



Orange County Auditor-Controller Internal Audit



Internal Control Audit:
Auditor-Controller
Procurement & Contract Administration

For the Year Ended
June 30, 2016

Audit Number 1522
Report Date: September 11, 2017



O R A N G E C O U N T Y
AUDITOR-CONTROLLER
INTERNAL AUDIT

Eric H. Woolery, CPA
Orange County Auditor-Controller

Toni Smart, CPA Director, Internal Audit

Scott Suzuki, CPA, CIA Assistant Director

Winnie Keung, CPA, CIA, CGMA Audit Manager II

Monica McCoy Auditor I

12 Civic Center Plaza, Room 200
Santa Ana, CA 92701

Auditor-Controller Web Site
www.ac.ocgov.com



ERIC H. WOOLERY, CPA
AUDITOR-CONTROLLER



Transmittal Letter

Audit No. 1522

September 11, 2017

TO: Eric H. Woolery, CPA
Auditor-Controller

SUBJECT: Internal Control Audit:
Auditor-Controller Procurement & Contract Administration

We have completed our Internal Control Audit of Auditor-Controller Procurement & Contract Administration for the year ended June 30, 2016. Our final report is attached for your review.

I submit an **Audit Status Report** quarterly to the Audit Oversight Committee (AOC) and a quarterly report to the Board of Supervisors (BOS) where I detail any critical and significant audit findings released in reports during the prior quarter and the implementation status of audit recommendations as disclosed by our Follow-Up Audits. Accordingly, the results of this audit will be included in a future status report to the AOC and BOS.

Additionally, we will request your department to complete a **Customer Survey** of Audit Services. You will receive the survey shortly after the distribution of our final report.

A handwritten signature in blue ink, appearing to read "Toni Smart".

Toni Smart, CPA, Director
Auditor-Controller Internal Audit Division

Attachments

Other recipients of this report:

Members, Board of Supervisors

Members, Audit Oversight Committee

Frank Kim, County Executive Officer

Alice Sinclair, Administration and Business Operations Manager, Auditor-Controller

Maribel Garcia, Purchasing Manager, Auditor-Controller

Foreperson, Grand Jury

Robin Stieler, Clerk of the Board of Supervisors

Macias Gini & O'Connell LLP, County External Auditor



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Auditor-Controller
Procurement & Contract Administration
Audit No. 1522***

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Internal Auditor's Report

Audit No. 1522

September 11, 2017

TO: Eric H. Woolery, CPA
Auditor-Controller

FROM: Toni Smart, CPA, Director
Auditor-Controller Internal Audit Division

SUBJECT: Internal Control Audit:
Auditor-Controller Procurement & Contract Administration

OBJECTIVES

We have completed our Internal Control Audit of Auditor-Controller Procurement & Contract Administration for the year ended June 30, 2016. We performed this audit in accordance with the FY 2016-17 Audit Plan and Risk Assessment, approved by the Audit Oversight Committee (AOC) and the Board of Supervisors (BOS), to assist management in evaluating and enhancing internal controls and the effectiveness and efficiency of the selected areas under audit. Our audit was conducted in conformance with the International Standards for the Professional Practice of Internal Auditing issued by the International Internal Audit Standards Board. The objectives of this audit were to:

1. Evaluate the adequacy of internal controls over the procurement and administration of contracts to ensure they are procured, executed, and administered in compliance with the County's 2012 Contract Policy Manual (2012 CPM).
2. Evaluate the adequacy of internal controls over the contract payment and approval process to ensure the payments are accurate, valid, adequately supported, and properly recorded.
3. Evaluate the efficiency and effectiveness over the administration and procurement of contracts (e.g., no backlogs, duplication of work, or manual processes that could benefit from being automated).

RESULTS

Objective 1: Our audit found that internal controls were generally in place to ensure contracts were procured, executed, and administered in compliance with the County's 2012 CPM; however, we identified **three (3) Control Findings** where internal controls can be enhanced as follows: 1) stronger justification for sole source requests (**Finding No. 1**); 2) establish a training program for new contract administrators (**Finding No. 3**); 3) sole source justification approval timing (**Finding No. 4**).

Objective 2: Our audit found that internal controls over the contract payment and approval process were generally in place to ensure payments were accurate, valid, adequately supported, and properly recorded; however, we identified **one (1) Control Finding** where a contract was overrun (**Finding No. 2**).

Objective 3: Our audit did not disclose any instances concerning duplication of work, backlogs, or manual processes that could benefit from being automated.



Internal Auditor's Report

BACKGROUND

The Auditor-Controller's (A-C) mission is to promote public oversight, provide accountability, and support financial decision-making for the County.

The A-C achieves its mission through five divisions as follows:

1. Central Accounting Operations

Provides the core services, e.g., accounts payable, financial reporting, maintenance of the property tax rolls, payroll, and services traditionally associated with the A-C's Office.

2. Satellite Accounting Operations

Provides specialized accounting services, e.g., reimbursement claiming, accounts receivable, and grant accounting to nine County departments in accordance with the needs of each host department.

3. Executive & Administrative Services

Provides leadership and direction for the department. The Administrative Services Unit (Administrative Services) within this division is responsible for purchasing, budget management and administrative support, and provides central administrative support to the remainder of the A-C's Office.

4. Information Technology

Maintains the A-C and Countywide financial systems running accurately and timely. Provides support to the County's infrastructure required for County operations, which includes CAPS+ Financial and Procurement and CAPS+ Human Resources and Payroll Systems, and CAPS+ System Security & Workflow and CAPS+ Program Management Office.

5. Internal Audit (IA)

Performs countywide audits of County departments/agencies related to internal controls and financial statement accounts and transactions. Conducts A-C's legally mandated audits required by the Government Code and the Welfare Institutions Code and performs quarterly reviews of the Treasurer's Schedule of Assets.

The focus of this audit engagement is on the procurement and contract administration functions within Administrative Services. The IA and the Executive & Administrative Services Divisions report directly and separately to the elected Auditor-Controller.

County Purchasing Policy

On July 24, 2012, the Board of Supervisors (BOS) adopted the 2012 County of Orange Contract Policy Manual (2012 CPM), which provides general procurement policy and standards that govern the conduct of County's procurement activities and personnel engaged in these activities. Our audit period included contracts subject to requirements in the CPM.

Auditor-Controller Contracts

As of June 30, 2016, the Auditor-Controller had 31 master agreements, totaling \$22,878,831. Some agreements were created prior to our audit period from July 1, 2015 through June 30, 2016. During our audit period, A-C entered into 13 agreements, totaling \$6,308,439.



Internal Auditor's Report

Table 1. Contract Detail (Count and Amount) by Division

Division	Contracts as of June 6/30/2016	Contracts Created During the Audit Period
Central Accounting Operations	7	\$3,156,504
Satellite Accounting Operations	0	0
Executive & Administrative Services	6	235,272
Information Technology	14	19,353,480
Internal Audit	4	133,575
Total	31	\$22,878,831
		\$6,308,439

During the audit period, A-C had seven sole source contracts. Among these, three totaling \$6,018,469 were awarded during the audit period.

Table 2. Sole Source and Non-Sole Source Contract (Count and Amount)

	Contracts as of June 6/30/2016	Contracts Created During the Audit Period
Sole Source	7	\$18,589,172
Non-Sole Source	24	4,289,659
Total	31	\$22,878,831
		\$6,308,439

Purchasing Documents

A purchasing document is created in the Countywide Accounting and Payroll System (CAPS+) for internal controls and payment process for an agreement. There are three (3) different documents:

1. A delivery order (DO) is an encumbering document that is used to purchase commodities and services via a specific master agreement.
2. A purchase order (PO) is a formal document used by the County to enter into a contractual agreement with registered vendors for specific goods and services. A PO is used to encumber funds for purchases of goods and services, is non-renewable, and is commonly used for one order, one invoice, and one payment.
3. A contract (CT) is a formal type of purchase order in CAPS+ used by the County to enter into legal agreements with registered vendors for specific goods and services; it is similar to a PO, but allows for multiple invoices and payments.



Internal Auditor's Report

Table 3. Purchasing Documents Created During the Audit Period

Purchasing Documents	Count	Amount
Delivery Order (DO)	23	\$8,852,614
Purchase Order (PO)	*16	*270,945
Contract Document (CT)	1	18,569
Total	40	\$9,142,128

*One (1) purchase order in the amount of \$15,266 was a sole source.

Table 4. Purchasing Documents (Count and Amount) by Division During the Audit Period

Division	Count	Amount
Central Accounting Operations	6	\$639,412
Satellite Accounting Operations	1	7,500
Executive & Administrative Services	6	105,332
Information Technology	25	8,242,809
Internal Audit	2	147,075
Total	40	\$9,142,128

OC Expediter

We were informed the A-C will utilize OC Expediter in fiscal year 2017-18 for all purchase requisitions. The new process will eliminate some of the manual processes and forms which we evaluated in this audit.

Prior Audit Coverage

There have been no audits with this scope at the A-C within the last ten years.

SCOPE AND METHODOLOGY

Our audit covered the year ended June 30, 2016, and included A-C's administration over the procurement of contracts and reviewing and approving contract payments. Our scope and methodology included:

1. Obtaining an understanding of internal controls and processes in A-C to ensure contracts or purchase orders, including sole source, were awarded in compliance with the 2012 CPM.
2. Obtaining an understanding of internal controls and processes in A-C to ensure contract amendments were processed in compliance with the 2012 CPM.
3. Obtaining an understanding of internal controls and processes in A-C to ensure contract payments are accurate, valid, adequately supported and properly recorded.

Scope Exclusions

Our audit scope excluded the following areas:

- Any aspects of contracts or amendments initiated outside of the A-C
- CAPS+ and OC Expediter



Internal Auditor's Report

FOLLOW-UP PROCESS

Please note we have a structured and rigorous **Follow-Up Audit** process in response to recommendations and suggestions made by the AOC and the BOS. Our **First Follow-Up Audit** will generally begin at six months from the official release of the report. A copy of our Follow-Up Audit reports is provided to the BOS as well as to all those individuals indicated on our standard routing distribution list.

The AOC and BOS expect that audit recommendations will typically be implemented within six months, and often sooner, for significant and higher risk issues. Our **Second Follow-Up Audit** will generally begin at six months from the release of the first Follow-Up Audit report, by which time **all** audit recommendations are expected to be addressed and implemented. We bring to the AOC's attention any audit recommendations we find still not implemented or mitigated after the second Follow-Up Audit. Such open issues appear on the AOC agenda at their next scheduled meeting for discussion.

We have attached a **Follow-Up Audit Report Form**. Your department should complete this template as our audit recommendations are implemented. When we perform our first Follow-Up Audit approximately six months from the date of this report, we will need to obtain the completed form to facilitate our review.

MANAGEMENT'S RESPONSIBILITY FOR INTERNAL CONTROL

In accordance with the Auditor-Controller's County Accounting Manual Section S-2 Internal Control Systems: "All County departments/agencies shall maintain effective internal control systems as an integral part of their management practices. This is because management has primary responsibility for establishing and maintaining the internal control system. All levels of management must be involved in assessing and strengthening internal controls." Control systems shall be continuously evaluated by Management and weaknesses, when detected, must be promptly corrected. The criteria for evaluating an entity's internal control structure is the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control – Integrated Framework. Our Internal Control Audit enhances and complements, but does not substitute for the A-C's continuing emphasis on control activities and self-assessment of control risks.

Inherent Limitations in Any System of Internal Control

Because of inherent limitations in any system of internal control, errors or irregularities may nevertheless occur and not be detected. Specific examples of limitations include, but are not limited to, resource constraints, unintentional errors, management override, circumvention by collusion, and poor judgment. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or the degree of compliance with the procedures may deteriorate. Accordingly, our audit would not necessarily disclose all weaknesses in the A-C's operating procedures, accounting practices, and compliance with County policy.

The Auditor-Controller Internal Audit Division is available to partner with your staff so that they can successfully implement or mitigate difficult audit recommendations.



Internal Auditor's Report

ACKNOWLEDGEMENT

We appreciate the courtesy extended to us by the personnel of Auditor-Controller Administrative Services Unit during our audit. If you have any questions regarding our audit, please contact me directly at (714) 834-5442, or Scott Suzuki, Assistant Director, at (714) 834-5509.



Detailed Findings, Recommendations, and Management Responses

Business Process & Internal Control Strengths

Business process and internal control strengths noted during our audit included:

- ✓ Buyers and the Purchasing Managers are knowledgeable of the procurement process.
- ✓ Duties to procure a contract and process a contract payment are adequately segregated.
- ✓ The 2012 CPM and internal procedures are followed for processing requisitions, soliciting bids from vendors, reviewing vendor proposals, and awarding contracts.
- ✓ A contract master list is maintained to monitor the status of each contract.
- ✓ Reminder emails are sent to end user manager for contract renewals to ensure there is no lapse of services.
- ✓ There is a purchasing/contract folder for each requisition.
- ✓ A-C divisions use a requisition form to document procurement requests in detail.
- ✓ Administrative Services works with the end user to ensure the scope of the work is properly developed.
- ✓ Administrative Services uses a payment log for each requisition to prevent budget overrun.
- ✓ Each contractor payment request is reviewed by the user division and Administrative Services to ensure goods and services were received, the amount is accurate and in compliance with the contract terms and conditions, the account coding is correct, and that no duplicate payment was made.

The following areas are where we believe business processes and internal controls should be enhanced:

Finding No. 1 – Justification for a Sole Source Contract was Inadequate (Control Finding)

Among the four sole source contracts and purchase orders tested, we found the justification for one request could be enhanced to support that only one source (the selected contractor) existed to fulfill the A-C's requirements.

Inadequate justification for a sole source contract does not comply with the CPM and circumvents the competitive bid and proposal process that could result in the County not obtaining commodities or services from a vendor for the best price or value.

The A-C awarded a fixed fee sole source service contract in the amount of \$34,772 for governance assessment consultant services. A detailed justification was provided and maintained in the contract file. Although we were convinced the selected contractor had the required qualifications and may be a preferred contractor to meet the business need, we found the documented justification was inadequate so that an independent third party would conclude there was only one source in existence to fulfill the County's requirements.



Detailed Findings, Recommendations, and Management Responses

We also found that supporting documentation to substantiate the vendor's pricing was comparable to other vendors in the industry was not maintained in the contract file. Therefore, we were unable to determine if the contractor's price was comparable as stated. Complete documentation for a contract agreement should be maintained in the contract file.

The 2012 CPM, Section 4.4 ~ Sole Source and Proprietary Requests, states that, "*It is the policy of the County of Orange to solicit competitive bids and proposals for its procurement requirements. Sole source procurement should not be used unless there is clear and convincing evidence that only one source exists to fulfill the County's requirements.*"

Recommendation No. 1:

We recommend the A-C establish a policy to require that stronger justifications be provided to support a sole source contract and all supporting documents, including pricing, should be maintained in the contract file.

Auditor-Controller Management Response:

Concur: No comparable services were found, which is why a quote was not attached to the sole source form. Auditor-Controller has established a policy to require stronger justifications and to attach comparable quotes when available for sole source contracts.

Finding No. 2 – One Contract was Overrun (Control Finding)

During our review of contract payments, we found one instance of a contract overrun.

Allowing a contractor to provide services in excess of authorized amounts is against the 2012 CPM, could affect departmental budgeting, and may require additional staff time to request a retroactive contract amendment from the County Procurement Office (CPO) or BOS.

In April 2015, the A-C entered into a professional contract with a vendor for graphic design services for an amount not to exceed \$6,000, through June 2015. Subsequently, the contract was amended twice to increase the price to a not to exceed amount of \$30,000 and to extend the term through February 2016. In March 2016, the contractor submitted a payment request for services performed in February 2016 totaling \$9,510; however, this amount exceeded the available contract amount by \$5,272. As a result, the A-C submitted a contract increase form, at the CPO's request, so that the payment for the contract overrun could be processed.

We found the contract overrun was due to an oversight. The contractor included the updated remaining balance on each invoice; however, these amounts were different from the records maintained by the A-C. A-C Administrative Services has a process in place to ensure contract payments are accurate, valid, adequately supported, and properly recorded; however, it did not include validating other information listed on the vendor's invoice. As such, the contractor was not aware of the discrepancies and continued to perform the service beyond the maximum price. See **Finding No. 3** for a related recommendation on contract administrator training to prevent overruns.

Recommendation No. 2:

We recommend the A-C enhance its contract payment process to review or validate contractor's information on the invoice and to communicate timely with the contractor if there is any discrepancy.



Detailed Findings, Recommendations, and Management Responses

Auditor-Controller Management Response:

Concur: The County does not require a contractor to include the remaining contract balance on their invoice. As this is not standard information, it was not audited along with the rest of the invoice. Auditor-Controller procurement notified the County Procurement Office of the situation when it was discovered, and was instructed to complete a Contract Increase Form in order to pay the outstanding invoices. This form was approved by the County Procurement Office.

Auditor-Controller has revised its auditing procedures to clarify that all information on an invoice should be audited whether or not it is required information, and has retrained staff. As a note, the involved contract administrator and invoice auditor no longer work for the Auditor-Controller's office.

Finding No. 3 – Inadequate Training for New Contract Administrators (Control Finding)

In April 2015, the A-C entered into a professional contract with a vendor for graphic design services with a contract amount not to exceed \$6,000 through June 30, 2015. Subsequently, the A-C amended and modified the contract to increase the price to \$35,272 and extend the term to April 2016. These changes resulted in a contract increase of \$29,272 (\$35,272 less \$6,000) more or 588% of the original contract amount. The hourly rate remained unchanged; however, actual hours needed were a lot higher than the original estimate. The A-C submitted the amendments to the CPO for review and approval.

The requesting manager was new to the position and was inexperienced with planning the purchasing needs for the unit. Also, there was no historic reference to establish this contract in the department; therefore, the hours needed were substantially underestimated. Although the actual hours incurred appeared to be reasonable for completing the project, if the scope of the service was accurately projected and identified in the beginning, the vendor would have been subject to the competitive bid process. The 2012 CPM, Section 3.3-108, states that for Contracts \$25,001 and over, "*Awards in all cases will be made to the lowest responsive and responsible bidder.*" Additionally, contract administrators should obtain cost/time estimates for additional work added to prevent contract overruns.

Recommendation No. 3:

We recommend the A-C establish an internal training program for new contract administrators who are involved in planning and requesting a purchase for the division to better assess the needs for the division, work closely with Administrative Services, and improve contractor monitoring to prevent contract overruns.

Auditor-Controller Management Response:

Concur: Auditor-Controller took two actions shortly after the situation was discovered: we established a training program for new contract administrators, and began to require requisitions for usage of similar standing contracts.



Detailed Findings, Recommendations, and Management Responses

Finding No. 4 – Sole Source Justification Approved After Contract Effective Date (Control Finding)

Among the four sole source contracts and purchase orders tested, a contract agreement in the amount totaling \$15,266 was executed on April 4, 2016, with an effective period of April 4, 2016 through April 3, 2017. We found that a sole source justification form was properly prepared with all the required elements and maintained in the contract file; however, the review and approval date was April 11, 2016. While, the contract was executed prior to its final review and approval of the supporting documentation in the A-C's Office, no services were requested and no payments were made to the contractor prior to April 11, 2016.

Commencing a sole source contract prior to obtaining approval of the sole source justification does not comply with the CPM and could result in additional procedures or contract termination should the sole source justification be denied.

2012 CPM, Section 4.4 ~ Sole Source and Proprietary Requests, states that, "*It is the policy of the County of Orange to solicit competitive bids and proposals for its procurement requirements. Sole source procurement should not be used unless there is clear and convincing evidence that only one source exists to fulfill the County's requirements*". "*Formal justification for sole source procurements is required. A sole source justification will be prepared by the user agency/department and approved by the agency/department head or designee.*"

Recommendation No. 4:

We recommend the A-C enhance procedures to ensure sole source justification approval is obtained prior to entering into a contractual agreement with a sole source vendor.

Auditor-Controller Management Response:

Concur: The contract in question was for a one-time purchase and install of proprietary hardware. As mentioned above, the contract document was signed prior to the sole source justification approval date, but it was intentionally kept in a locked office within the Auditor-Controller's department and not approved in CAPS+ nor distributed to the vendor until after the sole source justification was signed. As mentioned above, no services were requested and no payments were made prior to the sole source approval. Staff have been retrained to not sign a contract until after the sole source document is approved, whether or not it is distributed.



Detailed Findings, Recommendations, and Management Responses

ATTACHMENT A: Report Item Classifications

For purposes of reporting our audit findings and recommendations, we will classify audit report items into three distinct categories:

Critical Control Weaknesses	Significant Control Weaknesses	Control Findings
<p>These are audit findings or a combination of audit findings that represent critical exceptions to the audit objective(s) and/or business goals. Such conditions may involve either actual or potential large dollar errors or be of such a nature as to compromise the department's or County's reputation for integrity.</p> <p>Management is expected to address Critical Control Weaknesses brought to its attention immediately.</p>	<p>These are audit findings or a combination of audit findings that represent a significant deficiency in the design or operation of internal controls.</p> <p>Significant Control Weaknesses require prompt corrective actions.</p>	<p>These are audit findings concerning internal controls, compliance issues, or efficiency/effectiveness issues that require management's corrective action to implement or enhance processes and internal controls.</p> <p>Control Findings are expected to be addressed within our follow-up process of six months, but no later than twelve months.</p>



Detailed Findings, Recommendations, and Management Responses

ATTACHMENT B: Auditor-Controller Management Responses



ERIC H. WOOLERY, CPA
AUDITOR-CONTROLLER



September 7, 2017

Toni Smart, CPA
Director of Internal Audit

ATTENTION: Scott Suzuki, Assistant Director
SUBJECT: Audit Report No. 1522 – Internal Control Audit: Auditor-Controller Procurement & Contract Administration

Following is our response to the recommendations contained in Report No. 1522 – Internal Control Audit: Auditor-Controller Procurement & Contract Administration.

Recommendation No. 1:

We recommend the A-C establish a policy to require that stronger justifications be provided to support a sole source contract and all supporting documents, including pricing, should be maintained in the contract file.

Auditor-Controller Management Response:

Concur: No comparable services were found, which is why a quote was not attached to the sole source form. Auditor-Controller has established a policy to require stronger justifications and to attach comparable quotes when available for sole source contracts.

Recommendation No. 2:

We recommend the A-C enhance its contract payment process to review or validate contractor's information on the invoice and to communicate timely with the contractor if there is any discrepancy.

Auditor-Controller Management Response:

Concur: The County does not require a contractor to include the remaining contract balance on their invoice. As this is not standard information, it was not audited along with the rest of the invoice. Auditor-Controller procurement notified the County Procurement Office of the situation when it was discovered, and was instructed to complete a Contract Increase Form in order to pay the outstanding invoices. This form was approved by the County Procurement Office.

Auditor-Controller has revised its invoice auditing procedures to clarify that all information on an invoice should be audited whether or not it is required information, and has retrained staff. As a note, the involved contract administrator and invoice auditor no longer work for the Auditor-Controller's office.

AUDITOR-CONTROLLER • 12 CIVIC CENTER PLAZA, ROOM 200 • SANTA ANA, CALIFORNIA 92701
PHONE (714) 834-2450 • FAX (714) 834-2569 • eric.woolery@ac.ocgov.com • ac.ocgov.com



Detailed Findings, Recommendations, and Management Responses

ATTACHMENT B: Auditor-Controller Management Responses (continued)

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Recommendation No. 3:

We recommend the A-C establish an internal training program for new contract administrators, who are involved in planning and requesting a purchase for the division, to better assess the needs for the division, work closely with Administrative Services, and improve contractor monitoring to prevent contract overruns.

Auditor-Controller Management Response:

Concur: Auditor-Controller took two actions shortly after the situation was discovered: we established a training program for new contract administrators, and began to require requisitions for usage of similar standing contracts.

Recommendation No. 4:

We recommend the A-C enhance procedures to ensure sole source justification approval is obtained prior to entering into a contractual agreement with a sole source vendor.

Auditor-Controller Management Response:

Concur: The contract in question was for a one-time purchase and install of proprietary hardware. As mentioned above, the contract document was signed prior to the sole source justification approval date, but it was intentionally kept in a locked office within the Auditor-Controller's department and not approved in CAPS+ nor distributed to the vendor until after the sole source justification was signed. As mentioned above, no services were requested and no payments were made prior to the sole source approval. Staff have been retrained to not sign a contract until after the sole source document is approved, whether or not it is distributed.

A handwritten signature in blue ink, appearing to read "Alice Sinclair".

Alice Sinclair, Manager, Administration & Business Operations

A handwritten date in blue ink, reading "9/7/17".

Date

AUDITOR-CONTROLLER • 12 CIVIC CENTER PLAZA, ROOM 200 • SANTA ANA, CALIFORNIA 92701
PHONE (714) 834-2450 • FAX (714) 834-2569 • eric.woolley@ac.ocgov.com • ac.ocgov.com