

**SUPPLEMENT TO THE
ADVISORY LETTER
OF THE PURCHASING/CONTRACTING
PROCEDURES AND CONTROLS
FOR THE STATE OF NEBRASKA
FOR THE FISCAL YEAR ENDED JUNE 30, 2002
DATED DECEMBER 11, 2002**

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STATE OF NEBRASKA

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Dear Governor Johanns and Senator Engel:

The Auditor of Public Accounts issued an Advisory Letter of the Purchasing/Contracting Procedures and Controls for the State of Nebraska for the fiscal year ended June 30, 2002. The Letter was issued on December 11, 2002 and can be found in its entirety at the Auditor of Public Accounts' web site at <http://www.auditors.state.ne.us>. We were unable to complete certain procedures originally planned because of a directive by the Governor. The issue brought up in the Governor's directive has been resolved and all 30 agencies that had not provided certain information and documentation originally requested have now done so.

The information and documentation the agencies had not provided generally fell within the following 3 categories:

1. Completion of an Internal Control Questionnaire (ICQ) - All 30 agencies
2. Documentation regarding contracts/purchases previously selected for testing - 5 agencies
3. Responses to additional questions regarding policies and procedures - 5 agencies

We have performed certain procedures related to the above information and documentation. The procedures were performed in accordance with Neb. Rev. Stat. Sections 84-304(3) and 84-305 and in accordance with *Government Auditing Standards*.

Since the procedures performed, as noted in this Supplement To The Advisory Letter, are the completion of the procedures originally planned in the Advisory Letter referenced above, the user of this Supplement To The Advisory Letter should consider those procedures along with any previously completed procedures to better understand the overall objectives of the review, which were to:

1. Determine the laws and regulations that govern the purchases of materials, supplies, and equipment, services, construction/repair of buildings and roads, lease/rent, and other purchases not falling within the above categories.
2. Determine the adequacy of procedures/controls the State of Nebraska has centrally, and at the agency level, to ensure all purchases were made in accordance with all applicable laws and regulations.
3. Determine if key procedures/controls were actually in place based on a sample testing of purchase transactions.

The following procedures were performed:

- Requested the completion of an Internal Control Questionnaire to document the procedures/controls each agency had over purchases to ensure compliance with all laws and regulations.
- Examined the responses to determine if key procedures/controls were in place to ensure purchases were in accordance with all laws and regulations.
- Completed testing of the transactions, and related purchasing documentation as noted in the Advisory Letter of the Purchasing/Contracting Procedures and Controls issued December 11, 2002, to determine if key procedures/controls were in place to ensure purchases were in accordance with all laws and regulations.

The results of the procedures performed can be found in the appendices of this letter. The results were reported to each agency in a management letter. The management letters for the following agencies where testing of transactions were completed have been incorporated in this Supplement To The Advisory Letter in their entirety:

Agency 12 – Office of the State Treasurer

Agency 25 – Department of Health and Human Services

Agency 26 – Department of Health and Human Services Finance and Support

Agency 46 – Department of Corrections


Agency 65 – Department of Administrative Services

A draft copy of each individual agency management letter was furnished to each agency to provide them an opportunity to review the management letter and respond to its content. All formal responses received have been incorporated into this Supplement To The Advisory Letter. Where no response has been included, the agency declined to respond. Responses have been objectively evaluated and recognized, as appropriate, in this letter. Responses that indicate corrective action has been taken were not verified at this time.

All financial data included in this Supplement To The Advisory Letter was obtained from the Nebraska Accounting System (NAS) of the State of Nebraska. We have not audited, examined, or reviewed this financial data and, accordingly, do not express an opinion or any other form of assurance on this data.

The information in this Supplement To The Advisory Letter is intended for the Governor and the Chairman of the Executive Board of the Legislature; however, this letter is a matter of public record and its distribution is not limited.

April 23, 2003


Assistant Deputy Auditor

APPENDICIES TO SUPPLEMENTAL ADVISORY LETTER

For the following agencies, either all other testing was previously completed or no transactions were selected for testing. The ICQ was the only documentation that was not previously received. The following is a list of those agencies, as well as the results of our review of the responses to the ICQ. The agencies were:

Agency 3 – Legislative Council
Agency 7 – Office of the Governor
Agency 8 – Office of the Lieutenant Governor
Agency 15 – Nebraska Pardon/Parole Board
Agency 17 – Department of Aeronautics
Agency 18 – Department of Agriculture
Agency 19 – Department of Banking and Finance
Agency 20 – Department of Health and Human Services Regulation and Licensure
Agency 22 – Department of Insurance
Agency 23 – Department of Labor
Agency 24 – Department of Motor Vehicles
Agency 27 – Department of Roads
Agency 28 – Department of Veterans' Affairs
Agency 29 – Department of Natural Resources
Agency 32 – Department of Educational Lands and Funds
Agency 37 – Nebraska Workers' Compensation
Agency 61 – Nebraska Dairy Industry Development Board
Agency 64 – State Patrol
Agency 72 – Department of Economic Development
Agency 76 – Commission on Indian Affairs
Agency 78 – Crime Commission
Agency 84 – Department of Environmental Quality
Agency 86 – Dry Bean Commission
Agency 88 – Nebraska Corn Board
Agency 96 – Property Assessment and Taxation

For the above listed agencies we obtained a completed ICQ and reviewed them for any documented or obvious procedure/control weaknesses. Based on the above-mentioned procedures, we noted no obvious weaknesses in the controls over purchases. However, no control testing was done during this review, as such we have no assurance that the procedure/controls noted are actually in place and working effectively. On the next scheduled audit of the above agencies we will be examining those procedures to determine if those procedures/controls as noted are actually in place.

Agencies where testing needed to be completed

For the following agencies, we were previously unable to complete some testing, or no documentation/response was received from the agency. The ICQ was also previously unanswered by these agencies. The following is a list of those agencies, as well as the results of our review of the subsequent responses to the ICQ and the completion of the testing of the previously selected transactions. The agencies were:

Agency 12 – Office of the State Treasurer

Agency 25 – Department of Health and Human Services

Agency 26 – Department of Health and Human Services Finance and Support

Agency 46 – Department of Corrections

Agency 65 – Department of Administrative Services

The following is a list of the findings regarding our review of the ICQ and the completion of the testing of the transactions mentioned for each agency. For a list of the documentation and responses that were not previously received refer to the Advisory Letter of the Purchasing/Contracting Procedures and Controls issued December 11, 2002.

Agency 12 – Office of the State Treasurer

The following procedures were performed:

- Requested the completion of an Internal Control Questionnaire (ICQ) to document the procedures/controls your Department had over purchases to ensure compliance with all laws and regulations.
- Examined the responses to the ICQ to determine if key procedures/controls were in place to ensure purchases were in accordance with all laws and regulations.
- Completed testing of the transactions, and related purchasing documentation as noted in the Advisory Letter of the Purchasing/Contracting Procedures and Controls issued December 11, 2002, to determine if key procedures/controls were in place to ensure purchases were in accordance with all laws and regulations. The transactions tested were as follows:

- Centurion, Inc. – Doc # 105451 (\$190,742)

Payment was for the purchase of computer hardware and software for the State Disbursement Unit.

- World Technologies – Doc # 2125442 (\$67,202)

Contract provides for computer processing, imaging, and mailing of State warrants related to the State Disbursement Unit's function.

Based on the responses to the Internal Control Questionnaire (ICQ), we noted weaknesses in the controls over purchases/contracting procedures. However, the controls were not specifically tested during this review, but will be examined and tested in more detail in future audits to determine whether the controls are in place.

The following comments and recommendations are based on our review of the State Treasurer's response to the ICQ and our testing of the above transactions:

1. Lack of Written Policies

Good internal control and good business practices require policies and procedures to be in writing to ensure they are consistently applied, adequately understood by staff, and that all necessary procedures are completed. This is especially important when it involves procedures which are complex or have numerous steps, such as those involved with the bidding of contracts.

The State Treasurer's Office did not have written policies and procedures regarding the bidding of service contracts.

- The Internal Control Questionnaire (ICQ) indicated the Treasurer's Office followed Executive Order 00-04 in limited instances regarding the State Disbursement Unit (SDU) where a formal bid process was not used. However, it was also verbally communicated to us that since they are not required to comply with the Executive Order, they chose not to follow the Executive Order. Of the documentation we received for the World Technologies contract, there was no documentation indicating compliance with the Executive Order.
- The following specific procedures were not executed for both the World Technologies and the Centurion, Inc. contracts:

The State Treasurer's Office did not review the Federal government's "Excluded Parties List" to ensure contracting parties were not suspended or debarred from receiving Federal funds, as this relates to the State Disbursement Unit, which expends Federal funds.

- The State Treasurer's Office did not have written policies regarding the renewal of contracts, specifically to determine if the contract remains in the best interest of the State.

Because of these issues, there is an increased risk that procedures will be inconsistently applied, misunderstood by staff, or not applied at all. It also increases the risk that contracts may be entered into or renewed, which are not in the best interest of the State.

We recommend the State Treasurer establish written policies and procedures regarding the bidding of service contracts and the renewal of contracts, and ensure that the execution of these policies and procedures are adequately documented. The renewal policy may include factors such as the research of readily available economic indicators (such as the Consumer Price Index), an understanding of the competition level in the business sector, an understanding of changes in technology, or a survey of prices or rates.

2. Legal Review of Contracts

A contract is a binding agreement between two or more persons. A written contract is a document made by the parties to evidence the terms and conditions of a contract. In the preparation of a contract, parties should consider principles of contract law, the specific requirements of the parties, and for state government contracts, Federal and State laws and regulations.

Good business practice and good internal controls over contracts would require that certain contracts be reviewed by a person or persons having the legal expertise and knowledge to determine if the contract is in compliance with contract law and with federal and State laws and regulations governing contracts, and to ensure the best interest of the State is being served. In addition, good internal controls would require that when a legal review is performed that it be documented. This would document the review in accordance with management's directives.

For both contracts tested, Centurion, Inc. and World Technologies, the State Treasurer stated that a legal review had occurred, however documentation confirming this review was not provided.

When a legal review of a contract is not performed there is a greater risk that a contract will not be in conformity with contract law or Federal and State laws and regulations, or be in the best interest of the State. In addition, when a review is not documented there is no assurance that the review was actually performed.

We recommend the State Treasurer establish written policies relating to when contracts should have a legal review. The policies might consider the following, among other things: the type of contract, the dollar amount of the contract, the complexity of the contract, who would perform the review, and how that review would be documented.

3. Lack of Approval from the Department of Administrative Services (DAS) for the purchase of Goods

Neb. Rev. Stat. Section 81-153 R.S.Supp., 2002 gives DAS the power to "purchase or contract for, in the name of the state, the personal property required by the *using agencies* and the state," and the power to create rules and regulations to carry out the statutes related to these purchases. Neb. Rev. Stat. Section 81-145(3) R.S.Supp., 2002 states, "*using agencies* shall mean and include all officers of the state" The Nebraska Constitution, Article IV, Section 1 states, "The executive officers of the state shall be the . . . State Treasurer . . ." (emphasis added)

The following are questions from the ICQ, with the accompanying answers provided by the Treasurer's Office (emphasis added):

- ICQ: Where purchases are for more than \$10,000, are bids taken on a competitive formal sealed bidding process?

Answer: Yes *if possible*.

Neb. Rev. Stat. section 81-1118(5a) R.S.Supp., 2002 states all purchases for goods shall be made “by a competitive formal sealed bidding process through the materiel division in all cases in which the purchases are of estimated value in the amount of ten thousand dollars or more.”

- ICQ: Where purchases are for more than \$5,000 but less than \$10,000 are bids taken on a competitive informal bidding process? How is this documented?

Answer: We attempt to obtain the best possible prices and *if necessary we request bids*.

Neb. Rev. Stat. section 81-1118(5b) R.S.Supp., 2002 states all purchases for goods shall be made “by a competitive informal bidding through the materiel division in all cases in which the purchases are of estimated value equal to or exceeding five thousand dollars but less than ten thousand dollars.”

The DAS Procurement Manual for Goods states, “all informal purchases are processed through the State Purchasing Bureau. Whenever possible a minimum of three (3) competitive bids should be solicited, received and documented....” “Informal bids may be obtained by mail, fax, e-mail or phone.”

- ICQ: Do you have “direct market purchase authority” from DAS? If yes, are there any restrictions on purchases?

Answer: Yes. As a Constitutional Officer we *may* utilize DAS Materiel guidelines, purchasing services and/or expertise *on an as needed basis*.

As noted above, Neb. Rev. Stat. section 81-153 R.S.Supp., 2002 gives DAS the power to contract for purchases of goods required by the using agencies of the State. Therefore, the Treasurer’s Office may not utilize DAS Materiel on “an as needed basis,” but is required to follow DAS guidelines on such purchases of goods.

During testing of the Centurion, Inc. contract, the following was noted:

- The Exhibit 1 in the DAS-Materiel Procurement Manual for Goods states that all computer hardware and software purchases of an amount greater than \$10,000 must be approved by DAS – Information Management Services (IMS), through the purchasing agency submitting DAS Form 1909 to the Department.

Purchase of computer hardware and software from Centurion, Inc. totaled \$190,742, thus greatly exceeding the \$10,000 threshold. However this purchase was not submitted for approval to DAS-IMS.

As noted in the above referenced statutes, the State Treasurer’s Office is required to purchase goods through the DAS – Materiel Division. The answers to the ICQ questions indicate the Treasurer’s Office policy does not conform to these statutes. Furthermore, in the absence of purchasing through DAS, the Treasurer’s Office is not complying with the other provisions outlined in these statutes.

The Treasurer's Office was requested to provide the auditors with any statutes or Attorney General opinions which substantiate the claim that they are not required to purchase goods through the DAS - Materiel Division. To date, we have not received any such documentation from the Treasurer's Office.

We recommend the State Treasurer comply with the above referenced statutes and regulations.

4. Lowest Responsible Bidder

Absent any written policies, good internal control requires the criteria used to evaluate bids be documented and applied to all bids or proposals.

For the contract awarded to World Technologies, there was no documentation showing what criteria was used to evaluate the bids, no bid tabulation comparing the bids, and hence no documentation showing that the firm selected was in fact the lowest responsible bidder and in the best interest of the State.

We recommend the State Treasurer create procedures to document the criteria used to select the lowest responsible bidder, and develop a bid tabulation, which provides a determination of the lowest responsible bidder.

As of the date of this supplement, the Auditors have received no response or any communication from the Office of the State Treasurer regarding these comments and recommendations.

Agency 25 – Department of Health and Human Services

The following procedures were performed:

- Requested the completion of an Internal Control Questionnaire (ICQ) to document the procedures/controls your Department had over purchases to ensure compliance with all laws and regulations.
- Examined the responses to the ICQ to determine if key procedures/controls were in place to ensure purchases were in accordance with all laws and regulations.
- Completed testing of the transactions, and related purchasing documentation as noted in the Advisory Letter of the Purchasing/Contracting Procedures and Controls issued December 11, 2002, to determine if key procedures/controls were in place to ensure purchases were in accordance with all laws and regulations. The transactions tested were as follows:
 - Vista Staffing – Doc #2221335 (\$9,957.00)

This was a payment for medical services performed at the Hastings Regional Center.

- Newton Manufacturing – Doc #2301748 (\$6,584.03)

This payment was for the purchase of tote bags and plastic drinking bottles for a women's program.

- Wyeth Group – Doc #2305163 (\$4,440.00)

This transaction was for the purchase of birth control devices.

- Young Williams P.C. – Doc #2485165 (\$382,189.50)

This was a contractual payment for child support enforcement services.

- Rushmore Group, LLC – Doc #2254171 (\$86,961.33)

This payment was for management of the Food Stamp Program.

Based on the responses to the Internal Control Questionnaire, we noted no obvious weaknesses in the controls over purchases/contracting procedures. The controls were not specifically tested during this review, but will be examined and tested in future audits to determine whether the controls are in place. However, we did note during our testing of the above transaction the following problems:

1. Direct Purchase from Wyeth

We noted the following items as they relate to the purchase as described above:

- The agency did not ensure that the vendors from whom they purchased had a Drug-free Workplace Policy on file with the State Purchasing Bureau or the agency before they made a purchase using their direct purchase authority.
- The agency did not have a monthly report on file with the State Purchasing Bureau for the purchases that were made using their direct purchase authority.
- The agency did not have documentation to show the vendor was the sole source. Disbursement documents indicated direct buy approval from DAS. However documentation of this approval was not provided.

The Department of Administrative Services (DAS) - Materiel Division's Direct Market Purchase Authority Memo states, "[Agencies] will be responsible for ensuring that vendors you purchase from support a Drug-free Workplace Environment." This can be accomplished by either of two methods, having a statement on file from the vendor, or including an attestation statement on a signed document such as a contract or an "invitation to bid" document.

A memo dated July 1, 2001 was sent from Doni Peterson, Administrator of DAS - Materiel Division, to all agencies, boards, and commissions concerning direct market purchase authority. The memo stated, "Agencies are required to submit monthly reports for ALL purchases made directly from \$500.00 to \$4999.99."

The memo also stated, "You are strongly urged to obtain a minimum of three bids on orders over \$500. Good internal control also requires that agencies document they received at least three bids to ensure that bidding was competitive.

As a result, the agency was not in compliance with Department of Administrative Services – Materiel Division policies and procedures, and DAS did not have the information necessary to monitor direct purchases.

We recommend the agency create procedures to ensure that for all direct purchases, the vendor's drug-free workplace policy is on file or is attested to prior to the purchase. This may include changes to Department procedural manuals or the creation of a checklist to ensure direct purchases proceed through all required steps. We also recommend the agency submit the required direct purchase report on a monthly basis. Finally, we recommend the agency document all bids that are received on direct purchases over \$500.

2. Direct Purchase from Newton Manufacturing

We noted the following item as it relates to the purchase as described above:

- The agency did not have a monthly report on file with the State Purchasing Bureau for the purchases that were made using their direct purchase authority.

A memo dated July 1, 2001 was sent from Doni Peterson, Administrator of DAS - Materiel Division, to all agencies, boards, and commissions concerning direct market purchase authority. The memo stated, "Agencies are required to submit monthly reports for ALL purchases made directly from \$500.00 to \$4999.99."

As a result, the agency was not in compliance with Department of Administrative Services – Materiel Division policies and procedures, and DAS did not have the information necessary to monitor direct purchases.

We recommend the agency submit the required direct purchase report on a monthly basis.

3. Documentation of Review by Legal Counsel

Good business practice and good internal controls over contracts requires that certain contracts be reviewed by a person or persons having the legal expertise and knowledge to determine if the contract is in compliance with contract law and with Federal and State laws and regulations

governing contracts, and to ensure the best interest of the State is being served. In addition, good internal controls would require that when a legal review is performed that it be documented. This would document the review in accordance with management's directives.

We received indication that legal services for the agency reviewed the contracts. A routing sheet containing all review signatures is used before a contract is completed and signed. The presence of these review signatures is necessary prior to the Director's signature, which when present signifies the necessary reviews were completed. The agency does not, however, require the program divisions to retain the contract routing sheets after the contract is signed. Because these routing sheets are not retained there is no documentation showing a legal review.

When a review is not documented there is no assurance the review was actually performed.

We recommend the legal review of contracts be documented. This can be accomplished by retaining the routing sheet for the contract containing all the signatures of the people who reviewed the contract, or by legal counsel drafting correspondence stating the recommended changes to the contract or approval of the contract.

4. Documentation not on file

The General Records Retention Schedule 124-1-143 states contracts shall be maintained three years after completion of the contract. It also states that documents, such as accepted and rejected bids should be maintained. The General Records Retention Schedule 124-1-144 states that accepted bids and proposals should be disposed of three years after fulfillment of the contract. Rejected bids should be retained for a period of four years.

The contract with the Rushmore Group, LLC was awarded based on selection committee scores. The Agency could not locate these documents showing the breakdown of these scores or how the proposals that were received were evaluated.

As a result, there is an increased risk to the State when it does not have a copy of all legal documents pertaining to a contract it has executed.

We recommend the Agency review its procedures to ensure all such documents relating to the contract are retained for the period of time required by the Retention Schedule.

5. Information and documentation not provided

No documentation was received regarding the contract with Vista Staffing listed above. We requested the information and documentation on December 12, 2002. As of the date of this Supplementary letter we have not received adequate documentation regarding the following:

- Prior written approval from HHSS (per contract). HHSS responded that the Hastings Regional Center, who contracted with Vista Staffing, provided the approval for the agency. However, no documentation was provided to support this transfer of authority.

- Documentation for Vista Staffing's actual cost for automobile expense (Supporting documentation shows \$25 per day.) HHSS responded that the \$25 per day is an agreement between Vista Staffing and their physicians. However, no documentation was provided to support this amount when the signed contract between Vista Staffing and HHSS indicated "actual expenses."
- Documentation to support that legal counsel reviewed the terms of the contract before it was signed. HHSS responded that a legal review had been done, however documentation to support this review was not available.

If this documentation does not exist and is not kept on file with the contract, the agency is in violation of the General Records Retention Schedule. The General Records Retention Schedule 124-1-143 states contracts shall be maintained three years after completion of the contract. It also states that documents, such as accepted and rejected bids, specifications, purchase orders, inspection reports, and correspondence should be maintained for the same period.

Because there was no documentation showing prior written approval from HHSS, it appears that the contract terms were not being followed. The \$25 per day charge for automobile expenses appears to have been a per diem rate rather than the actual cost. Because there was no documentation showing the actual expenses, it was impossible to tell how much should actually be paid for automobile expenses. This increased the risk that the State's money was being misused.

We recommend all information and documentation pertaining to monitoring and ensuring compliance with the contract be documented to ensure both parties are meeting the terms of the contract. We also recommend this documentation be retained in the contract file according to the Records Retention Schedule.

Agency Response:

- *Documentation of Review by Legal Counsel*

We agree that certain contracts should have legal review. Larger, unusual and more complicated contracts endure multiple legal reviews prior to their execution. However, to reduce duplication of effort, HHSS program and operational areas utilize standardized agreements that have been developed by HHSS Legal Services to assure legal requirements pertinent to the agency and program are included. We do not require additional legal review unless a variance from a standardized format is proposed.

- *Documentation not on File*

The summary of evaluation committee scoring related to the Rushmore contract have been located and copies are included with this response. Four proposals were evaluated and interviews were held April 3, 2000 with the top two candidates. Rushmore was selected.

- *Information and Documentation not Provided*

Agency Response, Concluded:

Documentation provided on March 7, 2003 included the November 6, 2001 record of the Hastings Regional Center Executive Committee (Credentials Committee) regarding the review of credentials and granting of temporary privileges for Dr. Broome. This printed record of the meeting is provided to VISTA as the prior written approval referenced in the contract. We do not understand the statement about transfer of authority. We do not see the need for a transfer of authority. The automobile reimbursement rates in subsequent agreements with VISTA have been revised to correspond to the state mileage rate.

Auditors' Response: The documentation provided regarding the Rushmore contract did not include the individual evaluation committee scores, which were used to award the contract. Without the individual evaluation committee scores, HHSS does not have documentation.

The contract with Vista Staffing stated that the Hastings Regional Center would perform the credentials verification process. It also stated that Vista would be required to receive prior written approval from the Department of Health and Human Services before such individual's services could be used in fulfilling Consultants' obligations under the agreement. There was nothing in the contract to say that the Hastings Regional Center had the right to approve the agreement with individuals themselves.

Agency 26 – Department of Health and Human Services Finance and Support

The following procedures were performed:

- Requested the completion of an Internal Control Questionnaire (ICQ) to document the procedures/controls your Department had over purchases to ensure compliance with all laws and regulations.
- Examined the responses to the ICQ to determine if key procedures/controls were in place to ensure purchases were in accordance with all laws and regulations.
- Completed testing of the transactions, and related purchasing documentation as noted in the Advisory Letter of the Purchasing/Contracting Procedures and Controls issued December 11, 2002, to determine if key procedures/controls were in place to ensure purchases were in accordance with all laws and regulations. The transactions tested were as follows:
 - Nebraska Schools Medicaid Consortium – Doc #2285368 (\$1,645,585.20)

This transaction was for payment of services for administering case planning and coordination through Early Periodic Screening, Diagnosis and Treatment (EPSDT), also known as Health Check.

- FileNET Corporation – Doc #8284851 (\$21,875.00)

This was a contract for maintenance services to the Optical Imaging System of the State of Nebraska.

- Nebraska Health System – Doc #2296905 (\$18,792.20)

This was a payment for services related to the chronic renal disease program.

- First Health Services – Doc #2300259 (\$287,500.00)

This was a contractual payment for conversion and implementation of a pharmacy system.

- City of Lincoln Health Department – Doc #2300059 (\$735,170.00)

This was a payment on a contract for Medicaid and Managed Care enrollment broker services.

- Norfolk Public Schools – Doc #2285175 (\$310,664.20)

This transaction was for payment of services for administering case planning and coordination through EPSDT, also known as Health Check.

- Jared S. Kramer – Doc #2289362 (\$195,000.00)

This payment was for loans made under the Rural Health Systems and Professional Incentive Act to thirteen medical students for \$15,000 each under the Medical Student Loan Program.

Based on the responses to the Internal Control Questionnaire, we noted no obvious weaknesses in the controls over purchases/contracting procedures. The controls were not specifically tested during this review, but will be examined and tested in future audits to determine whether the controls are in place. However, we did note during our testing of the above transaction the following problems:

1. Documentation of Review by Legal Counsel

Good business practice and good internal controls over contracts requires that certain contracts be reviewed by a person or persons having the legal expertise and knowledge to determine if the contract is in compliance with contract law and with Federal and State laws and regulations governing contracts, and to ensure the best interest of the State is being served. In addition, good internal controls would require that when a legal review is performed that it be documented. This would document the review in accordance with management's directives.

We received indication that legal services for the agency reviewed the contracts. A routing sheet containing all review signatures is used before a contract is completed and signed. The presence of these review signatures is necessary prior to the Director's signature, which when present signifies the necessary reviews were completed. The agency does not, however, require the program divisions to retain the contract routing sheets after the contract is signed. Because these routing sheets are not retained there is no documentation showing a legal review.

When a review is not documented there is no assurance the review was actually performed.

We recommend the legal review of contracts be documented. This can be accomplished by retaining the routing sheet for the contract containing all the signatures of the people who reviewed the contract, or by legal counsel drafting correspondence stating the recommended changes to the contract or approval of the contract.

2. Information and documentation not provided

No documentation was received regarding the contract with FileNET Corp. listed above. We requested the information and documentation on December 12, 2002. As of the date of this Supplementary letter we have not received the documentation listed below. It is our belief no documentation exists regarding the following:

Document #8284851 – FileNET Corporation

1. Please provide documentation to support the open competitive bidding process and the bidding tabulation to support the selection of the bidder.
2. If the open competitive bidding process was not followed, please provide documentation for justification.
3. Please provide a copy of the Request for Proposal.
4. Please provide a copy of the separate agreement between FileNET and the State for the technical consulting service to support invoice #90071911.
5. Please provide documentation to support that legal counsel reviewed the terms of the contract before it was signed and executed.

If this documentation does not exist and is not kept on file with the contract, the agency is in violation of the General Records Retention Schedule. The General Records Retention Schedule 124-1-143 states contracts shall be maintained three years after completion of the contract. It also states that documents, such as accepted and rejected bids, specifications, purchase orders, inspection reports, and correspondence should be maintained for the same period.

We recommend all information and documentation pertaining to monitoring and ensuring compliance with the contracts be documented to ensure both parties are meeting the terms of the contract. We also recommend this documentation be retained in the contract file according to the Records Retention Schedule.

3. Inadequate documentation

Responses were received regarding the contracts with the City of Lincoln Health Department, Norfolk Public Schools, and Nebraska Schools Medicaid Consortium. However, the auditor could not verify the responses due to lack of supporting documentation for the following:

Document #2300059 – City of Lincoln Health Department

The agency was asked to provide documentation to support the on-site visits to monitor the contract. The agency responded by providing the 2003 dates for meetings and future meeting agendas. However, these are future dates. The contract began in July 1999 and no documentation of monitoring from the audit period was provided. Also, without meeting minutes the auditor cannot verify the meetings were held, who attended, or what was discussed.

Document #2285175 – Norfolk Public Schools and Document #2285368 – Nebraska Schools Medicaid Consortium

The agency was asked to provide documentation supporting a review and evaluation of the program was completed. The agency responded they are in regular phone contact with the two entities and a meeting was held with each entity in early 2002. However, no documentation was provided to support the phone conversations or meetings were held, who was involved, or what was discussed.

When adequate supporting documentation is not maintained there is no assurance the review was actually performed.

We recommend the on-site monitoring visits and program evaluations be documented. This can be accomplished by maintaining minutes of meetings, including when the meeting was held, who attended, and what was discussed.

1. Documentation of Review by Legal Counsel

We agree that certain contracts should have legal review. Larger, unusual and more complicated contracts undergo multiple legal reviews prior to their execution. However, to reduce duplication of effort, HHSS program and operational areas utilize standardized agreements that have been developed by HHSS Legal Services to assure legal requirements pertinent to the agency and program are included. We do not require additional legal review unless a variance from a standardized format is proposed.

Agency Response, Concluded:

2. Information and Documentation not Provided

We apologize for the delay in providing the information on the FileNET agreement. It was necessary to search for files from 1995 to determine the proper answer to the questions. It appears our response was sent at the same time your letter was being issued. The copy of the maintenance agreement with FileNET for January, 2001 through December 31, 2001 which supports the payment of \$21,875 for that period, was forwarded on 3/26/03. The 2001 maintenance agreement is separate but related to the purchase of an Optical Imaging System and a Cash Register System for Vital Records. It was bid in 1995, DAS State Purchasing No. SCA-0036. We were able to locate copies of some 1995 correspondence related to the bid and the original 1995-1997 agreement which explains the original system and the 4 partners involved in the successful bid to provide the system -- Information Technology Division of Sterling Software, FileNET Corporation, Information Systems Inc., and INFOCORP.

3. Inadequate Documentation

Program management staff are responsible for program and performance evaluation related to the contractually purchased services in their program area. On-site visits are one tool to monitor performance and do this program evaluation. A schedule of the meetings with Lincoln/Lancaster County Health Department for 2002 were provided at the time of the original request. The meetings with the schools for program review and evaluation of policies were held and will continue to occur. We will be taking steps to improve our documentation of program and performance evaluation in our contract management efforts related to NIS implementation.

Auditors' Response: The documentation provided regarding the agreement with FileNET Corporation was not adequate documentation for any of the items mentioned above. We received information regarding the original purchase of the Optical Imaging System in 1995. FileNET was to perform maintenance on the system for one year, after which time the State could negotiate a contract with a third party to perform the maintenance. No documentation was provided to show that the State ever attempted to bid out or request proposals for the maintenance agreement from other vendors.

The existing contract with FileNET for the maintenance services also mentions that extended coverage could be provided by separate agreement. The extended coverage included on-site technical consulting support. This was the description listed on the invoice that was part of the documentation to support the payment for the transaction listed above. The on-site technical consulting was not included in the standard maintenance agreement and the separate agreement was not provided. Also, no documentation was provided to show that legal counsel reviewed the individual maintenance contract.

Agency 46 – Department of Corrections

The following procedures were performed:

- Requested the completion of an Internal Control Questionnaire (ICQ) to document the procedures/controls your Department had over purchases to ensure compliance with all laws and regulations.
- Examined the responses to the ICQ to determine if key procedures/controls were in place to ensure purchases were in accordance with all laws and regulations.
- Completed testing of the transactions, and related purchasing documentation as noted in the Advisory Letter of the Purchasing/Contracting Procedures and Controls issued December 11, 2002, to determine if key procedures/controls were in place to ensure purchases were in accordance with all laws and regulations. The transaction tested was as follows:
 - St. Joseph Hospital – Doc # 2398207 (\$233,719.48)

This payment was for medical services for inmates of the Department of Correctional Services.

Based on the responses to the Internal Control Questionnaire, we noted no obvious weaknesses in the controls over purchases/contracting procedures. The controls were not specifically tested during this review, but will be examined and tested in future audits to determine whether the controls are in place. However, we did note during our testing of the above transaction the following problems:

1. Documentation Supporting Sole Source

For the contract noted above the Department identified the entity as being the only source for the service. However, the Department did not have documentation to support they had used an open competitive process for selecting the entity who provided the contracted services. For example, there was no documentation to support that the Department had attempted to contact other parties to determine if they could provide the needed services. Also, there was no deviation from the contractual process form noting the entity as a sole source provider.

The Governor issued Executive Order 00-04 on December 21, 2000, which State agencies were to follow in selecting and contracting for services. Previous to that, Executive Order 95-4 was issued April 5, 1995 and required all service contracts over \$25,000 to utilize an open competitive process for selecting recipients for contracted services. Executive Order 02-03 was issued December 20, 2002 and gave further guidance on the process to follow in selecting and contracting for services. The Department indicated they had followed Executive Order 00-04 although some contracts did not adhere to the Order. In part, the Executive Order stated, “State

agencies shall immediately utilize an open competitive process for selecting recipients for contracted services.” In addition, good internal control requires documentation be retained to support that an open competitive process was followed. The Department also indicated they were in the process of bringing all contracts into compliance with Executive Order 02-03.

We recommend the Department document its competitive bidding process or document the deviation from the contractual process. This documentation should include how and which entities were considered eligible to provide the service, and how the entity selected to provide the service was determined. This would provide evidence that the contract was competitively bid, support the award of the contract to the lowest responsible bidder, or document the entity as a sole source provider.

2. Contract was Not Monitored

Good business practices require a contract be monitored to ensure services that are being paid for are actually received, and the terms and conditions of the contract are being complied with. The contract with St. Joseph Hospital was not being monitored.

The contract stated that certain services would be billed to the Department at a rate not to exceed the usual and customary charges. This was an important term of the contract that should have been monitored by the Department. The Department did not have a listing of the usual and customary charges that could be used to compare to what they were actually charged.

By not monitoring this contract, the Department has increased the risk that these funds may be used improperly.

We recommend the Department request the appropriate information and create procedures for monitoring all contracts. We also recommend the review be documented.

3. Contract Terms

Good business practices require a contract to have specific terms regarding how long a contract will be in effect and how often it needs to be renewed or re-bid. The contract with St. Joseph Hospital did not have a set time period during which the contract was in effect. The term clause in the contract stated, “This agreement is effective upon signature of both parties. It shall continue and remain in effect unless sooner terminated as herein provided.”

The contract had a clause for amendments and a termination clause. The termination clause stated that either party upon thirty (30) days written notice to the other party may terminate the agreement. Because there is no set term for the contract, the contract could be in effect indefinitely. Section 4.2 (D)(4) of Executive Order 02-03 states that, “Agencies may not enter into contracts for services with an unspecified duration or an unlimited duration.”

We recommend the Department review the contract and determine if the contract should be modified to include a set time period the contract will be in effect and how often the contract should be renewed. The decision on renewal of the contract should be documented and should consider what is in the best interests of the State.

4. Department in Violation of Administrative Regulations

Department of Corrections Administrative Regulation 113.07 (Revised December 31, 2001) states that, "All contracts in excess of \$25,000 for the contract period are subject to Executive Order 00-04, Selection of Contractual Services." In part, the Executive Order stated, "State agencies shall immediately utilize an open competitive process for selecting recipients for contracted services."

There was no documentation to show that the agreement with St. Joseph Hospital ever followed an open competitive process for selecting recipients for contracted services, as was required by Executive Orders 95-4 and 00-04. In response to our question answered above, the agency stated that they did not follow Executive Order 95-4 in regards to the contract with St. Joseph Hospital.

We recommend the Department comply with its own Administrative Regulations. We also recommend the agency document the procedures used when a service contract does not follow the Executive Orders.

Agency Response: Thank-you for the opportunity to present comments based on the Auditor of Public Accounts points regarding the Internal Control Questionnaire and supplemental questions related to purchases/contracting procedures.

The Department of Correctional Services (DCS) has implemented a new process for all contracts that are covered by the Governor's Executive Order 02-03 as follows:

- *All areas within DCS are required to submit contract requests and specifications to DCS Purchasing.*
- *DCS Purchasing staff will coordinate the development of requests for proposals, obtaining bids, selection of providers, and issuing contracts. Where appropriate Purchasing will also coordinate obtaining deviations in accordance with the requirements of the Governor's Executive Order 02-03. Any coordination with DAS Materiel will be DCS Purchasing's responsibility as well.*
- *Contracts will be monitored for compliance to terms either by the requesting area, DCS Purchasing, DCS Accounting or jointly by these areas.*
- *DCS Accounting staff are responsible to see that they have documentation showing receipt of services before processing payments.*

We believe that these changes will allow DCS to meet the requirements of the Governor's Executive Order. Additionally, we will be modifying our Administrative Regulations where needed.

Agency Response, Concluded:

In addition to the general comments above, I would like to clarify an issue in Documentation Supporting Sole Source. Your report refers to the entity as being the only source for the service. Our response indicated that Saint Joseph Hospital is the closest medical treatment facility to our inmates and therefore a contract was required. It is necessary to take emergency cases to the closest medical facility. We have used other medical treatment facilities in the Omaha area and most likely will in the future, as some medical diagnosis may need to be treated at a certain location.

Agency 65 – Department of Administrative Services

The following procedures were performed:

- Requested the completion of an Internal Control Questionnaire (ICQ) to document the procedures/controls your Department had over purchases to ensure compliance with all laws and regulations.
- Examined the responses to the ICQ to determine if key procedures/controls were in place to ensure purchases were in accordance with all laws and regulations.
- Completed testing of the transactions, and related purchasing documentation as noted in the Advisory Letter of the Purchasing/Contracting Procedures and Controls issued December 11, 2002, to determine if key procedures/controls were in place to ensure purchases were in accordance with all laws and regulations. The transactions tested were as follows:

Building Division

- FBG Service Corporation – Doc # 2435310 (\$78,838.06)

This was a contractual payment for monthly cleaning services.

- JRM NE Management & Leasing - Doc # 2443193 (\$56,945.98)

The payment was for a lease of space by Health and Human Services at Gold's Galleria in Lincoln, Nebraska.

- Gold's Limited Partnership – Doc # 2436140 (\$54,506.68)

The payment was for a lease of space by Health and Human Services at Gold's Galleria in Lincoln, Nebraska.

- Keystone Landing – Doc # 2438076 (\$48,800.00)

The contractual payment was for the lease of space for the Department of Labor in Omaha, Nebraska at Keystone Landing.

- Mark 1 Waterproofing & Restoration Co. – Doc # 2438694 (\$742,907.50)

This was a partial payment for work performed on the State Capitol Masonry Restoration Project.

- Asbestos Removers Inc. – Doc # 2436051 (\$36,200.00)

This was a payment on a construction contract to remove and dispose of materials containing asbestos from Bensen Hall.

- Fenton Art Glass Co. – Doc # 8434742 (\$30,029.16)

This payment was for partial payment of the contract to make four iron blow moulds and completed ornamental glass light shades for the east chamber of the Capitol.

- First Federal Lincoln Bank – Doc # 2441388 (\$9,991.20)

This was a payment for a lease of space by Health and Human Services in Lincoln, Nebraska.

Information Management Services Division

- Black Box Corporation – Doc # 344503 (\$5,047.21)

This was a purchase of data communication equipment.

- IBM Corporation – Doc # 345187 (\$318,377.34)

This was a contractual payment for enterprise software and services.

Based on the responses to the Internal Control Questionnaire, we noted no obvious weaknesses in the controls over purchases/contracting procedures. The controls were not specifically tested during this review, but will be examined and tested in future audits to determine whether the controls are in place. However, we did note during our testing of the above transactions the following problems:

Building Division

1. Documentation not on file

The General Records Retention Schedule 124-1-136 stated building construction contracts and records, which includes performance bonds, should be retained permanently or microfilmed.

The contract with Fenton Art Glass Co. was a construction contract that was completed August 31, 2001. Fenton Art Glass Co. was to construct glass light shades for the east chamber of the Capitol. The contract amount was over \$40,000, so a performance bond was required to be obtained. The Agency could not locate the performance bond.

As a result, there is an increased risk to the State when it does not have a copy of a legal document it has executed.

We recommend the Agency review its procedures to ensure all documents that are a part of the contract are retained for the period of time required by the Retention Schedule.

2. Certificate From The Committee on Building Maintenance Not On File

For the lease contract with First Federal Lincoln Bank we tested, we noted that the certificate from the Committee on Building Maintenance was not on file with the State Building Division. From correspondence with the State Building Division we were unable to determine if the certificate was no longer on file or if the certificate was never included in the request to the Director of Administrative Services.

Neb. Rev. Stat. Section 81-1108.22(2) R.S.Supp., 1999, states that, “When any board, agency, commission, or department of the state government not otherwise specifically authorized by law desires to use funds available for the purpose of renting office space outside of the State Capitol, it shall submit a request to the Director of Administrative Services accompanied by a certificate from the Committee on Building Maintenance...” Good internal control also requires documentation be kept on file to support the approval of the lease contract.

We recommend the State Building Division keep the certificates on file to document the reasons for the approval of the lease contracts.

Information Management Services Division

1. Direct Purchase of data communication equipment

We noted the following items as it relates to the direct purchase from Black Box Corporation as noted above:

- The Division did not have documentation that confirmed they had received a minimum of three bids on direct purchases.
- The Division did not have documentation to show the criteria used to select the vendor.

A memo dated July 1, 2001, which relates to Direct Market Purchase Authority, was sent to all agencies, boards, and commissions from Doni Peterson, Administrator of DAS - Materiel Division. The memo stated, “You are strongly urged to obtain a minimum three bids on orders over \$500.” Good internal control requires that agencies document they received at least three bids to ensure that bidding was competitive.

As a result, the Division was not in compliance with DAS Materiel procedures.

We recommend the Division develop procedures to document all bids that are received when the total direct purchase order is over \$500. Additionally, we recommend the Division document the criteria they used to select a vendor.

2. Documentation Supporting Sole Source

For the contract with IBM Corporation noted above, the Division identified the entity as being the only source for the service. However, there was no deviation from the contractual process form noting the entity as a sole source provider. Materiel Division's approval should have been kept with the contract file but it could not be found.

The Governor issued Executive Order 00-04 on December 21, 2000, which State agencies were to follow in selecting and contracting for services. Previous to that, Executive Order 95-4 was issued April 5, 1995 and required all service contracts over \$25,000 to utilize an open competitive process for selecting recipients for contracted services. Executive Order 02-03 was issued December 20, 2002 and gave further guidance on the process to follow in selecting and contracting for services. The Department indicated they had followed Executive Order 00-04. The Department also indicated they were now following Executive Order 02-03. In part, Executive Order 00-04 stated, "State agencies shall immediately utilize an open competitive process for selecting recipients for contracted services." It also stated, "DAS Materiel Division shall provide procedures to grant limited exemptions for 'sole source,' 'specialized sources,' 'emergency,' and other unique requirements, subject to review by the DAS Director." In addition, good internal control requires documentation be retained to support that an open competitive process was followed or an exemption was granted.

We recommend the Department document their competitive bidding process or document the deviation from the contractual process. This documentation should include how and which entities were considered eligible to provide the service, and how the entity selected to provide the service was determined. This would provide evidence that the contract was competitively bid, support the award of the contract to the lowest responsible bidder, or document the entity as a sole source provider.

Materiel Division

1. Documentation of Internal Control Procedures

During our review of the transactions noted above and those previously tested, the Division indicated to us that there are processes in place to determine when to renew or not renew contracts. The process consists of reviewing the contract terms to insure renewal is an option, checking the Consumer Price Index (CPI) for any price reductions in the area, and consider the competition level in the relevant area. The only documentation that is kept regarding this review is the buyer's signature, the Procurement Manager's initials, and the Administrator's signature. These signatures were the documentation that the review was completed. However, no other documentation exists to show that they performed this review. There is also no documentation to show how the renewal would be in the best interests of the State.

In addition, there was no written policy documenting the process listed above that was to be used for determining when a contract should or should not be renewed. The Division handles statewide contract renewals that are worth millions of dollars each year. By not having written policies the Division has increased the risk that funds may be used improperly. There is also a greater risk that the procedures will be applied inconsistently.

Good internal controls would require when a review of a contract that could potentially be renewed is performed that it be documented. This would document that the procedures, in accordance with management's directives, were actually performed. Good accounting practice would require the policies and procedures to be in writing to ensure consistency and avoid confusion.

We believe the internal control procedures noted above are excellent; however, when an internal control procedure is not documented there is no assurance the procedure was actually performed.

We recommend the internal control procedures the Division indicates are in place be documented. We also recommend the Division establish a written policy regarding the processes and procedures that are to be followed when considering whether a contract should be renewed.

Agency Response: The agency read the letter and chose not to respond.