings allowed for boards and commissions, state commission staff were unable to obtain the required approvals of commissioners in time to complete a competitive bid process before the current contract expired in December 2003.

This is not a compelling argument for two reasons: First, the Department of Finance letter was issued in January 2003, 11 months before this contract was set to expire. We believe the state commission staff reasonably could have obtained the commissioners' approval at a quarterly meeting and conducted a competitive bid process in 11 months. Alternatively, if the state commission believed that obtaining board approval and using the competitive bid process would require more than 11 months, it should have begun the process before the Department of Finance issued its letter. Second, the term of the initial contract was three years. The state commission should have known that the expiration date was approaching. Thus, we must conclude that the condensed time frame referred to in its justification is due to poor planning on the part of the state commission.

## THE STATE COMMISSION DID NOT FOLLOW STATE CONTRACTING POLICIES WHEN USING INTERAGENCY AGREEMENTS AND CONTRACTS WITH GOVERNMENT AGENCIES

The state commission did not always ensure that its interagency agreements met the requirements in state policy for using subcontractors, and the agreements regularly allowed for payment of administrative overhead fees at amounts higher than state policy allows. As a result of the latter, it approved budgets for $1.2 million more than it should have.

### The State Commission Did Not Always Follow State Policies When Allowing Subcontractors Under Its Interagency Agreements and Contracts With Government Agencies

Of the 24 interagency agreements and four contracts with other government agencies we reviewed, 25 included the services of subcontractors, for a total of at least $64.6 million. This represents 53.6 percent of the total of $120.6 million for these agreements and contracts. For 17 of these 25, the state commission did not always comply with state policies when justifying the use of subcontractors. Three of the 17 appear to have included subcontractors, but the amount of funds for subcontractors is not clear. We question the justification for the remaining 14 subcontracts totaling $38.3 million. Table 2 provides a summary of the 17 interagency agreements and contracts with other government agencies that used subcontractors and the amounts of the subcontracts for which we question the justification.

## TABLE 2

### Summary of the Interagency Agreements and Contracts With Other Government Entities With Questionable Rationales for Using Subcontractors

| Count | Contract Amount | Original Contract Approval Date | Subcontract Amount with Questionable Rationale | Percentage of Prime Contract |
|---|---|---|---|---|
| 1 | $ 1,000,000 | July 2003 | $ 1,000,000 | 100.0% |
| 2 | 3,000,000 | January 2004 | 2,850,000 | 95.0 |
| 3 | 10,000,000 | November 2003 | 8,926,136 | 89.3 |
| 4 | 18,384,697 | June 2001 | 11,707,385 | 63.7 |
| 5 | 10,081,505 | November 2001 | 6,220,861 | 61.7 |
| 6 | 5,100,000 | June 2001 | 2,944,276 | 57.7 |
| 7 | 1,300,000 | February 2005 | 718,085 | 55.2 |
| 8 | 1,832,838 | December 2003 | 390,856 | 21.3 |
| 9 | 4,000,000 | October 2000 | 645,000* | 16.1 |
| 10 | 10,000,000 | November 2001 | 1,439,104 | 14.4 |
| 11 | 2,300,000 | May 2002 | 203,000 | 8.8 |
| 12 | 12,950,000 | September 2000 | 853,085 | 6.6 |
| 13 | 7,381,225 | October 2000 | 220,850 | 3.0 |
| 14 | 6,100,000 | June 2001 | 135,000 | 2.2 |
| 15 | 1,500,000 | January 2003 | Unknown† | — |
| 16 | 1,500,000 | October 2000 | Unknown† | — |
| 17 | 1,000,800 | October 2003 | Unknown† | — |
| **Totals** | **$97,431,065** | | **$38,253,638** | **39.3%** |

Sources: Contract files at the California Children and Families Commission (state commission). The subcontract amounts include costs characterized by the state commission as subcontractor costs.

* This contract includes $550,000 for research and evaluation. The work plan shows that responsibility for completing these tasks was shared by the prime contractor and subcontractors but does not provide a cost breakdown. We have included the entire $550,000 in our calculations.

† Evidence indicates that subcontracts were probably used. However, there is insufficient information to establish the extent to which they were used.

The contracting manual allows agencies to award service contracts to other state agencies and government entities without a competitive bid process provided that the contracted entities' staff primarily perform the services. The contracting manual does allow subcontracting under these agreements, but it requires the contracting agency or the prime contractor

to fulfill one of a number of conditions when the total of all subcontracts exceeds $50,000 or 25 percent of the total contract, whichever is less. These conditions include the following:

- Approval by the highest executive officer, attesting that the selection of the particular subcontractor without competitive bidding is necessary to promote program needs and is not used to circumvent competitive bidding requirements.
- Prior written approval from General Services' Office of Legal Services has been received.
- Certification that the prime contractor has selected the subcontractors through a bidding process requiring at least three bids from responsible bidders.
- All subcontracts are with an organization listed in the contracting manual as exempt from this provision, such as other state agencies, University of California, or their auxiliary organizations.

***The state commission's justifications for using subcontractors for 17 contracts we reviewed was not always adequate.***

For each of the 25 agreements and contracts with subcontractors, the state commission used one or more of these conditions to justify the use of subcontractors, but its justifications were not always adequate.

For example, in 10 of the interagency agreements and contracts with other government agencies we reviewed that included subcontractors, the state commission relied on the provision permitting subcontracting if the highest executive officer attests that the selection of a specific subcontractor without competitive bidding is necessary to promote the program needs and is not done to circumvent competitive bidding requirements. However, for four of these 10 the state commission either provided incomplete certifications or certifications from an unauthorized executive. For example, for two interagency agreements totaling $12.3 million, the former executive director completed the certifications, indicating that the selection of subcontractors at a total cost of $6.1 million was necessary to meet program needs. However, the certifications addressed only the largest of several subcontractors, even though each of the remaining subcontracts individually met the $50,000 threshold for requiring justification. For another two interagency agreements totaling $2.3 million, the state commission submitted certification letters to General Services that were signed by unauthorized state commission staff. As we noted previously, these certifications are required to be from

the highest executive officer. For these two, representing at least $700,000 in subcontractor costs, the certifications came from the former chief of administration.

*General Services informed us that its prior written approval of subcontractors is a separate document from its approval of contracts. Thus, the state commission incorrectly equated the 10 final contract approvals by General Services to its approvals of subcontractors.*

When we asked the state commission to demonstrate that the subcontracts in another 10 contracts were allowable, its justification was based on the provision of the contracting manual that allows subcontracting when prior written approval from General Services' Office of Legal Services has been received. However, the copies of the contracts containing General Services' approval stamps provided as evidence of prior written approval do not meet General Services' requirements. An attorney from General Services informed us that prior written approvals from General Services are never actually part of the contract but are separate documents that should be part of the contract files. Thus, the state commission incorrectly equated the final contract approval by General Services to its approval of subcontractors. In each of these 10 instances, the state commission attached a copy of the approved contract but provided no other documentation.

For one $18.4 million interagency agreement, the state commission indicated that the agreement's subcontracts, totaling $11.7 million, were permissible because they had been selected through a competitive bidding process. However, the contracting manual calls for certification of the competitive selection, and the contract file contained no such certification. Additionally, in response to our request for documentation showing that the subcontracts were allowable, the state commission merely stated that they had been competitively bid and that we could contact the prime contractor for proof of this. When we contacted the prime contractor, it indicated that the subcontracts were competitively bid. However, the prime contractor stated that it could find no evidence that the state commission had requested certification that the subcontracts were competitively bid. It is the state commission's responsibility to ensure that the certification exists, and we believe it is reasonable to expect it to retain the certification in its files.

For two contracts totaling $5.8 million, the state commission again could not provide adequate justification for subcontracts totaling $1 million. For one of these contracts the state commission indicated that the subcontracting was allowable because the subcontractor was one of a number of allowable government entities listed in the contracting manual or the services to be provided were otherwise exempted from competitive bidding.

In this case, neither of the two provisions cited by the state commission was applicable to the nonprofit entity chosen as the subcontractor. In the second instance, the state commission correctly identified two of the subcontracted services as being exempt from competitive bidding rules. However, the commission failed to show that the remaining subcontracts were allowable.

The state commission also entered into a series of three contracts, lasting roughly four years, with one contractor to revise, update, and produce parents guides in various languages. In these contracts, the budgets were so vague that we were unable to determine whether subcontractors were employed and, if so, to what extent. Figure 2 shows one of these budgets. However, in a memo dated two months after the first of these three contracts was approved, General Services told the state commission it had been informed that the prime contractor had "vended the entire project of half a million books" to a private firm. Furthermore, the third contract contained a provision that clearly shows an intent to solicit bids for the subcontracting of printing services. The contract files for these three contracts did not contain certifications for the use of subcontractors. Because all three contracts were for similar services and the evidence indicates that the contractor used subcontractors on the first and third contracts, it seems plausible that the contractor would subcontract at least a portion of the second contract as well.

### The State Commission Agreed to Reimburse Contractors for Indirect Costs at Higher Rates Than State Policy Allows

*The state commission, in its interagency agreements, approved budgets that included administrative overhead fees of $1.2 million more than the contracting manual allows.*

The state commission did not always comply with state policies limiting the amount of administrative overhead fees paid to contractors for each subcontract. In fact, the state commission, in its interagency agreements, approved budgets to reimburse its contractors for over $1.2 million more than the contracting manual allows.

For the 14 interagency agreements and four contracts with other government agencies we reviewed that used subcontractors and had related overhead charges, the state commission agreed in 13 instances to pay its contractors administrative overhead fees at higher rates than permitted. According to the contracting manual, state agencies may pay contractors overhead charges only on the first $25,000 of each subcontract awarded, and it allows the contractor and the state agency to negotiate a reasonable charge. However, all but one of the interagency

## FIGURE 2

### Budget for a $1 Million Contract With the University of California Regents

**EXHIBIT B**
**(Interagency Agreement)**
**Attachment I**
**Budget**

Provide 120,000 copies of the Parents Guide, consisting of 60,000 in Chinese, 25,000 in Korean, and 35,000 in Vietnamese (the respective amounts of each language are amendable).

| | |
|---|---|
| Total Cost | $1,000,800.00 |
| Total Copies | $120,000.00 |
| Cost Per Copy | $8.34 |

Total cost includes printing, storage and shipping.

Source: State commission contract file.

agreements and contracts with government agencies we reviewed contained budgets that allowed overhead fees on the total of each subcontract. The budget for a $10.1 million contract included overhead charges of $480,000, apparently calculated as a flat 5 percent of the contract's total direct costs of $9.6 million for both the subcontract's and primary contract's direct activity. As a result, the budget incorrectly included nearly $300,000 more in overhead fees than allowed. Table 3 on the following page identifies the amounts the state commission agreed to pay compared to what it should have agreed to pay based on the limits established by the contracting manual. As the table indicates, the agreement terms allowed a total of more than $1.2 million in excess of allowable overhead reimbursements.

## TABLE 3

### Comparison of Budgeted and Allowable Overhead Costs

| Count | Contract Amount | Original Contract Approval Date | Budgeted Overhead Costs for Entire Contract | Allowable Overhead Costs for Entire Contract* | Excess Overhead Costs |
|---|---|---|---|---|---|
| 1 | $10,081,505 | November 2001 | $ 480,072 | $ 184,029 | $ 296,043 |
| 2 | 7,381,225 | October 2000 | 350,987 | 68,382 | 282,605 |
| 3 | 5,000,000 | September 2000 | 238,000 | 98,350 | 139,650 |
| 4 | 10,000,000 | November 2001 | 454,156 | 337,984 | 116,172 |
| 5 | 10,000,000 | November 2003 | 147,680 | 58,016 | 89,664 |
| 6 | 2,000,000 | January 2001 | 95,238 | 21,097 | 74,141 |
| 7 | 2,300,000 | May 2002 | 109,524 | 57,023 | 52,501 |
| 8 | 1,300,000 | February 2005 | 93,010 | 45,382 | 47,628 |
| 9 | 4,000,000 | October 2000 | 190,476 | 163,976 | 26,500 |
| 10 | 1,832,838 | December 2003 | 135,766 | 109,695 | 26,071 |
| 11 | 1,300,000 | January 2002 | 75,893 | 51,445 | 24,448 |
| 12 | 1,000,000 | August 2005 | 24,733 | 5,023 | 19,710 |
| 13 | 6,100,000 | June 2001 | 554,544 | 543,546 | 10,998 |
| | **Totals** | | **$2,950,079** | **$1,743,948** | **$1,206,131** |

Sources: Contract files at the California Children and Families Commission.

* Overhead cost was calculated by applying each contractors overhead rate to the contract's personnel and operations totals. The contract's overhead rate was also applied to the first $25,000 of each subcontractor's budget, as required by the contracting manual.

When we asked the state commission to explain why it used overhead fees that exceeded the limitations of state policy, it indicated that its staff historically misunderstood this provision of the contracting manual. Further the state commission also stated that it is requiring those who regularly work with state contracting issues to attend General Services' training with the expectation that this topic is covered. When the state commission's interagency agreements contain budgets that include administrative overhead fees greater than allowed by state policy, it overpays contractors, reducing the funds available for direct program services.

## THE STATE COMMISSION CIRCUMVENTED CONTRACTING LAW WHEN IT USED MEMORANDUMS OF UNDERSTANDING TO OBTAIN SERVICES

In fiscal years 2004–05 and 2005–06, the state commission awarded five memorandums of understanding (MOUs) and two amendments totaling more than $595,000. It appears to have

intentionally used some of these to avoid having to comply with state contracting requirements, and for at least two MOUs and one amendment the intention was explicit. In fact, in a September 2005 e-mail the former chief of administration warned that the language of an amendment required careful wording to avoid the appearance that the state commission was circumventing the State's competitive bid process.

Although state contracting law allows agencies to enter into contracts with local government entities without competitive bidding, it strictly prohibits agencies from using these contracts to circumvent competitive bidding requirements. Also, the contracting manual refers to MOUs as "contracts," suggesting that they are subject to state contracting requirements. In addition, an attorney from General Services has indicated that MOUs must be treated as contracts and therefore must go through the General Services approval process and meet all contract language requirements. It appears that the state commission incorrectly believed that MOUs were subject to lesser requirements.

For one MOU totaling $150,000, the state commission first attempted to enter into a standard contract with one county to obtain statewide training services. In November 2005 the state commission submitted the contract to General Services for approval. On December 6, 2005, General Services returned the unapproved contract and requested additional information. Specifically, General Services questioned the cost justification and reasons for contracting out these services. It also questioned the sufficiency of the budget and the lack of a specific requirement that the contractor complete work by the time the state commission was scheduled to make the last payment.

***The state commission appears to have intentionally used an MOU totaling $150,000 to avoid having to comply with state contracting requirements.***

In January 2006, without evidence that it had responded to General Services' request for additional information, the state commission sent an MOU totaling $150,000 to the county for its signature. The MOU had the same budget General Services had questioned, and its scope of work was nearly identical to that of the proposed contract. Further, we found the following comment in the state commission's contract database: contract "unapproved by General Services, changed to an MOU." Thus, the state commission appears to have intentionally used an MOU to avoid having to comply with state contracting requirements.

For another two MOUs and two amendments totaling $300,000, the state commission arranged for services with one county. One MOU was to assess county commissions' financial management functions and identify ways to improve their existing systems.

The second was to assist the state commission in establishing a framework to evaluate services at both the state and local levels. The state commission did not obtain General Services' approval for either of these MOUs. The invoices submitted by the county show that subcontractors, not county staff, performed all the services. Also, neither MOU file contains any documentation that the state commission ensured a competitive process for selecting subcontractors.

In fact, evidence suggests that the state commission intentionally avoided competitive bidding by entering into at least one of these MOUs with the county to obtain the services of a specific subcontractor. We found e-mail correspondence from the county requesting the state commission to reimburse it for the cost of services obtained from the subcontractors for both MOUs on behalf of the state commission. The e-mail correspondence between state commission staff and management also acknowledged that the subcontractors for both MOUs were receiving payment from the county but were taking direction from and delivering a product to the state commission. Finally, the minutes of a discussion at a commissioners' meeting explicitly indicate that the state commission would allocate funds to a county, as a fiscal agent, and obtain the services of a certain subcontractor for one of the MOUs.

Had the state commission contracted directly with the MOU subcontractors, it would have needed to either competitively bid or justify the need for a noncompetitive process, requirements General Services is responsible for enforcing. In an e-mail written to the state commission's executive director and deputy director of research and evaluation in September 2005, the former chief of administrative services explicitly warned of the potential for appearing to circumvent state contracting policy when the state commission was preparing an amendment to an MOU. His e-mail noted, "We need to make sure that all information in the amendment refer[s] to the [county] commission as the primary contractor and does not directly relate to the [subcontractors] . . . Any other type of reference might be viewed as circumventing the states [sic] competitive bid process . . . We want to make sure we are always in compliance for any audits of our internal controls."

***The former chief of administration warned that the language of an amendment required careful wording to avoid the appearance that the state commission was circumventing the State's competitive bid process.***

In May 2006 the state commission entered into another MOU, totaling $64,400, with a county to obtain training and transition support for county commission staff on the state commission's

revised statewide evaluation framework. Although the state commission prepared the MOU in April 2006, subsequent internal e-mail correspondence indicates that it later considered entering into a standard contract for the services. However, evidence suggests that it ultimately sent the MOU to the county for signature when the county threatened to cut off services if the state commission did not deliver a signed agreement. The county signed the MOU at the end of May 2006.

*Notably missing was General Services' approval for all five MOUs we reviewed even though each was for services totaling more than $5,000, the threshold requiring General Services' approval.*

Notably missing was General Services' approval on all five MOUs, even though each was for services totaling more than $5,000—the maximum contract amount for services the state commission may enter into without General Services' approval.

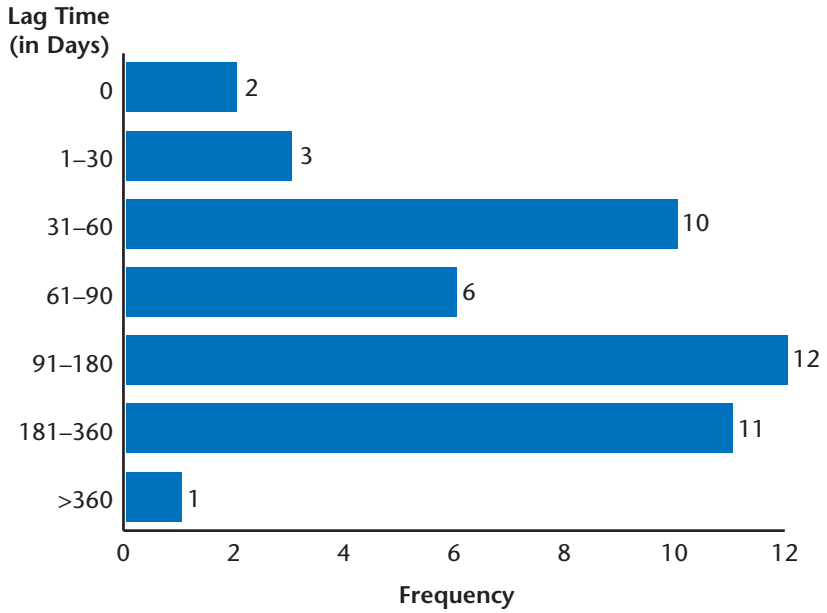
## THE STATE COMMISSION CONSISTENTLY FAILED TO OBTAIN APPROVALS FOR ITS CONTRACTS AND AMENDMENTS ON TIME

According to state law, all contracts entered into by state agencies, except those meeting criteria for exemptions, are not in effect unless and until approved by General Services. The state commission failed to obtain the required approvals before the beginning of the contract term for most of the contracts we reviewed. Similarly, it did not obtain the required approvals for 22 of the 44 amendments we reviewed until after the related contract or prior amendment had ended. Although we did not review all of the contracts to determine whether work began before approval, we noted three instances in which the contractor provided services totaling more than $7 million before the state commission obtained final approval of the contracts. The state commission also failed to obtain the required approvals altogether on three amendments.

General Services' approval for 43 of the 45 contracts executed between January 2000 and March 2006 that we reviewed lagged by a few days to more than a year after the contract start dates, averaging 123 days, or roughly four months. Figure 3 on the following page shows the range and frequency of the intervals between the contract start date and the time that the state commission obtained approval for these contracts. For the remaining two contracts, it appears that final approvals were on time only because the contract start date was "upon General Services approval." The state commission's tardiness in obtaining the required approvals may have contributed to some contractors performing work before the contract was approved. In these instances, the State is exposed to potential financial liability for work performed even though the contract is not approved.

## FIGURE 3

**Number of Days the State Commission's Contracts Were Executed Late**




Sources: Contract files at the California Children and Families Commission.

In the worst-case example, the state commission failed to obtain the required approval for one contract until after the term of the contract had expired. Consequently, the contractor provided services totaling nearly $7 million before the contract was approved in May 2000. The former chief deputy director also authorized work to begin before another two contracts were executed. The first occurred in 1999, while the commission was developing its $3 million public relations contract with a public relations firm. In a letter to the firm's executive vice president at the time, the former chief deputy director wrote that the commission was "currently in the process of developing an official contract for your services. In the interim, this letter will serve as our commitment to reimburse [your organization] for all expenditures, including fees, expenses, and subcontractor costs for all approved activities." This letter predated the final approval by General Services by more than two months.

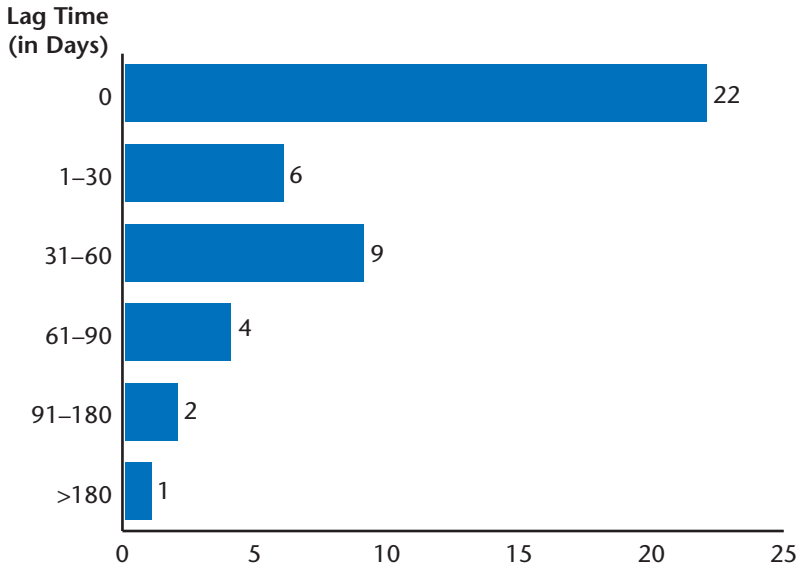
In another instance, the former chief deputy director justified the contractor's beginning work before approval in writing to staff in General Services' Office of Legal Services, "Additionally, the [state commission] is a new agency and is still not completely staffed. Accordingly, staff was unavailable to begin

working on the approval process until late April. The contractor began work in good faith knowing that the project had been approved and that the funding was available."

In addition, the state commission failed to obtain approval for amendments before the original contract or previous amendment's term ended. Between July 2000 and March 2006, for 22 of the 44 amendments we reviewed, the average approval date was 59 days late. Figure 4 shows the range and frequency of the intervals between the contract amendment start date and the time that the state commission obtained approval for these amendments. For example, it added two years and $7.1 million to a $2.6 million child care and health services contract but did not obtain the necessary approval until 52 days after the initial contract had expired on June 30, 2002. In another case, it increased the budget for a $7 million advertising contract by an additional $7 million and extended the term of the contract by six months, but failed to get approval from General Services for the amendment until 56 days after the contract had expired on May 15, 2000.

## FIGURE 4

**Number of Days the State Commission's Contract Amendments Were Executed Late**




Sources: Contract files at the California Children and Families Commission.

In three instances, the state commission failed altogether to obtain the required approval from General Services for its amendments. In one of these instances, it failed to obtain General Services' approval for a second amendment to a contract dated June 2002. Although the contracting manual exempts amendments that extend the contract's term for one year or less, an agency can use this exemption only once. According to the state commission's manager of fiscal operations, state commission analysts apparently did not notice that it was the second amendment to extend the contract's term. We notified the state commission of the lack of required approvals, but it took no action because the contract expired in 2003.

In another example that required General Services' approval, the state commission modified the scope of work and budget in an amendment dated December 2005, but it did not increase the contract funding. According to its manager of fiscal operations, once we notified the state commission it immediately contacted General Services and obtained a belated review and approval in late June 2006. This same manager indicated that, to prevent these mistakes in the future, the state commission has taken steps to ensure that the contract analyst identifies whether a contract or amendment requires General Services' approval.

Although the amendment dated September 2005 for a third contract did not include additional funds and did not change the contract terms, it did replace the original budget with a revised budget, again requiring General Services' approval. The state commission's response to our inquiries indicated that, when it created the amendment, it did not believe the amendment required General Services' approval, and thus it did not seek such approval.

## THE COMMISSIONERS MAY HAVE IMPROPERLY DELEGATED AUTHORITY TO AWARD CONTRACTS

***Without the statutory authority our legal counsel advised is necessary, the commissioners delegated their authority to enter and amend contracts to state commission staff.***

State law authorizes the state commissioners to enter into contracts on behalf of the state commission. The commissioners adopted a formal resolution in May 2001 delegating their contracting authority to enter into and amend contracts to state commission staff. In this same resolution, the commissioners took action to ratify all prior contracts. It is our understanding that although the commissioners meet in public session to authorize expenditure authority and specify amounts of money for particular purposes, the ultimate decision to enter into contracts and the selection of providers of goods and services is

performed by state commission staff. Our legal counsel advised us that it is a well-accepted principle of law that a power given to a public official that involves the exercise of judgment or discretion may not be delegated to others without statutory authority.[7] In this case, no statute authorizes the commissioners to delegate their contracting authority.

Various judicial decisions in this area indicate that there are circumstances in which a governmental body may effectively ratify some prior action, assuming that it has lawful authority to take that action in the first place. Our review shows that the commissioners approved the funding for projects or contracts but were generally not involved in selecting the contractors or in reviewing and approving the contracts. Consequently, many of the contracts were approved outside of an open meeting where the public would have an opportunity to be fully informed about contractual obligations of the state commission. The state commission believes that its enabling statutes delegate this authority to the executive director. Despite the high degree of deference that must be given to an agency's interpretation of statute, we do not believe this is a reasonable interpretation. We have not reached a conclusion on the legal validity of these contracts, but we believe it would be appropriate for the state commission to seek legal counsel on this matter.

## RECOMMENDATIONS

To ensure that it protects the State's interests and receives the best products and services at the most competitive prices, the state commission should take the following actions:

- Follow the State's competitive bid process for all contracts it awards, unless it can provide reasonable and complete justification for not doing so. Further, it should plan its contracting activities to allow adequate time to use the competitive bid process.

- Fully justify the reasonableness of its contract costs when it receives fewer than three bids or when it chooses to follow a noncompetitive bid process.

- Advertise all nonexempted contracts in the state contracts register.

[7] *Sacramento Chamber of Commerce v. Stephens,* 212 Cal. 607, 610 (1931).

To ensure that it promotes fair and open competition when it awards contracts using a competitive bid process, the state commission should ensure that it fully documents its process for scoring proposals, and that it retains the documentation.

To ensure that it follows state policies and protects the State's interest when using interagency agreements and contracts with government agencies, the state commission should do the following:

- Obtain full justification for the use of subcontractors when required and, if it is unable to do so, deny the use of subcontractors.

- Limit the amount that it will reimburse its contractors for overhead costs to the rates established in the contracting manual.

To ensure that MOUs it awards allow for fair and competitive contracting and protect the State's best interests, the state commission should follow laws and policies applying to contracts when awarding and administering MOUs.

To ensure that it does not expose the State to potential financial liability for work performed before the contract is approved, the state commission should ensure that it obtains General Services' approval of its contracts and amendments before the start of the contract period and before contractors begin work.

To ensure that state commission staff may lawfully enter into or amend contracts on behalf of the commissioners, the state commission should seek appropriate legal counsel. ■

# CHAPTER 3

## *Although the State Commission's Payments Were Generally Consistent With the Restrictions On the Use of Public Funds, Certain Payments During 2004 are Questionable*

### CHAPTER SUMMARY

Between 2000 and 2006 the California Children and Families Commission (state commission) used four media and public relations contractors to conduct mass media campaigns related to various issues. More than one of these campaigns promoted the value of preschool. Within this same period, there were three ballot proposals that either related to preschool or that, if enacted, would have affected the work of the state commission. Two of these proposals ultimately qualified for the ballot.

The first proposal, Proposition 28, which would have repealed the tobacco surtax that funds the state commission, qualified for the ballot but was rejected by the voters in March 2000. The second proposal—the Improving Classroom Education Act—commonly known as the California Teacher's Association (CTA) Reiner Initiative, related to voluntary preschool**.** Its proponents failed to gather sufficient signatures for placement on the ballot, and it was never submitted to the voters. The third proposal, Proposition 82, the Preschool for All Act, which also related to voluntary preschool, qualified for the ballot but was rejected by the voters in June 2006. The timing of the state commission's publicly funded media campaigns, in light of these proposals, has raised questions about whether it inappropriately used public funds for campaign activities or political advocacy.

We found that the state commission had clear legal authority to conduct its public advertising campaigns related to preschool. We also found that the content of these advertisements and the timing of their broadcast were consistent with applicable legal restrictions related to the use of public funds for political

purposes. We also confirmed that the state commission did not contribute any of its public funds to campaign accounts used to support the various ballot measures.

Although the same individuals who worked for the media contractor also worked for the campaign committees supporting the Improving Classroom Education Act and Proposition 82, we were generally able to determine that the state commission's payments to these individuals were consistent with the restrictions on the use of public funds for political purposes. We were, however, concerned about the appropriateness of certain payments made to these three individuals during a period of approximately four months between May 1 and August 18, 2004. During this period, the Improving Classroom Education Act had begun the ballot qualification process and the proponents were authorized to gather signatures to qualify it for the ballot. We asked the state commission to provide us with documentation that would show what services these individuals were paid to perform during this period, and it was unable to do so. So that we might learn what services these three individuals were paid to perform during this time, we contacted each of these individuals as well as the former chair of the state commission. We were able to talk with two of the three individuals and with the former chair of the state commission.[8] All of the individuals we talked to indicated that they did not perform any campaign activities during this period. Although these individuals asserted to us that they did not engage in campaign activities during this period, the state commission was unable to confirm this because it did not have adequate records. Thus, we lack documentary evidence that would allow us to definitively determine the appropriateness of using public funds to pay these individuals during this period.

## VARIOUS RESTRICTIONS APPLY TO THE USE OF PUBLIC FUNDS FOR POLITICAL PURPOSES

The most general principle of law governing the expenditure of public funds is that they may be used only for an authorized public purpose. In addition, specific restrictions apply to the use of public funds for political purposes. A public official, such as a commissioner or a designated employee of the state commission, may not use public funds to support campaign activities or make expenditures on behalf of a campaign

[8] The third person was willing to speak with us, but was not able to meet with us prior to the publication of our report.

committee. Impermissible campaign activities include making a contribution to a campaign committee or expending public funds for express political advocacy.

The restriction against using public funds for campaign activities, as outlined in the Introduction, does not mean that a public official is completely prohibited from using such funds for activities related to a ballot measure. The judicial decisions that have examined the circumstances under which it is permissible to expend public funds for political purposes draw a clear distinction between a "proposal" that has not yet qualified for the ballot and a "ballot measure" that has qualified for the ballot and is under public consideration. Until a proposal becomes a ballot measure,[9] a public official may generally use public funds to undertake a wide variety of activities related to that proposal. He or she may conduct research about the merits of the proposal, conduct activities to determine a need to undertake the proposal, draft proposed language for the ballot measure, or even secure a proponent to carry the proposal forward as a ballot measure. A public official may not, however, use public funds to gather signatures to qualify a proposal for the ballot. The efforts undertaken by public officials at the proposal stage are generally not viewed as political advocacy or campaign activities based on the rationale that there is nothing yet before the voters to advocate for or against.

***Public officials may use public funds to undertake activities related to a ballot proposal before it qualifies for the ballot.***

Once a proposal qualifies for the ballot, it becomes known as a ballot measure, and the ability to spend public funds related to that ballot measure is more limited. At this point, the public official may not use such funds to advocate for the passage or defeat of the measure. The official may, however, use public funds to provide the public with a "fair and impartial presentation of the facts" related to the measure or an analysis of how the ballot measure, if enacted, would affect the agency the public official represents.

[9] We treated a proposal as a ballot measure as of the date that the proponents of the measure received their official title and summary and were authorized to gather signatures to quality the proposed measure for placement on the ballot. The law is not explicit on this point, but various judicial decisions related to this issue suggest that this is the appropriate point at which to draw that distinction.

## THE STATE COMMISSION'S USE OF A MEDIA CONTRACTOR TO CONDUCT MASS MEDIA CAMPAIGNS WAS WITHIN ITS LEGAL AUTHORITY

Proposition 10, the California Children and Families Act of 1998 (Children and Families Act) expressly authorizes the state commission to deposit 6 percent of the 20 percent share of the revenue it received into an account for expenditures on communications to the general public using television, radio, newspapers, and other mass media on subjects relating to and furthering the goals and purposes of the Act. These subjects include methods of nurturing and parenting that encourage proper childhood development; the informed selection of child care; health and social services; the prevention and cessation of tobacco, alcohol, and drug use by pregnant women; and the detrimental effects of secondhand smoke on early childhood and development. To achieve these goals, the state commission has typically entered into contracts with consultants and service providers for such activities as research, planning, and public relations, including advertising campaigns.

Between January 2000 and August 2005 the state commission entered into seven contracts with four media and public relations contractors for a variety of services, including placing educational messages on television or radio. These contractors arranged for print, television, and cable announcements from 2000 through 2006 to educate the public about appropriate parenting skills, the benefits of preschool, childhood health issues, and the dangers of tobacco smoke to young children.

***The state commission's use of public funds to develop and air educational messages in the mass media was consistent with the various legal requirements related to the expenditure of public funds for political purposes.***

Our legal counsel advised us that the state commission had clear legal authority to conduct public advertising campaigns related to these subjects. In addition, when we reviewed the timing and content of the advertisements produced as a result of these media contracts, we found that nothing in the advertisements constituted political advocacy. The advertising campaigns clearly promoted the benefits of preschool, tobacco cessation, prevention of childhood obesity, and parenting, but they made no reference to upcoming measures that might be placed on the ballot; nor did they urge voters to take any particular position on a matter that might ultimately appear before them on the ballot. Accordingly, the use of public funds to develop and air these educational messages in the mass media was consistent with the various legal requirements related to the expenditure of public funds for political purposes previously described. Finally, we confirmed that the state commission did not contribute any of its public funds to campaign accounts used to support the various ballot measures.

## WE CANNOT CONCLUDE WHETHER THE STATE COMMISSION USED PUBLIC FUNDS FOR CAMPAIGN ACTIVITIES DURING A FOUR-MONTH PERIOD IN 2004

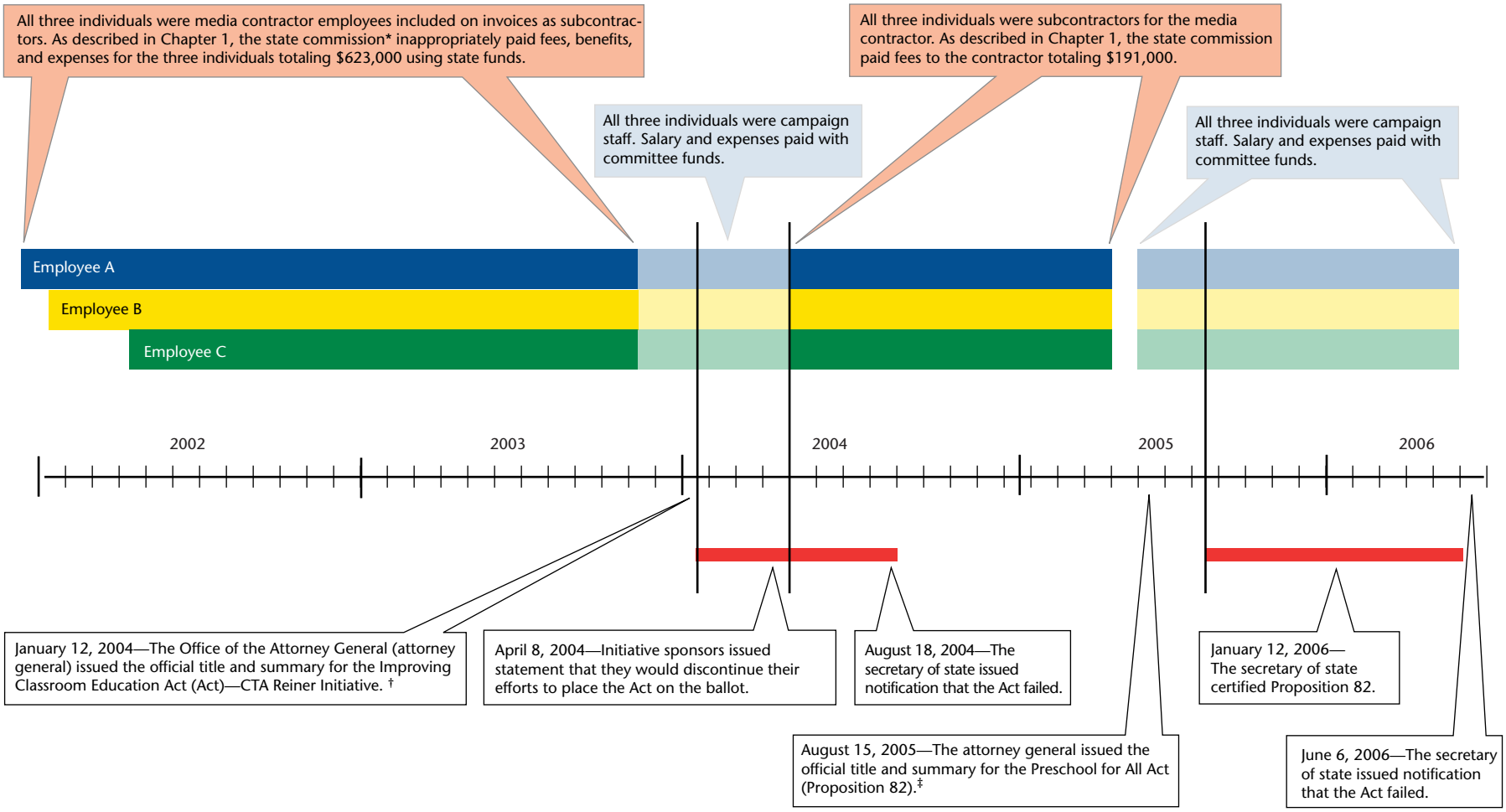
Although three individuals who worked for the state commission's media contractor were also employed by the campaign committee for Proposition 82, we were generally able to determine that the state commission's payments to these individuals were consistent with the restrictions on the use of public funds for political purposes. However, for an almost four-month period in 2004, we cannot determine whether public funds were spent appropriately to pay for the services of these three individuals because the state commission did not have adequate records.

*The state commission's payments to three individuals, who worked for the media contractor, were generally consistent with the restrictions related to the use of public funds for political purposes. However, for a period of almost four months in 2004, the state commission could not demonstrate that these payments were appropriate.*

Between February 2002 and May 2006, the three individuals alternately worked for the media contractor and for the campaign committee for the Improving Classroom Education Act and Proposition 82. We discussed the contract more fully in Chapter 1. Their salaries and expenses were paid either by the state commission, using tobacco tax funds provided under the contract between the state commission and the media contractor, or by the campaign committee, using campaign committee funds. We were not able to obtain documentary information from the state commission that clearly demonstrates what activities these three individuals were paid to perform at various points in time. To determine whether the state commission's payments to these individuals were consistent with the restrictions related to the use of public funds for political purposes, we examined the timing of its payments in the context of what activity was ongoing at the time related to either a proposal for a ballot measure or a ballot measure. In addition, we interviewed two of the three individuals, as well as the former chair of the state commission, so that we could ask the three individuals what services they were paid to perform when public funds were used to pay for their services. Figure 5 on the following page shows the time periods during which the state commission paid these individuals through its contract with the media contractor and also shows the dates when the various proposals received their official title and summary from the Office of the Attorney General (attorney general), thus authorizing the proponents of the proposals to gather signatures to qualify them for placement on the ballot.

## FIGURE 5

### California Children and Families Commission–Time Periods For Various Political Initiatives and Propositions




Sources: The attorney general, secretary of state, and state commission contract files.

* California Children and Families Commission.

† The Act was submitted to the attorney general on November 21, 2003.

‡ Proposition 82 was submitted to the attorney general on June 15, 2005.

Based on the information we saw, the time periods for which the state commission made payments to these individuals generally corresponded with those periods when no campaign activities were underway with the exception of an almost four-month period in 2004. In other words, the state commission generally only paid for the services of these three individuals prior to the time a proposal for a ballot measure was submitted to the attorney general to begin the ballot qualification process. As described earlier, during this stage a state agency may permissibly support many activities related to a proposal using public funds. The presumption is that those activities will not involve political advocacy because nothing is before the voters for their approval or rejection. Once the proposals were submitted to the attorney general to start the ballot qualification process, the state commission no longer paid these individuals to perform services for it, with the exception of the period already mentioned.

During some or all of the period between February 2002 and early December 2003, some of the services paid for by the state commission, as shown in Figure 5, may have involved various types of activities related to the Improving Classroom Education Act, which had not yet become a ballot measure. At this point it was permissible to use public funds to support various activities related to what was a ballot proposal, and we do not question payments made during this period.

We were, however, concerned about the appropriateness of certain payments made to these three individuals during a period of approximately four months between May 1 and August 18, 2004. During this period, the Improving Classroom Education Act had begun the ballot qualification process. The attorney general had issued a ballot title and summary and the proponents were authorized to gather signatures for the proposal to qualify it for the ballot. The proponents had, however, publicly announced that they were withdrawing their support for the measure and were discontinuing efforts to place it on the ballot. We did not find any documentary evidence demonstrating that the three individuals were paid with public funds to perform campaign activities during this period. However, because of the state commission's poor management of the contract and lack of supporting documentation, the state commission was unable to provide us with documentation that showed what these individuals were paid to do during this

period or how it knew that these payments were appropriate. We discuss the inadequacy of the state commission's management of this contract more fully in Chapter 1.

So that we might learn what services these individuals were paid to perform between May 1 and August 18, 2004, we contacted each of them as well as the former chair of the state commission. We were able to talk with two of the three individuals and with the former chair of the state commission. All of the individuals we talked to indicated that they did not perform any campaign activities between May 1 and August 18, 2004. The former chair indicated that at this point it was their understanding that this ballot measure was "dead" because the proponents had officially withdrawn their support. Moreover, one of the individuals we talked to indicated that while he had some limited involvement in the Improving Classroom Education Act at other points in time, he had been advised by legal counsel not to undertake any efforts related to a ballot proposal once it was submitted to the attorney general, and he stated that he had followed this legal advice. As stated earlier, the state commission could not provide us with any documentation that identified what services it paid these three individuals to perform, so we could not confirm the assertions made to us by these individuals. Consequently, we cannot definitively determine whether the payments made by the state commission to the three individuals during this period were appropriate.

Between August 19, 2004, and April 30, 2005, it is possible that these individuals were engaged in various activities related to the proposal that later became Proposition 82. However, at this point, the proposal had not yet been submitted to the attorney general, and the state commission had broad latitude in supporting various preliminary, noncampaign, nonadvocacy activities related to the proposal. Further, the state commission stopped paying these three individuals for their services before the proposal was submitted to the attorney general to begin the process of qualifying for the ballot. As Figure 5 on page 64 shows, after this proposal was submitted to the attorney general, the campaign committee for Proposition 82 paid the salaries and expenses of the three individuals. Thus, with the exception of the period between May 1 and August 18, 2004, where we cannot definitely conclude on the appropriateness of the payments, we found that the state commission's payments to these three individuals were consistent with the various legal restrictions related to the use of public funds for political purposes.

We conducted this review under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,

ELAINE M. HOWLE
State Auditor

Date: October 31, 2006

Staff: Denise L. Vose, CPA, Audit Principal
Tammy Lozano, CPA, CGFM
Richard J. Lewis
Richard Power
Toufic Tabshouri

Blank page inserted for reproduction purposes only.

*Agency Comments provided as text only.*

California Children and Families Commission
501 J Street, Suite 530
Sacramento, CA 95814

October 18, 2006

Ms. Elaine M. Howle*
State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Re: Draft Report, 2006 BSA Audit of the California Children and Families Commission

Dear Ms. Howle:

The California Children and Families Commission (the "Commission") has spent the past six days carefully examining the draft audit report (the "Draft Report") prepared by the Bureau of State Audits ("BSA") over the past six months. When this audit process started in March 2006, prompted by public concerns that public funds may have been used to support the now-failed Proposition 82, the Commission committed to cooperating fully with the BSA's efforts. We believe we have fulfilled that commitment, as your staff has repeatedly recognized throughout the audit process. The Commission's efforts to cooperate with the audit manifest its commitment to public accountability.

**The Political Advocacy Question**

We fully agree with several of the Draft Report's findings. For example, at the end of the Draft Report's review of the Commission's activities, the BSA presents its findings regarding the issue that began this process, i.e., public concerns about improper use of public funds for political advocacy in the period leading up to the 2005 special election. The BSA concludes that the Commission's preschool ads furthered its statutorily-mandated duties; that "when we reviewed the timing and the content …, nothing in the advertisements constituted political advocacy;" and that the Commission "had clear legal authority to conduct its public advertising campaigns related to preschool." Draft Report, p. 73.

Moreover, after six months of review, the BSA concluded that:

> Although the three individuals who worked for one of [the Commission's] media contractors were also employed by the campaign committee for Proposition 82, we were generally able to determine that the state commission's payments to these individuals were consistent with the restrictions on the use of public funds for political purposes.

Draft Report, p. 74.

Although we fully expected these findings, we are gratified by them nonetheless.

* California State Auditor's comments begin on page 81.

**The Commission's Contracting Practices**

The bulk of the Draft Report focuses on the Commission's contracting practices. We believe that the Draft Report lacks the context necessary to fully understand the constraints under which the Commission has been operating. Specifically, the Draft Report does not acknowledge the Commission's history of scarce resources for administration or the Commission's use of and reliance on other state agencies for advice regarding contracting practices, and as a check on those practices. When we expressed this concern to the BSA, it invited us to include such context in our response, and we do so below. We also include some clarifications of the Commission's position on certain issues within the Draft Report. Finally, we turn to the BSA's recommendations and the Commission's response to those recommendations.

**The History and Context of the Commission's Contracting Practices**

The Draft Report's critique of the Commission's contracting practices is very surprising, as throughout its short history the Commission has reached out to and relied upon multiple state agencies to assist it in complying with all state contracting laws. We also note that in the last year the Commission has made significant changes in its practices, in part due to the addition in July 2005 of a new Executive Director, the appointment in March 2006 of a new Commission chair, and the even more recent addition of a Chief Deputy Director and a Chief of Administration. With these varied perspectives, and in combination with the Commission's longer-term staff, the Commission has become proactive in identifying new processes, procedures, and policies that will formalize existing Commission practices, modify current practices as needed, and create new procedures to help the Commission efficiently and effectively achieve its statutory objectives.

It is important to put the Commission's administrative history in context so that the progress it has made, particularly in the last year, is apparent. As the San Diego Superior Court observed in 2000, the Commission began its existence in 1999 with a "skeleton" staff, and was immediately hit by litigation, including "17 Public Records Act requests and numerous discovery requests" that "diverted scarce resources of the Commission from performing other essential functions." *Cal. Assoc. of Retail Tobacconists, Inc. v. California*, (San Diego Superior Court, Case No. 732079 ), Final Statement of Decision (Dec. 7, 2000), p. 40. The Commission's resources remain scarce due to the notable and unique statutory cap on the Commission's administrative budget. The vast majority of California agencies operate without any comparable constraint.

Because it was a start-up agency, the Commission deliberately sought assistance from experienced state agencies, such as the Department of General Services, the Department of Finance, and the Attorney General's office, to assist it in compliance with all state laws, specifically including contracting laws. While the Commission retains responsibility for compliance with applicable state contracting requirements, it was reasonable for it to, and it did, rely on the input from each of these agencies as a basis for its understanding that it was complying with state contracting law and policy.

For example, according to the State Contracting Manual ("SCM") drafted by the Department of General Services, Office of Legal Services ("DGS/OLS"), DGS approval of contracts "serves to assist state agencies by … ensuring effective compliance with applicable laws and policies," "conserving the fiscal interests of the state and preventing improvident acts," and "applying contract knowledge and legal expertise prior to final approval." SCM 4.02(c). Virtually all of the contracts reviewed by the BSA were reviewed and approved by DGS/OLS. While the Commission understands that it, too, must be responsible for its contracting practices, the DGS/OLS approval of the vast majority of the contracts at issue indicated to the Commission that its contracting practices complied with state laws and policies.

In another example of the safeguards the Commission relied on, the Commission retained the Attorney General's office to advise the Commission on legal matters, including contracting laws, and attorneys from the Attorney General's office attended every Commission meeting. The Commission also contracted with the Department of Finance to perform annual audits of the Commission to ensure that the Commission was engaged in appropriate fiscal management. In the 2004 and 2005 fiscal audit reports, the Department found "no instances of noncompliance" with law, regulation, or contract that required reporting under generally accepted accounting principles and "no matters involving the internal control and its operation that [the Department] considers to be material weaknesses."

Thus, based on its own efforts and the safeguards provided by three other state agencies, the Commission historically understood that it was complying with state contracting laws and policies. Its understanding was bolstered by the 2004 BSA audit of the Commission. As noted on the BSA's website, "governmental audits by the State Auditor are an important cornerstone in the system of checks and balances expected by the people of California." (www.bsa.ca.gov/aboutus/statute.php.) At the end of its 2004 audit, which began in March and ended in July 2004, the BSA concluded that: "*The state commission consistently followed contracting rules applicable to all state agencies….*"

After validation like that, the Commission had no reason to believe that there was anything wrong with its contracting practices. While the Commission appreciates the Draft Report's new guidance on contracting issues, many of its findings pertain to issues the BSA reviewed in 2004 and did not "call out." The Commission regrets that it did not have the opportunity to understand and address these issues previously.

Some of the issues the BSA reviewed in 2004 include the following matters addressed in the Draft Report:

- The Draft Report indicates that payments of $623,000 for three employees/subcontractors to a media contractor that occurred between February 2002 and December 2003 were not allowed under the terms of the contract. (Draft Report, pp. 20-23.) In 2004, the BSA reviewed the same file, which included all of the relevant invoices, but made no findings regarding this contract. Had the issues been raised in 2004, the Commission may very well have clarified the situation and proceeded consistent with the contract's terms.

- The BSA concludes that payment of $50,000 to a media contractor for a Preschool for All Advocacy Plan was not contemplated in the contract and payment was inappropriate because the Commission never obtained a finalized plan. (Draft Report,

pp 23-24.) Although the plan was presented to the Commission and paid for in 2003, the BSA reviewed this contract file in 2004 and made no findings regarding this payment.

- The Draft Report cites a March 2004 contract as having no schedules for progress and completion of work, leaving the Commission with "insufficient means with which to monitor its contractors." (Draft Report, pp. 25-27.) The BSA reviewed this contract in 2004, but made no finding. The Commission may have been better able to address the issue in 2004 when the contract had just begun and expectations between the Commission and the contractor had not yet been settled by a two-year course of dealing. The June 2002 and October 2003 contracts cited on pages 26 and 27 of the Draft Report similarly were reviewed during the BSA's 2004 audit, but the BSA made no findings regarding those contracts.

- The BSA indicates that best practices would suggest that the Commission's five "most recent" media and public relations contracts should have contained specific clauses defining "out-of-pocket" costs. (Draft Report, pp. 27-28.) Three of these five contracts were in the file in 2004, and the BSA specifically reviewed two of them in 2004. The BSA did not recommend, in 2004, inclusion of an "out-of-pocket" cost definition in these types of contracts, or note the lack of such a clause as a deficiency. Both of the most recent media and public relations contracts were executed after the BSA issued its final 2004 audit report. Had the BSA made a recommendation in July 2004, it is likely that these two contracts would include the "out-of-pocket" language the BSA now identifies as a contracting best practice for state agencies.

- In the Draft Report, the BSA examines seven media and public relations contracts dating back to 1999 and states that the Commission failed to appropriately utilize workplans to manage these contracts. (Draft Report, pp. 28-30.) The BSA specifically reviewed two of the contracts cited, "Public Relations Contract #2" and "Media Contract #3," in 2004. In fact, Public Relations Contract #2 is identified in the Draft Report as having the highest incidence of workplan deficiencies of any of the contracts examined, including six workplans without detailed budgets and two missing workplans. Nonetheless, the BSA made no workplan deficiency findings in 2004 and the Commission continued to administer the workplans consistent with the BSA's 2004 conclusion that the Commission's practices complied with contracting rules.

- The BSA cites an April 2004 invoice with insufficient documentation to support $73,805 in charges. (Draft Report, p. 34.) That invoice was part of the contract file when the BSA reviewed it in 2004. All but one of the remaining unsupported charges cited in the Draft Report occurred during or after the 2004 BSA audit. (Draft Report, pp. 33-36.) Had the Commission been alerted to this issue in 2004, many, if not all, of the subsequent charges may have been handled much differently. Moreover, as to the $191,000 in charges related to media subcontractors, the invoices from May 2004 to mid-April 2005 contain substantially equivalent information to that in the invoices for the same subcontractors in 2002 and 2003. If the BSA had noted that in 2004 the information in the earlier invoices was insufficient, the Commission would have taken action to require further support for future invoices.

- The BSA indicates that the Commission made advance payments to its public relations contractor in July 2003, December 2003, February 2004, and September 2004 for purposes of paying Community Based Organizations for their efforts in educating the public about the needs of California children in the first five years of life. (Draft Report, pp 37-38.) The BSA reviewed this file in April 2004, over a year after the first of these payments was made to the public relations contractor. The BSA now criticizes these four payments in support of the Community Based Organization program, three of which were in the file in April 2004, as well as one subsequent payment. Had the Commission been made aware of this issue in connection with the 2004 audit, it is quite possible that the September 2004 payment never would have been made or would have been structured differently.

- The BSA cites the Commission for failing to keep a copy of a state contract register advertisement in the file with the contract that was ultimately awarded in 2001 after 13 bids were received and reviewed. (Draft Report, pp. 48-49.) The BSA reviewed this contract in 2004 and made no findings of advertising problems. Regardless, this issue appears to be a one-time problem, as the BSA found no similar problems with other competitively-bid contracts. Moreover, it is highly likely that this contract was, in fact, advertised, since it did receive 13 bids.

- The BSA cites a February 2004 media contract amendment as an example of insufficient justification for a non-competitively bid contract amendment, one of six such amendments the BSA cites in the same section. (Draft Report, pp. 52-53.) In 2004, the BSA reviewed the contract file for the media contract at issue and made no finding that the amendment was insufficiently justified. Four of the five remaining amendments were executed after the BSA issued its 2004 audit report.

- The BSA cites seventeen agreements with other California agencies (interagency agreements) as having insufficient documentation that subcontractors were selected by competitive bidding processes or were exempt from such processes. (Draft Report, pp. 54-58.) In 2004, the BSA reviewed at least eight of the seventeen interagency agreement files cited in the Draft Report, and made no finding of non-compliance with subcontractor selection requirements.

- The BSA cites thirteen contracts that calculate permissible indirect costs by multiplying an agreed percentage against the full contract amount or all of the subcontract amounts found in the contract, rather than limiting the percentage application to the first $25,000 of each subcontract under a single, primary contract. (Draft Report, pp. 58-59.) To illustrate this point, the Draft Report uses a November 2001 interagency agreement that the BSA reviewed in 2004, although the BSA made no findings related to incorrect calculation of indirect costs at that time. Indeed, during the 2004 audit, the BSA reviewed six of the thirteen interagency agreements it now cites as including incorrect calculations of indirect costs. In any event, the Commission has already addressed this issue, which appears to stem from staff's misunderstanding regarding how to calculate these fees.

- The BSA cites forty-three contracts and twenty-two amendments as approved by DGS after the date cited in the contract or amendment as the start date of the contract period. (Draft Report, pp. 62-65.) Thirty-six of the forty-three contracts and twelve of the twenty-two amendments were executed between 2000 and 2004. The BSA specifically reviewed seventeen of these thirty-six contracts and two of the amendments during the 2004 audit, and made no finding that the Commission had failed to use best practices with regard to their approval. The six contracts cited by the BSA that were executed in 2005 or 2006 would have been handled differently had the Commission been alerted to the problem in 2004.

In sum, given the Commission's history of working with other, more experienced and knowledgeable agencies, and given the BSA's 2004 conclusion that "[t]he state commission consistently followed contracting rules applicable to all state agencies," the Commission was both concerned and surprised by many of the Draft Report's findings. Nonetheless, the current audit will provide a template for the Commission to identify and correct weaknesses in its practices, policies, and procedures. This year the Commission is already a dramatically different agency than it was last year, due to the diligent and conscientious efforts of its Commissioners and staff to continuously improve in every area of operation. With the information we now have, we will work very hard to ensure that next week, next month, and next year the Commission becomes a model for state contracting. Indeed, many of the actions we outline below have already been implemented, either formally or informally, and the change in the Commission's operations are already apparent.

***Clarifications of Specific Issues in the Draft Report***

While the Commission does not dispute the Draft Report's overall conclusion that there is room to improve the Commission's contracting practices, there are some limited areas of the Draft Report that do not reflect the Commission's position or understanding of the facts.

**Media Subcontractors as Employees**. The Draft Report concludes that $623,000 in payments to media subcontractors were impermissible under the terms of the media contract. Although determining that the retention of these subcontractors may have been permissible under the contract if they had been treated as subcontractors (Draft Report, pp. 21, 32), the Draft Report concludes that because they were employees of the media contractor rather than subcontractors, the payments were impermissible. (Draft Report, pp. 20-23.) We believe this finding excessively emphasizes the form of these individuals' engagement by the media contractor over its substance.

That is, the media contractor could have engaged these individuals as subcontractors. (Draft Report, p. 32 ("Although paying these individuals as subcontractors under its media contract was allowable in certain circumstances under the contract's terms. . . .").) That the media contractor or Commission staff may have called these individuals "employees" in some cases rather than "subcontractors" does not justify the rather harsh conclusion that "the state commission allowed its media contractor to circumvent the payment provisions of the contract." (Draft Report, p. 22.) In fact, whether someone is an employee or an independent contractor is a highly fact-specific inquiry turning on many factors. S.G. Borello & Sons v. Dept. of Industrial Relations (1989) 48 Cal. 3d 341, 350-351; Empire Star Mines Co. v. California Employment Commission (1946) 28 Cal. 2d 33, 43-44.

Indeed, the media contractor did not even consistently describe these subcontractors as "employees," and the reality appears to be that it treated them as subcontractors. While some of the media contractor's e-mails discuss the three subcontractors as employees or state that the individuals are "technically" employees, other e-mails refer to them as contractors. Still other e-mails suggest that the media contractor did not direct the subcontractors as employees, and did not apply the same terms and conditions of employment to them that it did to its regular employees. In addition, it is our understanding that the media contractor did not provide these individuals with offices, e-mail accounts, computer server access, or other resources that it generally provided to its regular employees. And perhaps the most important evidence on this issue, i.e., the media contractor's invoices to the Commission, describe the individuals as subcontractors. In short, the weight of the evidence suggests that the media contractor actually considered these individuals consultants rather than employees, making the Commission's payment to them much more in line with the terms of the contract.

In any event, this finding is directed at an isolated issue. While the Commission has no reason to believe the situation will be repeated, it will ensure through staff training that it understands the concerns and will clarify any future contractor/subcontractor relationships that are unclear.

**Work Within the Scope of the Media Contract**. The Draft Report also indicates that payment to the subcontractors was improper because, according to the BSA, the activities performed by the individuals were outside the scope of the contract. (Draft Report, pp. 20-24.) The Commission does not believe this is a wholly accurate depiction of the subcontractors' activities. We very recently learned that the subcontractors spent a good deal of time on activities like developing media/advertisements, aligning the Commission's media strategy with its programs, and implementing media campaigns addressing preschool and healthcare for children. The media contract at issue includes in its scope of work conceptualizing, developing, pre-testing, and implementing advertising campaigns, and ensuring advertising content compliments the Commission's program activities. Thus, it appears that at least some of the activities performed by these subcontractors were within the scope of the contract, although the Commission understands that the lack of documentation in its files renders a precise understanding difficult.

The Draft Report also concludes that development of the Preschool for All Advocacy Plan was outside the scope of the media contract, which the Draft Report describes as "purchasing printed ad space or broadcast media time." (Draft Report, pp. 23-24.) The contract specifically states that the contractor is "responsible for, but not limited to," a variety of activities including developing "a plan to ensure that advertising content is consistent with and complementary to CCFC-funded program activities," and conducting research and market analysis to provide information about "how to best position CCFC public education advertising messages relative to other social marketing and advertising campaigns and the relative merit of selected strategies and messages." Thus, developing a Preschool for All Advocacy Plan that encompasses not only traditional media but social marketing and advertising campaigns appears to be within the scope of the contract.

**Draft Report Title**. The Draft Report's title reflects only the first two chapters of the report regarding contracting. Given that the audit was prompted by public concerns that the Commission spent tens of millions of dollars improperly on advertising the benefits of preschool, and given that the BSA found that the Commission's advertising was well within its statutory authority, did not constitute political advocacy, and met the constraints on the use of public funds for political advocacy, the Commission expressed its concern to the BSA that the Draft Report's title did not reflect the BSA's findings on these critical issues. The BSA indicated that selection of the report title was within its discretion and it chose to leave the title as reflective of only the contracting chapters. The Commission disagrees with this exercise of the BSA's discretion.

**Chapter Two Title**. The title of Chapter Two indicates that inconsistencies in the Commission's contracting practices resulted in "violations of state laws and policies." The Commission requested that the BSA specify within Chapter Two where it found violations of law as opposed to violations of policy. The BSA indicated that it would review the chapter to ensure clarity, but indicated that it had found only one instance that it believed was a violation of state law (as opposed to policy). With this understanding, the Commission requested that the title of Chapter Two be changed to reflect that inconsistencies in the Commission's contracting practices resulted in "violations of state policies and, in one case, of state law." The BSA indicated it would consider the request but, to the Commission's knowledge, it has not modified the chapter title.

**CTA Improving Classroom Education Proposed Ballot Measure**. The BSA examined the Commission's payment to its subcontractors who also worked on the 2003/2004 California Teachers Association's ("CTA") Improving Classroom Education proposed ballot measure, for the purpose of determining whether the Commission improperly spent public funds on political advocacy. (Draft Report, pp. 74-78.) The Draft Report focuses on the period between April 8, 2004, when the CTA withdrew its support for its own proposed ballot measure (thereby rendering it a nullity), and August 18, 2004, when the Secretary of State officially determined that the initiative had failed to qualify for the ballot. The BSA indicates that the documents in the Commission's files are insufficient to establish what the subcontractors were doing when they worked for the Commission's media contractor. The BSA therefore theorizes that the subcontractors might have been working on the Improving Classroom Education proposed ballot measure. The Commission disagrees with this theory.

As the BSA acknowledges in the Draft Report, the CTA withdrew its support on April 8, 2004, and both the former chair of the Commission and one of the subcontractors interviewed by the BSA indicated that the proposed ballot measure was "dead" as of that date, i.e., three weeks before the subcontractors resumed working with the Commission's media contractor. There is no evidence that anyone performed any work on the proposed ballot measure after the CTA withdrew its support. Moreover, after six months of unrestricted access to the Commission's files and systems and after interviewing the former Commission chair, the former Commission Chief Deputy Director, and the subcontractors, the BSA found no evidence that the subcontractors performed any work on the proposed ballot measure during the period in question. In short, all the circumstances and evidence suggest that the subcontractors did not work on the proposed ballot measure while they worked with the Commission's media contractor. As a result, the Commission does not find any support for the theory that because Commission records are not fully developed, these subcontractors might have been working on activities related to the initiative.

**Use of Subcontractors under Interagency Agreements**. The Draft Report indicates that the use of subcontractors under seventeen interagency agreements lacked sufficient justification/ documentation. (Draft Report, pp. 54-58.) Ten of the agreements, including eight reviewed by the BSA in 2004, included express language that subcontractors would be used. (Some contracts specifically identified the subcontractor(s) and provided specific budgets and task lists for them.) These ten contracts were approved by the Department of General Services/Office of Legal Services. Written approval by DGS/OLS is one of the ways that agencies can comply with subcontracting requirements for interagency agreements. The Commission therefore believed it had complied with the requirements when it obtained DGS/OLS approval of the contracts.

To support its alternative conclusion regarding these contracts, the BSA called an attorney at DGS/OLS and obtained an oral opinion that DGS/OLS written approval is provided in a document that is separate from the contract itself. The Commission notes that the State Contracting Manual, drafted by DGS/OLS, makes no such distinction in whether written approval of subcontractors is included within, or separate from, the contract itself. We have never seen any written policy or other documentation that the official position of DGS/OLS is as reported to the BSA. While the Commission does not dispute the DGS/OLS's attorney's position and will treat these contracts differently in the future, the DGS/OLS requirement of a second document confirming the provisions of a DGS/OLS approved contract is not apparent in the provisions of the SCM. State agencies may appreciate more specific direction on compliance with this specific practice of DGS/OLS.

**Justification for Non-Competitively Bid Contract**. The Draft Report identifies one contract, let in 1999/2000, as problematic in its justification for non-competitive bidding and in its justification of the contract amount. (Draft Report, pp. 50-52.) But as the report acknowledges (p. 52), the Commission let two other non-competitively bid contracts in 2000 that were challenged in litigation, in part on the basis that the justification for non-competitive bidding and the justification of the contract amounts were insufficient. In that case, the court held that under the circumstances then prevailing at the Commission, the Commission's acts in non-competitively bidding those two contracts and in setting the contract prices were reasonable. Although no one challenged the non-competitive bid status or the cost-justification of the third contract, it was let at the same time and under the same circumstances as the two other contracts. All three of these contracts are a product of difficult circumstances recognized by the San Diego Superior Court in upholding the validity of the two contracts before it. We feel confident that had the third contract been included in the same litigation, the court would have reached the same conclusion. We also note the Superior Court's finding with respect to the two litigated contracts that the state received its money's worth.

***The BSA Recommendations and the Commission's Responses***

The Commission has carefully reviewed all of the BSA's recommendations in regard to Chapter One (Contract Management) and Chapter Two (Contracting Practices). As to Chapter 3 (Political Advocacy), the BSA had no recommendations.

The Commission believes that the majority of BSA's recommendations regarding Chapters One and Two result from a lack of updated training programs and procedures for contracting. We are addressing the recommendations as follows:

1. Policies. Since mid-2005, the Commission has been re-examining its existing administrative structure. In mid-2006, when our new Chief Deputy Director (previously the Board of Equalization's Chief of Customer and Taxpayers Services Division) and new Chief of Administration (previously the Department of Education's Manager of Funding, Allocations, and Administrative Services) were selected, the focus turned from larger reorganization issues to specific needs like revised policies and procedures. We have developed an outline for a new Administrative Policies and Procedures Manual that will include a section on contracting generally and on contracts unique to the Commission specifically. The policies will cover:

    a. Key contract compliance standards and policies to address consultant service contracts, interagency agreements, and contracts with local governments;

    b. Guidelines for reviewing and approving subcontractors in advance, including methods of documenting the approvals;

    c. Guidelines for oversight of subcontractor usage in interagency agreements, including required documentation of competitive bidding or other avenues for appropriate selection of subcontractors;

    d. Competitive bidding, including steps to be taken when fewer than three bids are received, and standardized documentation requirements for scoring competitive bids. We will also address appropriate use of non-competitive bids, including justification requirements;

    e. Advertising proposed contracts for bid;

    f. Calculating indirect costs on subcontracts under interagency agreements;

    g. Media and public relations contract management, addressing issues specific to these types of contracts. Workplan requirements, review, and approval will be included;

    h. Invoice review and approval, including acceptable documentation of expenses and other charges;

    i. Documentation and filing of all contract documents; and

    j. Contract life cycles, including planning for the time required to both develop the contract and obtain approval from DGS in advance of the contract start date.

2. Training. All staff who have responsibility for contracting will now be required to complete specific training regarding contracts, and to renew their training periodically to ensure that they are exposed to and retain all key contracting concepts and stay informed of new developments in state contracting requirements. Training will be tailored to each staff member's level of responsibility for contracting. Training requirements will be outlined in each staff member's individual development plans, which form the basis for annual evaluations. Specifically:

    a. We have already sent multiple staff members to training provided by the Department of General Services on various contracting issues, including scope of work, documentation, non-competitive bids, and evaluation criteria. We have a schedule of classes for staff members to ensure that all staff members complete all required DGS classes no later than July 2007. Because DGS's classes have limited space, last month we requested that DGS perform on-site training with a large group of our staff. DGS has not yet responded to our request. If DGS is able to accommodate our request, we anticipate that all staff will complete all required DGS training early next year.

    b. We have already conducted in-house classes, developed and administered by our new Chief of Administration, regarding contract management. We plan to continue this program to include formal training sessions depending on need but on a frequency of three to twelve sessions annually.

    c. As noted above, we are reviewing and revising all of the Commission's policies. As they relate to contracting, all staff with contract-related responsibilities will receive training on the Commission's policies.

    d. We have assigned the coordination of staff training to a staff member, who will provide quarterly reports to senior management on the status of staff training.

3. We have already drafted a board procedures manual and will finalize and adopt it for use by the Commission soon. We believe that a board procedures manual will assist the Commissioners in understanding their roles and responsibilities, both at meetings and in other interactions with staff. We believe that providing Commissioners with tools to understand the state process will result in more informed interactions between Commissioners and staff both at and outside of Commission meetings.

As to the remaining issues, the Commission has suspended the MOU program. No new allocations under Health and Safety Code section 130125(i) will be made until the Commission's counsel can review the statutory authority previously relied on for this program and advise the Commission whether or not the program may continue and, if so, under what circumstances. In addition, the Commission will continue its discussion with its counsel regarding the Commission's authority to delegate contracting authority.

**Conclusion**

In conclusion, the Commission appreciates the BSA's hard work and its findings. We are pleased that the BSA has confirmed that the initial basis for requesting the audit – concerns that the Commission had misspent public monies on political advocacy and had coordinated its spending with the proponents of Proposition 82 – was unfounded. The Commission is also pleased with the BSA's provision of a roadmap, through its audit report, for the Commission to make itself a model for state contracting practices. We are deeply committed to that objective, which we have already begun to pursue aggressively by implementing new policies and practices and by improving staff training.

Sincerely,

*(Signed by: Kris Perry)*

Kris Perry
Executive Director

# COMMENTS

## *California State Auditor's Comments on the Response From the California Children and Families Commission*

To provide clarity and perspective, we are commenting on the California Children and Families Commission's (state commission) response to our audit report. The numbers below correspond to the numbers we placed in the margins of the state commission's response.

- The state commission's comments are misleading and fail to address our entire conclusion. Although we conclude on page 63 that we were generally able to determine that the state commission's payments to these individuals were consistent with the restrictions on the use of public funds for political purposes, we also concluded that for almost a four-month period in 2004, we could not determine whether public funds were spent appropriately to pay for the services of these three individuals because the state commission did not have adequate records.

- The state commission is being disingenuous. Beginning in fiscal year 1999-2000, the state commission has received an average of $6 million each year for a total of $42 million as of June 30, 2006, to use for its own administrative functions. Further, because it has not fully expended the funds available to it every year, as of June 30, 2006, it has $22.6 million of the $42 million still available for its use. Thus, its claim of a history of scarce resources does not appear to be valid.

- The state commission is correct in its response by recognizing that it, and not the Department of General Services, the Attorney General's Office, or the Department of Finance is responsible for its contracting practices.

- To provide clarification, the scope of the 2004 audit primarily focused on the county commissions' policies and procedures for allocating the 80 percent of the tobacco tax revenues they received. Because the focus of the 2004 audit was mainly on the county commissions, we selected only a small sample of the state commission's contracts to perform a high-level review, limited to the contracting methods and whether the state commission obtained certain approvals.

Additionally, because our 2004 audit was focused on allocation procedures, we did not review a sample of invoices or deliverables. In contrast, our current audit includes an in-depth review of state contracting rules as well as a review of 62 payments and selected deliverables. Many deficiencies we discuss in our current report we identified during our review of these payments and deliverables. Finally, the state commission incorrectly assumed that we reviewed all 27 contracts on a list it provided to us during our 2004 audit. We only selected eight contracts from that list to review; thus, many of the contracts the state commission discusses in the bullet points of its response were not, in fact, reviewed during our 2004 audit.

- The state commission is missing the point in its characterization that we excessively emphasized the form of the engagement of three of the media contractor's employees over the substance. As we state on page 19, the provisions of the contract did not allow the contractor to charge the state commission directly for the services of its employees. Further, even if we were to view these three individuals as subcontractors, which we do not, the payments made by the state commission would still be impermissible. According to the contract provision that that we cite on page 19, all subcontracts must be pre-approved by the state commission and, as we state on page 19, the state commission neither received nor approved subcontracts for these three individuals.

- We are puzzled by the state commission's assertion that "the weight of the evidence suggests that the media contractor actually considered these individuals [as] consultants rather than employees, making the commission's payment to them much more in line with the terms of the contract." The media contractor provided us with payroll records, which indicated that the three individuals were, in fact, its employees. Further, as we state on page 19, correspondence we obtained between the media contractor and the state commission clearly indicated that it was aware that these individuals were employees of the media contractor rather than subcontractors. Further, as we state on page 20, other correspondence we obtained indicated the contractor had concerns about whether these types of charges were appropriate under the terms of the media contract. Thus, it does not seem plausible to us that either the media contractor or the state commission believed these individuals were other than employees.

- The state commission is incorrect. We do not state that payment to the subcontractors was improper because the activities performed by the individuals were outside the scope of the contract. Instead,

what we do state on page 18 is that these types of payments violated the terms of the contract, which allowed for payments based only on the contractor's own services, in the form of commissions applied to the cost of the advertising it placed; no other services or fees were to be charged.

- The state commission is again incorrect when it states that our report concludes that development of the Preschool for All Advocacy Plan was outside the scope of the media contract. Our conclusion on page 20 is that this is another instance of the state commission making an unallowable payment under the contract provisions that specify no fees would be charged.

- The state commission misstates what we said. While it is true that only one state law was violated, based on our testing, it was violated multiple times.

- We did not theorize. As we indicate on pages 65 and 66, because of its poor management of the contract and lack of supporting documentation, the state commission was unable to provide us with evidence that showed what these individuals were paid to do during this period or how it knew these payments were appropriate. Further, the only evidence we have as to what these individuals were doing during the period from May 1 through August 18, 2004, are based on their assertions, which cannot be corroborated by documentation from the state commission. Thus, we stand by our statement that we cannot definitively determine whether the payments made by the state commission to the three individuals during this period were appropriate.

- As we state on page 43, although the court found that these two contracts were valid and reasonable under the circumstances, the court also indicated it reached this conclusion despite the fact that there were technical violations of state contracting laws and policies. We believe we have appropriately identified the deficiencies with this third contract that was not part of the court's ruling.

cc: Members of the Legislature
Office of the Lieutenant Governor
Milton Marks Commission on California State Government Organization and Economy
Department of Finance
Attorney General
State Controller
State Treasurer
Legislative Analyst
Senate Office of Research
California Research Bureau
Capitol Press