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Audit Report

CONTRACT PROCESS

As of December 31, 2010

**Office of the Controller
County of Northampton
Pennsylvania**



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October 17, 2011

Members of the Northampton County Council
John Stoffa, County Executive
County of Northampton, Pennsylvania

We have completed an audit of the County's Contract Process as of December 31, 2010.

The Executive Summary on page 1 summarizes the audit results and identifies opportunities for improvement, while the Audit Results section provides a detailed explanation.

We acknowledge the cooperation and assistance we received from the Procurement Division and all of the other offices we contacted for this audit. Their help was essential to the performance of this audit.

Our report was discussed with management at our exit conference on October 12, 2011. Management's response is included in the Audit Results section of the report.

Very truly yours,

Stephen J. Barron, Jr., CFE
County Controller

Paul L. Albert, CIA
Lead Auditor

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EXECUTIVE SUMMARY - OPPORTUNITIES FOR IMPROVEMENT

The following is a summary of the content of the enclosed report. See report references noted below for full detail.

Section A – Internal Controls

1. Having an up-to-date Procurement Manual available to all employees will provide employees with knowledge of County purchasing policies and the steps to achieving compliance. It's an invaluable training tool and an objective means for Procurement to measure compliance and improve the purchasing process. (Section A-1, pg. 5)
2. Performing onsite monitoring of social service providers in addition to the desk review of invoices and audit reports will give greater assurance that funds were properly accounted for and used, and that client eligibility was documented. (Section A-2, pg. 7)
3. A concise, written policy concerning direct expenses would provide guidance to employees involved in the payment of invoices, and provide management an objective method of enforcing compliance. (Section A-3, pg. 9)

Section B – Economy and Efficiency

1. Eliminating the requirement of advertising in the newspaper twice before a bid/proposal opening would save the County money. (Section B-1, pg. 10)
2. Developing a consistent method of establishing encumbrances and paying invoices against them would make the financial statements more reliable and make the Accounts Payable process more efficient. (Section B-2, pg. 11)

Section C – Compliance

1. Enacting performance measures to monitor compliance with the requirements of the Administrative Code in the bid/contract process will help Procurement obtain better compliance with the Administrative Code. (Section C-1, pg. 12)
2. Making some minor changes to the boilerplate contracts will bring compliance with the Administrative Code and make the contracts easier to read. (Section C-2, pg. 14)
3. Preparing a report of expiring contracts awarded through the RFP process and providing that list to Council will provide compliance with the Administrative Code. (Section C-3, pg. 15)

INTRODUCTION

The County's Administrative Code, Article XIII "Procurement and Disposition of County Property" provides the basis of regulations over the procurement of goods and services, and the requirements of contracts. Procurement authority and responsibility resides with the County Executive, who delegated that authority to the Procurement Manager. Professional service agreements entered into, or authorized by, the Courts are not subject to approval by the County Executive or County Council. Professional service agreements for social services entered into by Human Services are not subject to the approval of County Council. Those professional service agreements by the Courts and Human Services are not bid or negotiated through Procurement. County Council must be notified of contracts awarded through the bid process if the consideration exceeds \$100,000. Council must give their approval for contracts exceeding \$100,000 if the contracts were awarded through other methods such as competitive or noncompetitive negotiation.

With the exception of professional services noted above and other exemptions noted in Section 13.04.b. of the Administrative Code, the procurement of goods and services over \$25,000 must be by Competitive Sealed Bid, Competitive Negotiation or Cooperative Purchasing, unless the County Executive, with the approval of County Council, determines those methods aren't practical. Agencies are encouraged to take advantage of the professional services available in the Procurement Office such as the preparation of bid specs to be used for bids or proposals.

Exhibit 1 displays the details of the 167 active contracts that were negotiated through Procurement as of August 1, 2011, broken down by dollar amount. The list does not include professional service contracts entered into by Human Services or the Courts.

EXHIBIT 1

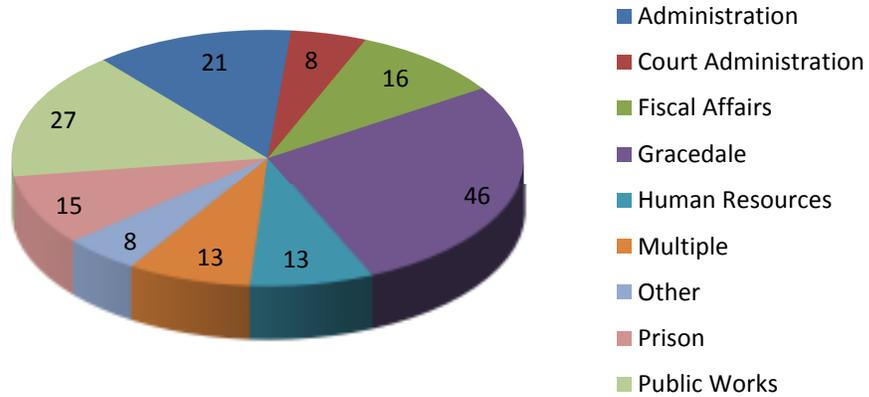
Active Contracts Negotiated through Procurement as of 8/1/11

<i>Dollar Range</i>	<i>Number of Contracts</i>	<i>Total Dollar Amount</i>	<i>Percent of Contracts</i>	<i>Percent of Dollar Amount</i>
\$1-\$50,000	84	\$974,502	50%	1%
\$50,001-\$100,000	21	\$1,577,657	13%	2%
\$100,001-\$500,000	39	\$9,186,141	23%	11%
\$500,001-\$1,000,000	8	\$5,823,705	5%	7%
Over \$1,000,000	15	\$65,436,427	9%	79%
TOTAL	167	\$82,998,432	100%	100%

Exhibit 2 displays the detail of the 167 active contracts broken down by the department they pertain to. The list does not include the professional service contracts entered into by Human Services or the Courts.

EXHIBIT 2

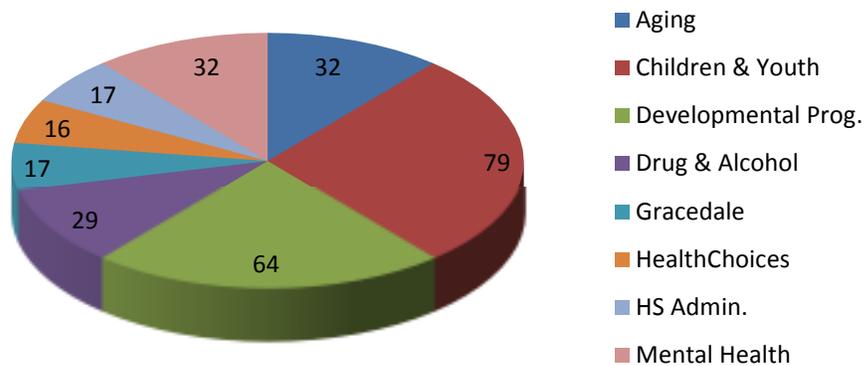
Number of Active Contracts by Department as of 8/1/11



Social service contracts in Human Services are negotiated by each of the different divisions, receiving approval from the Director of Human Services and the County Executive. For the fiscal year ended June 30, 2011 there were 286 social service contracts totaling \$57,437,709. Exhibit 3 displays the number of contracts broken down by division.

EXHIBIT 3

Number of Active Social Service Contracts by Division for FYE 6/30/11



PURPOSE AND SCOPE

The purpose of the audit was to:

- Determine if the controls over the contract process are adequate.
 - Determine if the processes are in compliance with laws and regulations.
 - Determine if the processes are efficient and effective.
 - Determine the extent of monitoring that is done of invoices and service providers.
-

METHODOLOGY

Our methodology included:

- Determining the laws and regulations applicable to the contract process and the methods by which contracts are awarded.
- Reviewing the Administrative Code and Procurement Manual for policies and procedures that relate to the audit.
- Reviewing boilerplate contracts for compliance with the Administrative Code.
- Interviewing appropriate employees involved with the contract process or the authorization of invoices for payment.
- Using the Association of Local Government Auditors listserv for their input on best practices.
- Reviewing contract and bid folders for documentation to support compliance with County regulations.
- Determining if change orders complied with the requirements of the Administrative Code.
- Determining the level of monitoring being done of invoices pertaining to contracts and of Human Service providers.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

AUDIT RESULTS

Section A – Internal Controls

1. Procurement Manual

OBSERVATION

Procurement does not have a current policies and procedure manual. The link to the manual on the Intranet indicates that it's "Coming Soon".

As stated in the outdated Procurement Manual "the purpose of the manual is to provide procedural guidelines for the implementation of a purchasing system as provided in Article XIII of the Administrative Code". In the last 2 years a new financial system was implemented, new employees and supervisors that purchase goods and services were hired or promoted, and changes were made in how management wants to carry out the requirements of the Administrative Code. A manual helps the staff understand their roles and responsibilities, and it provides an excellent source for training new employees and management. Without a resource like the Procurement Manual, management cannot expect consistency with how goods or services are procured.

The Administrative Code in Section 13.05 states that the Procurement Officer may make changes to the manual. If the changes do not conflict with the policies required in the Administrative Code, the Procurement Officer only needs to notify County Council of the changes in writing. Policies that conflict with the manual would require a change to the Administrative Code by County Council.

RECOMMENDATION

The management of Procurement should develop and implement a policies and procedures manual to document the policies necessary to comply with Article XIII of the Administrative Code. Any changes to the previous manual should be communicated to County Council in writing. Once policies and procedures are documented and communicated, Procurement should begin to monitor and enforce compliance. The Controller's Office is available to assist Division management upon request.

MANAGEMENT RESPONSE

Kathryn Anderson, Procurement Manager

We concur. Management is in full agreement with the recommendation.

Updates to the existing Procurement Policy Manual have been “on hold” pending full implementation of the new ERP System. To date, Procurement has achieved on-line requisitioning of goods and services. Specific implementation timelines for other Procurement modules is currently unknown but targeted to commence in 2012. Management is receptive to beginning the process of updating the manual and realizes this will be an on-going task. We appreciate the offer for assistance from the Controller’s Office and will certainly utilize their services.

2. Contract Monitoring

OBSERVATION

We interviewed the individuals that authorized payment for invoices pertaining to the 25 non-Human Services contracts and the 15 Human Services contracts selected for testing. We wanted to learn how invoices are reviewed before payment to ensure compliance with the contract, and if additional monitoring is performed of Human Services agencies. As a result we found:

- The rates charged on invoices were agreed to the contract in 38 of the 40 contracts reviewed. In two of the instances the agency had a new accountant who did not have copies of the contracts.
- All of the authorized signers indicated that it was verified that the goods were received or the services were performed before they gave approval for the invoice to be paid.
- Monitoring is not being performed on one vendor paid through Human Service Administration. This provider received approximately \$300,000 during 2010, and was program funded for expenses incurred by the Agency for the program.

Contract monitoring is necessary to ensure vendors comply with the terms of the contract. This is achieved through the review of invoices making sure the County is billed at the correct rate and that the goods or services billed were authorized and received. In the case of Human Services providers it's important to evaluate the services being provided and their effectiveness. For agencies that are program funded instead of receiving a fixed rate for services performed, monitoring is necessary to make sure the agency properly accounts for the expenses, that expenses aren't charged to more than one program, and that clients meet the eligibility requirements of the program.

RECOMMENDATION

Human Services Administration should develop a policy of monitoring providers and the procedures to carry out that monitoring. Consideration should be given to the way agencies are funded and the eligibility requirements of the program.

MANAGEMENT RESPONSE

Ross Marcus, Director of Human Services

Regarding the third bulleted point, Human Services Administration believes it has adequate safeguards in place to protect public funds. All invoices are reviewed for accuracy and consistency to the contract before they are approved for payment. In addition, with the assistance of a well respected accounting firm that specializes in auditing government programs, the Department of Human Services has updated its audit standards to reflect the latest requirements of the Federal and State governments. The guidelines are strictly enforced and all audits are reviewed to further assure compliance with the contract. Finally, many of the grantees with contracts administered by Human Services Administration also have contracts administered by other divisions within the department. So, even though Human Services Administration may not be conducting on-site

monitoring, many of the grantees are monitored, on-site, by one of the other Department's divisions.

With the cutbacks in human services funding, and the corresponding reduction in County staff, the Department of Human Services has had to make difficult decisions on how to adjust to less funding and fewer staff. One of the decisions was to not do on-site monitoring of Human Services Administration contracts, unless there is reason to believe that a grantee has misused the funds. Thus far, this has not been necessary. It is our belief that these grants have a relatively low level of risk of abuse, in that most of the funds are used to reimburse the grantees for personnel-related costs.

3. Direct Expenses

OBSERVATION

Through the examination of 40 invoices related to the contracts we tested, we noted inconsistencies with how the invoices were paid. We found:

- Of the six vendors that did not have contracts, invoices ranging from \$2,900 to \$10,400 were paid direct. Encumbrances were not entered into the County's Integrated Financial & Administrative Solution (IFAS) system.
- Of the 11 vendors that had contracts but were paid direct, five were paid direct because encumbrances were never established in IFAS for the contracts. Two of the 11 contracts were encumbered but the invoices were mistakenly paid direct. Accountants for the remaining four offered explanations why encumbrances or amended encumbrances were not entered into IFAS.

A direct expense occurs when an invoice is not paid against an encumbrance. It could occur because an encumbrance wasn't established in IFAS or the invoice wasn't paid against an established encumbrance. The only written guidance on encumbrances is in Section 13.04.c. of the Administrative Code where it says "the Procurement Office shall encumber sufficient funds for the payment of all invoices for the procurement of supplies, services and construction."

Speaking with supervisors and employees involved with the bill paying process, it's clear that no one understands when an invoice may be paid direct or when an encumbrance is necessary, other than when a contract is involved. There is no written policy that explains management's intentions in either the Fiscal Affairs Policies and Procedure Manual, or the Procurement Manual.

RECOMMENDATION

Management should develop a written policy on direct payments, indicating when payments to vendors should be encumbered and when it's allowable to pay an invoice direct. The policy should be made a part of the Procurement Manual, communicated to County supervisors and employees, and enforced.

MANAGEMENT RESPONSE

Kathryn Anderson, Procurement Manager

We concur. Management is in full agreement with the recommendation.

This policy will be addressed as part of the updated Procurement Manual. We realize that the formation of the guidelines and the monitoring of this effort will require direct coordination with the Director of Fiscal Affairs, the Controller's and Solicitor's offices and Accounts Payable personnel.

Section B – Economy and Efficiency

1. Advertising Bids in Newspapers

OBSERVATION

Section 13.08.b.(1) of the Administrative Code contains the requirement that bids/proposals must be advertised in at least one newspaper of general circulation in the County, at least two times within specified periods before the date of the bid/proposal opening. During 2010 Procurement spent \$12,251 on advertising bids/proposals in newspapers.

In addition to newspaper advertising, Procurement posts bids/proposals on *Public Purchase* and *BidNet*, two Internet services that specialize in matching the goods and services needed by government with vendors who provide those goods and services. There is no expense to the County for the use of these websites and they reach a larger number of vendors, increasing the opportunity for savings to the County. A neighboring county of similar size has discontinued the use of newspaper advertising.

RECOMMENDATION

The requirement of advertising in newspapers should be evaluated to determine if it's cost effective at a time when so much commerce is conducted electronically. If Procurement determines that it isn't cost effective, they should approach County Council with an amendment to change the Administrative Code. Newspaper advertising could always be left to Procurement's discretion depending on the type of goods or services needed. Procurement may also want to provide a link to *Public Purchase* on the County's website as a convenience to vendors looking to do business with the County.

MANAGEMENT RESPONSE

Kathryn Anderson, Procurement Manager

We concur. Management is in full agreement with the recommendation.

Procurement began utilizing an internet based web platform, "Public Purchase" late December 2010 and will review current year's expenditures for advertising against previous year to determine if the spend is cost effective. A request to post a link to "Public Purchase" on the Northampton County web page has been sent to the County IT subcontractor (ACS). This will immediately redirect any potential bidders to the on-line bidding platform currently utilized by Northampton County for distribution of all bidding documents.

2. Encumbrances

OBSERVATION

Most encumbrances are entered by user divisions, not Procurement. As a result they are not entered uniformly which sometimes makes the process of entering invoices into IFAS more cumbersome and time consuming. Also, encumbrance or contract numbers are not always written on invoices resulting in the added work of researching the encumbrance number in IFAS or the invoice being paid direct. Invoices paid direct instead of against established encumbrances result in inflated encumbrance numbers giving the impression that less funds are available in the budget than really are.

An encumbrance is a commitment of funds within a budget. It represents the estimated amount of expenditures that are ultimately needed for an unperformed contract or a known expenditure with a specific vendor. It allows the reader of a financial statement to know how much of a budget is available and uncommitted for an expenditure line item or group of accounts. Not encumbering contracts or large expenditures, or not paying against established encumbrances provides management and the reader of statements with unreliable information.

RECOMMENDATION

When Procurement updates the section of the Procurement Manual dealing with encumbrances, they should consult with personnel in the Accounts Payable section of Fiscal Affairs to obtain their input. Encumbrances should be entered consistently and uniformly, to enhance the value of financial statements and make the payment of invoices more efficient. When an expenditure is encumbered, the invoice presented for payment should reflect that information so the Accounts Payable Clerks do not have to perform additional research.

MANAGEMENT RESPONSE

Kathryn Anderson, Procurement Manager

We concur. Management is in full agreement with the recommendation.

In order to facilitate the flow of information between all business functions, procurement recommends implementation of the IFAS receiving module which will eliminate the manual coding of invoices by end users and reduce the data entry task for Accounts Payable personnel ultimately making all staff more efficient.

Section C – Compliance

1. Compliance with Contract Related Requirements of Administrative Code Article XIII

OBSERVATION

We selected 25 non-Human Service vendors that received more than \$25,000 during 2010 to test compliance with various provisions of Article XIII. The attributes examined included requirements of the bid process and the awarding of the contract. We found:

- The services of one vendor who delivered liquid propane were not put out to bid and there was no contract with the vendor. The supervisor thought liquid propane was considered a utility and was exempt from the bidding/contract process.
- There were three instances where the newspaper advertising did not fall within the time frame required before a bid opening. The Code requires that advertising for bids/proposals be placed in a newspaper at least twice for a period of not less than 10 days nor more than 30 days prior to the date fixed for the opening of the bids/proposals.
- One professional service contract exceeding \$100,000 was signed 13 days after Council was notified of the contract, not at least 20 days after notification as is required in the Code.

As part of our testing, we also found areas where the County was in compliance with the Code. Those areas are:

- A representative of the Controller's Office was present to witness the opening of the requests for proposals (RFP's).
- Contracts were awarded within 60 days of bid openings and written notice was sent within that time period to the responsive and responsible bidder who submitted the lowest bid price.
- Council approval was received for the eight contracts awarded through Competitive Negotiation (RFP process) that exceeded \$100,000.
- All contracts were prepared and executed as directed by the County Executive by way of an Executive Order.
- All contracts were on file in the Procurement Office.

RECOMMENDATION

Procurement improved their compliance with the Administrative Code since the last contract audit in 2003. They should enact measures to continue making progress in this area and to monitor their own performance.

MANAGEMENT RESPONSE

Kathryn Anderson, Procurement Manager

We concur. Management is in full agreement with the recommendation.

Procurement will continue to monitor and improve our organizational effectiveness while working towards the accomplishment of the County's mandated mission and goals.

2. Required Wording in Contracts

OBSERVATION

Article XIII of the Administrative Code requires certain wording for County contracts. The contract committee formed in 2008 to standardize and consolidate the number of boilerplate contracts arrived at four standard contracts: vendor, professional services, human services and construction. The wording is found in the contract, or the terms and conditions referenced in the contract. The following language was missing from both the contract, and its terms and conditions, or it was found in more than one location.

- Section 13.16.g.(13).(b) has specific language dealing with Conflict of Interest. This language was not found in the boilerplate contract for professional services.
- Section 13.16.g.(3) has language concerning delinquent taxes. The professional service contract has this wording in both the contract, and the terms and conditions.
- Section 13.16.g.(13).(a) has specific language dealing with Undue Influence. The vendor contract has this wording in both the contract, and the terms and conditions.
- Section 13.16.g.(13).(c) has language dealing with Breach of Contract. The vendor contract has this wording in both the contract, and the terms and conditions.

RECOMMENDATION

The County should modify the appropriate boilerplate contracts to include missing language and eliminate duplicate language. The revised boilerplates should be used for all future contracts.

MANAGEMENT RESPONSE

Kathryn Anderson, Procurement Manager

We concur. Management is in full agreement with the recommendation.

The Solicitor's office is currently spearheading a committee to address revisions to the current language for Human Service and Non-Human Service Contracts as well as the specific Insurance Requirements of both entities. Procurement is represented on this committee and will propose the recommendation received.

3. Notification to Council for Expiring RFP's

OBSERVATION

Section 13.09.h of the Administrative Code entitled *Expired Contracts Awarded Through RFP Process* states that "County Council should be notified of the expiration date of contracts awarded through the RFP process at least sixty (60) days prior to the contract's expiration." Procurement was not performing this notification in part because they were not aware of this regulation.

RECOMMENATION

Procurement should use the ACS Contract Management Application to run the reports necessary to comply with this provision of the Administrative Code.

MANAGEMENT RESPONSE

Kathryn Anderson, Procurement Manager

We concur. Management is in full agreement with the recommendation.

Current practice is that notification from the ACS Contract Management Application is emailed every Monday to County Council, Procurement and the County Executive. The report identifies Procurement and Bargaining Unit Contracts that will expire within 90 days, and have a total contract value greater than \$100K. Procurement currently does not have capability for reporting contract expirations through IFAS as the Contract Management Module is required to implement this reporting.

ACCOMPLISHMENTS

Procurement

The Procurement Division made improvements to the contract process since the last audit. These improvements include:

- The time to review bids and award the contracts was shortened to comply with the requirements of the Administrative Code.
- Bids and proposals are being advertised at no cost to the County on two websites that specialize in government contracts and attract companies that want to provide those services.
- Procurement complied with the provisions of the Administrative Code for all change orders tested.
- Procurement maintains a contract tracking schedule which they agreed to make available to divisions that wish to monitor the progress of the contract process.

Contract Committee

In 2008 a contract committee was formed with representatives from the Solicitor's Office, Fiscal Affairs, Procurement and Human Services. The areas reviewed by the committee included the Administrative Code, boilerplate contracts, insurance requirements, contract tracking and the filing of contracts. Significant progress was made with boilerplate contracts because at the time there were many different types of contracts, and terms and conditions. The committee worked on the contracts and produced four boilerplate contracts: contracts awarded through bids, contracts awarded through competitive negotiation (RFP's), Human Service contracts and construction contracts. Having only one boilerplate contract for each area made the process more efficient.

Another area where significant improvement was made involved the insurance requirements of contracts. This was a problem mostly with Human Service vendors who often requested waivers from the insurance requirements. Previous to the review 25-30 vendors would request insurance waivers, now the number is fewer than 10. County representatives met with an insurance consultant who was very knowledgeable and the information he gave really helped when reviewing the insurance requirements of contracts and evaluating whether to grant waivers. This provided better protection to the County and made the process of reviewing and approving contracts more efficient.