

STATE OF CALIFORNIA

Unnecessary Administrative Fees Increase the State's Cost of Contracting With California State Universities

REPORT NUMBER 2000-001.4, NOVEMBER 2000

Audit Highlights . . .

Our review of the State's contracts with the California State University (CSU) system revealed that:

- While the contracts with CSU entities appear appropriate, state departments have unnecessarily paid or agreed to pay fees to administer these contracts.*
 - State departments will pay the CSU Board of Trustees \$1.5 million to simply act as an intermediary between the State and the CSU foundations.*
 - State departments could have saved \$1.4 million in administrative fees had they negotiated the average 15 percent rate for more of the contracts.*
 - By allowing CSU foundations to purchase goods and services for them, rather than doing it themselves, state departments paid \$102,000 more than necessary.*
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State departments (departments) contract for billions of dollars of services every year. To obtain needed services, departments sometimes contract with entities in the California State University (CSU) system for the expertise of the faculty, staff, and students at various CSU institutions. From July 1998 to February 2000, state departments had contracts worth \$143 million with the CSU system. We reviewed a sample of 183 contracts worth \$93 million and found CSU faculty and students appropriately performed the majority of the work. Furthermore, when subcontractors were hired, they were properly selected through a competitive bid process, if bidding was required. While the contracts with CSU entities appear appropriate, we did find that some state departments have unnecessarily paid or agreed to pay the university system \$3 million in fees to administer these contracts. Specifically, we found:

Finding #1: Contracting with the Board of Trustees of the CSU is more costly to the State.

Many departments are paying more than necessary for administrative fees because they are contracting with the CSU Board of Trustees (board) instead of negotiating contracts directly with the campuses. The board acts as an intermediary for departments and the CSU foundation that provides the services. It establishes master agreements with CSU foundations, enters into an interagency agreement with departments, and then issues work authorizations to the foundation that will provide the contracted services. Based on the terms of existing agreements, departments will pay the board about \$1.5 million for this limited service.

We recommended that departments avoid contracts using fiscal intermediaries, such as the board, that add little value.

Department Action: Corrective action taken.

Although we addressed this recommendation to all departments, we only elicited a formal response from the Department of Health Services because we discussed certain details regarding one of its contracts as an example of the condition we noted.

In April 2001 the Department of Health Services issued a policy memo to its management staff instructing them to contract directly with individual CSU campuses and foundations to avoid incurring unnecessary administrative costs charged by the trustees. The department also developed an on-line CSU contract model and user guides to assist staff when contracting with the CSU system.

Finding #2: Understanding the actual costs underlying administrative fees could enable departments to negotiate lower rates.

Some departments negotiate rates for administrative fees without sufficient knowledge of the cost the CSU campuses actually incur for administrative activities. For example, rather than inquiring about the level of administrative activities needed for a particular agreement, many times departments simply agree to pay an administrative rate equal to the maximum rate allowed in other contracts CSU foundations have with the federal government. This leaves the departments ill-equipped to bargain for more competitive rates.

In our sample of 183 contracts, fees generally ranged from 8 percent to 25 percent of the contracts' direct costs and covered expenses for administrative support as well as for managing personnel, finances, and facilities. The average administrative fee for the contracts reviewed was 15 percent of total direct costs. However, state departments often paid more than 15 percent. Taking into account only those 36 contracts not brokered by the board in which the administrative fee exceeded 15 percent, the State could have saved \$1.4 million had the contracting department negotiated the average 15 percent fee.

We recommended that state departments negotiate rates for administrative fees based on a fuller understanding of the actual costs comprising the rate.



Department Action: None.

Although we addressed this recommendation to all departments, we only elicited a formal response from the Department of Transportation (department) because we discussed certain details regarding one of its contracts as an example of the condition we noted.

The department stated that it accepts the federal rate for administrative costs in cases where the agreements are financed by federal funds. The department believes its current process of relying on the federal indirect cost rate-setting process, pre-award, and periodic post-audits ensures that indirect costs charged on contracts are reasonable. However, according to a representative of the federal Department of Health and Human Services, the federal cognizant agency for the department, the federal indirect cost rate represents a maximum administrative fee rate that an entity such as a CSU can charge in federally funded contracts. There is no prohibition for an organization to negotiate a lower administrative fee rate when appropriate. Therefore, we believe the department should negotiate rates based on a fuller understanding of the actual costs comprising the rate rather than simply accepting the maximum federal rate.

Finding #3: Departments may pay fees unnecessarily if CSUs procure goods and services from subcontractors.

Departments pay more in fees because CSU campuses hire subcontractors and purchase goods for them, although the departments could procure these services and goods more cheaply themselves or seek to avoid the amount of administrative fees tacked on to the cost of these items. We identified eight contracts in which campuses entered into large subcontracts for printing services and training materials that the departments could easily have procured themselves—and saved the State \$102,000 in administrative fees.

We recommended that departments contract directly with third parties for goods and services when it is more cost-effective, or avoid payment of the administrative fees tacked on to the cost of goods and services departments could procure at reduced costs on their own.

Department Action: Corrective action taken.

Although we addressed this recommendation to all departments, we only elicited a formal response from the Commission on Peace Officer Standards and Training (commission), the Department of Health Services, and the Department of Parks and Recreation because we discussed certain details regarding their contracts as examples of the conditions we noted.

In response to our recommendation, the commission reported in May 2001 that it does not have the staff to directly purchase all materials. However, it has been successful in securing agreement with CSU foundations to withhold administrative fees related to costs for simple purchases of materials or rental of equipment or facilities.

The Department of Health Services issued a policy memo to its management staff in April 2001 instructing them to evaluate the necessity of using subcontracts under university agreements and to eliminate their use whenever it is more practical and cost-effective for the department to directly secure the services of a third party. The department also developed an on-line CSU contract model and user guides to assist staff when contracting with the CSU system.

The Department of Parks and Recreation has updated its user's guide for contract administration and its administrative manual to provide additional guidance to its contract writers. Among other provisions, this guidance requires contract writers to contract with third parties for goods and services, when cost effective, to avoid payment of administrative fees added to the cost of these goods and services.