



Performance Audit:

Contract Monitoring and Compliance

Durham County Internal Audit Department

March 1, 2018



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March 1, 2018

Mr. Wendell Davis,
County Manager

Dear Mr. Davis:

Internal Audit completed its audit on Contract Monitoring and Compliance in Durham County. The audit focused on (1) determining whether departments are complying with established contract monitoring procedures and (2) determining whether established procedures and departmental practices are aligned with best practices. Internal Audit examined Durham County contract monitoring policies and procedures, and reviewed contract monitoring practices from ten (10) departments: Cooperative Extension, Criminal Justice Resource Center, Finance, General Services, Information Services and Technology, Public Health, Social Services, Tax Administration, Veteran Services, and Youth Home. The audit team also examined a sample of contracts from each department that were completed during fiscal year 2017. Additionally, the audit team reviewed contract review processes performed by the Purchasing Division of the Finance Department and the County Attorney's Office.

Internal Audit found that contract monitoring practices need improvement in all three phases of contract monitoring: pre-contract phase, contract phase, and post-contract phase. Additionally, contract monitoring policies and procedures need to be updated to align with certain department practices as well as to include certain best practices.

This report describes specific findings related to contract monitoring and provides recommendations to address the findings. All departments agree with the findings. **Please note that none of the findings in the report are material.**

The audit team appreciates the cooperation and assistance provided by department directors, contract administrators, additional department staff, the Purchasing Division of Finance, and the County Attorney's Office during this audit engagement.

Sincerely,

Darlana M. Moore,
Internal Audit Director

INTRODUCTION

The Audit Oversight Committee approved this audit in the fiscal year 2018 Annual Audit Plan. This audit was conducted to identify and examine departmental controls for contract monitoring and compliance.

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 the audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Performance audits are defined as audits that provide findings or conclusions based on an evaluation of sufficient, appropriate evidence against criteria. Performance audits provide objective analysis to assist management and those charged with governance and oversight in using the information to improve program performance and operations, reduce costs, facilitate decision making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability.¹

BACKGROUND

Durham County departments execute contracts for goods and services to carry out certain departmental functions and to serve Durham County residents. The Finance Purchasing Division of the Finance Department oversees the procurement of goods and services, and it processes departmental contracts and fund requests encumbering the funds to satisfy the pre-audit for the contracts. In fiscal year 2017, the Finance Purchasing Division processed over 1300 contracts and fund requests. Out of the 1300, there were 889 written contracts executed by departments and performed by vendors for a total value of approximately \$41.5M.

County departments conduct business with numerous vendors, and the Finance Purchasing Division maintains a list of vendors. All vendors interested in conducting business with Durham County must submit an application along with required documentation to be listed as County vendors. Additionally, the County encourages minority and women business owners to engage in business opportunities through its Minority and Women Business Enterprises (M/WBE) program. The County awards some contracts to M/WBEs for the provision of construction or repair work, goods, and services based upon applicable statutes and approved policies and procedures. The Finance Purchasing Division is responsible for administering, monitoring, and enforcing M/WBE policies, standards, and procedures.

Durham County has contract policies and procedures which departments must follow. The Durham County Contract Control Manual guides departments through contract execution and monitoring processes. When departments execute contracts with vendors, departments must engage in contract monitoring. Contract monitoring is the process of ensuring that a vendor adequately performs a contracted service. Although the Finance Purchasing Division manages the County's procurement process, individual County departments are responsible for

¹ Comptroller General of the United States, *Government Auditing Standards*, Washington D.C.: U.S. Governmental Accountability Office, 2011, p.17.

monitoring their contracts. Typically, departments assign at least one employee to be a contract administrator who shares the monitoring responsibilities with a project personnel and who is responsible for documentation of contract monitoring. The Durham County Administrative Guide to Effective Contract Monitoring provides best practices and sample forms to assist departments with contract monitoring.

Departmental contract monitoring efforts should occur during the three major contract phases: pre-contract phase, contract phase, and post-contract phase. During the pre-contract phase, departments must ensure that contracts are properly executed, and they must obtain all required supplemental documentation. Depending on the type of contract and the dollar amount, certain contracts must be approved by the Board of County Commissioners (BOCC) prior to execution. Additionally, certain contracts require review and approval from the Durham County Attorney's Office (Legal). Furthermore, some vendors may have to engage in Durham County's competitive bidding process to be selected to provide goods or services. Departments must follow Durham County policies on BOCC approval, Legal review and approval, and bidding.

During the contract phase, departments must monitor vendors as work is performed to ensure that vendors are providing the contracted goods or services. Examples of monitoring tasks include on-site visits, on-going performance evaluations, progress reports, and meetings to discuss work progress. Many vendors submit invoices periodically as work is completed, so on-going monitoring tasks are necessary to verify work performed prior to paying invoices. During the post-contract phase, departments must evaluate vendors' performance and determine whether or not to award future contracts. Post-contract monitoring efforts may include end of contract performance evaluations or surveys. Departments must also verify that all contract deliverables are met prior to making final payments. Contract monitoring efforts should be documented and maintained in departments' contract files.

AUDIT OBJECTIVES

The audit objectives were to (1) determine whether departments are complying with established contract monitoring procedures during the pre-contract phase, the contract phase and the post-contract phase and (2) determine whether established procedures and departmental practices are aligned with best practices.

AUDIT METHODOLOGY AND SCOPE

In order to conduct our review, we:

1. selected ten (10) departments to audit (Cooperative Extension, Criminal Justice Resource Center, Finance, General Services, Information Services and Technology, Public Health, Social Services, Tax Administration, Veteran Services, and Youth Home),
2. reviewed Durham County policies and procedures related to contract execution, contract monitoring, and vendor invoice payments,
3. researched and reviewed laws governing contracts,
4. identified best practices for contract monitoring,
5. compared best practices to departmental policies and practices,
6. interviewed departmental contract administrators who are responsible for monitoring contracts, and

7. tested a sample of 24 contract files to determine if departmental contract monitoring policies and procedures were followed.

Internal Audit judgmentally selected a sample of contracts with a cumulative value of at least 10% of the total contract population. The total contract population was \$41,539,230.24.

The audit scope was contracts that were completed during fiscal year 2017 (July 1, 2016-June 30, 2017).

FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS

Internal Audit identified the following findings and discussed conclusions and recommendations.

Durham County Contract Monitoring Policies and Procedures

The Durham County ("Contract Control Manual") and the Durham County Administrative Guide to Effective Contract Monitoring govern contract monitoring for departments for Durham County. The Contract Control Manual was last updated in 2011 and needs to be updated to reflect certain department practices and best practices as discussed below.

DocuSign Practice for Contract Execution

Internal Audit found that two departments² use DocuSign to execute contracts. The Purchasing Division coordinated with these two departments to use DocuSign in order to test electronic contract execution. The two departments believe DocuSign is a more efficient means to execute contracts as opposed to getting vendors to sign three original hard copies. Currently, the Contract Control Manual does not discuss DocuSign as a contract execution option. The effect is that there are inconsistent practices for contract execution.

Recommendation: We recommend that the Contract Control Manual be updated to include the DocuSign process which is currently in test mode.

Response: The Contract Control Manual has not yet been updated to include the DocuSign process because this process has been in test mode for electronic contract execution and has not yet gone live. Finance is in agreement with the recommendation that the Contract Control Manual does need to be updated to include the electronic contract execution process. Finance staff will amend the Contract Control Manual to include this process to be completed prior to go live of this process.

Executing Contracts with State Vendors

The Finance Purchasing Division permits departments to execute contracts with State approved vendors who can bypass the County's bidding process due to their status of being State approved. The Contract Control Manual does not discuss departments executing contracts with State

² IS&T and General Services

vendors. Currently, this department practice does not align with County policies. The Finance Purchasing Division has not updated the policy to include this practice. The effect is that some departments may not be aware of this practice.

Recommendation: We recommend that the Finance Purchasing Division update the policy regarding executing contracts with State vendors.

Response: The N.C.G.S. 143-129 allows certain contracts to be exempted from the competitive bidding requirements. This exemption includes contracts that are established and awarded to vendors issued by the NC State Division of Purchase and Contracts and the State Office of Information Technology Services. The Finance Purchasing Division permits departments to execute contracts that are covered by this exemption. However, the request for exemption to bidding is reviewed by the Finance Purchasing Division prior to entering into contract. The requirements for State Contract purchases are communicated in the County's Competitive Bidding Policy under Section 7.0 Exemptions to Bidding.

State Debarred Vendors List

Internal Audit found that neither the departments nor the Finance Purchasing Division maintains a list of State debarred vendors. The State of North Carolina maintains a list of debarred vendors who cannot engage in business with the State. Local governments that use State or Federal funds to pay for contracts cannot award contracts to bidders who have been debarred by the State or Federal government.

Currently, State approved vendors are not required to participate in the County's bidding process; thus, vendors who are debarred by the State must participate in the County's bidding process. The lack of tracking State debarred vendors creates the risk of State debarred vendors conducting business with Durham County. The Finance Purchasing Division and departments did not consider maintaining the State's debarred list. Internal Audit did not find any of the County vendors from this audit on the State's debarred list.

Recommendations: To ensure that State debarred vendors are not awarded contracts paid with State or Federal funds and to ensure that debarred vendors participate in the County's bidding process, Internal Audit recommends that the County maintain the State's debarred list. Since the Finance Purchasing Division is the central repository for contracts, we recommend that the Finance Purchasing Division retrieve the debarred list from the North Carolina Department of Administration website and place it in a convenient location for all departments to access.

Response: Finance is in agreement with this recommendation. The State Debarred List will be placed on MyDCo.

Vendor Complaint Process

The Finance Purchasing Division does not have a formal process for departments to communicate vendor complaints. The State of North Carolina Contract Administration and Monitoring Guide serves as a best practice, and it recommends that a vendor complaint form be used to

communicate complaints and/or discrepancies on vendor performance.³ The Finance Purchasing Division did not develop a formal complaint process.

Recommendation: We recommend that the Finance Purchasing Division implement a process and a complaint form for departments to provide vendor complaints and include this process and form in the policy.

Response: Finance is in agreement with the recommendation. In updating the manual and policy, Finance staff will include the process for departments to communicate vendor complaints to include a complaint form.

Corrective Action Plans

The Contract Control Manual does not have a provision related to corrective action plans. A corrective action plan should establish guidelines agreed by the departments and the vendors regarding escalation of issues to the next level of authority if problems arise.⁴ The lack of a corrective action plan prevents departments and vendors from anticipating potential issues and agreeing on resolution steps during the contract execution phase.

Recommendation: We recommend that the Finance Purchasing Division update the Contract Control Manual to include a section regarding corrective action plans.

Response: Finance is in agreement with the recommendation. In updating the manual, Finance staff will include a section regarding corrective action plans.

Payments for Goods and Services Without Executing Contracts or Encumbering Funds

In fiscal year 2017, there were 79 instances Countywide when departments paid vendors for goods and services without executing contracts or encumbering funds. Most of these instances occurred due to emergency situations such as the heating and air conditioning system needing immediate repair; however, some of these instances occurred due to departments' oversight, the lack of contract monitoring efforts, or vendor error. There were 24 of 79 (30%) instances when payments were made due to departments' oversight, the lack of contract monitoring efforts, and vendor error for a total cost of \$185,015.21. The Finance Department has procedures for processing payments for goods and services received without an encumbrance, but these procedures are not outlined in a formal policy.

Recommendations: Although these procedures should not replace the County's existing contract execution process, we recommend that these procedures be included in the Contract Control Manual. The Manual should also specify consequences if departments consistently use these procedures for non-emergency circumstances to circumvent the formal contract execution process. The Finance Purchasing Division should strictly monitor these procedures, and enforce

³ "State of North Carolina Contract Administration and Monitoring Guide," Department of Administration Division of Purchase and Contract, March, 2013, page 16.

⁴ "State of North Carolina Contract Administration and Monitoring Guide," Appendix C.

consequences and inform the CFO when departments consistently use these procedures for non-emergency circumstances to circumvent the formal contract execution process.

Response: Finance is in agreement with the recommendation. In updating the Contract Control Manual, Finance will include the procedures for procuring goods and services without executing contracts or encumbering funds due to emergency situations. Finance will also include that these procedures are not be used for non-emergency situations as well as consequences if and when used for non-emergency circumstances to circumvent the formal contract execution process.

Contract Administrator Independence Statement

Based upon interviews conducted, Internal Audit found that Contract Administrators did not disclose whether or not they had any official, professional, personal, or financial relationships with vendors that they monitored. Disclosing relationships with vendors is not currently part of the Contract Administrators' practices. The failure to disclose relationships, if any, increases the possibility of collusion, fraud, and kickbacks. Also, there is a risk that Contract Administrators may not follow policies and procedures that negatively impact their relationships with vendors.

Recommendations: Based upon the high volume of contracts executed and due to the risk of conflicts of interest, Internal Audit recommends that the Finance Purchasing Division require all Contract Administrators to sign an independence statement declaring that they do not have any official, professional, personal, or financial relationships with vendors. Contract Administrators should include the statement in each contract file. Independence statements should be updated annually and maintained in contract files for seven years.

Response: Finance is in agreement with the recommendation. Finance staff will create and implement a disclosure statement for contract administrators and will include this in the Contract Control Manual as well as County guidelines. It will be a requirement that all Contract Administrators sign an independence statement that they do not have any official, professional, personal, or financial relationships with vendors that they have monitored or are currently monitoring. These independent statements will be updated annually and maintained in contract files for seven years.

Departmental Contract Monitoring During the Pre-Contract Phase

Certificates of Insurance Documents

23 of 24 (96%) contracts required a vendor to submit a Certificate of Insurance, and 22 of 23 (96%) certificates contained at least one error. Errors included missing automobile or workers compensation liability coverage, no indication of insured vendors' waiver of subrogation rights against the County for all insurance policies, the County listed as an additional insured, and the insurance dates did not cover the entire contract period as required by contract. Almost all Contract Administrators communicated that they were unaware that they had to review the content of the Certificates of Insurance to make sure they complied with the contracts. Vendors that do not carry the required insurance limits or have a lapse in insurance coverage risk not having protection in the event of a loss while performing services. Vendors who suffer losses, but do not have insurance coverage may initiate a lawsuit against the County to recover losses.

Vendors' insurance policies that do not waive subrogation rights against the County create the risk that the vendors' insurance companies will initiate lawsuits against the County to recover any losses caused by the County.

Recommendations: Internal Audit recommends that Contract Administrators review Certificates of Insurance to ensure contract compliance. For vendors who cannot comply with certain insurance requirements, Contract Administrators should inform them to request a waiver from Legal in writing.

Response: Finance is in agreement with the recommendation. Contract Administrators will be trained by Finance staff on how to review Certificates of Insurance to ensure contract compliance. This review process will be implemented and updated in the Contract Control Manual. The review process will include that for vendors who cannot comply with certain insurance requirements, Contract Administrators will inform them to request a waiver from the County's Legal Office in writing.

Contracts Missing Certain Provisions

1 of 24 (4%) contracts were missing the E-verify⁵ contract provision. North Carolina law prohibits Durham County from entering into a contract with a contractor unless the contractor complies with E-verify requirements.⁶ Durham County is in compliance with North Carolina law if the contract includes a term requiring the contractor to comply with E-verify requirements.⁶ The contract was missing the E-verify provision because the Contract Administrator did not use the right contract template that contained the E-verify provision. County contracts that do not contain a term requiring the contract to comply with E-verify create the risk that the County is not in compliance with North Carolina law.

1 of 24 (4%) contracts were missing the contract provision related to the Iran Divestment Act. During FY 2017, Durham County was required to ensure that any person or company who entered into, renewed, or assigned a contract with the County certify that the person or company was not on the State Treasurer's list of persons engaged in investment activities in Iran.⁷ The contract provision was missing because the Contract Administrator used the incorrect contract template. The missing provision created the risk of non-compliance with NC law.

1 of 24 (4%) contracts were missing a provision for dispute procedures. Durham County's Administrative Guide provides that contracts should include clear language of dispute procedures. The contract was missing the dispute procedures provision because the Contract Administrator used the wrong contract template. The lack of dispute procedures outlined in the contract creates

⁵ E-verify is the federal internet-based system used to verify individuals' work authorizations. North Carolina law requires non-governmental employers who conduct business in NC and employ 25 employees or more in NC to verify employees' work authorization through E-verify (N.C.G.S. Chapter 64 Article 2).

⁶ (N.C.G.S. 143-133.3).

⁷ (N.C.G.S. § 147-86.59) Note: This certification provision was applicable for County contracts during Internal Audit's scope, but this provision has been repealed by the General Assembly effective October 1, 2017.

the risk that the vendor initiates a lawsuit against the County if a legal issue arises instead of using an alternate dispute resolution method such as mediation.

Recommendation: Since Durham County contracts must comply with NC law, we recommend Contract Administrators use the correct contract templates for all contracts, including renewals and amendments, which contain the necessary contract provisions. We also recommend the Finance Purchasing Division store these templates in a centralized location accessible to all Contract Administrators.

Response: In coordination with the County's Legal Office, the Finance Purchasing Division reviews and updates contract templates every fiscal year and when required due to immediate changes in legislation. Contract templates are maintained on the County's intranet under Purchasing Forms. Department Contract Administrators are also notified by email when templates have been revised and available for their use. With the volume of contracts currently processed manually by the Finance Purchasing Division, an incorrect contract template submitted by a Contracts Administrator can be overlooked by human error. The implementation of an electronic contract software should eliminate this problem.

Performance Bonds

2 of 24 (8%) contracts required a performance bond. Of the 24, one bond was not provided and the amount of another bond was lower than the contract amount. The contracts required the vendors to submit performance bonds to the County that equaled 100% of the contract amounts. One bond was missing because the Contract Administrators did not receive it and did not follow up to acquire the performance bond. A Contract Administrator did not ensure the other bond amount matched the contract amount. The absence of a performance bond or an insufficient bond amount increases the risk that more tax-payer dollars will be spent in the event a contractor does not complete contracted work.

Recommendation: Internal Audit recommends that Contract Administrators ensure that performance bonds are submitted when required and that the amounts comply with the contracts.

Response: Finance is in agreement with this recommendation. When Finance staff trains the Contract Administrators on the complete contract review process and check list, they will also be trained to ensure that performance bonds are submitted when required and that the amounts comply with the contracted amounts.

Vendors Paid Prior to Contract Execution

For 3 of 24 (13%) contracts reviewed, the vendors performed services and were paid prior to contract execution. According to the Contract Control Manual, contracts shall be submitted for processing prior to the term of the contract date allowing time for review, resolution of issues, encumbering of funds (pre-audit), approval and execution.⁸ These vendors performed services

⁸ "Durham County Contract Control Manual," Purchasing Division, January, 2011, Section 7.

and were paid prior to contract execution due to the untimely processing of the vendors' renewal contracts. These vendors were already working for Durham County under contracts and when their contracts were up for renewal, the vendors continued providing services even though the renewal contracts were not yet processed. Contract Administrators did not ensure the execution of renewal contracts occurred prior to vendors working. Allowing vendors to perform work prior to contract execution prevents the County from reviewing the contracts and resolving any issues prior to conducting business with the vendors.

Recommendation: We recommend that Contract Administrators follow the County's policy of contract submission so that contracts will be executed prior to vendors working.

Response: Finance is in agreement with this recommendation. When Finance staff conducts training for the Contract Administrators, the training will include following the Contract Control Manual as well as County policy that contracts are to be fully executed prior to vendors working. In addition, the contracts shall be submitted for processing prior to the term of the contract date allowing time for review, resolution of issues, encumbering of funds, approval and execution. That portion of the Contract Control Manual will be updated to include consequences when vendors begin working before the contract is full executed.

Non-Compliant Contracts Executed

Since 22 of 23⁹ (96%) contracts had Certificates of Insurance that contained at least one error, these contracts were executed despite not being compliant with County policies. 16 of 23 (69%) contracts contained comments from the Finance Purchasing Division instructing departments to correct contract related issues. Only 5 of 16 (31%) contracts were corrected for the issues identified, but Internal Audit found that these 5 contracts still contained at least one error on the Certificates of Insurance. The other 11 of 16 (69%) contracts with comments were not corrected at all. The Finance Purchasing Division marked the remaining 6 of 23 (26%) contracts as compliant, but these contracts were not compliant because they contained at least one error. The Contract Control Manual states that when the contract package has been reviewed and determined to be compliant with all applicable policies, the contract is routed for approval signatures.¹⁰ Most departments communicated that they were unaware that Finance Purchasing Division provided comments instructing them to make changes because the comments were provided along with executed contracts. The departments did not notice the comments and assumed that the contracts were compliant since they contained approval signatures. The Finance Purchasing Division did not ensure that these contracts were compliant prior to routing them for approval signatures.

Recommendation: We recommend that Contract Administrators ensure contract compliance prior to submitting documents to the Finance Purchasing Division. We also recommend that the Finance Purchasing Division not approve contracts until all issues are resolved to ensure compliance with policies and procedures.

⁹ One contract did not require a certificate of insurance.

¹⁰ "Durham County Contract Control Manual," Section 4.

Response: Finance is in agreement with this recommendation. Contract Administrators will be trained on the review process so that in their review, they ensure contract compliance prior to submitting contracts to the Finance Purchasing Division for execution. In addition, effective immediately, the Finance Purchasing Division will no longer approve/execute contracts if there are any outstanding, unresolved issues. In these circumstance, the contracts will be returned to the Contract Administrator in the department for resolution. Once successfully resolved, the contract will be sent to the Finance Purchasing Division. Once all issues are resolved, the Finance Purchasing Division will approve and execute the contracts. This process will ensure compliance with the County’s policies and procedures.

Departmental Contract Monitoring During the Contract Phase

On-going Monitoring

7 of 24 (29%) of contract files reviewed did not contain evidence of on-going monitoring. The Contract Control Manual states that on-going monitoring shall be administered by the departments.¹⁰ The departments should hold the vendor responsible for meeting all contract requirements for quality, quantity, and timeliness. The lack of on-going monitoring creates the risk that vendors are not providing required contract deliverables prior to payment. Departments that did not perform on-going monitoring did not comply with County policies and procedures. This finding is a repeat finding since Internal Audit identified it in the 2015 audit.¹¹

Recommendation: We recommend that Contract Administrators perform on-going monitoring for all contracts and include documentation of on-going monitoring in contract files for seven years.

Response: Finance agrees with this recommendation. Effective immediately, the on-going monitoring for all contracts will be performed by the Contract Administrators in their respective departments. In addition, the on-going monitoring will be documented and included in the contract files for seven years.

Lack of Segregation of Duties

Internal Audit also found that there was a lack of segregation of duties for managing two contracts. Two departments intended to share contract management responsibilities for two contracts and the departments created written procedures outlining the tasks to be performed by each one. Nevertheless, one department performed budget functions, including selecting the vendor and allocating funds, as well as contract monitoring functions except for payments. The department that issued payments did not review any contract deliverables prior to approving payments because it assumed the other department verified deliverables. Budget functions and contract monitoring functions should be appropriately segregated. Also, Contract Administrators should review all contract deliverables prior to approving payments. There was a lack of segregation of duties because one department assumed the budget and contract monitoring roles

¹¹ “Follow-up Audit of Contract Monitoring Procedures,” Durham County Internal Audit, June 2015.

to efficiently manage the contracts. Nevertheless, the lack of segregation of duties creates the risk for fraudulent activities to occur. Also, paying invoices without verifying contract deliverables resulted in vendors being paid without providing all required contract deliverables.

Recommendations: Internal Audit recommends that budget and contract monitoring duties are appropriately segregated to create appropriate checks and balances. Audit also recommends that Contract Administrators follow County's policy and monitor contracts to ensure that contract deliverables are met prior to making payments.

Response: Finance agrees that stronger internal controls are needed to ensure deliverables are satisfactorily met before processing payments. One department can perform the budget functions and contract monitoring functions. However, effective immediately, the department approving and issuing payments must verify that the deliverables were met and were met satisfactorily to the County before approving and issuing payments. This approach will strengthen internal controls by increasing the checks and balances in place regarding the deliverables.

Departmental Contract Monitoring During the Post-Contract Phase

Performance Evaluations

10 out of 24 (42%) contract files did not contain a final vendor performance evaluation. The County's Administrative Guide states that departments should evaluate vendors' performance at or near the end of a contract period.¹² All contracts should be subject to a final evaluation of whether vendors have performed services sufficiently to fulfill the contract terms. Most departments did not perform an evaluation due to oversight or lack of communication with project managers. The lack of vendor evaluations creates the risk that vendors will not fulfill their contractual obligations prior to being paid. Also, information concerning poor vendor performance is not documented which could result in the County continuing business with a vendor who does not provide satisfactory goods or services.

Recommendation: Internal Audit recommends that departments perform final evaluations for all vendors and include documentation of evaluations in the contract files for seven years.

Response: Finance is in agreement with this recommendation. Effective immediately, County's Administrative Guide will be followed to include departments evaluating vendors' performance at or near the end of a contract period. The vendor evaluations will be documented and included in the contract files for seven years.

Contract Close-out Procedures

19 of 24 (79%) contract files did not contain contract close-out procedures. This finding is also a repeat finding. The County's Administrative Guide provides that formal, written close-out procedures should be used at the completion stage of the contract.¹³ These close-out procedures

¹² "Durham County Administrative Guide to Effective Contract Monitoring," Purchasing Division, July, 2016, page 7.

¹³ "Durham County Administrative Guide to Effective Contract Monitoring," page 7.

ensure that all contract related actions such as paying invoices and performing evaluations have been completed. The Contract Administrators are responsible for ensuring that contract files contain all necessary documentation before close-out.

Recommendations: We recommend that Contract Administrators implement contract close-out procedures for all contract files to ensure the County receives its contracted goods and services prior to payments. We also recommend that Contract Administrators follow the State's best practices to receive clearly marked FINAL invoices and progress reports along with a signed certification statement that the expenses were true and accurate and for appropriate purposes in accordance with the contract.¹⁴

Response: Finance is in agreement with this recommendation. Effective immediately, the County's Administrative Guide will be adhered to regarding contract close-out procedures. Formal, written close-out procedures will be performed at the completion state of the contract to ensure that all contract related actions have been completed. Finance will also include in the Guide the State's best practice of receiving clearly marked FINAL invoices, progress reports and a signed certification statement that the expenses were true and accurate and for appropriate purposes in accordance with the contract.

Payments

Internal Audit tested a sample of payments for each contract to determine accuracy of payments and to ensure payments did not exceed contract amounts. Internal Audit found that 1 of 24 (4%) vendors worked and was paid more than the contract amount. Payments should not exceed contract limits.¹⁵ Contract Administrators should monitor contract funds and modify the contract amounts through contract amendments, if necessary. The Contract Administrator did not monitor the contract funds. The lack of monitoring contract funds resulted in more money spent than was budgeted and initially encumbered to satisfy the pre-audit.

3 of 24 (13%) vendors were paid without providing all required contract deliverables. Contract Administrators are responsible for ensuring all deliverables are provided so that the County receives the contracted benefits. The Contract Administrators did not adequately monitor these contracts which resulted in the County paying for services not provided.

In addition, one department did not pay a vendor in a timely manner due to the lack of monitoring payments. The vendor needed the funds to provide resources to the Durham community. Contract Administrators are responsible for paying vendors in a timely manner. Untimely payments create the risk that the vendor did not have sufficient resources to serve the community.

One vendor performed services, but did not get paid. Contract Administrators are responsible for ensuring vendors get paid for services provided. The vendor did not submit an invoice for payment and the Contract Administrator did not issue a payment. The effect is that the County is liable to pay for services rendered.

¹⁴ "State of North Carolina Contract Administration and Monitoring Guide," Appendix B.

¹⁵ "State of North Carolina Contract Administration and Monitoring Guide," page 12.

Recommendation: We recommend that Contract Administrators monitor contract funds, collect contract deliverables, pay vendors in a timely manner, and coordinate with vendors to provide payments.

Response: Finance is in agreement with the recommendation. In updating the Contract Control Manual, Finance will include the process for Contract Administrators to monitor contract funds, collect contract deliverables, pay vendors in a timely manner and coordinate with vendors to provide payments. Consequences will also be included when this process is not followed.

Purchasing Division's Review of Contracts

Contract Monitoring Audits

The Finance Purchasing Division did not conduct its own audits of departments' contract monitoring practices. The North Carolina Contract Administration and Monitoring Guide states that "monitoring reviews, audits and investigations must be followed up on a routine basis to:

- Ensure corrective actions have been taken,
- Identify problem areas that might require training, and
- Improve future contracts."¹⁶

Since the Division has not conducted audits, it is unaware of the level of departmental non-compliance with contract monitoring policies and procedures. Also, the Division is unaware of whether or not vendors are providing satisfactory performances.

Recommendation: Since departments need to improve contract monitoring controls and since several findings are repeat findings, we recommend that the Finance Purchasing Division assign staff to conduct contract monitoring audits to ensure compliance with policies and procedures.

Response: Finance is in agreement with the recommendation Finance staff be assigned to conduct contract monitoring audits to ensure compliance with policies and procedures. However, Finance is unsure at this time which Finance staff will be assigned to conduct the contract monitoring audits. Finance will perform an assessment and assign this task to the Finance area/division that is the most appropriate.

Risk Assessments

The Finance Purchasing Division did not perform risk assessments to assess vendors' contract performance. According to the North Carolina Guide, "an effective risk assessment model will help focus monitoring resources on contractors or performance activities with the highest risk of noncompliance."¹⁷ The lack of a risk assessment limits the Finance Purchasing Division's ability to identify which types of contracts require additional monitoring efforts to ensure compliance. Risk assessments can assist the Finance Purchasing Division with selecting high risk contracts to audit.

¹⁶ "State of North Carolina Contract Administration and Monitoring Guide," page 11.

¹⁷ "State of North Carolina Contract Administration and Monitoring Guide," page 7.

Recommendation: We recommend that the Finance Purchasing Division coordinate with Risk Management to perform risk assessments to identify departments with high risk contracts.

Response: Finance is in agreement and that Finance will coordinate with Risk Management to perform risk assessments to identify departments with high risk contracts.

Complete Contract Files

Internal Audit found that the Finance Purchasing Division does not maintain complete contract files for all departments which include vendors' performance evaluations and other contract monitoring documentation. The Contract Control Manual states that all completed original contracts, attachments, and associated documents shall be filed in the central repository located in the Finance Purchasing Division.¹⁸ Contract files should be maintained for seven years.¹⁸

Recommendation: Internal Audit recommends that the Finance Purchasing Division maintain a complete copy of contract files that contain evidence of contract monitoring. Files should be maintained for seven years. The Finance Purchasing Division maintaining complete contract files not only complies with policy, but provides an alternate location to retain contracts in case departments lose contract files. Additionally, receiving complete contract files will enable the Finance Purchasing Division to conduct contract monitoring audits to ensure contract compliance and to identify vendors that perform below expectations.

Response: The Finance Purchasing Division has complied with the Contract Control Manual and Policy where on page 12 of the manual under Contract Monitoring and Performance, language specifically states that contract monitoring forms and documentation must be kept at the department level and maintained for auditing purposes. Finance is in agreement with the recommendation for the Finance Purchasing Division to maintain a complete copy of the contract files that includes evidence of contract monitoring files and will make revisions to this section of the manual. However, in an effort to continue with the Finance Department's goal to go paperless, the Finance Purchasing Division will begin receiving complete contract files from all departments once an electronic software has been selected and implemented.

Contract Administrator Training

Contract Administrators from 8 of 10 (80%) departments did not attend contract monitoring training during FY 2017. The County's Administrative Guide states that "training increases the likelihood that individuals will monitor contracts reliably by giving them the appropriate background knowledge related to contracts."¹⁹ In the past, the Finance Purchasing Division held training sessions occasionally, for departments. All departments stated that they did not have sufficient knowledge about Certificates of Insurance or certain contract provisions to make sure they had accurate and complete contract files.

¹⁸ "Durham County Contract Control Manual," Section 4.

¹⁹ "Durham County Administrative Guide to Effective Contract Monitoring," page 3.

Recommendations: Since contract monitoring is an essential process to ensure the County receives the benefits it pays for and to ensure it is not vulnerable to legal claims, departments should assign contract monitoring responsibilities to employees who can effectively perform the duties. Additionally, we recommend that the Finance Purchasing Division coordinate with Legal to properly train Contract Administrators. Specifically, Contract Administrators should be trained to understand the following topics:

- Certificates of Insurance,
- Insurance liability limits,
- Waiver of subrogation rights,
- Additional insured,
- Performance bonds,
- Required contract provisions,
- M/WBE policies and procedures, and
- Major contract monitoring risks.

Response: Finance is in agreement with this recommendation. The Finance Purchasing Division will coordinate with Legal to properly train Contract Administrators. We will develop training materials and class curriculums. Once developed, training will be bi-annually.

Timeliness of Contract Execution Process

Internal Audit could not conduct a timeliness test of the contract execution process. The Durham County Contract Control Manual provides that contracts shall be submitted for processing prior to the term of the contract day allowing time for review, resolution of issues, encumbering of funds (pre-audit), approval, and execution.²⁰ The normal turnaround time for processing contracts is 3 to 5 working days.²⁰ Internal Audit could not conduct a timeliness test due to insufficient information. Most contracts executed did not provide the dates of signatures. Also, there was not enough information regarding how long it took contracts to flow through each step in the execution process including vendors reviewing and signing contracts.

Recommendation: We recommend that the Finance Purchasing Division use an electronic contract tracking system to track and monitor the status of contracts during the execution process and to identify dates of signatures as well as for electronic archival/storage purposes.

Response: Finance is in agreement with this recommendation. Finance working with IS&T have already begun looking at electronic contract software. There has been one software demonstration. Finance and IS&T are in the process of scheduling a second demonstration with another software. The goal is to have the software selected and purchased in FY18 with implementation to occur before the end of FY19.

²⁰ "Durham County Contract Control Manual," Section 7.

Contracts Missing Certain Provisions

Internal Audit found that 3 of 24 (13%) contracts were missing certain provisions which Legal should have provided. Legal is responsible for ensuring that all contract templates contain the necessary contract provisions. One contract was missing the E-verify clause; one contract was missing the dispute procedures provision, and one contract was missing language prohibiting the County from being listed as an additional insured as well as missing language requiring the contractor's insurance policies to waive subrogation rights against the County. These contracts were missing the provisions because the contracts were originally executed in the past when County contracts did not include these provisions nor were these provisions warranted at that time. When the contracts were up for renewal in FY 2017, the contract amendment documents were used which did not contain the required provisions. Missing contract provisions creates the risk that Durham County is not in compliance with North Carolina laws, and it also makes the County more vulnerable to lawsuits.

Recommendations: We recommend that Legal update contract templates annually to provide all required contract provisions. Additionally, for contract renewals and amendments, we recommend that Legal inform Contract Administrators to use the most updated fiscal year contract templates which contain all the required provisions.

Response: Finance is in agreement with this recommendation. Legal will provide updated contract templates annually to provide all required contract provisions to the Finance Purchasing Division who will then place them on MyDCo removing the out of date contract templates from the site. This process will ensure that the most updated fiscal year contract templates are being used by the Contract Administrators.

Approved Contracts Still Contained Errors

Internal Audit found that 3 of 24 (13%) contracts were approved by Legal, but the Certificates of Insurance did not waive subrogation rights against the County as required by contracts. When contracts are submitted to Legal for review, Legal is responsible for reviewing contract provisions as well as supporting documentation, including Certificates of Insurances, to ensure contract compliance. Legal may waive certain provisions in writing. The contract files with errors were approved due to oversight. As previously stated, vendors' insurance policies that do not waive subrogation rights against the County create the risk that the vendors' insurance companies will initiate lawsuits against the County to recover any losses caused by the County.

Recommendation: We recommend that Legal ensure that all supporting documentation such as Certificates of Insurance to comply with contract provisions, unless the office provides waivers.

Response: Finance is in agreement with this recommendation. When updating the Contract Control Manual, we can ensure that this process is included and up to date in the Manual.

Review New Contracts Identified as Major Risks

Legal does not always review new contracts executed with new vendors which may be high risk contracts. Legal reviews contracts under the following circumstances:

1. The contract is related to engineering, architecture, construction or a lease;
2. The contract is drafted solely by a Vendor;
3. The department wants to modify the County's contract template; and
4. Vendors have questions about certain contract terms.

This criteria for contract review has been Legal's practice. Nevertheless, if contract review is limited to these circumstances, Legal may not review some new contracts in areas that may have a high risk of vendor non-compliance or litigation. Certain contracts including transportation contracts, may need to be reviewed by Legal to ensure insurance liability limits are appropriate and to minimize any risks to the County.

Recommendations: We recommend that Legal coordinate with Risk Management to identify contract areas that have a major risk of non-compliance or litigation. We also recommend that Legal review all new contracts and supporting documentation for areas identified in the risk assessment to protect the County's interests.

Response: Finance is in agreement with this recommendation. When updating the Contract Control Manual, we can ensure that these review processes are included and up to date in the Manual.

Back-Up Contract Attorney

Legal only has one person assigned to reviewing contracts and does not have a process in place to assign a back-up person to review contracts. Cross-training another employee to perform key job functions reduces the County's dependence on one person and enables the County to continue operations without interruptions. The lack of a back-up person could result in untimely contract reviews if the contract attorney is not available. Untimely contract reviews may prevent vendors from starting work at the beginning of their contract periods.

Recommendation: We recommend that Legal cross-train another employee to review contracts when the contract attorney is unavailable.

Response: Finance is in agreement with this recommendation. Finance will discuss with the County Attorney and the General Manager for Goal 5 the need to cross train another attorney to serve as a back-up person to review contracts in the County Attorney's Office.

