

OFFICE OF
CONTROLLER

LAURA N. CHICK
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September 23, 2008

The Honorable Antonio Villaraigosa
The Honorable Rockard J. Delgadillo
Honorable Members of the City Council

The Port of Los Angeles is one of the most important and vibrant economic engines to the City. Opened in 1907, the Port is now a major international hub for trade and commerce.

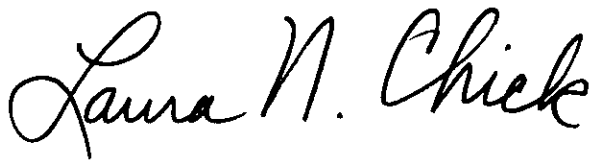
In 2003, my audit of the Port's multi-million dollar shipping leases found some serious problems that needed to be addressed. Today my report looks at the overall Harbor Department's contracting practices and finds some of the same issues.

Close oversight of multi-million dollar contracts is an important part of any successful business model. My audit found that the Port does not have an effective centralized oversight function. As a part of this deficiency there are a lack of clear guidelines on the use of change orders and contract amendments. Changes during a project must be closely managed as they can radically inflate the cost, quite often resulting in millions of dollars in increases.

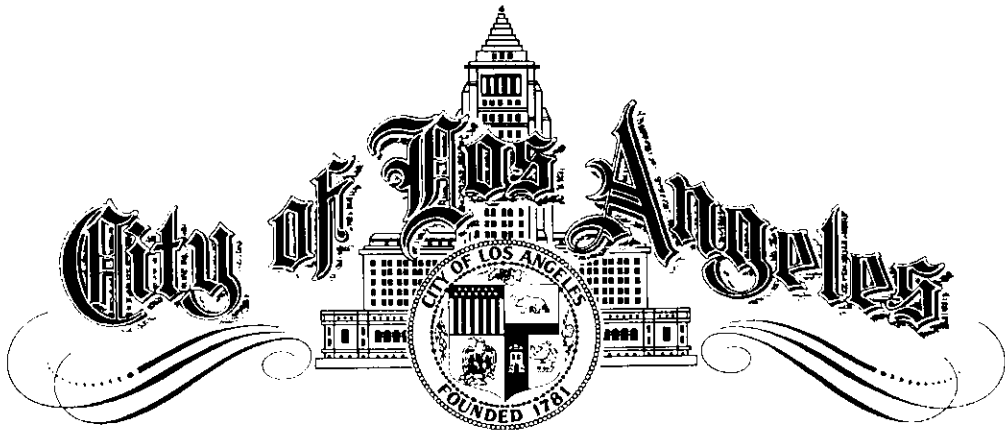
Clearly defined and understood policies and procedures are essential to a fair and open process in awarding contracts. However, those policies are not worth the paper they are printed on if they are not followed. We found that overall the Port staff did not have a clear understanding of the rules which resulted in problems such as a lack of documentation during the award process. Nothing is more essential to ensuring the public a fair and transparent process than proper documentation as to why certain decisions were made.

Once again, I am hopeful that out of these individual audits come valuable lessons to be learned for all City Departments. The findings and recommendations for one department almost always are relevant for the others. After all, contracting is something that occurs in every department.

Sincerely,

A handwritten signature in black ink that reads "Laura N. Chick". The signature is written in a cursive, flowing style with a large initial "L".

LAURA N. CHICK
City Controller



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September 23, 2008

Geraldine Knatz, Executive Director
Harbor Department
425 S. Palos Verdes Street,
San Pedro, CA 90731

Dear Ms. Knatz:

Enclosed is a report entitled "Performance Audit of the Harbor Department's Contracting Practices." A draft of this report was provided to your office on September 9, 2008. Comments provided by your Department at the meeting held on September 16, 2008, were evaluated and considered prior to finalizing the report.

Please review the final audit report and advise the Controller's Office by October 23, 2008, of actions taken to implement the recommendations. If you have any questions or comments, please contact me at (213) 978-7392.

Sincerely,

FARID SAFFAR, CPA
Director of Auditing

Enclosure

cc: Robin Kramer, Chief of Staff, Office of the Mayor
Jimmy Blackman, Deputy Chief of Staff, Office of the Mayor
Raymond P. Ciranna, Interim City Administrative Officer
Karen E. Kalfayan, Interim City Clerk
Gerry F. Miller, Chief Legislative Analyst
Helmi Hisserich, Deputy Mayor
S. David Freeman, President, Board of Harbor Commissioners
Independent City Auditors



City of Los Angeles Office of the Controller

Performance Audit of the Harbor Department's Contracting Practices

September 23, 2008

Laura N. Chick
City Controller

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PERFORMANCE AUDIT OF THE HARBOR DEPARTMENT'S CONTRACTING PRACTICES

EXECUTIVE SUMMARY

The Controller's Office has completed a performance audit of the Harbor Department's Contracting Practices. The objective of the audit was to determine the adequacy of the Department's efforts to improve controls over contracting practices for professional/personal service and commodity contracts, from the initial decisions to contract out for services, to processes for soliciting and evaluating competitive bids, awarding contracts, and performing adequate monitoring and oversight.

This audit was performed in accordance with Generally Accepted Government Auditing Standards. The audit focused on Harbor's current contracting procedures for professional/personal service and purchasing contracts; construction contracts were not included in the review. Fieldwork was conducted between March and July 2008.

BACKGROUND

Operated as the City's Harbor Department, the Port of Los Angeles spans 7,500 acres along 43 miles of waterfront property. It includes 26 major cargo facilities, the world's largest proprietary-operated container terminal and the West Coast's hub for cruise ship travel. The Port is self-supporting and does not receive an allocation from the City's general fund. The Harbor Department's recent initiatives include the terminal expansion consistent with its "green" growth policies, environmental initiatives under the Clean Air Action Plan (CAAP), security projects, technology enhancements and community outreach programs.

In implementing these initiatives and the resulting capital projects, the Harbor Department has increased its contracted professional/personal services for design, environmental and project management. For fiscal year 2007-08 the Department budgeted \$37 million for consulting services related to capital projects, while contract expenses budgeted for port maintenance and other professional services related to operations totaled \$61.8 million. During FY 2007-08 the Department reports it spent a total of \$112.5 million on professional services contracts. An additional \$27 million was expended for commodities.

In 2003 the Controller's Office conducted a preliminary review of the Harbor's contracting practices and noted control risks in the areas of 1) contract administration and monitoring; 2) solicitation, selection and award of professional/personal service contracts; 3) development and review of the scope of work for professional/personal service contracts; and 4) economic or feasibility justifications for contracting and/or

awarding contracts. The Controller recommended that Harbor initiate a formal review of its contracting practices, policies and procedures and take appropriate action to mitigate any risks identified.

SUMMARY OF AUDIT RESULTS

Our audit found that Harbor has made some progress in addressing issues identified in the 2003 Controller's risk assessment. The Department created a Contracts and Purchasing Division (CPD) with the intent to centralize the contracting process and contract monitoring duties, to better control and coordinate contracting activities. Additional actions included the creation of a Contracts Task Force, development of a contracts procedures manual, adoption of a Small Business Development Program, and implementation of a web-based contractor registration database called "Diversity Xchange."

However, our audit found that more needs to be done to ensure the Harbor's contracting activities serve the City's best interests and result in a fair and transparent process. In July 2003, Harbor management indicated that CPD would be implemented to ensure conformance by all Harbor divisions to a fair, consistent and objective process. Through a centralized approach, CPD was to be involved in the contracting process from beginning to end, i.e., review of the initial decision to contract out, oversight of the selection process, and monitoring the results. However, our audit found that the Harbor Department still lacks an effective centralized contracting unit to ensure consistent compliance with the Department's policies and applicable laws and regulations related to contracting.

We found inconsistencies in the implementation of the Department's contracting policies and procedures. The procedures lacked adequately defined guidelines, and we found that Harbor could not consistently demonstrate compliance with City Charter and Administrative Code provisions requiring fair and open competition and contract award processes. In addition, Harbor did not always demonstrate adequate contract management related to issuing change orders and amendments, and monitoring contract deliverables. The lack of specific guidance for some key processes, coupled with the lack of a strong and effective oversight unit and controls, create an environment where potential conflicts of interest or abuses could occur.

KEY FINDINGS

- **The Department does not have an effective centralized oversight function to ensure required contracting procedures are followed, including ensuring appropriate justifications and approvals are obtained and documented, and administrative tasks are completed.**

Despite establishing the Contract and Purchasing Division and developing contracting policies and procedures, our audit noted deviations from policies and

incomplete administrative tasks. In addition, justifications and approvals for initiating the contracting process were not adequately documented.

The Department utilizes pre-approval forms or “green sheets” to provide pertinent contracting information for management’s consideration and approval before contract solicitation efforts begin or before contracts are amended. As a centralized control process, requesting divisions should complete a “green sheet” that provides the economic or feasibility reasons for contracting out, and to document the results of the City Charter’s required determination of whether existing City employees can perform the proposed work. The requesting divisions are not consistently completing the pre-approval forms. As a result, the Department is unable to demonstrate that contract services were justified or formally approved.

We also found issues related to inadequate documentation of proposal evaluations and negotiations. Other administrative tasks were also found lacking, such as ensuring Business Tax Registration Certificates and insurance assessments had been completed. The Department’s stated intent in 2003 of CPD becoming an effective centralized oversight unit has not been achieved.

□ **Policies and procedures for evaluating proposals and awarding contracts are not always followed.**

Division staff involved in contracting decisions have not demonstrated a good understanding of the policies or what is expected for adequate documentation. For example, based on our sample of six competitively awarded contracts:

- The proposal evaluation committee did not have an “independent” evaluator from outside the requesting division (two of the 6 contracts);
- There was no documented management approval of the evaluation committee for all six contracts reviewed;
- Interview questions were not documented to demonstrate that uniform questions were used for all proposers (four of the 6 contracts);
- Professional reference checks were not documented (four of the 6 contracts);
- Contract negotiations (contract price, deliverable schedule or other terms) were not documented for five of the six contracts reviewed.

In addition, one division awarded a contract based solely on the results of interviews and did not consider the written proposals. For another, only written proposals were considered, contrary to information contained in the RFP.

The contracting procedures do not provide specific direction on how these tasks should be documented and maintained in contract files. Without specific guidance and adequate oversight that established protocols are followed, the Department may not be able to support fair and transparent contracting decisions.

- **Individual projects are assigned to “as-needed” contractors without ensuring fair and open competition.**

Environmental related contracts are generally awarded to “as-needed” contractors who were initially selected through an open, competitive process. The initial contracts have general descriptions of work that may be performed, but do not constitute a commitment for any specific work or payment. As specific projects are identified, a Project Directive is created and may be awarded to an as-needed contractor based on staff’s assessment of their area of expertise and availability. Project Directives are not awarded based on an open, competitive process.

- **The Department lacks clear guidelines on the use of change orders, contract amendments or contract re-bids to ensure that contracts are not inappropriately extended or the scope of work expanded.**

The Harbor Department has not provided clear guidance or criteria for using change orders, contract amendments or contract re-bids when additional work or modifications to the original contracted scope of work is needed. Three contracts we reviewed had a total of 28 changes, adding approximately \$8.5 million to the original contract costs.

Better planning and coordination at project initiation would have minimized the need for many of the change orders and amendments. Significant scope expansions during a contract may alter a project to the extent that a separate competitive process is warranted.

For example, the original scope of work for a security system contract was expanded through 11 change orders to include additional building structures for system installation, as well as to update the technology. To date, the change orders and contract adjustments total \$4.1 million, increasing the original overall contract cost by 82%, from \$5 million to \$9.1 million. While the Department considers this to be a “design-build” contract, the project has substantially expanded from its original intent to address basic security upgrades, to a more comprehensive portwide security infrastructure.

We also noted a construction project management contract had four change orders and one amendment totaling approximately \$4 million. Some of these changes involved additional work that was beyond the original contracted scope of work and could potentially have been separately solicited. For example, the development of a web-based construction management system (CMS) to be used to monitor projects Department-wide. According to management, CMS will cost approximately \$1 million.

While in both cases the original contracts resulted from a competitive bid process, the subsequent contract changes significantly modified the scope of services. Had

the full scope been assessed initially, or additional work been separately bid, contracting costs may have been reduced.

In several instances, we found the Department used change orders rather than formal amendments to effect changes to professional services contracts, avoiding a more detailed scrutiny. By using the change orders rather than a formal amendment, the Department did not obtain pre-approval by managers outside the requesting division, prepare a justification of why the change was necessary, or ensure the appropriate procurement vehicle was used.

- **Internal cost estimates and contract cost reviews are not completed to ensure a contractor's proposed costs are reasonable.**

The Department does not prepare an internal cost estimate for desired contract changes that would assist in negotiating the final costs. Further, there was no documentation to indicate that the Department conducted a detailed review and verification of the cost breakdown of the contractor's cost proposal. The absence of such a practice could result in the Department accepting an inflated or unreasonable cost proposed by the contractor.

- **Questionable use of confirming purchase orders and single vendor quotes for commodities.**

Our review of commodity contracts disclosed that many purchases were made without a purchase order preceding it. The Department uses confirming purchase orders to initiate payment, after the goods have been received and billed. A confirming purchase order should only be used in rare circumstances, when it is not possible to initiate a purchase order based on an existing agreement or by obtaining comparable price quotes. Such a practice lends itself to circumventing purchasing procedures. Additionally, CPD staff frequently obtain only one quote for commodity purchases below \$100,000.

- **The Department lacks a comprehensive integrated information system for contracting activities.**

The Harbor Department does not have an effective contract management system. Separate databases are maintained by each division to monitor their own contracting activities. In addition, some purchasing activities rely on manual, handwritten logs. The Department cannot achieve effective contracting oversight without adequate, reliable, accurate and timely information related to contracting activities.

- **Sole source contracts lack adequately defined contract deliverables.**

For 3 of the 5 sole source contracts reviewed, the Department did not adequately define what it expected from the contracts. For example, one contract's scope of

work states “to conduct research and outreach to appropriate media contacts.” There is no other indication of the expected number of contacts or what media (newspaper, television, etc.) should be pursued, or the expected outcome from those efforts. With such a general description, it would be difficult to determine, from either the Department’s viewpoint or the consultant’s, that the Contractor had performed the services satisfactorily. We also noted that sole source and piggyback contracts did not have evidence of contract monitoring during the contract period.

In addition, the Department has no formal policy to evaluate contractors at the end of the contract period. This practice would assist the Department in making future contract decisions, should the same consultants be considered for contract awards.

REVIEW OF REPORT

A draft report was provided to Harbor on September 8, 2008. We discussed the draft report with Harbor management at an exit conference held on September 16, 2008. We considered the Department’s comments before finalizing this report. We would like to thank Harbor management and staff for their cooperation and assistance during the audit.

TABLE of RECOMMENDATIONS

RECOMMENDATIONS	PAGE REFERENCE
1. Ensure staff understand their roles and responsibilities for performing the various initial analyses, reviews and approvals and adhere to the contracting policies and procedures by completing the pre-approval forms. The economic or feasibility justification should be documented on the pre-approval forms and the required 1022 Determination form should accompany the pre-approval forms.	15
2. Require CPD to confirm that pre-approval forms are completed appropriately and other required contracting processes are adequately documented.	15
3. Ensure the required Contract Review Report, union notifications and agreements are completed and documented by the Human Resources Division.	15
4. Revise the contracting policies and procedures to reflect the current required approval levels and procedures for proposal evaluation committees.	17
5. Ensure evaluation committees meet the membership guidelines and are approved by the appropriate level of management, and any potential conflicts are discussed and documented, including a positive statement attesting members are free from conflict.	17
6. Ensure staff evaluates written proposals with the option of conducting interviews in compliance with policies and procedures and documents results of all stages of the evaluative process.	17
7. Ensure staff complies with policies and procedures related to documenting the entire selection process, including contractor interview questions, conducting professional reference checks and the negotiation process. Provide specific direction on what information should be documented and retained in the contract files.	17
8. Harbor management should establish a formal policy that requires individual project directives to be awarded based on a fair, open and competitive process for “as-needed” contractors. This policy should also define the requisite documentation to support all project directive award decisions.	18

RECOMMENDATIONS	PAGE REFERENCE
9. Develop policies and procedures that provide staff with criteria to follow to determine when contract changes should be processed through a change order, contract amendment or be competitively re-bid.	20
10. Ensure increased contract costs due to change orders or contract amendments are appropriate and supported by comparing the contractor's cost proposal to an internally developed cost estimate to determine and negotiate a fair and reasonable cost.	21
11. Develop a policy that limits the use of confirming POs to emergency or time-sensitive occasions.	22
12. Develop a policy that defines the number of quotes necessary for commodity purchases to ensure fair, competitive pricing is obtained.	22
13. To ensure Department-wide conformance with the City's and Department's contracting policies, Harbor management should reaffirm CPD's role as a contracting oversight function by specifying what specific tasks should be performed by CPD.	24
14. Consider the need for a comprehensive contracting information system that will support an effective contracting oversight function as system upgrades are developed and implemented.	25
15. Determine whether Diversity Xchange has the capacity to provide an integrated and comprehensive contracting information system.	25
16. Strengthen its procedures to ensure every contract includes adequately defined and measurable deliverables to facilitate contract monitoring and ensure satisfactory performance.	26
17. Require contract/project managers to periodically monitor and document contractor progress. A policy should be developed defining the acceptable methods of monitoring and expected frequency for all contracts. The policy should also require an evaluation of the contractor's overall performance at the end of the contract.	26
18. Harbor management should develop and implement a formal policy for "cooperative arrangement/piggy back" contracts requiring staff to ensure all applicable City requirements have been met	27

BACKGROUND AND METHODOLOGY

BACKGROUND

Founded 100 years ago, the Port of Los Angeles (Port), also referred to as the Los Angeles Harbor Department (Harbor or Department), has grown into one of the busiest seaports in the world. With 7,500 acres of cargo terminals, marinas, roadways, railroads, ship channels, berths and wharves, the port is one of the largest on the west coast and handles more than 20% of the nation's containerized cargo worth more than \$200 billion, as well as 1.2 million cruise passengers.

The Harbor Department was created by the City Charter as an enterprise fund, and is one of the City's three self-supporting proprietary departments. The Port is governed by a five-member Board of Harbor Commissioners, appointed by the Mayor to oversee the Department's management and operations. An appointed Executive Director manages the day-to-day activities and leads a staff of 950. The Department maintains its own facilities and supports its operations through income derived from fees and lease charges for shipping services, property rentals, oil royalties, and other services.

For FYs 2006-07 and 2007-08 the Port generated a total of \$459 and \$451 million in revenue, and spent a total of \$354 and \$412 million in operating and capital expenses, respectively.

On June 11, 2003, the Controller's Office issued a letter report on the results of a high-level review of the Department's contracting practices, which focused on purchasing agreements and professional and personal service contracts. The report identified areas of risk and internal control deficiencies and recommended that the Department conduct a formal review of its contracting practices, policies and procedures to address these risks. Specific areas with identified risk included (1) contract administration and monitoring; (2) the solicitation, selection and awarding of professional and personal service contracts; (3) the development and review of scope of work for professional and personal service contracts; and (4) economic or feasibility justifications for contracting and/or amending contracts.

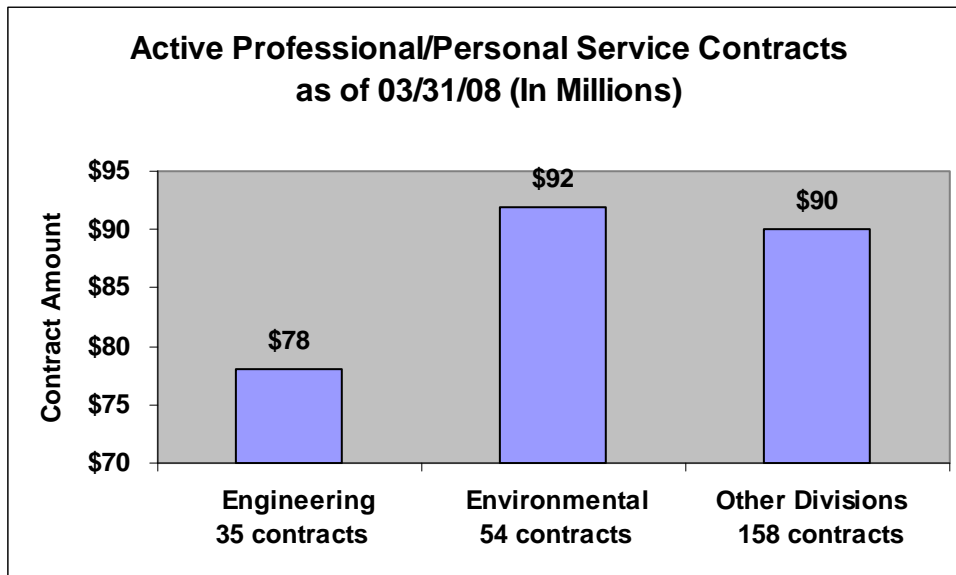
CONTRACTING ACTIVITIES

Harbor's contracting activities include the use of three different types of contract agreements:

- Professional/personal service agreements, which are used for unique, scientific, expert, or technical services of a temporary and occasional nature (these include but are not limited to construction design and project management services);

- Purchasing/procurement agreements, which are used to acquire materials, supplies and equipment (commodities) and services related to those items; and
- Construction contracts for building facilities, structures, etc.

Our audit focused on professional/personal service contracts and purchase agreements for commodities. For our audit period, Harbor provided a list of contracts and payments from the Department’s financial system as of March 31, 2008. This listing included some encumbrances and payments that were related to debt management services or other governmental agencies, such as the State Water Resources Control Board or South Coast Air Quality Management District, which do not meet our criteria of professional/personal service contracts. Excluding these types of “obligations”, we noted the Harbor had approximately 247 active professional/personal service contracts with maximum amounts totaling over \$260 million over the contract period. These include agreements that were made during prior years. As shown in the graph below, Harbor’s Engineering and Environmental Divisions accounted for the majority of the contract expenditures and individually have the highest number of contracts related to professional/personal service contracts.



For FY 2007-08, Harbor budgeted \$99 million for payments to outside professional/personal services. In addition, Harbor had 1,200 purchasing contracts for goods and related services, and during FY 2007-08, Harbor expended \$27 million for commodities, through both formal purchasing contracts and one-time purchase orders.

Generally, the Harbor awards contracts through a competitive process initiated by a Request for Bids, Request for Proposals (RFP) or Request for Qualifications (RFQ). The professional/personal service contracts generally emphasize qualitative factors and

are initiated by a RFP or a combination of RFQ and RFP. The RFQ is used to identify a "short list" of proposers who are identified as the most qualified in meeting the specific project needs. The RFP is then directly sent to the most qualified firms.

Purchasing (commodities) contracts are awarded to the lowest responsive and responsible bidder. Purchasing contracts are initiated by a Purchase Requisition from the requesting division.

The Harbor's contracts are administered by the Contracts and Purchasing Division (CPD) which was created in September 2003 to provide guidance to staff on the Department's contracting process and to monitor adherence to the City's contracting policies and procedures. CPD has three sections: Contracts, Purchasing, and Warehouse. The Contracts section handles professional/personal service contracts, the Purchasing section processes requisitions for materials, supplies, and equipment, and the Warehouse is responsible for maintaining inventories for materials and supplies.

NOTABLE ACCOMPLISHMENTS

According to the Department, CPD was established and written policies and procedures were developed to help standardize contracting practices and strengthen controls. Other improvements included the creation of a Contracts Task Force and adoption of a Small Business Development Program. These actions represent a significant improvement over the contracting activities noted in 2003.

OBJECTIVES, SCOPE AND METHODOLOGY

Our primary audit objective was to determine the adequacy of Harbor's efforts to improve controls over contracting practices for professional/personal service and commodity contracts, as identified in the Controller's report dated June 11, 2003. The specific objectives included an evaluation of the following:

- Whether the Department is contracting-out for services that would be more efficiently performed by City personnel.
- Whether the Department is unnecessarily or inappropriately extending or amending contracts in order to avoid the RFP process.
- Whether a clear scope of work and deliverables were specified in the RFP/contract to provide a foundation for proper contract monitoring.
- Whether the Department is practicing adequate monitoring and oversight over contract services to ensure that the quality of services received justify the cost incurred.
- Whether the Department's practices of awarding contracts are fair and follow the policies and procedures of the City's bidding process.

The audit was performed in accordance with Generally Accepted Government Auditing Standards. Our audit scope focused on Harbor's current contracting procedures for professional/personal service and purchasing contracts; construction contracts were not included in the review. We interviewed Harbor's management and staff involved in procuring professional/personal services and commodity products, reviewed policies, procedures and supporting documents, and conducted detailed testwork for a sample of competitively bid open (contracted services had not yet been completed and services were still being provided) and closed professional service contracts (contracted services had been completed), as well as sole source and commodity contracts. We sampled and reviewed a total of 63 professional and commodity contracts (11 for professional/personal and 52 for commodity purchases) totaling \$48 million in contract amounts (\$47 million for professional and \$1 million for commodity purchases). We selected high dollar contracts from the Department's Environmental and Engineering Divisions, which account for the majority of the professional/personal service contracts. The dollar value of our sample contracts represented 17% of the Department's contract value for professional/personal services and commodity purchases. Fieldwork was conducted between March and July 2008.

AUDIT FINDINGS AND RECOMMENDATIONS

SECTION I: CONTRACT INITIATION, EVALUATION AND AWARD

The Harbor Department procures over \$100 million per year of goods, materials and services for its operations and economic and environment-related priorities. From construction materials, to safety equipment, to consulting services, outside contractors provide specialized products or services to fulfill the Department's needs. The Harbor manages hundreds of contracts each year ranging in value from a few thousand to several million dollars.

To promote fair and open competition for City contracts and ensure a transparent selection process, the City Charter and Administrative Code stipulate certain contracting requirements. In addition, the Harbor Department has developed some policies and procedures that are aligned with the City Charter and Administrative Code contracting requirements.

Our review of the Harbor's contracting practices revealed deficiencies in controls related to the initiation, evaluation, and award of contracts. We found that the Department's contracting practices lack uniformity and documentary support to adequately defend its award decisions. The lack of specific guidance for some key processes, coupled with a lack of oversight and controls, create an environment where potential conflicts of interest or abuses could occur.

Finding #1: Contract pre-approvals are not always obtained or documented.

Harbor's contracting procedures require that professional/personal service contracts, as well as related amendments, be initiated with a pre-approval form or "green sheet." The requesting division completes the green sheet that includes pertinent information such as the scope of work to be performed, estimated contract term and amount, desired competitive process (e.g., Request of Qualifications, Request for Proposal, sole source, etc.), and determination as to whether City employees could also perform the services involved.

Before a contract solicitation can take place, the green sheet must be approved by the Senior Manager and Division Head and other key divisions (e.g., Risk Management, CPD, and Human Resources). Management's decision to contract out is based on the information provided on the green sheet, which also documents a formal approval that appropriate justification and analysis was performed. However, we noted 3 of 11 (27%) contracts reviewed did not have the corresponding pre-approval forms for the original agreement and/or contract amendments. We also noted several instances where the

green sheets were in the contract files, but lacked the required management approvals and/or Human Resources' approvals.

Incomplete or missing pre-approval forms indicate a control weakness as there is no assurance of appropriate management approval for the contracting decision. Harbor's executive management relies on division managers to review and confirm critical information for the project, such as funding availability, and appropriateness the scope of work or the selection process (RFP, RFQ, sole source, etc.) Documented approval should occur before a contract solicitation takes place, so there is clarity that the contracting process should be initiated.

Finding #2: The Department's procedures do not ensure that contracting decisions are based on documented cost/benefit or feasibility analyses, and unions were properly notified.

For 6 of the 11 (55%) professional/personal service contracts reviewed, we noted that there was no documented cost-benefit or feasibility justification supporting the contracting decision. We also noted some instances where contract files did not include documentation demonstrating that unions were properly notified of the proposed contract with sufficient time to raise protest, or that an actual agreement was reached between the union and the requesting division.

Harbor's pre-approval process helps to ensure it has complied with the City's Charter Section 1022, which requires the City's contracting agencies to confirm that "the work can be performed more economically or feasibly by independent contractors than by City employees" when the contracted labor cost is estimated to be more than \$25,000. This determination is to ensure, in part, that contracting dollars and outside resources are being used only when necessary. Some conditions that must be met to justify a contract for professional services include: (1) the work is of limited scope and/or of an intermittent nature; (2) the City would have no use for the contractor's expertise after the work is done; (3) civil service personnel cannot be employed in a timely fashion; or (4) existing City staff cannot absorb the work. Council-controlled departments must submit a Form 1022 to the Office of the City Administrative Officer (CAO) to provide assurance that the feasibility of using City employees in lieu of contracted services has been assessed. In the case of the Harbor Department, the 1022 determination does not need to be reviewed by the CAO, but is prepared for internal review and approval by the requesting division with the assistance of Harbor's Human Resources Division.

Discussions with Harbor management and staff administering contracts disclosed that they were either not familiar with the 1022 determination policy or how to complete the economic feasibility analysis. Although CPD has provided some training, requesting divisions have not demonstrated a thorough understanding of the steps necessary to justify a contracting decision. Without completing or documenting the 1022 determination, management cannot be assured that the work must be contracted out or

if the Department has complied with its responsibility to identify whether City employees could perform the proposed work.

As part of the 1022 determination unions are to be notified of the potential outsourcing of work. The Department's Human Resources Division (HR) reviews the proposed work relative to the City's civil service job classifications, documents their findings on a Contract Review Report, and notifies and coordinates with the applicable union when it determines that certain City job classifications could potentially provide the services. Any requirements to 'meet and confer' are coordinated by Human Resources and the requesting division. However, HR's standard union notification letter states that no response is necessary if the union believes no City employees can perform the contracted services. Our contract reviews disclosed that union notification letters were not always in the contract files. Further, by not requiring a response from the unions, it is difficult to confirm that the notification was actually received and considered.

Recommendations

Harbor management should:

- 1. Ensure staff understand their roles and responsibilities for performing the various initial analyses, reviews and approvals and adhere to the contracting policies and procedures by completing the pre-approval forms. The economic or feasibility justification should be documented on the pre-approval forms and the required 1022 Determination form should accompany the pre-approval forms.**
- 2. Require CPD to confirm that pre-approval forms are completed appropriately and other required contracting processes are adequately documented.**
- 3. Ensure the required Contract Review Report, union notifications and agreements are completed and documented by the Human Resources Division.**

Finding #3: Some contract proposal evaluations were not adequately documented to support the contract awards and did not comply with the Department's contracting policies and procedures or RFP terms.

Based on our review of six competitively bid professional service contracts, we noted instances where some Harbor policies were not followed or sufficiently documented to demonstrate a transparent and well-supported proposal evaluation and contract award. For example:

- The proposal evaluation committee did not have an "independent" evaluator from outside the requesting division (two of the 6 contracts);

- There was no documented management approval of the evaluation committee for all six contracts reviewed;
- Interview questions were not documented to demonstrate that uniform questions were used for all proposers (four of the 6 contracts);
- Professional reference checks were not documented (four of the 6 contracts);
- Contract negotiations (contract price, deliverable schedule or other terms) were not documented for five of the six contracts reviewed.

We also noted that the Department's policy for evaluating written proposals and conducting interviews is not always followed and in one instance, the evaluation process did not comply with the information contained in the RFP.

The Department's policy states that consultants with the highest scoring proposals may be invited for an interview. This implies that written proposals must first be evaluated, regardless of whether an interview is deemed necessary to make a final decision. However, Environmental Management staff indicated consultants may be selected based on interviews only. In addition, for one of the contracts reviewed, the RFP indicated that "a selection committee comprising of Port personnel will individually rate all submitted proposals and firms receiving the highest scores will be invited for an oral interview." However, in that case, a selection was made based only on the written proposals; no interviews were conducted.

The Department's procedures set the composition of an evaluation/selection committee as follows:

- (1) Project Manager and/or contract administrator;
- (2) Staff member with expertise in the type of work being contracted;
- (3) Executive Director or Bureau Chief (optional); and
- (4) Staff member outside the requesting division.

Additionally, the evaluation committee members must be approved by CPD and the Executive Director.

According to CPD, this policy has also been recently revised, though changes have not yet been reflected in the existing policies and procedures manual. The new policy requires that potential members of the evaluation committee be pre-approved by the requesting Division's Senior Manager, and each member should be asked to disclose any possible conflicts of interest through their participation in the selection process. If a conflict exists, the individual should be excused from participating on the evaluation committee. The exceptions noted in our sample did not comply with either the old or recently revised policies, since two of six lacked an "independent" member, and none of the panels included documented management approval or included statements regarding potential conflicts.

The Department has not ensured there is a clear understanding of the contracting requirements and the current contracting manual does not reflect recent changes.

Additionally, the policies do not specify what should be documented and retained in the contract files. For example, the policy requires contract negotiations to be fully documented but does not specify what details or elements of the process are to be noted in contract files, or for how long these documents are to be retained.

Without detailed procedures for conducting and documenting the evaluation and negotiation processes, the Department cannot assure consistency among staff involved with contracting activities. Consistent, well-documented procedures help ensure a transparent and fair contract award process that can withstand challenge or scrutiny.

Recommendations

Harbor management should:

- 4. Revise the contracting policies and procedures to reflect the current required approval levels and procedures for proposal evaluation committees.**
- 5. Ensure evaluation committees meet the membership guidelines and are approved by the appropriate level of management, and any potential conflicts are discussed and documented, including a positive statement attesting members are free from conflict.**
- 6. Ensure staff evaluates written proposals with the option of conducting interviews in compliance with policies and procedures and documents results of all stages of the evaluative process.**
- 7. Ensure staff complies with policies and procedures related to documenting the entire selection process, including contractor interview questions, conducting professional reference checks and the negotiation process. Provide specific direction on what information should be documented and retained in the contract files.**

Finding #4: The Department’s process for assigning individual projects to “as-needed” contractors does not ensure fair and open competition.

The majority of contracts for the Environmental Management Division are awarded to a pre-approved, short list of qualified contractors that are used on an “as-needed” basis. The contracted services are for specialized environmental related services such as preparing environmental impact reports for planned Harbor projects. Contractors are initially identified and selected through an open, competitive RFP process. However, because the contracted services are “as-needed”, the scope of work, expected deliverable(s), and timeframes, are described in only general terms in the contract. The as-needed contracts do not commit to using the consultant for any specific work, or for payment of a specified amount. As individual projects are identified, staff prepare a

“Project Directive” detailing the scope of work, estimated cost, deliverables and timeframes.

Although these as-needed contractors are initially selected through an open process, Environmental Management does not require a competitive selection process to award project directives. Instead, projects are assigned to consultants by Department staff, based on their assessment of a contractor’s expertise and availability.

Allowing staff to use their discretion in assigning contracted work could, at a minimum, result in a perception of favoritism or bias. This practice also increases the risk of perceived or actual conflict of interest, should a contractor be selected for a majority of the projects.

According to staff, Environmental Management is considering changing their current practice to allow all the as-needed contractors the opportunity to submit proposals for specific projects.

Recommendation

- 8. Harbor management should establish a formal policy that requires individual project directives to be awarded based on a fair, open and competitive process for “as-needed” contractors. This policy should also define the requisite documentation to support all project directive award decisions.**

Finding #5: The Department’s contracting policies and procedures do not adequately address the use of change orders, contract amendments or contract re-bids for contract changes.

The Harbor Department does not have clear guidelines on when to process contract changes through a change order, contract amendment, or require a separate competitive bid. We reviewed contracts that involved the use of change orders and contract amendments. Three of the 11 contracts reviewed had a total of 28 change orders, contract amendments and other contract changes that resulted in additional costs totaling more than \$8.5 million, substantially increasing the original contract amounts. In some cases, the change orders and contract amendments were used to significantly expand contract scope, were the result of poor planning, or for additional work that could have been re-bid.

Change orders were used to significantly expand the scope for a security system contract. The original scope of work was expanded through 11 change orders to include additional building structures for system installation, as well as to update the technology. This is an active project and to date, the change orders and contract adjustments total \$4.1 million, increasing the original overall contract cost by 82%, from \$5 million to \$9.1 million. The Department considers this to be a “design-build” contract, however, the project has substantially expanded from its original intent in 2005 to

address basic security upgrades at five facilities, to a more comprehensive port wide security infrastructure.

With better planning and coordination, many of the contract changes would have been identified as part of the original scope of work, and the related proposals would have been more reflective of the Department's actual needs, resulting in more competitive pricing from the outset.

An engineering contract to develop a conceptual design for the Cabrillo Way Marina included 12 change orders totaling \$544,000. With better initial planning, many of these changes may also have been unnecessary, as they would have been considered in the original scope of work, for example, integrating the design work related to ongoing planned development of alternative cruise line facilities.

A contract for construction project management had four change orders and one amendment totaling approximately \$4 million. Some of these changes involved additional work that was beyond the original contracted scope of work and could potentially have been separately solicited. For example, the development of a web-based construction management system (CMS) to be used to monitor projects Department-wide. According to management, CMS will cost approximately \$1 million.

While the original contracts resulted from a competitive bid process, the change orders, contract amendments and other contract changes significantly modified the scope of services. Had the full scope been assessed initially, or additional work been separately bid, contracting costs may have been reduced.

Change orders are normally used to modify a construction contract, and are used to document required modifications to original plans and specifications, and serve as legal amendments to construction-related contracts. When professional service contracts must be modified, the additional service(s) should be first considered as a potential separate service that could be competitively awarded, if not directly related to the original scope of work. If the modification does not significantly alter or expand the original scope, it is appropriate to execute a formal amendment to the professional services contract.

Contract amendments provide better controls than change orders as they are preceded by a pre-approval process which requires the requesting division to formally review and document the need to continue the agreement, analyze/justify why the amendment is required, provide notification to management, and allows for review by the City Attorney's Office. Conversely, the change order approval process as adopted by Harbor does not allow for the administrative review of the change and thus may not assure that the appropriate procurement vehicle is used.

Contract changes and the resulting increase in costs are effectively controlled and monitored when policies and procedures require management to:

- determine the appropriate method to effect the change in work, such as change order, contract amendment or re-bid;
- determine whether the change in work is the result of an unforeseen event; and,
- for changes that are deemed significant or outside the initial contract scope, initiate a new competitive selection process to ensure the Department receives the best proposed cost from the most qualified provider.

Department management stated that they strive to obtain competitive contract terms; however, in some cases other priorities may take precedence over a competitive process. For example, the Department determine it was more expedient to modify the port security project, rather than initiate a separate competitive process, or award a new contract.

Given the number and dollar value of approved contract changes, the Department may have missed savings opportunities. The contracts we reviewed included more than \$8.5 million in contract changes that did not go through a separate competitive process for which the Department may have not received the best price, terms, or service.

The Department's ability to negotiate the best price is hampered without the benefit of a competitive process. Post-award contract changes also preclude the Department from potentially identifying contractors better suited to accommodate the newly defined scope of work.

Recommendation:

Harbor management should:

9. **Develop policies and procedures that provide staff with criteria to follow to determine when contract changes should be processed through a change order, contract amendment or be competitively re-bid.**

Finding #6: The Department does not use internal cost estimates to assure the reasonableness of increased costs for contract changes, and does not perform a detailed review of proposed costs.

Our review of the three contracts with substantial contract changes included no evidence that internal cost estimates were used to assist Harbor staff in negotiating the final costs. Also, there was no documentation indicating that the Department conducted a detailed review and verification of the cost breakdown of a contractor's proposal.

For change orders and contract amendments, best practices require management to require the contractor to submit a cost estimate for proposed changes, develop an in-house cost estimate, perform a detailed cost analysis between the two, and form a

negotiating position before approving final costs and changes with the contractor. However, we found that this process was not evident for the contracts we reviewed.

Without developing and using in-house cost estimates and performing a detailed cost analysis, the Department cannot be assured that it received the best and most reasonable price.

Recommendation:

Harbor management should:

- 10. Ensure increased contract costs due to change orders or contract amendments are appropriate and supported by comparing the contractor's cost proposal to an internally developed cost estimate to determine and negotiate a fair and reasonable cost.**

Finding #7: The Department's extensive use of confirming purchase orders and obtaining only one quote does not ensure fair and competitive vendor selection or pricing for commodities.

We reviewed purchase order documents for May and June 2008 and noted that there was a significant use of "confirming purchase orders", that is, items that are purchased without an initial request or purchase order. Additionally, we noted that for commodity purchases below \$100,000, CPD staff frequently obtain only one quote. For the last three fiscal years, the Department spent an average of \$10.3 million per year for purchases of items priced below \$100,000. This is a significant amount of purchasing activity that may not have had the benefit of competitive pricing.

Contracting best practices limit confirming purchase orders (PO) and single quote purchases to situations that require expedient or emergency procurement. Confirming POs and single quote purchases should not be used for routine purchases.

Because the Purchasing Division has only three full-time and one part-time staff who process purchase requests, and more than 200 requisitions per month must be processed, there is a backlog of at least 100 requisitions on any given day, resulting in a 2 to 3 week delay. Staff use confirming POs and obtain informal price quotes via fax or telephone to expedite the procurement process and serve the Department's needs in a timely manner. CPD management also stated their understanding that only one vendor quote for purchases under \$100,000 was permissible under the City's Administrative Code. While the City Attorney's Office provided direction to CPD that informal quotes (fax or telephone) were acceptable in lieu of formal bids and in accordance with the Administrative Code, there was no implication or assertion that obtaining only a single quote was acceptable.

While the use of confirming POs and obtaining only one vendor quote may be considered efficient on an individual or divisional basis, it increases the risks of potential

conflicts of interest by the preferential use of certain vendors, and paying more than necessary for services or goods.

Recommendations

Harbor management should:

- 11. Develop a policy that limits the use of confirming POs to emergency or time-sensitive occasions.**
- 12. Develop a policy that defines the number of quotes necessary for commodity purchases to ensure fair, competitive pricing is obtained.**

SECTION II: CONTRACT OVERSIGHT AND MONITORING

In 2003, the Harbor Department created the Contracts and Purchasing Division (CPD) to centralize contracting functions and ensure consistency with City and Department policies. CPD developed contracting policies and procedures for Harbor staff to follow in an effort to standardize processes and provide an understanding of various roles and responsibilities within the contracting process. However, we noted the Department lacks adequate oversight of contracting activities as evidenced by the various examples of non-compliance with policies. In addition, contract oversight is hindered because the Department lacks a comprehensive information system that would provide reliable, timely and accurate information on contracting activities.

Finding #8: The Department does not have an effective centralized contract oversight function to ensure required administrative tasks are completed.

Though a key function of the Contracts and Purchasing Division (CPD) was to centralize the contracting administrative functions and ensure consistency with City and Department policies, our review disclosed that the Department still lacks an adequate oversight function. We also noted a lack of consistency between divisions in complying with the Department's contracting policies and procedures. We also noted that CPD does not consistently coordinate or communicate with other divisions in verifying compliance with all aspects of the administrative requirements. As a result, some administrative requirements are not being followed. Specifically,

- Proposals are not prescreened upon receipt and prior to the evaluation process to ensure all required documents or information have been included, such as Business Tax Registration Certificate (BTRC), insurance and SBE/WBE/MBE participation.
- Insurance assessments are not always completed prior to contract award and insurance information is not always updated. According to Harbor's Risk Management Division, there were instances where insurance requirements were assessed after the contracts had already been awarded. We also noted that 271 of 1,157 (23%) identified active contracts do not have updated insurance information.

Most divisions prefer to maintain oversight of their own contracts, and division staff verify compliance with administrative requirements; however, these activities may not be consistent Department-wide. Also, some participants in the contract process may not have received adequate training on the overall contracting process and instead applied their own interpretation and understanding of the contracting process.

Although the Harbor Department created CPD to handle the contracting process review and contract monitoring duties, as well as to provide guidance to Department staff on the contracting process and to monitor adherence to the City's contracting policies and procedures, we found that CPD does not function as originally intended. CPD also lacks the authority to enforce compliance with the required contracting policies and procedures.

Without adequate oversight, there is no assurance that the Department's contract processes follow City and Department policies and procedures. In addition, noncompliance with various laws and regulations exposes the Department and contractors to potential liability and possibly costly legal ramifications.

Recommendation

- 13. To ensure Department-wide conformance with the City's and Department's contracting policies, Harbor management should reaffirm CPD's role as a contracting oversight function by specifying what specific tasks should be performed by CPD.**

Finding #9: The Department lacks a comprehensive integrated information system for contracting activities.

Information systems are not sufficiently integrated at the departmental level to capture contracting activities department-wide to assist Harbor staff in effectively and efficiently managing contract activity.

During our review, we noted that Harbor's divisions (CPD, Engineering, Construction and Environmental) maintain their own separate databases for tracking professional/personal and construction contracts. Also, many of the activities associated with the contracting process are tracked and controlled manually. For example, CPD tracks purchases manually and purchase order numbers are issued using a manual log book. Professional/personal service contracts and pre-approval forms (green sheets) are also tracked manually.

Despite a significant budget to support information technology and systems infrastructure, the Harbor Department still utilizes many outdated systems -1980s and 1990s technology- with many other internally developed programs using Microsoft Access and Excel. The Department's accounting system (GEAC) was implemented in the 1980s and does not have the ability for the divisions outside of accounting to retrieve and compile contracting data to assist with contract management. Staff stated the system has limited ability to produce relevant reports for contract management purposes.

We also noted that the Department uses a system called "Diversity Xchange" that appears to be capable of capturing and tracking contract information Department-wide.

However, this system is primarily used for monitoring the Department's business enterprise outreach programs. According to staff, the Department has elected not to activate all of the modules within Diversity Xchange.

The Department cannot achieve effective contracting oversight without adequate, reliable, accurate and timely information related to contracting activities.

The Department's Information Technology (IT) Division is currently working with a consultant to develop a 5-year IT strategic plan for fiscal years 2008-2013. A draft of the IT strategic plan is anticipated in October 2008. However, this IT strategic plan will not address specific information systems (i.e., integrating contracting information Department-wide and the existing financial system). Division-specific systems will be addressed in detail upon implementation of the IT strategic plan.

Recommendations

Harbor management should:

- 14. Consider the need for a comprehensive contracting information system that will support an effective contracting oversight function as system upgrades are developed and implemented.**
- 15. Determine whether Diversity Xchange has the capacity to provide an integrated and comprehensive contracting information system.**

Finding #10: The Department does not consistently define contract deliverables for sole source contracts. Contract monitoring and evaluation of contractor performance is lacking.

For 3 of the 5 sole source contracts reviewed, the Department did not adequately define what it expects from these contracts. In some cases, the scope of work is vague as to what is expected. For example, one contract's scope of work states "to conduct research and outreach to appropriate media contacts." There is no other indication of the expected number of contacts or what media (newspaper, television, etc.) should be pursued, or the expected outcome from those efforts. With such a general description, it would be difficult to determine, from either the Department's viewpoint or the consultant's, that the Contractor had performed the services satisfactorily.

Contracting best practices state that contracts should include well-defined and measurable deliverables to facilitate contract monitoring and evaluation and to ensure that expected results are met. Without fully defined and measurable contract deliverables, the Department may not receive the expected services or results from its contracts.

While evidence of contract monitoring was noted with the Department's competitively bid contracts, none of the sole source or "piggy-back" contracts¹ we reviewed had any documentation from the contract administrators commenting on the contractor's performance during the life of the contract. Department staff stated that sole source contracts are frequently completed in short time frames or are used on an as-needed basis, and in these cases, formal contractor monitoring is not necessary until project completion. Department staff also explained that payments for some sole source contracts are made only after completing the deliverable. However, waiting until the deliverable is completed to assess a contractor's performance could result in wasted time, effort and money if the deliverable does not meet expectations.

Contract administrators do not evaluate the contractor's overall performance at the end of the contract period. The Department does not have a formal policy to evaluate contractors at the end of the contract; however, a contractor performance evaluation is a valuable tool in making decisions for possible future agreements.

Harbor's contracting policies and procedures do not provide adequate guidance to promote monitoring activities on all contracts, such as sole source or piggy back. Ongoing contract monitoring enables the project manager to ensure expected progress is being met and to intervene in a timely manner if progress or the expected deliverable is not meeting expectations.

Recommendations

Harbor management should:

- 16. Strengthen its procedures to ensure every contract includes adequately defined and measurable deliverables to facilitate contract monitoring and ensure satisfactory performance.**
- 17. Require contract/project managers to periodically monitor and document contractor progress. A policy should be developed defining the acceptable methods of monitoring and expected frequency for all contracts. The policy should also require an evaluation of the contractor's overall performance at the end of the contract.**

Finding #11: The Department does not ensure that "piggy-back" contracts have met City contracting requirements.

Our review of purchase order contracts found that Harbor routinely uses "cooperative arrangement/piggy back" contracts. The CAO's contracting guidelines, specifically, Charter Section 1022 determination and Charter Section 371 policies, state that for piggybacking or cooperative arrangements, the awarding department does not have to

¹Governmental agencies may utilize contracts that have been competitively bid and selected by another governmental agency.

select the contractor through another competitive bid or request for proposals process. However, the awarding department is still responsible to ensure their contract has met all City contracting requirements and approvals.

We noted that Harbor's Procurement Analysts/Buyers do not confirm that all applicable contract requirements, such as BTRC, insurance coverage and 1022 determination, have been met by the vendor. The Department's contracting policies and procedures do not address the City's requirements regarding piggy back contracts.

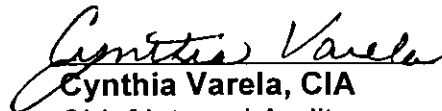
Recommendation

18. Harbor management should develop and implement a formal policy for "cooperative arrangement/piggy back" contracts requiring staff to ensure all applicable City requirements have been met.

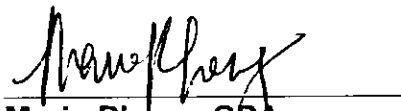
Respectfully submitted,



Thomas Martinez
Internal Auditor II



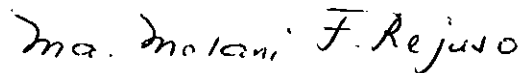
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Director of Auditing

July 29, 2008

			<p>committees meet the membership guidelines and are approved by the appropriate level of management, and any potential conflicts are discussed and documented, including a positive statement attesting members are free from conflict.</p> <p>N</p> <p>6. Ensure staff evaluates written proposals with the option of conducting interviews in compliance with policies and procedures and documents results of all stages of the evaluative process.</p> <p>N</p> <p>7. Ensure staff complies with policies and procedures related to documenting the entire selection process, including contractor interview questions, conducting professional reference checks and the negotiation process. Provide specific direction on what information should be documented and retained in the contract files.</p>
4	The Department's process for assigning individual projects to "as-needed" contractors does not ensure fair and open competition.	U	8. Harbor management should establish a formal policy that requires individual project directives to be awarded based on a fair, open and competitive process for "as-needed" contractors. This policy should also define the requisite documentation to support all project directive award decisions.
5	The Department's contracting policies and procedures do not adequately address the use of change orders,	N	9. Develop policies and procedures that provide staff with criteria to follow to

	contract amendments or contract re-bids for contract changes.		determine when contract changes should be processed through a change order, contract amendment or be competitively re-bid.
6	The Department does not use internal cost estimates to assure the reasonableness of increased costs for contract changes, and does not perform a detailed review of proposed costs.	N	10. Ensure increased contract costs due to change orders or contract amendments are appropriate and supported by comparing the contractor's cost proposal to an internally developed cost estimate to determine and negotiate a fair and reasonable cost.
7	The Department's extensive use of confirming purchase orders and the requirement to obtain only one quote does not ensure fair and competitive vendor selection or pricing for commodities.	U U	11. Develop a policy that limits the use of confirming POs to emergency or time-sensitive occasions. 12. Develop a policy that defines the number of quotes necessary for commodity purchases to ensure fair, competitive pricing is obtained.
	Section II – Contract Oversight and Monitoring		
8	The Department does not have an effective centralized contract oversight function to ensure required administrative tasks are completed.	N	13. To ensure Department-wide conformance with the City's and Department's contracting policies, Harbor management should reaffirm CPD's role as a contracting oversight function by specifying what specific tasks should be performed by CPD.

9	The Department lacks a comprehensive integrated information system for contracting activities.	N	14. Consider the need for a comprehensive contracting information system that will support an effective contracting oversight function as system upgrades are developed and implemented.
		N	15. Determine whether Diversity Xchange has the capacity to provide an integrated and comprehensive contracting information system.
10	The Department does not consistently define contract deliverables for sole source contracts. Contract monitoring and evaluation of contractor performance is lacking.	N	16. Strengthen its procedures to ensure every contract includes adequately defined and measurable deliverables to facilitate contract monitoring and ensure satisfactory performance.
		N	17. Require contract/project managers to periodically monitor and document contractor progress. A policy should be developed defining acceptable methods of monitoring and expected frequency for all contracts. The policy should also require an evaluation of the contractor's overall performance at the end of the contract.
11	The Department does not ensure that "piggy-back" contracts have met City contracting requirements.	N	18. Harbor management should develop and implement a formal policy for "cooperative arrangement/piggy back" contracts requiring staff to ensure all applicable City requirements have been met.

Description of Recommendation Ranking Codes

U- Urgent-The recommendation pertains to a serious or materially significant audit finding or control weakness. Due to the seriousness or significance of the matter, immediate management attention and appropriate corrective action is warranted.

N- Necessary- The recommendation pertains to a moderately significant or potentially serious audit finding or control weakness. Reasonably prompt corrective action should be taken by management to address the matter. The recommendation should be implemented within six months.

D- Desirable- The recommendation pertains to an audit finding or control weakness of relatively minor significance or concern. The timing of any corrective action is left to management's discretion.

N/A- Not Applicable