

Office of the President

TO MEMBERS OF THE COMPLIANCE AND AUDIT COMMITTEE:

DISCUSSION ITEM

For Meeting of September 13, 2017

STATE AUDIT OF CONTRACTED EMPLOYEES AND CONTRACTING PRACTICES

The following is an update on the results of the California State audit of contracted employees and contracting practices. The audit resulted in two reports – one focused on service contracts and the other focused on UCPATH and information technology (IT) contracting. The report on service contracts, released on August 22, included four recommendations to the Office of the President and one recommendation to the Legislature. The UCPATH and IT contracting report, released on August 24, included three recommendations to the Office of the President (UCOP) and one recommendation to the Board of Regents. University leadership appreciates the California State Auditor’s recommendations in both reports and believes they will help to improve operations, achieve greater efficiency, and better align with best practices.

Background

The California State audit of contracted employees and contracting practices was requested by State Senator Ricardo Lara and approved by the Joint Legislative Audit Committee in May 2016. Fieldwork for the audit began in November 2016 and included multiple site visits by the audit team to UCOP as well as visits to six campuses – UC Berkeley, UC Davis, UC Irvine, UCLA, UC Riverside, and UC San Francisco – and the UCPATH Center.

The draft audit report was sent to UCOP on August 1, 2017, triggering a five-day agency review period during which UCOP developed its responses to the report. Within that five-day period, as permitted by statute, the Board of Regents Compliance and Audit Committee held a closed session meeting to discuss the draft results and provide input to inform the University’s response.

Service Contracts Audit Results and Response

The service contracts audit report was released to the public on August 22. The report included discussion of areas of strength in the University’s procurement practices, as well as findings and recommendations relating to employee displacement when contracting for services, comparison of wages of contract workers with comparable University employees, adherence to procurement policies, use of competitive bidding, tracking contract information, and measuring savings from procurement activity.

In its response, the University indicated that it welcomes the constructive input from this report, which aligns with its proactive efforts to continually improve and strengthen its procurement policies and procedures.

UCPath and IT Contracting Audit Results and Response

The UCPath and IT contracting audit report was released to the public on August 24. The report included findings and recommendations relating to the original business case for UCPath compared to the current project status, the oversight of the UCPath project, UCPath project management, and management of IT vendors.

In its response, the University indicated that the recommendations are helpful and constructive, and align with its proactive efforts to continually improve UC's operations, policies, and transparency to the Legislature and the public at large. The response also emphasized some important context regarding the implementation and effectiveness of UCPath.

Attachments:

Attachment 1: Findings and Recommendations from State Audit of Contracted Employees and Contracting Practices

Attachment 2: California State Auditor Report – Service Contracts

Attachment 3: California State Auditor Report – UCPath and IT Contracting

Findings and Recommendations from State Audit of Contracted Employees and Contracting Practices

Service Contracts

Findings	Recommendations
The university's campuses and medical centers did not always follow the requirements for justifying employee displacement	<ol style="list-style-type: none"> 1. To ensure that university locations adequately justify the necessity of contracts that will displace university employees, the Office of the President should do the following: <ol style="list-style-type: none"> a. Actively enforce compliance with the displacement guidelines by monitoring university locations for compliance, providing regular training on the displacement guidelines to university locations, and amending the displacement guidelines to state that the Office of the President human resources department has the authority to approve or reject displacement decisions. b. Revise contracting policies to address situations in which university locations are contemplating entering into service contracts instead of hiring university employees to perform an activity. In these situations, the Office of the President should require university locations to perform an analysis that is similar to the one it requires when current university employees are displaced. c. Ensure that staff with the necessary business and financial skills at the Office of the President review and approve the cost analyses that university locations submit. d. Revise the cost analysis requirements in the displacement guidelines to mitigate the risk of university locations incorrectly estimating savings by requiring a threshold level of savings as part of their business and financial necessity analyses and requiring that university locations periodically reevaluate the savings after the services contracts take effect to inform future contracting decisions.
Services contract workers generally earned lower wages than university employees and often do not receive benefits	N/A
The university generally adhered to its procurement policy when entering into service contracts, but it can make improvements in certain areas	<ol style="list-style-type: none"> 2. To ensure that the university achieves its goals of obtaining services at the lowest cost or best value and of providing vendors with fair access to contracting opportunities, the Office of the President should do the following: <ol style="list-style-type: none"> a. Direct university locations, including its own local procurement office, to implement controls to ensure staff better comply with the university's contract manual's requirements for using standard terms and conditions, obtaining the proper contract approvals, and awarding of sole-source contracts.
The university could better maximize its	<ol style="list-style-type: none"> <ol style="list-style-type: none"> b. Revise the university's contract manual to incorporate the best

<p>use of competitive bidding</p>	<p>practices found in the <i>State Contracting Manual</i> for limiting the use of amendments to repeatedly extend existing contracts.</p> <ul style="list-style-type: none"> c. Revise the university’s contract manual to narrow the exemption from competition to only selected professional services, similar to the <i>State Contracting Manual</i>. d. Direct all university locations to implement controls in their online procurement systems to prevent staff from avoiding the requirement to competitively bid a contract when individual purchases of the same good or service accumulate to \$100,000 or more within a fiscal year. <p>To the Legislature:</p> <p>To ensure that the university maximizes the use of competition, the Legislature should revise the Public Contract Code to do the following:</p> <ul style="list-style-type: none"> a. Specify the conditions under which the university may amend contacts without competition. b. Narrowly define the professional and personal services that the university may exempt from competitive bidding.
<p>The Office of the President implemented a systemwide procurement program but could do more to create further process efficiencies</p>	<ul style="list-style-type: none"> 3. To help ensure that the university will implement its central contract database for tracking and monitoring all university contracts in a timely manner, the Office of the President should develop a detailed project implementation plan by October 2017 that outlines a schedule of the specific activities that will need to occur to complete this effort. 4. To maximize benefits from the systemwide procurement initiative and to ensure that the university uses those benefits for its teaching, research, and public service missions, the Office of the President should do the following: <ul style="list-style-type: none"> a. Direct all university locations to provide better documentation to substantiate actual benefits they claim related to their procurement decisions. b. Revise its guidance to ensure the benefits that university locations claim results from only procurement-related activities. c. Implement a process to centrally direct these benefits to ensure that university locations use them to support the university’s core missions. d. Study ways to measure actual procurement benefits – possibly focusing this effort on benefits from larger dollar amounts – and if such measurement is not possible, it should clearly disclose to the regents and the public that the amounts it reports are based on estimates. e. If actual benefits are measurable, implement a process to monitor and report annually to the regents the estimated and actual benefits.

UCPath and IT Contracting

Findings	Recommendations
UCPath's cost has soared, and its expected savings are unlikely to materialize	N/A
The Office of the President did not keep the Regents apprised of the significant cost increases and schedule delays that have plagued UCPath	<p>1. To ensure that it fully reports the cost of IT projects, the Office of the President should develop cost reporting guidelines by December 2017 for UCPath and other significant IT projects across all university locations. These cost guidelines should identify cost categories at both the Office of the President and university locations to ensure that the estimates capture and communicate all development and implementation costs. In addition, the Office of the President should produce cost reports to share with stakeholders at least quarterly.</p> <p>To the Regents: To ensure that they are able to exercise necessary oversight for the university's significant IT projects, the regents should develop status reporting standards for the Office of the President and all university locations to follow by December 2017. Such reporting standards should apply to all university IT projects with more than a specified cost and, at a minimum, should establish the following:</p> <ol style="list-style-type: none"> a. The frequency with which the Office of the President and all university locations must report to the regents. Such updates should occur at least three times per calendar year and coincide with regents' meetings to allow for oral discussions. b. The types of disclosures the Office of the President and all university locations must present about each IT project including, but not limited to, changes in scope, projected costs, and schedule. c. The types of significant project risks the Office of the President and all university locations must disclose. The updates should also describe the actions the Office of the President and all university locations are taking to mitigate risks and the potential effects of those risks on a project's cost, schedule, and scope.
Weaknesses in the Office of the President's project management likely contributed to UCPath's cost increases and schedule delays	<p>2. To ensure that it consistently follows best practices related to project management, the Office of the President should develop and implement guidelines for IT project development by June 2018. The guidelines should apply to all IT projects undertaken by any university location with a cost estimate of at least \$5 million or more and should include the following elements:</p> <ol style="list-style-type: none"> a. A means to assess schedules for reasonableness, and requirements for the creation and maintenance of an integrated schedule and resource plan for each project. b. Requirements for rigorous change management processes that establish a means of assessing the implications of changes to a project's scope, cost and schedule.

	<ul style="list-style-type: none"> c. Procedurally sound requirements for identifying, reviewing, and resolving risks to a project. d. IV&V to oversee the technical aspects of project development.
<p>Although invoice approval processes were followed, some campuses could better define IT deliverables</p>	<ul style="list-style-type: none"> 3. The Office of the President should require that all university locations follow best practices by ensuring that each location creates a deliverable expectations document for each IT contract similar to the documents the State’s management framework describes. The Office of the President should establish this requirement by December 2017. The deliverable expectations document should, at a minimum, identify the deliverables for each milestone and define the scope, content, entrance criteria, acceptance criteria, and development schedule for each deliverable.



The University of California Office of the President

It Has Not Adequately Ensured Compliance With Its
Employee Displacement and Services Contract Policies

Report 2016-125.1





CALIFORNIA STATE AUDITOR

621 Capitol Mall, Suite 1200 | Sacramento | CA | 95814



916.445.0255 | TTY 916.445.0033



For complaints of state employee misconduct,
contact us through the **Whistleblower Hotline:**

1.800.952.5665

Don't want to miss any of our reports? Subscribe to our email list at auditor.ca.gov 

August 22, 2017

2016-125.1

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the California State Auditor presents this audit report concerning the University of California (university) Office of the President's oversight of university locations' use of services contracts.

This report concludes that the Office of the President has not ensured that university locations follow its policy for justifying their decisions to displace university employees and it needs to ensure that university locations comply with its policy when contracting for services. Two of the 31 services contracts we reviewed displaced university employees. However, the two university locations administering these contracts did not fully adhere to the University Guidelines on Contracting for Services (displacement guidelines), in part because they did not submit required information to the Office of the President for review. Moreover, the Office of the President has not adequately enforced university locations' compliance with the displacement guidelines. Further, the displacement guidelines do not address situations in which university locations could hire new employees rather than contracting for the services. Nine of the 31 service contracts were for services that university employees might have been able to perform. We also observed that services contract workers generally received less compensation in wages and benefits than university employees who performed similar work.

Our review of 30 services contracts found that five university locations and the Office of the President generally adhered to the Office of the President's contracting policy. The remaining services contract we reviewed was solely to address the issue of displacement as described above. We found that university locations could make certain improvements, such as by ensuring they include the university's standard terms and conditions in their services contracts. We also found that some university locations avoided competitive bidding by repeatedly amending their services contracts. Moreover, the university's broad definition of professional services and misuse of sole-source exemptions may have contributed to some university locations avoiding competitive bidding requirements.

Finally, the Office of the President could do more to create cost efficiencies in its systemwide procurement program by implementing a central contract database and guiding the university locations on how to redirect procurement benefits to the university's core missions of teaching, research, and public service.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

Blank page inserted for reproduction purposes only.

Contents

Summary	1
Introduction	7
Audit Results	
The University's Campuses and Medical Centers Did Not Always Follow the Requirements for Justifying Employee Displacement	13
Services Contract Workers Generally Earned Lower Wages Than University Employees and Often Did Not Receive Benefits	23
The University Generally Adhered to Its Procurement Policy When Entering Into Services Contracts, But It Can Make Improvements in Certain Areas	25
The University Could Better Maximize Its Use of Competitive Bidding	28
The Office of the President Implemented a Systemwide Procurement Program But Could Do More to Create Further Process Efficiencies	34
Recommendations	40
Response to the Audit	
University of California Office of the President	45
California State Auditor's Comments on the Response From the University of California Office of the President	53

Blank page inserted for reproduction purposes only.

Summary

Results in Brief

The University of California (university) has not fully followed its policies for justifying its decisions to displace university employees. The university contracts with vendors for a variety of services. This practice can result in displacement—an employer’s replacement of regular, full-time employees with services contract workers who generally receive less pay. The university’s Office of the President’s University Guidelines on Contracting for Services (displacement guidelines) outline the process that campuses and medical centers must follow to demonstrate and justify the necessity of contracts that will displace university employees. Two of the 31 services contracts we reviewed at three campuses, two medical centers, and the Office of the President contained documentation indicating that university employees were displaced.

However, the two university locations administering these contracts did not fully adhere to the displacement guidelines in either contract. Specifically, in July 2016, the University of California, San Francisco, campus (San Francisco campus) entered into a contract to outsource certain information technology (IT) services, which it estimated would save \$30 million over five years. As the displacement guidelines require, the San Francisco campus conducted a cost analysis to justify the business and financial necessity for its contracting decision. Although the San Francisco campus made the Office of the President aware of its plans, it did not provide formal, written notification of the displacement that included analysis justifying its outsourcing decision as required to the Office of the President for its review. Ultimately, the contract displaced 49 career and 12 contract employees. In the second instance, the University of California, Davis medical center failed to notify the Office of the President of a contract for housekeeping management services that displaced 12 employees.

We also found that the Office of the President has not enforced compliance with the displacement guidelines and that weaknesses in the displacement guidelines may undermine their effectiveness. For example, although the Office of the President was aware of the San Francisco campus’s decision to contract for IT services, it did not follow up to ensure that the campus’s analysis complied with the displacement guidelines. By not enforcing the guidelines, the Office of the President undercut its commitment to requiring adequate justification for displacement decisions. In addition, a lack of clarity in the displacement guidelines may reduce their effectiveness. For example, the displacement guidelines do not address situations in which university locations could provide services by hiring employees rather than by contracting for the services. In fact, we

Audit Highlights . . .

Our audit concerning the Office of the President’s oversight of university locations’ use of services contracts revealed the following:

- » *The university has not fully followed its policy for justifying its decisions to displace university employees with services contract workers.*
 - *Two of the 31 services contracts we reviewed contained documentation that university employees were displaced.*
 - *The two university locations administering these contracts did not fully adhere to the displacement guidelines in either contract.*
- » *The Office of the President has not enforced compliance with the displacement guidelines and weaknesses in the guidelines may undermine their effectiveness.*
- » *Low-wage services contract workers received hourly wages that were \$3.86 lower than comparable university employees received.*
- » *The university generally adhered to the Office of the President’s contract policy, but it could make improvements, such as ensuring the standard terms and conditions are included in services contracts.*
- » *Some university locations avoided competitive bidding by repeatedly amending contracts and through sole-source exceptions.*
- » *The Office of the President lacks a systemwide database that would allow it to track contracts at all university locations and report basic contract data.*

continued on next page . . .

» *The Office of the President could not substantiate \$109 million in benefits it claimed as resulting from its systemwide procurement program.*

identified nine contracts for services that university employees could have likely performed, yet we found no indication that the university locations analyzed this option before entering these contracts. The university locations later replaced four of these contracts with university employees.

We also observed that services contract workers generally received less compensation in wages and benefits than university employees who performed similar work, which is not surprising given that university locations would not normally contract for services if it would cost more to do so. Specifically, we found that nearly all services contract workers in low-wage contract categories—such as janitors, landscapers, and security guards—earned lower hourly wages than their university counterparts. Low-wage services contract workers received hourly wages that were on average \$3.86 lower than the wages received by comparable university employees. In addition, one-quarter of the vendors that we contacted did not provide any form of either health or retirement benefits to their workers. Further, the health and retirement benefits that services contract workers did receive were often irregular or less generous than those received by comparable university employees.

Although our review of 30 services contracts determined that the campuses and medical centers generally adhered to the Office of the President's contract policy, we identified certain areas in which they could make improvements.¹ For example, the university locations generally followed competitive bidding guidelines related to bid solicitation and evaluation methods. However, the locations did not always include the university's standard terms and conditions in their services contracts, even though these terms and conditions are meant to protect the university from potential legal problems in areas that are common to nearly all goods and services contracts. Further, the university locations could not demonstrate that the procurement staff who signed seven of the 30 services contracts we reviewed had the proper authority to do so.

Our review of these 30 contracts also found that some university locations did not consistently use competitive bidding to ensure that they procured services at the lowest cost or best possible value. For example, we found that some locations used amendments to repeatedly extend services contracts far beyond their original parameters. In one instance, the University of California, Davis, campus amended its contract with a food service vendor 24 times, extending the contract's term from seven years to 19 and increasing its value from \$71 million to \$237 million. The Office of the

¹ We reviewed 30 of 31 contracts for adherence with contract policy; the remaining contract we reviewed only against the displacement guidelines.

President only provides vague guidance on the appropriate use of amendments, which hinders the university locations' ability to fulfill their services needs at the lowest cost or best possible value while maximizing opportunities for vendors wishing to contract with them. In addition, some university locations appear to have misused sole-source exemptions to avoid the competitive bidding process. For example, the University of California, San Francisco medical center asserted to us that it used a sole-source contract to hire a janitorial services vendor because it had an urgent need for the services, yet its contract file lacked sufficient justification for the need to forego competitive bidding.

Additionally, in 2012 the Office of the President implemented a systemwide procurement program that has resulted in the university entering a number of procurement agreements that leverage the university's purchasing power to generate potential savings as a result of vendors discounting their rates. However, the Office of the President could do more to create further cost efficiencies. Specifically, the Office of the President lacks a systemwide database that would allow it to track contracts at all university locations and report basic contract data in the aggregate. To address this issue, the Office of the President executed a contract in May 2017 with a new procurement software vendor and anticipates implementing a central contract database within two years. Although the systemwide chief procurement officer indicated that planning efforts for the central contract database began in July 2017, the Office of the President has yet to develop a project implementation plan to guide this effort.

Finally, the university president asserted that in fiscal year 2015–16, the systemwide procurement program produced \$269 million in procurement benefits—a term it uses to refer to cost reductions or avoidance, incentives, or revenue—and that the university redirected this \$269 million to its core missions of teaching, research, and public service. However, our review found that the Office of the President lacked adequate support to substantiate nine of the 10 estimated benefits we reviewed, totaling \$109 million. Moreover, as we noted in our March 2016 audit, *University of California: Its Admissions and Financial Decisions Have Disadvantaged California Resident Students*, Report 2015-107, the Office of the President has not provided guidance to university locations on how they should redirect benefits to the university's core missions of teaching, research, and public service.

Selected Recommendations

Legislature

To ensure that the university maximizes the use of competition, the Legislature should revise the Public Contract Code to specify the conditions under which the university may amend contracts without competition and more narrowly define the professional and personal services that the university may exempt from competitive bidding.

Office of the President

To ensure that all university locations adequately justify the necessity of contracts that will displace university employees, the Office of the President should do the following:

- Actively enforce compliance with the displacement guidelines by monitoring university locations for compliance and providing regular training on the displacement guidelines to university locations.
- Revise the university's contracting policy to address situations in which university locations are contemplating entering into services contracts instead of hiring university employees to perform an activity. In these situations, the Office of the President should require university locations to perform an analysis that is similar to the one it requires when current university employees are displaced.

To ensure that the university achieves its goals of obtaining services at the lowest cost or best value while providing vendors with fair access to contracting opportunities, the Office of the President should do the following:

- Direct all university locations to implement controls to better ensure compliance with the university contracting policy requirements for using standard terms and conditions, to ensure that the individuals who sign contracts have the proper authority to do so, and to ensure the appropriate use of sole-source contracts.
- Revise the university's contract policy to limit the use of amendments to repeatedly extend existing contracts.

To help ensure that the university will implement its central contract database for tracking and monitoring all university contracts in a timely manner, the Office of the President should develop a detailed project implementation plan by October 2017.

To maximize the benefits from the systemwide procurement initiative and ensure that the university uses those benefits for its academic, research, and public service missions, the Office of the President should, to the extent possible, implement a process to centrally direct these funds to ensure that university locations use them to support the university's core missions. Further, the Office of the President should study ways to measure actual procurement benefits and fully substantiate the benefits claimed.

Agency Comments

The Office of the President agreed with most of our recommendations, indicating that they are constructive to its goals of continued improvement, progress, and success. However, the Office of the President disagreed with recommendations we made for maximizing the benefits from its systemwide procurement initiative.

Blank page inserted for reproduction purposes only.

Introduction

Background

Founded by the Legislature in 1868 as a public, state-supported, land-grant institution, the University of California (university) is an extensive business enterprise. It has 10 campuses and five medical centers, and it is also involved in the management of three national laboratories and several research centers. It has more than 200,000 employees. Each year, it receives over \$30 billion in revenues from a variety of public and private sources, including \$3 billion in state funding and \$10 billion generated from its medical centers.

The California Constitution established the university as a public trust to be administered by the University of California Board of Regents (regents). As a result, the Legislature's oversight of the university is limited to certain circumstances, such as specifying provisions the university must meet before it can spend state appropriations. The head of the university is the president, to whom the regents have granted full authority and responsibility over the administration of all the university's affairs and operations. The Office of the President manages the university's fiscal and business operations. A chancellor at each campus is responsible for managing campus operations. At applicable campuses, those chancellors delegate management authority over the medical centers—which are semi-autonomous, self-supporting operations—to chief executive officers.

Although the campuses and medical centers must follow the university's systemwide procurement policies, they have significant autonomy over their contracting decisions. The Office of the President reported that in fiscal year 2015–16, the university spent \$8 billion through contracts on goods and services.

Contracting for Services Is a Major Component of the University's Operations

The university's operations require a wide variety of support services, such as janitorial services, security services, food services, landscaping services, and medical services. The university provides many of these services by using its own employees, some of whom are career employees, and others of whom are contract employees that have appointments with the university for defined periods of time. The university also contracts with outside parties for some services. Contracting for services allows the university to fill short-term labor needs or supplement its workforce with needed skill sets.

Although the Office of the President is responsible for the university's overall policy development, the campuses and medical centers operate their own procurement offices, which are responsible for ensuring that their contracts for services follow university policy. At the university locations we visited—the University of California, Davis, campus (Davis campus) and medical center (Davis medical center); the University of California, Riverside, campus (Riverside campus); and the University of California, San Francisco, campus (San Francisco campus) and medical center (San Francisco medical center)—each individual department is largely responsible for determining its needs for services and working with the location's procurement office to complete the contracting process. In addition, the Office of the President has a local procurement office to support the procurement of services for its own operations.

The Office of the President also operates a systemwide procurement program to reduce costs for the university. This systemwide procurement program, also known as P200, launched in 2012 under the Office of the President's leadership as one of 34 Working Smarter initiative projects. In response to state funding cuts the university implemented these 34 projects with the intention of streamlining university operations, ensuring operational efficiencies, and building a sustainable financial model. The Office of the President stated that as a whole, the 34 projects would generate \$500 million in administrative savings and new revenue within five years and that the university would redirect these funds toward its core missions of teaching, research, and public service. The Office of the President set a goal for P200 to save the university \$200 million annually by the end of fiscal year 2016–17 through the realignment of the university's systemwide procurement organization, the implementation of procurement sourcing and spending technology, and the consolidation of campus spending.

Elements of the Public Contract Code Incorporated Into the University Contracting Manual

- The university must competitively bid service contracts of \$100,000 or more in annual expenditures, except those for professional or personal services.
- The university shall award contracts to the lowest bidder in most cases, but it may use best value in certain circumstances.
- The university may use sole-source purchasing in limited circumstances.

Source: Public Contract Code, sections 10507 to 10510.

Systemwide Policies Govern University Contracting Practices

Although each campus and medical center has a degree of latitude in determining its need for services, it must follow certain systemwide policies and agreements when entering contracts. The university's BUS-43 Materiel Management manual (contract manual) details the process campuses and medical centers must follow when they solicit services. The university based the contract manual on a section of the State's Public Contract Code that applies specifically to it, as the text box summarizes. However, the contract manual's requirements

for soliciting services contracts do not apply to contracts for professional services, which the university defines as infrequent, technical, and unique functions that independent contractors or partnerships, firms, or corporations perform. In addition, the university must comply with its bargaining agreements with unions when contracting for services. For instance, the university's agreement with the American Federation of State, County and Municipal Employees has a provision restricting the university from contracting for services solely on the basis of lower contractor pay rates and benefits. However, the agreement allows services contracts in other cases, such as when the university requires special services or equipment.

The Office of the President also has guidelines outlining the circumstances under which university locations may enter into services contracts that displace existing university employees. The University Guidelines on Contracting for Services (displacement guidelines) state that before a university location can enter into a services contract that will displace university employees with services contract workers, that location must do the following:

- Take into account appropriate personnel policy and collective bargaining agreement provisions to minimize the impact on university employees.
- Justify its business decision by preparing an analysis that considers certain financial or service requirement factors.
- Submit the analysis to the Office of the President for review before entering into the services contract.

A Recent Displacement at the San Francisco Campus Generated Concern About the University's Contracting Policies

In July 2016, the San Francisco campus entered into a services contract for information technology (IT) services with HCL America, Inc. (HCL) that had, effective February 2017, displaced 49 university career staff and 12 contract staff. The San Francisco campus's decision to outsource these IT services was based on its analysis showing that outsourcing would save at least \$30 million over five years, a conclusion it reached by comparing the cost of retaining campus employees to provide these services to the estimated cost of outsourcing the services and retaining fewer employees. The San Francisco campus estimated that it would pay HCL about \$50 million over five years for IT services. According to a presentation the San Francisco campus provided to the Office of the President, it determined that outsourcing would help compensate for an expected increase in demand—and therefore costs—for IT services.

The San Francisco campus's decision to displace university employees garnered national media attention and resulted in heightened public interest in the university's contracting practices. In particular, elected officials, the San Francisco campus's faculty association, and university employees objected to the replacement of employees with overseas labor for the purpose of reducing costs. In addition, some media articles stated that the HCL contract could expand to other campuses and thus lead to additional layoffs of university employees. Because the HCL contract is a master services agreement, any university location can obtain services from HCL under the terms of the agreement. Further, some employees criticized the San Francisco campus's decision to enter into the contract because they believe it will result in inferior service. Articles have also reported that the San Francisco campus asked some of the employees to train the contractors before they were displaced from university employment.

Scope and Methodology

The Joint Legislative Audit Committee (Audit Committee) directed the California State Auditor to conduct an audit of the university's contracting practices. The analysis the Audit Committee approved contained eight objectives. This report addresses all the objectives that relate to the university's contracts for services. We list the objectives and the methods we used to address them in Table 1. We report on the audit objectives related to IT projects in our report number 2016-125.2, which we will issue on August 24, 2017.

Table 1
Audit Objectives and the Methods Used to Address Them

AUDIT OBJECTIVE	METHOD
1 Review and evaluate the laws, rules, and regulations significant to the audit objectives.	We identified relevant state law, collective bargaining agreements, university policies and procedures, and best practices that pertain to the university's contracting and procurement services.
2 Determine whether the university and its campuses' contracting policies and procedures are in compliance with applicable federal and state laws and regulations as well as with best practices for procurement.	<ul style="list-style-type: none"> • We assessed the compliance of the relevant university contract policies with applicable law and best practices. • We interviewed staff at the Office of the President and each university location we reviewed to assess contracting practices.
3 For a selection of services contracts, determine the university's compliance with applicable laws, regulations, policies, and procedures.	<ul style="list-style-type: none"> • We worked with procurement staff at six university locations (three campuses, two medical centers, and the Office of the President) to collect contract information within requested parameters and to access paper and electronic procurement files. • We selected five contracts that each of the six university locations entered into from fiscal years 2011–12 through 2015–16 based on the following factors: type of service focused on those service types listed in a legislative request for information, the likelihood an equivalent or comparable university job classification existed, and the likelihood the contract amount was sizable enough to create a significant employment impact (where possible).

AUDIT OBJECTIVE	METHOD
	<ul style="list-style-type: none"> • For an additional contract at the San Francisco campus that we did not identify through our selection of contracts, we interviewed IT, finance, and human resources staff and reviewed documentation to determine if the campus's decision to displace employees complied with the university's guidelines. • We reviewed procurement files and worked with procurement, human resources, and departmental staff to identify instances in which the university replaced its employees with services contract workers. In one instance we identified, we reviewed evidence to determine if the university's decisions complied with its guidelines. • We met with representatives of a large public employees union to obtain their perspectives on the university's practice of contracting for services and its impacts on university employees. • We examined the procurement files for each of the selected 30 contracts for evidence of compliance with the applicable services contract-related policies. We did not include the additional San Francisco campus contract in this testing. • We reviewed the university's procurement practices and identified areas where it could increase opportunities for competitive bidding.
<p>4 For the past five years for the Office of the President—and to the extent possible for its campuses—determine the types of contracts, procurement methods, and types of goods and services purchased by university via contracts.</p>	<ul style="list-style-type: none"> • We requested data for all contracts—including purchase orders—from procurement IT staff at all 10 campuses, five medical centers, and the Office of the President for fiscal years 2011–12 through 2015–16. We reviewed these data to determine if they included certain basic information and interviewed procurement staff to confirm gaps in the data. • We reviewed documentation and interviewed staff at the Office of the President to assess the university's efforts in implementing a central contract database and its procurement benefits tracking system.
<p>5 For services contracts, to the extent possible, compare the compensation and benefits of university employees to those of contract employees in comparable positions and identify trends. Include an analysis of per-employee cost based on the total contract amount.</p>	<ul style="list-style-type: none"> • We worked with human resources staff at each of the university locations we visited to obtain wage data, union representation information, benefits information, and descriptions for selected job classifications. • For the selected services contracts in Objective 3, we contacted vendors to obtain wage and benefit data for job positions related to their respective contracts with the university.
<p>6 Analyze how the university is managing IT contracts, including the contract for University of California Payroll, Academic Personnel, Timekeeping and Human Resources (UCPath), by doing the following:</p> <ol style="list-style-type: none"> Determine what contract oversight exists to ensure IT projects are delivered on time and on budget. For UCPath, assess the reasonableness of the project's increased cost and schedule delays. Determine if UCPath is adequately communicating project risks, costs, and delays to the regents. 	<p>This objective will be addressed in Report 2016-125.2.</p>
<p>7 To the extent possible, assess actions the university is taking to overcome contracting challenges and cost efficiencies.</p>	<p>We reviewed documents and interviewed staff at the Office of the President to assess the university's efforts to implement a procurement initiative to increase savings from systemwide agreements.</p>
<p>8 Review and assess any other issues that are significant to the audit.</p>	<p>We did not identify any other significant issues.</p>

Sources: California State Auditor's analysis of the Audit Committee's audit request number 2016-125 and information and documentation identified in the table column titled *Method*.

Assessment of Data Reliability

The U.S. Government Accountability Office, whose standards we are statutorily required to follow, requires us to assess the sufficiency and appropriateness of computer-processed information that we use to support findings, conclusions, or recommendations. In performing this audit, we obtained electronic data files from each selected university location. These files contained a list of certain services contracts that the university locations compiled in response to a legislative request for information. We obtained these services contract lists to select services contracts for testing the university's compliance with its contract policy and displacement guidelines. We also performed completeness testing of the services contract lists by comparing these lists to extracts from contract databases of the university locations we visited and found them to be incomplete. However, we used the services contract lists to select contracts for testing and did not use them to support findings, conclusions, and recommendations.

We also obtained an electronic data file extracted from the Office of the President's Benefit Bank System for the purpose of assessing the benefits—a term it uses to refer to cost reductions or avoidance, incentives, or revenue. We performed data-set verification and electronic testing of key data elements and did not identify any significant issues. We were unable to perform completeness testing because the documents necessary for us to review to determine whether the Benefit Bank System is complete are maintained at the university location level, making such testing cost-prohibitive. In addition, we tested the accuracy of the amounts entered in the extract by reviewing supporting documentation for 10 entries and found significant issues with the documentation, which we discuss in detail in the Audit Results. Consequently, we determined that the university's procurement benefits data are not sufficiently reliable for the purposes of this audit. Although these determinations may affect the precision of the numbers we present, there is sufficient evidence in total to support our audit findings, conclusions, and recommendations.

Audit Results

The University's Campuses and Medical Centers Did Not Always Follow the Requirements for Justifying Employee Displacement

When we reviewed 31 services contracts at three campuses, two medical centers, and the Office of the President, we found that two contained documentation indicating that university employees were displaced. In both these instances, the university locations did not fully adhere to the Office of the President's displacement guidelines. Specifically, when the San Francisco campus entered into a contract to outsource certain IT services, it did not provide formal written notification with its analysis of the displacement of IT employees to the Office of the President as required. Additionally, when the Davis medical center decided to displace housekeeping managers with a services contract, it did not conduct a complete analysis of the displacement and also failed to notify the Office of the President. Although we did not find evidence that the San Francisco campus or Davis medical center violated personnel policies by displacing employees, their failure to fully comply with the displacement guidelines increased the risk that they might improperly displace employees.

We also found that the Office of the President has not ensured that university locations are aware of the displacement guidelines, has not adequately overseen compliance with them, and has not fully enforced them. Further, weaknesses in the displacement guidelines make them less effective at ensuring that university locations justify their displacement decisions. For example, the displacement guidelines do not address instances in which campuses and medical centers contract for services that university employees might otherwise have provided.

In Two Instances, University Locations Displaced Employees Without Meeting All the Requirements of the Displacement Guidelines

Because the San Francisco campus and Davis medical center did not fully comply with the displacement guidelines, the Office of the President cannot be certain that these locations adequately justified their displacement of employees. As the Introduction states, the San Francisco campus's outsourcing of certain IT functions through a services contract with HCL resulted in the displacement of 49 career and 12 contract university employees. The text box shows the status of the displaced employees as of July 2017. In addition, the San Francisco campus eliminated

Disposition of Staff Displaced by the San Francisco Campus's IT Services Contract

As of July 2017, the San Francisco campus's IT services contract had displaced 49 career and 12 contract staff.

Career staff:

- Seventeen retired.
- Ten found other positions with the campus.
- Fifteen were laid off.
- Six received temporary extensions or reassignments.
- One accepted another job.

Contract staff:

- Eight had their appointments ended.
- Two separated to accept other jobs.
- One separated to seek another job.
- One found another position with the campus.

Source: California State Auditor's analysis of the San Francisco campus's employment documents.

Note: The terms and conditions of contract staff appointments are specified in their employment contracts.

18 vacant positions. The San Francisco campus estimated it would save \$30 million over five years as a result of the HCL contract. Because it has not yet completed a full year of operations with HCL, it is too early to evaluate how much the San Francisco campus has actually saved. However, it has decreased its budget for the affected IT services by about \$5 million for fiscal year 2017–18, the year after the displacement.

We found that the San Francisco campus followed the displacement guidelines when conducting its analysis related to the outsourcing of these IT activities. First, the displacement guidelines require university locations to justify their decisions to contract for services while taking into account relevant university personnel policies and collective bargaining agreements, among other things. As Table 2 shows, the San Francisco campus considered the relevant personnel policies and determined that the collective bargaining agreements did not apply to the affected employees. Second, although the San Francisco campus excluded annual costs of \$1.6 million for facilities, equipment, and administration related to the displaced employees from its analysis, the vice president of IT explained that the IT department's budget does not directly include these types of costs. We found that the San Francisco campus's decision was appropriate because if it had included these costs in the analysis, its savings estimate would have increased by \$1.6 million, even though the campus's IT department did not have control of this spending.

The San Francisco campus failed to provide a formal, written notification to the Office of the President's human resources department that included its analysis justifying its outsourcing decision.

However, despite the fact that the San Francisco campus followed the displacement guidelines when conducting its analysis, it failed to provide a formal, written notification to the Office of the President's human resources department that included its analysis justifying its outsourcing decision. The displacement guidelines require that before entering a services contract that exceeds \$100,000 per year that may displace university employees, a university location must provide informal notification to the Office of the President's human resources department one month before issuing a request for proposal and formal notification at the time it issues the request for proposal. Although the San Francisco campus outlined its conceptual plan for outsourcing IT services in a PowerPoint presentation to the Office of the President, this presentation occurred before San Francisco completed the analysis required by the displacement guidelines. Because the San Francisco campus did not submit a formal, written notification that included its complete displacement analysis—both personnel policy and business and financial—the Office of the President's human resources department did not get an opportunity to critically review the San Francisco campus's planned application of university personnel policies or its cost analysis.

Table 2
The San Francisco Campus and Davis Medical Center Did Not Fully Adhere to the Displacement Guidelines in Two Services Contracts

CONTRACT INFORMATION	SERVICES CONTRACT	
	SAN FRANCISCO CAMPUS	DAVIS MEDICAL CENTER
Contract purpose	To outsource five IT services	To manage housekeeping services
Contract value	\$50 million (5-year estimate)	\$5.2 million (18-month total)
Estimated savings	\$30 million (5-year estimate)	\$57,000 (annually)
Positions displaced	<ul style="list-style-type: none"> • 49 career staff • 12 contract staff* • 18 vacant positions 	12 career housekeeping managers
Union positions displaced	None	None
DISPLACEMENT GUIDELINES REQUIREMENTS		
If contract for services displaces university staff, do the following:		
• Apply relevant staff personnel policies.	✓	✓
• Apply collective bargaining agreements.	Not applicable. Displaced staff were not unionized.	Not applicable. Displaced staff were not unionized.
Determine whether the reason for displacing staff is either of the following:		
1. Business and financial necessity.	Business and financial necessity	Business and financial necessity [†]
2. Service requirements.		
If a contract for services displaces university staff because of business and financial necessity, do the following:		
• Calculate the actual cost of services that university staff perform and also include costs related to facilities, equipment, supervision, and payroll and benefits administration.	✓‡	✓‡
• Calculate total cost of the contract plus the costs of administering it.	✓	✓
• Compare the two above costs over the life of the contract and articulate an economic advantage resulting from contracting for the services.	✓	✓
• Describe the benefits in protecting the quality and effectiveness of university core functions.	✓	✗
Contracts for services that displace university staff and exceed \$100,000 per year are subject to review by the Office of the President's human resources department as follows:		
• Provide informal notification one month before issuing the request for proposal.	✓	✗
• Provide formal written notification before or at the same time as issuing the request for proposal.	✗	✗
The formal written notification must include the following:		
1. Application of personnel policies and collective bargaining agreements.	✗	✗
2. Analysis for business and financial necessity or assessment of service requirements.	✗	✗

Sources: California State Auditor's analysis of the San Francisco campus's and Davis medical center's analysis supporting the need for displacing university employees and related contract documents, and the displacement guidelines from the Office of the President.

✓ = Complied.

✗ = Did not comply.

* Contract employees have an appointment with the university for a definite period of time, and the terms and conditions of employment are defined in their appointment contracts with the San Francisco campus.

† In July 2017, the chief operating officer at the Davis medical center notified us that the contracting decision was actually based on service requirements but was unable to provide the service analysis the displacement guidelines require. Because the Davis medical center previously provided us a cost analysis for this contract, we continued to evaluate the contract as a business and financial necessity decision.

‡ The San Francisco campus and Davis medical center did not include all required elements. However, the missing costs were not directly part of the San Francisco campus IT budget and were immaterial at Davis medical center. We therefore marked that they had complied.

Both the San Francisco campus's chief information officer and the Office of the President's vice president of human resources stated that they believed the PowerPoint presentation met the displacement guidelines' requirements for formal, written notification. However, we disagree because the presentation did not show how the San Francisco campus planned to apply university personnel policies to displaced employees, nor did it compare university costs to contractor costs. Moreover, San Francisco gave its presentation more than eight months before it issued the request for proposal, much earlier than the displacement guidelines require.

In addition, the Davis medical center erred in its approach to outsourcing 12 housekeeping manager positions. In 2015 the Davis medical center entered into a housekeeping services contract valued at \$5.2 million over 18 months that resulted in the displacement of 12 managers in its housekeeping services department. Our review found that the medical center generally applied university personnel policies when laying off these 12 managers, and because they were nonrepresented employees, it did not need to consider provisions of collective bargaining agreements. The Davis medical center estimated that the cost of retaining its housekeeping managers would have been \$3.5 million annually, just \$57,000 more than the cost of using its chosen vendor. Thus, the displacement was only marginally cost-effective.

However, as Table 2 shows, the Davis medical center failed to complete the remaining requirements of the displacement guidelines. Specifically, it did not analyze how the displacement of these 12 housekeeping managers would protect the core functions of the university, and it neglected to provide the required informal and formal notifications to the Office of the President's human resources department. When asked about these requirements, the director of supply chain management for the Davis medical center—who, along with the medical center's human resources staff, oversaw this displacement—indicated she was unaware of the displacement guidelines. As a result, the Davis medical center did not adequately analyze the displacement of the 12 housekeeping managers, and the Office of the President did not have the opportunity to provide oversight and guidance. According to the Office of the President's vice president of human resources, he did not know that the Davis medical center displaced these managers. Further, he stated that although the Office of the President does not provide training or direction, it expects university locations to understand and follow the displacement guidelines. We discuss later in this report our concerns about the Office of the President's dissemination of the displacement guidelines.

The Davis medical center did not adequately analyze the displacement of 12 housekeeping managers, and the Office of the President did not have the opportunity to provide oversight and guidance.

In July 2017, the chief operating officer of the Davis medical center notified us that the medical center based its decision to displace the 12 housekeeping managers on service requirements rather than on business or financial necessity. He explained that the Davis medical center wanted to improve the service and quality of its housekeeping department because its patient satisfaction scores were low, particularly for cleanliness. However, he was unable to provide an assessment of the Davis medical center's service needs to support its decision to displace the 12 managers, which the displacement guidelines require. Because the medical center provided us with a cost analysis related to the displacement, we evaluated the contract using the displacement guidelines' business and financial necessity criteria. Regardless, the reason that the chief operating officer provided—low patient satisfaction scores—would not have been sufficient to satisfy the service requirement justification in the displacement guidelines. Rather, the Davis medical center would have needed to demonstrate why the special services, expertise, facilities, or equipment necessary to achieve the quality and quantity of service it required was not readily available internally.

The Office of the President Could Better Enforce Accountability and Address Deficiencies in the Displacement Guidelines

As the displacement guidelines acknowledge, the university's business policies and practices must provide enough flexibility to address the campuses and medical centers' different programmatic needs while maintaining the university's contractual commitments to its employees. However, our review suggests that the displacement guidelines are not fully serving the purposes for which the university created them. Specifically, although the displacement guidelines stated purpose is to ensure university locations have sound business justifications when displacing employees, the Office of the President does not ensure that all university locations are aware of the guidelines. Further, the Office of the President's process for ensuring that university locations follow the displacement guidelines is ineffective. Finally, the displacement guidelines have a number of deficiencies that undermine the Office of the President's ability to ensure that university locations justify their decisions to contract for services.

The vice president of human resources at the Office of the President stated that he reviews about one or two displacement decisions that university locations submit a year and that the displacement guidelines are widely known and understood by university locations. Nonetheless, the lead procurement staff at both the San Francisco campus and the Davis medical center indicated being unaware of the displacement guidelines. Both the vice president of human resources and the director of strategic sourcing

The Office of the President does not ensure that all university locations are aware of the displacement guidelines, and its process for ensuring that university locations follow the guidelines is ineffective.

acknowledged that the Office of the President does not provide training relating to the displacement guidelines to university location staff responsible for human resources or procurement.

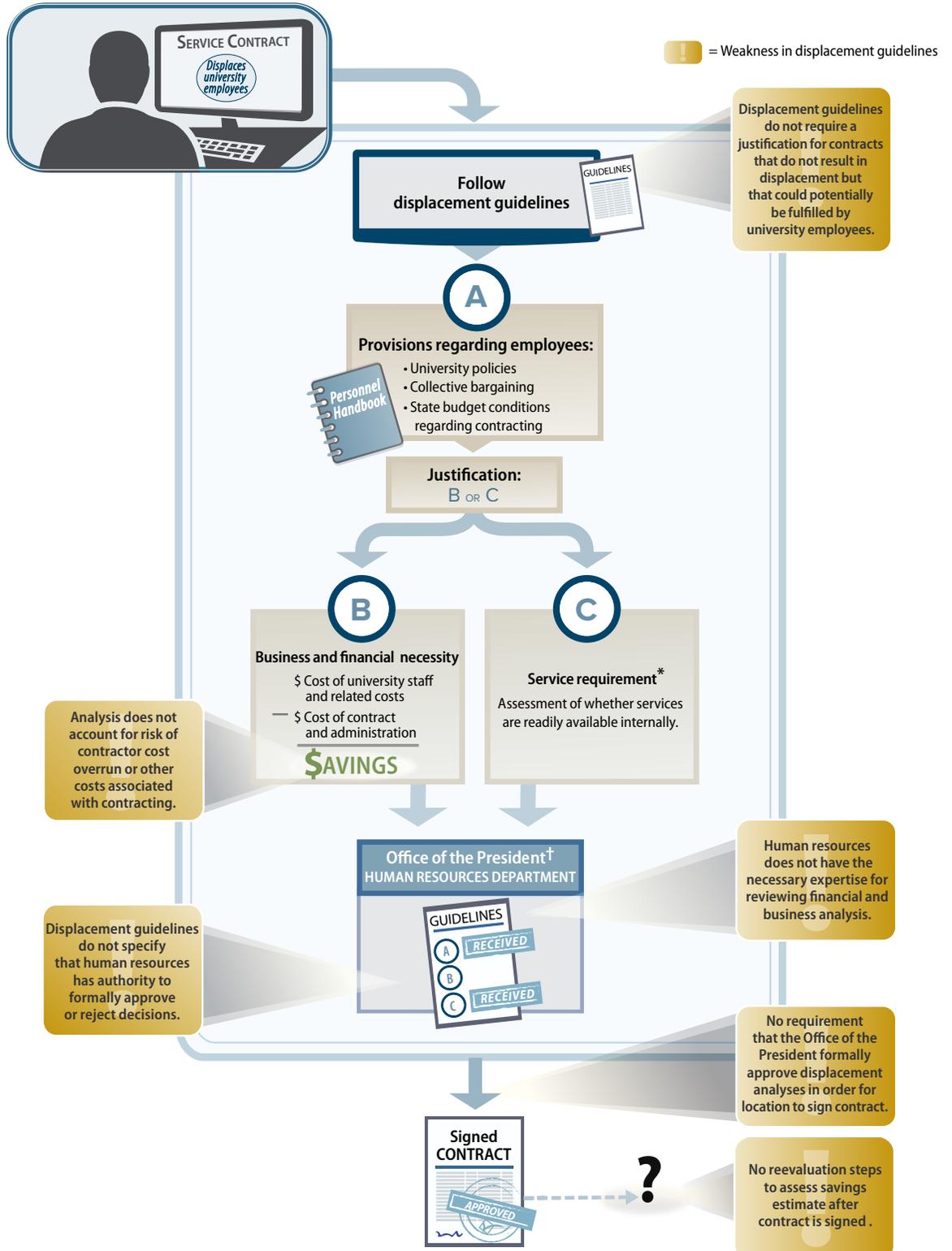
Moreover, in the two services contracts we reviewed in which university locations displaced employees, the Office of the President did not adequately ensure that the locations followed the displacement guidelines thoroughly, which put the university employees at risk of unjustified displacement. The displacement guidelines state that the Office of the President's human resources department has a role in reviewing displacement decisions if a services contract exceeds \$100,000 per year. However, as we described in the previous section, after hearing the San Francisco campus's presentation, the Office of the President did not follow up with a request for the missing business and financial justification. Further, it was not even aware of the displacement of housekeeping managers at Davis medical center.

The displacement guidelines do not clearly state that the Office of the President must approve university locations' displacement analyses and has the authority to formally reject the analyses.

In addition, deficiencies in the displacement guidelines weaken their effectiveness. For example, as Figure 1 shows, the displacement guidelines do not clearly state that the Office of the President must approve university locations' displacement analyses and has the authority to formally reject the analyses. Rather, the guidelines only state that the Office of the President must review such analyses if contracts exceed \$100,000. If the Office of the President does not require university locations to support their decisions to displace employees with analyses that it must approve or disapprove, those locations may not provide employees the full protections the Office of the President intended when it adopted the displacement guidelines. The Office of the President could improve the displacement guidelines by clarifying its responsibilities for conducting reviews and requiring its formal approval before university locations can enter into services contracts that displace university employees.

Moreover, the Office of the President has not ensured it meets all of its review requirements under the displacement guidelines by having staff with the appropriate skill sets review the analyses. According to the vice president of human resources, his goal is to ensure that university locations follow collective bargaining agreements and personnel policies, which includes addressing the impact of services contracts on university employees, and he works with university locations to address any deficiencies. He acknowledged, however, that human resources does not have the necessary expertise to evaluate the analysis for business and financial necessity. To address this issue, the Office of the President could assign the review of business and financial necessity to one of its units that has staff with the appropriate skills.

Figure 1
Weaknesses in the Displacement Guidelines Undermine Their Effectiveness



Source: California State Auditor's analysis of the university's displacement guidelines.

* The displacement guidelines also state that a university location can demonstrate a service requirement in cases where the university location must use nonuniversity employees because of the need for external perspective or avoidance of conflict of interest.

† The Office of the President's human resources department review step does not apply to contracts that are \$100,000 or less per year.

The displacement guidelines do not state whether or how a university location should reevaluate a services contract's financial and nonfinancial costs after the contract takes effect to ensure that the location is receiving the savings it anticipated.

We also identified several other areas in which the displacement guidelines lack clarity, as Figure 1 demonstrates. For instance, our review of business literature shows that business-process outsourcing projects, such as a displacement of university employees, carry significant risks when not managed properly and can result in less than satisfactory outcomes when the business entity's original estimates fail to include the total cost of the process. Because the displacement guidelines require a university location to create an analysis of its business and financial necessity before signing a contract, the location may underestimate the actual cost of the contract. As a result, a university location might save less money than it anticipated from its services contract, undermining the original justification for displacing employees. The displacement guidelines could address this risk by requiring a minimal level of savings as part of the justification of business and financial necessity. Similarly, the displacement guidelines do not state whether or how a university location should reevaluate a services contract's financial and nonfinancial costs after the contract takes effect to ensure that the location is receiving the savings it anticipated. If it determines that it did not achieve savings, the university location could terminate the contract for convenience, renegotiate it, find another vendor, or rehire former university employees.

Finally, the displacement guidelines do not cover situations in which university locations contract for services that university employees could provide but that do not result in the displacement of existing university employees. Such situations may result in the university unnecessarily soliciting outside services, as we discuss below. The Government Accountability Office recommends that public entities rely on cost data to justify the need to contract out for services. However, we found no evidence of such assessments in the procurement files of the 29 other services contracts we selected for review. Furthermore, none of the departmental staff we contacted at the university locations we visited could provide evidence showing how they determined the need to contract out for services, such as a comparison of the costs of university employees performing a service to those of a vendor doing so. Absent such assessments, the university cannot support its decision to contract out for services.

Several University Locations Entered Into Services Contracts Instead of Hiring Employees

In addition to the two services contracts in which university locations displaced university employees, we identified that nine of the 31 services contracts we reviewed may have resulted in university locations avoiding hiring university employees, a situation

that the displacement guidelines do not address. Rather, the Office of the President has written the displacement guidelines to apply only to services contracts that displace university employees. As Table 3 shows, we determined that each of these nine services contracts fell into one of three situations in which university employees might have been able to perform the services in question. In the remaining 20 services contracts, the information in the contract files either warranted the use of service workers or did not clearly show whether the university locations could have hired university employees rather than services contract workers.

Table 3
University Locations Have Used Services Contracts to Minimize Their Hiring of New Employees

CAMPUS	TYPE OF SERVICE	NUMBER OF SERVICES CONTRACT WORKERS	STATUS OF CONTRACT
Transitioned from service contract workers to university employees			
Davis campus	Food services	80	Terminated
San Francisco medical center	Security	50	Terminated
Office of the President	Security	13	Terminated
Office of the President	Janitorial	NR	Terminated
Solicited service contract despite providing services internally			
San Francisco campus	Janitorial	5	Active
San Francisco campus	Valet parking	30	Active
San Francisco medical center	Billing coder	7	Active
Davis medical center	Billing coder	6	Active
Entered service contract rather than create a new job classification			
Davis medical center	Medical scribes	49	Active

Sources: California State Auditor's analysis of services contracts, consultation with university staff, and unaudited information provided by the services contract vendors.

NR = Vendor did not provide a response.

Four of the nine contracts involved university locations entering into services contracts then subsequently transitioning to having university employees perform these services. For the first four services contracts shown, the university has demonstrated it could have provided the services internally by its decision to transition from activities that services contractors perform to performing these same activities using university employees. For instance, in 2016 the Davis campus amended its food services contract to end on June 30, 2017, so that it could transition management of its food service to campus employees. Likewise, the San Francisco medical center indicates it once used outside security guards to meet half of its security needs. This heavy reliance on services contract workers suggests that the medical center could have brought on full-time workers to provide security

We identified four services contracts in which university locations solicited vendors to perform services despite having employees that already performed similar services.

services. For the two additional contracts, the Office of the President transitioned from service workers to university employees to perform security and janitorial services due to a change in a bargaining agreement.

Although one reason to enter into a services contract is that a vendor can provide a service that the university cannot provide itself, we also identified four services contracts in which university locations solicited vendors to perform services despite having employees that already performed similar services. For example, the San Francisco campus uses over 152,000 square feet of space at an off-campus facility for research laboratories. According to the campus's director of facilities, the San Francisco campus has contracted for janitorial services at this space since at least 1994. Given the large area covered, the long-term use of the facility, and the routine nature of the service provided, the San Francisco campus could use university employees to perform this work.

Similarly, for the other contracts—one for parking valets and the other two for billing coders—the university locations contracted for services that their respective staff already perform. For example, the San Francisco campus provides a valet service for faculty and staff, but relies on a services contract to provide valet services to patients at two medical facilities. According to the director of transportation services, using services contract workers allows the location to adjust to demand more easily and is more cost-effective. However, the campus has not conducted an analysis showing increased cost-effectiveness. In addition, both the Davis and San Francisco medical centers use contracts to provide billing coding services due to what they assert are the difficulties of finding qualified people to perform this highly technical work. However, both medical centers acknowledge that their own employees already perform similar work. Thus, these two medical centers may have been better served by having their employees work overtime or by intensifying their hiring efforts.

Finally, one university location entered into a services contract rather than create a new job classification to perform an activity. In 2013 the Davis medical center contracted for services contract workers to serve as scribes to take notes for medical staff in its emergency room department. It has since expanded the use of this service, and it now uses 49 services contract workers for this purpose, each of whom work up to 32 hours a week. According to the chief administrative officer for the department of emergency medicine, the Davis medical center continues this practice because many scribes are students looking for short-term work, resulting in high turnover. However, the medical center's reasoning does not preclude it from hiring employees to fulfill this service, and using university workers might decrease the turnover rates.

Although using services contract workers instead of hiring employees to do the same work is justifiable under certain circumstances, we believe the Office of the President should revise the displacement guidelines and the university's other contracting policies to address the types of situations we identified in Table 3. By doing so, the Office of the President could better ensure that university locations make careful and thoughtful decisions when using services contracts. Further, revisions to the displacement guidelines could also allow the Office of the President to monitor and provide guidance regarding the university locations' decisions.

Services Contract Workers Generally Earned Lower Wages Than University Employees and Often Did Not Receive Benefits

Although the university locations we visited do not track services contract worker data, such as wages or benefits, our analysis shows that services contract workers who worked for the university locations we visited generally earned less than university employees who performed comparable work. The university's Fair Wage/Fair Work Plan, which became effective October 2015, sets a minimum wage for the university's services contract workers. That minimum hourly wage started at \$13 in October 2015, is currently at \$14, and will increase to \$15 in October 2017. We determined that in all but four of the contracts we reviewed, the university locations included language requiring compliance with the minimum wage policy when applicable. However, as Table 4 on the following page shows, nearly all services contract workers in low-wage contract categories earned lower hourly wages than their university-employed counterparts, although a few contract workers in high-wage positions earned higher hourly wages than their counterparts. For example, janitors, landscapers, and security guards hired through the services contracts we reviewed earned less per hour than university employees doing similar work at the university locations we visited. Low-wage services contract workers received hourly wages that were on average \$3.86 lower than the hourly wages comparable university employees received, with the difference in wages ranging from \$1.43 to \$8.50 per hour for those services contract workers who earned less than comparable university employees.

Table 4 also shows that services contract workers either did not receive medical and retirement benefits or received benefits that were irregular or less generous than those comparable university employees received. Specifically, one-quarter of the vendors did not provide any form of either health or retirement benefits to their workers. Further, nearly one-third provided either health or retirement benefits, but not both. Our review found that vendor-provided health benefits tended to be limited to medical benefits, while their retirement contributions generally consisted

Nearly all services contract workers in low-wage contract categories earned lower hourly wages than their university-employed counterparts.

Table 4
Wages and Benefits for Most Services Contract Workers Are Less Than Those of Comparable University Employees

POSITION	LOCATION	SERVICES CONTRACT WORKER*				UNIVERSITY EMPLOYEE	
		HOURLY WAGE†	HEALTH BENEFITS OFFERED	RETIREMENT BENEFITS OFFERED	NUMBER OF WORKERS UNDER CONTRACT‡	HOURLY WAGES	BENEFITS OFFERED
LOW WAGE							
Landscape	Davis campus#	\$12.00	–	–	3	\$18.54	All university employees working 50 percent or more of full-time hours are eligible for medical, dental, vision, and pension benefits.
	San Francisco campus	14.00	M, D, V	Yes—401(k)	3	22.50	
Parking valet	San Francisco campus#	13.00	M	–	30	16.47	
Clerical	Riverside campus#	13.00	M, D, V	–	1	14.67	
Food services worker	Riverside campus	14.00	–	–	8	16.47	
Janitor	Davis medical center	14.00	–	–	12 (part-time)	18.28	
	San Francisco campus	14.00	M, V	–	4	17.35	
	San Francisco campus	14.00	–	–	5	17.35	
	San Francisco medical center	14.00	–	–	NR	17.35	
	San Francisco medical center	16.50	M	–	20	21.68	
Farm laborer	Davis campus	14.00	M	–	120	16.47	
Driver	Office of the President [¶]	11.50	M, D, V	–	14	§	
	Riverside campus	14.00	M	–	2	17.44	
	Davis campus	17.00	M	Yes—401(k) after 5 years of service	4	16.72	
Scribe	Davis medical center	14.00	M	Yes—401(k)	49	§	
Office furniture installer	Office of the President	14.37	M	Yes—pension	9	§	
Maintenance mechanic	Office of the President	16.00	M, D, V	Yes—401(k)	10	§	
Mental health worker	Davis medical center	17.00	M, D, V	Yes—401(k)	21	20.61	
Security guard	Office of the President [¶]	12.86	M	–	13	17.98	
	Riverside campus	14.00	M, D, V	Yes—401(k)	6	16.69	
	San Francisco medical center	17.30	M, V	Yes—401(k)	50	24.36	
Medical assistant	Riverside campus	17.50	M	Yes—401(k)	5	18.93	
Food services supervisor	Davis campus	17.75	M,D,V	Yes—401(k)	80	22.80	
HIGH WAGE							
Housekeeping manager	Davis medical center	\$23.17	M,D,V	Yes—401(k)	13	\$21.98	
Linen delivery	San Francisco medical center	23.97	M,D,V	Yes—pension	6	20.37	
Billing coder	Davis medical center	53.00	–	–	6	28.10	
	San Francisco medical center	NR	–	–	7	44.92	

Sources: California State Auditor's analysis of university wage and benefit data and unaudited information provided by the services contract vendors.

M = Vendor contributes to medical benefits. D = Vendor contributes to dental benefits. V = Vendor contributes to vision benefits.

NR = Vendor did not provide a response.

* The table does not include positions from three services contracts whose vendors did not respond to our inquiries for wage and benefit information.

† All wages are entry level and reflect what the vendor currently pays employees in that position, whether or not the vendor still has a contract with a university location.

‡ Total of all employees under contract, not just those in the job position selected for comparison.

These contracts or amendments were executed prior to the implementation of the university's Fair Wage/Fair Work Plan.

¶ This contract was executed prior to the implementation of the university's Fair Wage/Fair Work Plan, but because the contract term is indefinite, the contract should be amended to include the provision.

§ The university location where this contract was active did not have a comparable position.

of 401(k) defined-contribution plans. By comparison, all university employees who work 50 percent or more of full-time hours for one year or longer receive a full range of health benefits—medical, vision, and dental—and can enroll in the university’s more lucrative retirement plan that offers defined benefits. In fact, the university contributes an amount equal to about 37 percent of each employee’s annual salary toward benefits costs.

The fact that the wages and benefits of services contract workers generally compare unfavorably to those of university employees is not particularly surprising. A business enterprise, such as the university, would not normally contract out for services if doing so would cost more, unless it had a special or urgent need. However, in some situations, services contract workers could cost more than university employees, depending on whether one considers all costs, such as overhead. The displacement guidelines recognize as much, as reflected in its requirement that university locations must base any decision to displace university employees on a thorough analysis of all labor cost elements and a comparison between the two options that demonstrates real cost savings.

The University Generally Adhered to Its Procurement Policy When Entering Into Services Contracts, But It Can Make Improvements in Certain Areas

Our review of 30 services contracts from the six university locations we visited found that these locations generally adhered to systemwide contracting requirements but could improve their compliance in some areas.² The university’s contract manual contains the requirements university locations must follow when procuring services, including using specified competitive bidding solicitation and evaluation methods, awarding contracts to the lowest responsible bidder, determining price reasonableness, and ensuring appropriate contract approval. As Table 5 on the following page shows, the university locations we visited generally demonstrated compliance with the contract manual for the services contracts we tested. For example, these university locations almost always followed bidding requirements for the eight services contracts in which competitive bidding was required. Specifically, the contracts reflected that the university locations sought competition through public notice, solicited bids from at least three sources, and evaluated bids appropriately. However, in one instance, the Riverside campus could not demonstrate that it awarded a contract to the lowest responsible bidder. Although the contract file showed that the Riverside campus used an appropriate bid evaluation method, campus staff were unable to provide evidence that

Our review of 30 services contracts from six university locations found that these locations generally adhered to systemwide contracting requirements but could improve their compliance in some areas.

² We reviewed 30 of 31 contracts for adherence with contract policy; the remaining contract we reviewed only against the displacement guidelines.

the contract went to the vendor with the lowest bid. The remaining 22 contracts we tested were not subject to competitive bidding because their value was below the necessary thresholds, they were sole source, or they were amendments to existing contracts.

Table 5
The University Generally Complies With Services Contract Procurement Policy

UNIVERSITY LOCATION	COMPETITIVELY BID CONTRACTS*				NONCOMPETITIVE CONTRACTS*		CONTRACTS LESS THAN \$100,000†	ALL CONTRACTS		
	BIDS SOUGHT ACCORDING TO GUIDELINES	BIDDERS EVALUATED ACCORDING TO GUIDELINES	CONTRACT AWARDED TO LOWEST RESPONSIBLE BIDDER	REQUEST FOR BID INCLUDED KEY ELEMENTS	PRICES DETERMINED TO BE REASONABLE	SOLE SOURCE JUSTIFIED	PRICE WAS NEGOTIATED	STANDARD TERMS AND CONDITIONS UNCHANGED	PROPER AUTHORITY APPROVED CONTRACT	FAIR WAGE/ FAIR WORK PLAN PROVISION INCLUDED‡
Davis campus	1 of 1	1 of 1	1 of 1	1 of 1	NA	NA	0 of 3	4 of 5	4 of 5	4 of 5
Davis medical center	1 of 1	1 of 1	1 of 1	1 of 1	2 of 2	1 of 1	0 of 1	4 of 5	5 of 5	2 of 3
Riverside campus	2 of 2	2 of 2	1 of 2	2 of 2	NA	NA	1 of 1	5 of 5	5 of 5	3 of 3
San Francisco campus	3 of 3	3 of 3	3 of 3	3 of 3	2 of 2	0 of 1	NA	3 of 5	1 of 5	2 of 2
San Francisco medical center	NA	NA	NA	NA	1 of 2	1 of 2	0 of 2	5 of 5	4 of 5	1 of 2
Office of the President	1 of 1	1 of 1	1 of 1	1 of 1	NA	NA	NA	0 of 5	4 of 5	0 of 1
Exceptions Identified	0	0	1	0	1	2	6	9	7	4

Sources: California State Auditor's analysis of procurement practices at six university locations and the university's contract manual.

■ = An attribute for which we found an exception, regardless of the number of exceptions.

NA = This attribute did not apply to the contracts tested from this location.

* Not all competitive and noncompetitive attributes in the table apply to each contract we reviewed. For example, some contracts did not require competitive bidding because their value was less than \$100,000.

† Although university policy does not require price negotiation on contracts less than \$100,000, it is a best practice.

‡ The Fair Wage/Fair Work Plan provision applies to contracts or amendments entered into on or after October 1, 2015, among other limitations.

Table 5 also shows the requirements with which the university locations most commonly did not comply. For example, nine of the 30 services contracts we reviewed did not include the university's standard terms and conditions. The Office of the President makes these terms and conditions available on its website so university locations can easily reference them. These standard terms and conditions are meant to protect the university from potential legal pitfalls in areas that are common to nearly all goods and services contracts, as well as to promote issues that are important to the university. Some of the missing standard terms and conditions from these services contracts include provisions regarding conflicts of interest, audit requirements, and equal opportunity and affirmative action.

In one example, the Davis medical center used the vendor's terms and conditions in a contract. However, this vendor's terms and conditions omitted—among others—the university's conflict-of-interest provision,

which requires a vendor to affirm that to the best of its knowledge, that no university employee with a financial interest in the vendor participated in the decision to award the contract. This omission exposes the Davis medical center to the possibility of awarding a contract to a vendor that is aware that a university employee will financially benefit from the contract, which is a violation of university policy and could be a violation of state law. The Davis medical center explained that it occasionally uses a vendor's terms and conditions if they appear to be fair and reasonable and if it has the ability to terminate the agreement. Nevertheless, as this example demonstrates, this practice can create risk for the university when important provisions are omitted. In addition to the Davis example, none of the five services contracts we reviewed that the Office of the President's local procurement office entered into contained the standard terms and conditions. The Office of the President's local procurement manager was unable to explain why the standard terms and conditions were not included.

None of the five services contracts we reviewed that the Office of the President's local procurement office entered into contained the standard terms and conditions, and the local procurement manager was unable to explain why they were not included.

We also noted that four services contracts that university locations executed after October 1, 2015, were missing a required provision to ensure that the vendors comply with the university Fair Wage/Fair Work Plan. Effective October 1, 2015, the university began requiring that each new services contract or services contract renewal specifies that the vendor will pay its workers the university minimum wage. This wage will eventually increase to \$15 per hour on October 1, 2017, after the incremental increases already made in October 2015 and 2016. The policy requires that vendors who contract with the university pay their workers a wage that the university has determined is fair. Failure to include this provision could lead to vendors paying their contracted workers at rates that are below the university's minimum wage.

In addition, the university locations could not demonstrate that the procurement staff who signed seven of the 30 services contracts had the proper authority to do so. Procurement staff have purchasing authority up to a specific dollar amount, depending on their job classifications. In our opinion, these authorization levels are important because they help to ensure that purchases comply with university requirements. However, the San Francisco campus did not appropriately approve four of the five contracts we reviewed. In one example, a contract valued at nearly \$2.5 million required authorization from the San Francisco campus's procurement director, but it was approved by the former procurement manager, who only had a maximum signing authority for contracts valued up to \$1.5 million. The current procurement manager at the San Francisco campus could not explain why the four contracts were not properly approved. Noncompliance with this requirement puts university locations at risk of entering into legally binding contracts without the approval of authorized staff.

Several university locations avoided competitive bidding by repeatedly amending contracts; exempting broad service categories from competitive bidding requirements; using sole-source justifications; and making high-volume, low-value procurements that exceeded the competitive bidding threshold.

The University Could Better Maximize Its Use of Competitive Bidding

The university locations we reviewed did not consistently maximize competitive bidding opportunities to award contracts. Specifically, we found that several university locations avoided competitive bidding by repeatedly amending contracts; exempting broad service categories from competitive bidding requirements; using sole-source justifications; and making high-volume, low-value procurements that, in the aggregate, exceeded the competitive bidding threshold. The use of competitive bidding is critical because it helps ensure the university receives the lowest cost or best value when it procures services and helps to prevent favoritism and fraud, while at the same time it allows those who wish to become suppliers to the university the opportunity to compete for contracts. The instances we identified in which the university locations avoided using competitive bidding demonstrate areas where the Office of the President could revise its contracting policy and where the Legislature could revise state law to improve the university's use of competition.

Several University Locations We Reviewed Used Repeated Amendments to Extend Services Contracts

Several of the university locations we reviewed use amendments to extend contracts well beyond their original parameters, which prevented the locations from realizing potential cost savings from competitive bidding or fulfilling service needs by using other prospective vendors or their own staff. Unlike the Department of General Services' *State Contracting Manual*, which contains specific requirements applicable to state agencies, the university's contract manual offers only vague guidance regarding restrictions on the use of amendments to modify the terms of existing contracts. In fact, the contract manual merely states that changes in quantities or contract terms cannot violate the principle of competition.

In analyzing 30 services contracts, we found six instances in which the university's agreements with vendors far exceeded the terms and dollar amounts set forth in the original solicitations and contracts. For example, as Table 6 shows, the Davis campus originally entered into an agreement with a food services vendor for a maximum term of seven years, and it paid the vendor \$71 million over that period. It then amended this contract 24 times, increasing its length to 19 years and value to \$237 million. According to the Davis campus's director of hospitality and dining services, the campus began conducting analyses to determine how best to proceed with its food services operations in early 2015. Eventually, the Davis campus decided that it would

be more cost-effective to manage its own food services rather than continue to use a food services vendor. As a result, the Davis campus transitioned all food services operations to its own staff in June 2017. When asked why the campus had repeatedly extended the vendor’s contract rather than explore other options in the past, the director of facility services indicated that at the time of each amendment, the Davis campus believed that the contract was the appropriate delivery strategy for its food services operations.

Table 6
The University Has Used Amendments to Extend Services Contracts Far Beyond Their Original Parameters

UNIVERSITY LOCATION	DESCRIPTION OF SERVICE	YEARS AND MONTHS			IN DOLLARS		
		ORIGINAL MAXIMUM TERM	TOTAL TERM AS AMENDED	TIME BEYOND ORIGINAL MAXIMUM TERM	ORIGINAL VALUE THROUGH MAXIMUM TERM	VALUE THROUGH TOTAL TERM AS AMENDED	AMENDED VALUE IN EXCESS OF ORIGINAL MAXIMUM TERM
Davis campus	Food services	7 years	19 years	12 years	\$70,596,000*	\$237,408,000*	\$166,812,000
	Charter bus	2 months	2 years 5 months	2 years 3 months	28,000*	785,000*	757,000
Davis medical center	Emergency room scribes†	2 years	5 years 8 months	3 years 8 months	111,000	1,600,000	1,489,000
	Billing coder†	2 years 5 months	14 years 11 months	12 years 6 months	30,000	4,130,000	4,100,000
	Supplemental emergency room nurses†	6 months	4 years 10 months	4 years 4 months	300,000	2,000,000	1,700,000
San Francisco medical center	Billing coder†	1 year	5 years 2 months	4 years 2 months	400,000	5,050,000	4,650,000

Source: California State Auditor’s analysis of the university’s services contracts and other procurement documentation.

* The contract documentation did not indicate total amounts. The amount shown is the total expenditure according to the Davis campus.

† This contract is active.

The university’s contract manual does not explicitly prohibit such contract extensions, and the section of the Public Contract Code prescribing how the university must procure goods and services is also silent on how the university should treat contract amendments. The lack of such a restriction opens the door for potential abusive contracting practices by allowing the university to avoid the bidding process through repeated contract extensions. As Table 6 shows, we found another example in which the Davis campus initially entered into a two-month agreement in April 2014 for charter bus services valued at \$28,000. The campus extended the contract by over two years, spending \$757,000 more than the original contract value. However, we believe that when the Davis campus first became aware that the contract would exceed annual expenditures of \$100,000, it should have taken steps to solicit bids from other vendors or considered whether its employees could provide

this service. The Davis campus explained it eventually sought competitive bids for these bus charter services, but not until the fall of 2016. When the university extends contracts with existing vendors without exploring other options, it may miss opportunities to acquire the services at lower costs. Further, it limits the ability of other vendors to bid to provide these services.

The State Contracting Manual's Policy for the Use of Amendments in Contracts

State agencies may amend originally competitively bid services contracts if one of the following circumstances exists:

1. A statute exempts the amendment.
2. The department director, the agency head, and Department of General Services approve a detailed written justification that includes a determination that the price is fair and reasonable.
3. The contract provides specific amendment language (not merely a generic statement allowing amendments) and one of the following is true:
 - a. The original solicitation included the amendment language.
 - b. The amendment adds only time to complete performance of the original agreement (not to exceed one year).
 - c. The amendment adds no more than 30 percent (not to exceed \$250,000) to the dollar amount of the original contract.

Source: Department of General Services' *State Contracting Manual*.

Note: Time or money amendments are allowed only once. Further amendments require approval or a new bid.

Although not subject to the requirements in the *State Contracting Manual*, the university should consider mirroring some of those guidelines related to contract amendments. By limiting the ability of state agencies to amend contracts to only the particular circumstances listed in the text box, the Department of General Services attempts to ensure that state agencies do not use contract amendments to circumvent the competitive bidding process. Absent such restrictions, the current university contract manual allows university locations to continue services agreements without limit and without exploring other options that could offer better value. As the Davis campus's replacement of a food services vendor with its own employees demonstrates, university locations that explore other options may realize that hiring permanent employees to fulfill service needs can be more cost-effective.

The University's Broad Definition of Professional Services Limits Its Use of Competitive Bidding

The university's overly broad definition of professional services also allowed university locations to avoid competitive bidding in some of the services contracts we reviewed. The contract manual identifies *professional services* as infrequent, technical, or unique services, which are often performed by licensed professionals. It identifies medical, architectural, engineering, management consultation, research, and performing arts services as examples of professional services. This definition allows the university to enter into contracts for a broad range of services without using the competitive bidding process. For example, the Davis and San Francisco medical centers classified several contracts we reviewed as professional services, including services for billing coding and supplemental emergency room nurses. One of the Davis medical center's contracts, which began in 2001, stated that the vendor was to provide temporary coding personnel. However, the Davis medical center extended this contract for nearly 15 years, which indicates a need for a long-term service rather than a temporary one.

When we asked about these types of contract extensions, the director of supply chain management at the Davis medical center stated that university policy does not require competitive bidding for professional services. She added that the Davis medical center has difficulty finding qualified people to hire as full-time employees due to the specialized nature of certain positions, specifically billing coding. She stated that the Davis medical center extended the particular billing coding agreement previously described numerous times because it was satisfied with the level of service the vendor provided and that it compared the vendor's rates to other vendors to determine if it was competitive. However, despite this assertion, the Davis medical center could not provide us with those price comparisons. The purchasing manager at the San Francisco medical center offered similar explanations. He stated that the San Francisco medical center has attempted to hire permanent billing coders. However, the medical center believes that the vendors are able to employ and retain the most experienced and qualified billing coders available. He also noted that the San Francisco medical center is satisfied with the services provided by the vendor with which it contracts.

We believe there are two ways that the Office of the President could improve the university's contracting for professional services. The university could meet its professional service needs in a more cost-effective manner by requiring competitive bidding for professional services contracts with a total value above \$100,000 rather than using its current criteria of annual expenditures of \$100,000 or more. In addition, the university could more narrowly define the professional services that are exempt from competitive bidding requirements. For example, the *State Contracting Manual* indicates specific types of services that are exempt from competitive bidding, including legal services and expert witness contracts. Limiting the types of contracts that are exempt from competition would help the university achieve its goal of procuring services that represent the best value.

Some University Locations Inappropriately Used Sole-Source Contracts to Avoid Competitive Bidding

As Table 5 on page 26 shows, both the San Francisco campus and the San Francisco medical center awarded contracts to vendors through a sole-source process without proper justification. The university's contract manual defines a *sole-source contract* as one with "the only supplier capable of meeting university requirements within the time available, including emergency and other situations which preclude conventional planning and processing." Further, the contract manual states that competition is not required when a proprietary service is unique or available only from a sole-source contract.

However, we found two instances in which university locations did not provide adequate justifications for contracts that they awarded noncompetitively through a sole-source process. These misuses of the sole-source process represent instances in which the university locations improperly avoided competitive bidding.

In the first instance, the San Francisco medical center entered into a sole-source contract for hospital cleaning services, but its contract file lacked sufficient justification for its decision to forego competitive bidding. According to the director of procurement services for the San Francisco medical center, the medical center opened a hospital in early 2015, and the sole-source contract for hospital cleaning services was the result of an emergent need that only the selected vendor was capable of meeting within the time available. He indicated that the San Francisco medical center did not discover that the staffing levels for hospital cleaning were inadequate until it opened the hospital. The contract manual allows for emergency needs as a sole-source justification when an emergency or other situation precludes conventional planning. However, in justifying the sole-source contract, the medical center indicated that the contract was needed for temporary staffing until the medical center's employees could take over the cleaning and the justification did not mention an emergency. Moreover, the San Francisco medical center prepared the sole-source justification three months after entering into the contract and indicated that the work had been ongoing, despite the requirement on the sole-source form that a university location prepare and submit this justification for review before entering a sole-source contract.

Similarly, in the second instance, the San Francisco campus entered into a sole-source contract for vanpool services, but the contract file contained no rationale explaining why the selected vendor was the only vendor that could provide this service. Rather, in justifying this sole-source contract, the campus indicated that other university locations were satisfied with the vendor's services and that the vendor's prices were lower than those of another vanpool vendor. The San Francisco campus also indicated it wanted to curtail the rising cost of its transportation services. The San Francisco campus's current procurement manager speculated that the campus may have incorrectly described the contract as sole source. However, the procurement file did not show that the San Francisco campus competitively bid this contract, nor did it demonstrate why competitive bidding was not possible. By using sole-source contracts to avoid competitive bidding, the San Francisco campus and the San Francisco medical center prevented other vendors from competing for these services, and they risked entering into contracts that were not the lowest cost or best quality.

By using sole-source contracts to avoid competitive bidding, the San Francisco campus and the San Francisco medical center prevented other vendors from competing for the services, and they risked entering into contracts that were not the lowest cost or best quality.

One Campus Missed Opportunities to Use Competitive Bidding for Its Low-Value Procurements

Our review of low-value procurements at the Riverside campus suggests that it may have failed to identify services for which it could have used competitive bidding. Specifically, to reduce the cost of low-value purchases, the university's contract manual allows and encourages university locations to establish procurement programs that enable their departments to directly purchase services from vendors. These programs generally place limits on the dollar value of the procurements. The Riverside campus uses an online purchasing system called eBuy that the departments may use to make low-value purchases. For the time period we reviewed, the purchase limit was \$2,500 per eBuy transaction for nonprocurement staff, while procurement staff fulfilled requisitions over that amount.

Based on our review of the eBuy transaction history for low-value purchases from two vendors at the Riverside campus, we found an opportunity for competitive bidding related to one of the two vendors. Specifically, for a services contract with a charter bus vendor, the total value of the Riverside campus's purchases exceeded \$100,000 in each of the five fiscal years we reviewed. In fact, for fiscal year 2015–16, the annual expenditures related to this contract totaled nearly \$400,000. The contract manual states that university locations must competitively bid contracts with expenditures of more than \$100,000 annually, with few exceptions. Although most transactions with the charter bus vendor were typically \$2,500 or less, the total value of the purchases reflects that there was significant demand for this service and that Riverside could have sought competitive bids to possibly obtain a better price or better service.

According to the former interim procurement manager, the procurement department has the ability to track spending related to eBuy purchases but does not regularly do so. However, by not tracking and assessing the total value of purchases from a single vendor through its eBuy system, the Riverside campus is missing the opportunity to leverage the volume of its purchases through a competitive bidding process to potentially curtail its costs and receive better quality services. According to the associate vice chancellor of business and financial services, the Riverside campus hired a new procurement director in December 2016, and filled a vacant procurement manager position in May 2017. With the addition of these two individuals, the campus has begun a review of low-value purchases to identify opportunities to increase competitive bidding.

By not tracking and assessing the total value of purchases from a single vendor, the Riverside campus is missing the opportunity to leverage the volume of its purchases through a competitive bidding process to potentially curtail its costs and receive better quality services.

Although the Office of the President implemented a contract repository for systemwide contracts that university locations can access, it has yet to implement a central contract database to house contract information for all university locations.

The Office of the President Implemented a Systemwide Procurement Program But Could Do More to Create Further Process Efficiencies

As we describe in the Introduction, in 2012 the Office of the President implemented a systemwide procurement program, also known as P200, which has resulted in the execution of procurement agreements intended to benefit all university locations by leveraging the purchasing power of the university. Although P200 has led to some improvements in the university's procurement processes, the Office of the President could do more to create further process efficiencies. For example, it implemented a contract repository for systemwide contracts that university locations can access, but it has yet to implement a central contract database to house contract information for all university locations. As a result, neither the Office of the President nor the university locations have complete and accurate information regarding all university contracts. The Office of the President also lacked adequate support to substantiate nine of the 10 *benefits*—the term it uses for cost reductions or avoidance, incentives, or revenue—that we reviewed related to its implementation of P200. These nine benefits totaled \$109 million of the \$269 million savings the university president claimed for fiscal year 2015–16. Finally, despite its public statements regarding the use of the procurement benefits it achieves, the Office of the President has not established a policy to guide campuses in reallocating the claimed benefits to the university's core missions of teaching, research, and public service.

The Office of the President's Implementation of P200 Increased the University's Systemwide Agreements But Has Not Yet Resulted in a Database for Tracking Contracts

Since P200's launch in 2012, the Office of the President has hired staff and implemented tools to analyze university spending patterns and to identify procurement savings opportunities. To implement P200, the Office of the President added 22 positions, of which it has filled 19, to its systemwide procurement staff. The purpose of these new staff—who represented an annual cost of \$4 million in fiscal year 2016–17—is to allow the Office of the President to develop a greater understanding of which services best fit the university's needs and to coordinate systemwide procurement agreements. Further, the Office of the President established a systemwide shared-governance group composed of the systemwide chief procurement officer and campus procurement leaders, who propose, evaluate, and vote to approve procurement strategies, programs, and systemwide agreements that could benefit all university locations. The Office of the President's records indicate that it executed 65 systemwide agreements in fiscal year 2015–16 as a result of P200. According to the Office of the President, these

agreements have benefited the university by allowing the campuses and medical centers to consolidate and leverage their spending for common items they purchase to generate potential savings as a result of vendors' discounting their rates.

Despite the benefits of P200, the Office of the President has yet to implement an aspect of the program's plan that we consider critical. Specifically, the P200 plan stated that the Office of the President would implement a central contract database to oversee the university's fragmented contract data. Although it implemented a contract repository for systemwide contracts that university locations can access, the Office of the President has yet to implement a central contract database to house contract information for all university locations. Instead, each university location has developed its own method of tracking its contracts, and as a result, the Office of the President is unable to report in aggregate on the nature of the university's contracts, such as the types of contracts, procurement methods, and types of goods and services purchased.

In response to the Legislature's request for data on the university's contracting activities over the past five years, we contacted each campus, medical center, and the Office of the President to obtain extracts from the systems they use to track contract information. Specifically, we requested that each university location provide us with an extract of its contracts along with basic information about each contract, including whether the contract was to purchase a good or service, the contract amount, and the period it covered. However, despite the basic nature of our request, many of the campuses and medical centers, as well as the Office of the President, were unable to provide complete extracts, as Table 7 on the following page shows. For example, the University of California, Los Angeles, campus could not provide data on the procurement methods it used, such as whether contracts were competitively bid or were sole source. The university's decentralized approach to contract management has resulted in its inability to report even the most basic contract information in the aggregate without a manual review of all of its contracts. Moreover, because the campuses, medical centers, and the Office of the President all lack complete data in their tracking systems, we were unable to respond to the Legislature's request for information about the university's contract activities over the past five years.

The Office of the President attributes its delay in implementing a contract database to problems with finding the right vendor. Specifically, the Office of the President explained that in 2012 it contracted with a vendor to implement contract management software that was intended to include the capacity to store information on all university contracts, which would have addressed the university's lack of a central contract database. However, the Office of the President's director of information,

The university's decentralized approach to contract management has resulted in its inability to report even the most basic contract information in the aggregate without a manual review of all of its contracts.

Table 7
The University's Contract Databases Contain Fragmented and Incomplete Information

LOCATION	CONTRACT DATABASE NAME	SELECTED CONTRACT DATA			
		GOOD OR SERVICE INDICATOR	GOOD OR SERVICE DESCRIPTION	CONTRACT AMOUNT	PROCUREMENT METHOD
CAMPUS					
Berkeley	BearBuy	◆	✓	✓	✗
	Kuali (contracts)	✓	✓	✓	✓
Davis	Kuali (purchase orders)	✓	✓	✓	✓
	DaFIS (contracts—prior system)	✓	✓	✓	✗
Irvine	Excel	✗	◆	◆	✗
Los Angeles	PAC	✗	◆	✓	✗
Merced	CatBuy	✗	✓	✓	✗
Riverside	eBUY	✗	✓	✗	✗
San Diego	SciQuest	✗	✓	✓	✗
San Francisco	BearBuy (contracts)	✗	✗	◆	✗
	BearBuy (purchase orders)	✗	✓	✓	✗
Santa Barbara	Filemaker (prior system)	✗	◆	◆	✗
	Excel	✗	✓	◆	✗
Santa Cruz	Contract Manager (contracts)	✗	✓	✓	✗
	Cruzbuy (purchase orders)	◆	✓	✓	✗
MEDICAL CENTER					
Davis	Microsoft Access (contracts)	✗	✓	✓	◆
	Eclipsys (contracts and purchase orders)	✗	✗	✓	✗
Irvine	AMS (contracts)	✓	✓	✗	✗
	AMS (purchase orders)	✗	◆	✓	✗
Los Angeles	Caspio (contracts)	✓	✓	✗	✗
	Lawson (contracts)	✓	✓	✓	◆
San Diego	Aperek (blanket purchase orders)	✗	✓	✓	✗
	Aperek (purchase orders)	✗	✓	✓	✗
	Aperek (services contracts)	◆	✗	✗	✗
	Aperek (supply contracts)	✓	✓	✓	✗
San Francisco	Meditract (contracts)	✗	✓	✓	✗
	Global Health Exchange (contracts)	✗	✓	✓	✗
	Pathways Materials Management (purchase orders)	✗	✓	✓	✗
OFFICE OF THE PRESIDENT*					
Local procurement office	PAC	◆	◆	✓	✗
TOTALS					
✓ = Data available.		7	21	21	2
◆ = Inconsistent or incomplete data.		4	5	4	2
✗ = Data not available.		18	3	4	25

Sources: California State Auditor's analysis of contract data provided by university locations from their contract databases and other procurement tracking systems.

* The Office of the President also has a contract repository for systemwide contracts. We did not evaluate the contract repository because systemwide contract activity is reflected in the contract databases at the university locations.

analytics and systems (analytics director) indicated that the vendor was unable to deliver on the contract database to the university's satisfaction. As a result, the Office of the President executed a contract with a new vendor in May 2017 to implement a contract management software tool that will include a central contract database for all of the university's contracts.

Although the Office of the President has now found a vendor to assist in its efforts to centrally monitor the university's contracting activities, it has yet to develop a project plan to implement the database. The analytics director anticipates implementing the contract database within two years but stated that the only plan currently available was a high-level timeline and project approach that the Office of the President developed in April 2017. The analytics director explained that the lack of a project plan was the result of the Office of the President's focus on evaluating the new vendor's capabilities. She further stated that the Office of the President would develop a more detailed plan by assessing the status of current contract databases at each university location and determining the IT resources needed to assist with the project. Although the systemwide chief procurement officer indicated that planning efforts for the central contract database began in July 2017, because the Office of the President lacks a project plan, implementation of the central contract database could be delayed beyond the two years it estimates. In the meantime, the lack of a central contract database will continue to hinder the Office of the President's ability to track contracts across the university, identify systemwide contracting opportunities, and create additional cost efficiencies.

The Office of the President Has Reported Estimated Procurement Benefits as Actual Amounts and Has Not Ensured Those Benefits Are Redirected to the University's Core Missions

The Office of the President set a goal for P200 to deliver the university \$200 million in benefits annually by the end of fiscal year 2016–17 through strategic procurement activities. Examples of these activities include the realignment of the university's systemwide procurement organization and strategic sourcing to consolidate spending across the university. In January 2017, the university president reported to the regents that the university had achieved its goal by capturing \$269 million in annual procurement savings for fiscal year 2015–16. However, the Office of the President was unable to fully substantiate nine of the 10 benefits we reviewed. These nine benefits totaled \$109 million of the \$269 million savings the university president claimed for fiscal year 2015–16. The Office of the President's lack of supporting documentation to substantiate these benefits is similar to the problems we reported

In May 2017, the Office of the President contracted with a vendor to assist in its efforts to centrally monitor the university's contracting activities, but it has yet to develop a plan to implement the database.

with the university's other Working Smarter initiative projects in our March 2016 audit, *University of California: Its Admissions and Financial Decisions Have Disadvantaged California Resident Students*, Report 2015-107.

The Office of the President developed a tracking system in July 2014 to record, verify, and track benefits that result from P200 procurement transactions at all university locations. The Office of the President requires university locations to enter benefits into the tracking system and provide contracts, quotes, negotiation records, and other documentation to support the amounts claimed. The Office of the President's policy states it uses these documents to recalculate and verify the claimed benefits, which it then either approves or requests the university location to correct. The tracking system contains over 5,000 entries totaling \$269 million for fiscal year 2015–16, which corresponds to the savings that the president reported to the regents in January 2017.

Our review of 10 entries found that nine of the benefits, which totaled \$109 million, were not supported by accounting records or other appropriate documentation to substantiate the amounts. For example, we were unable to substantiate the Office of the President's claim of \$80 million in annual cost reductions for new contracts related to university health insurance programs. In May 2016, the Office of the President executed two separate agreements for vendors to provide claim administration and pharmacy benefits management services for the university's self-funded health insurance programs. It claimed that the two agreements together would provide \$80 million in annual cost reductions for three years solely as the result of lower expected costs for medical and pharmacy insurance claims.

The Office of the President failed to substantiate its claim of \$80 million in annual cost reductions for new contracts related to university self-funded health insurance programs.

However, the Office of the President failed to substantiate its claimed cost reductions by documenting how its new vendors would achieve lower expected costs for medical and pharmacy insurance claims. Such documentation would have included an analysis of previous costs and a description of how the new vendors would lower the costs of expected claims. Lacking this documentation, we were unable to determine the accuracy or reasonableness of the \$80 million in claimed annual cost reductions. The Office of the President also claimed that the annual cost reductions of \$80 million began in fiscal year 2015–16 even though the new vendors did not begin administering the university's self-insured health programs until January 2017. Although the Office of the President's methodology recognizes benefits as beginning in the same fiscal year that it signs an agreement, we believe it is more accurate to recognize the benefits when the agreement is in effect.

Further, the University of California, Irvine, campus (Irvine campus) claimed that it produced \$6.7 million in cost reductions for its Student Information System IT project. However, our review found that the Irvine campus's cost reductions were actually the result of a project management decision to reduce the scope of the IT project rather than resulting from a procurement action, such as the search for a new vendor or a renegotiation of an initial bid submission. In another example, the Office of the President reported that a multiyear, systemwide agreement for general lab supplies generated cost reductions of \$13 million in fiscal year 2015–16. However, our review found that the supporting documentation in the Office of the President's tracking system consisted of only a spreadsheet of estimated savings for all university locations. This spreadsheet lacked information to support the university's baseline spending or the assumptions the Office of the President used to calculate the cost reductions, such as vendors' prices for these supplies. Lacking these key pieces of information, we were unable to substantiate the cost reductions that the Office of the President reported for this contract.

The analytics director acknowledged that the Office of the President needed more and better information to substantiate some of the estimated benefit entries we reviewed. However, she stated that benefits from contracts that the shared-governance group had approved do not require additional documentation because the committee had already reviewed the business cases and voted to approve the contracts. Nonetheless, we believe additional information is still needed to verify the systemwide procurement program's benefits.

The analytics director also acknowledged that estimated benefits may differ from actual benefits because the factors the Office of the President uses to estimate the benefits, such as forecasted purchase volume, may not materialize over the life of a contract. For example, when the Office of the President enters into a systemwide contract, it estimates the cost reduction with the assumption that the university locations will make their procurements using that systemwide contract. However, because the Office of the President does not require the university locations to use systemwide contracts, the university locations would have to choose to participate for the university to realize the cost reductions. The analytics director stated that the Office of the President has not done any assessments to determine how much of the estimated benefits the university has actually realized. She explained that the university's decentralized financial systems combined with the high volume of purchase transactions make it cumbersome and expensive to measure actual benefits. However, despite its lack of verification, the president continues to publicly assert having achieved these savings.

The analytics director acknowledged that the Office of the President needed more and better information to substantiate some of the estimated benefit entries we reviewed.

Finally, although the Office of the President stated that the university would redirect any P200 benefits toward its core missions of teaching, research, and public service, it cannot substantiate this claim. According to the director of strategic sourcing, the Office of the President has not developed a policy or provided direction to university locations on how to reallocate procurement benefits because it believes doing so could discourage them from participating in systemwide procurement agreements. Instead, the director of strategic sourcing stated that the Office of the President allows university locations to decide how they will apply any benefits they achieve. However, our March 2016 report found that the three campuses we reviewed were unable to demonstrate through financial records that they redirected any benefits to the university's core missions. Until the Office of the President establishes measures for accountability over the uses of the benefits from P200, it is unable to assert with any assurance that the university is redirecting benefits to its teaching, research, and public service missions.

Recommendations

Legislature

To ensure that the university maximizes the use of competition, the Legislature should revise the Public Contract Code to do the following:

- Specify the conditions under which the university may amend contracts without competition.
- Narrowly define the professional and personal services that the university may exempt from competitive bidding.

Office of the President

To ensure that university locations adequately justify the necessity of contracts that will displace university employees, the Office of the President should do the following:

- Actively enforce compliance with the displacement guidelines by monitoring university locations for compliance, providing regular training on the displacement guidelines to university locations, and amending the displacement guidelines to state that the Office of the President's human resources department has the authority to approve or reject displacement decisions.

- Revise contracting policies to address situations in which university locations are contemplating entering into services contracts instead of hiring university employees to perform an activity. In these situations, the Office of the President should require university locations to perform an analysis that is similar to the one it requires when current university employees are displaced.
- Ensure that staff with the necessary business and financial skills at the Office of the President review and approve the cost analyses that university locations submit.
- Revise the cost analysis requirements in the displacement guidelines to mitigate the risk of university locations incorrectly estimating savings by requiring a threshold level of savings as part of their business and financial necessity analyses and requiring that university locations periodically reevaluate the savings after the services contracts take effect to inform future contracting decisions.

To ensure that the university achieves its goals of obtaining services at the lowest cost or best value and of providing vendors with fair access to contracting opportunities, the Office of the President should do the following:

- Direct university locations, including its own local procurement office, to implement controls to ensure staff better comply with the university's contract manual's requirements for using standard terms and conditions, obtaining the proper contract approvals, and awarding of sole-source contracts.
- Revise the university's contract manual to incorporate the best practices found in the *State Contracting Manual* for limiting the use of amendments to repeatedly extend existing contracts.
- Revise the university's contract manual to narrow the exemption from competition to only selected professional services, similar to the *State Contracting Manual*.
- Direct all university locations to implement controls in their online procurement systems to prevent staff from avoiding the requirement to competitively bid a contract when individual purchases of the same good or service accumulate to \$100,000 or more within a fiscal year.

To help ensure that the university will implement its central contract database for tracking and monitoring all university contracts in a timely manner, the Office of the President

should develop a detailed project implementation plan by October 2017 that outlines a schedule of the specific activities that will need to occur to complete this effort.

To maximize benefits from the systemwide procurement initiative and to ensure that the university uses those benefits for its teaching, research, and public service missions, the Office of the President should do the following:

- Direct all university locations to provide better documentation to substantiate actual benefits they claim related to their procurement decisions.
- Revise its guidance to ensure the benefits that university locations claim result from only procurement-related activities.
- Implement a process to centrally direct these benefits to ensure that university locations use them to support the university's core missions.
- Study ways to measure actual procurement benefits—possibly focusing this effort on benefits from larger dollar amounts—and if such measurement is not possible, it should clearly disclose to the regents and the public that the amounts it reports are based on estimates.
- If actual benefits are measurable, implement a process to monitor and report annually to the regents the estimated and actual benefits.

We conducted this audit under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives specified in the Scope and Methodology section of the report. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

Date: August 22, 2017

Staff: John Baier, CPA, Audit Principal
Sharon L. Fuller, CPA
Oswin Chan, MPP, CIA
Matthew McAuley
Christopher Purcell
Joseph S. Sheffo, MPA
Michael Tejada

Legal Counsel: Joseph L. Porche, Staff Counsel

For questions regarding the contents of this report, please contact Margarita Fernández, Chief of Public Affairs, at 916.445.0255.

Blank page inserted for reproduction purposes only.

UNIVERSITY OF CALIFORNIA

BERKELEY • DAVIS • IRVINE • LOS ANGELES • MERCED • RIVERSIDE • SAN DIEGO • SAN FRANCISCO



SANTA BARBARA • SANTA CRUZ

1111 Franklin Street
Oakland, CA 94607-5200
Phone: (510) 987-9074
<http://www.ucop.edu>

August 7, 2017

Ms. Elaine M. Howle*
California State Auditor
621 Capitol Mall, Suite 1200
Sacramento, California 95814

State Auditor Howle:

This letter is in response to your draft audit report on contracted employees and practices for the University of California Office of the President (UCOP). We welcome the constructive input, which aligns with the University's proactive efforts to continually improve and strengthen its policies and procedures. Our specific responses to individual recommendations are attached, and for context, I would like to take this opportunity to emphasize some important aspects of UC's operations and goals.

UC's Employee Population and Use of Service Contracts

The California State Auditor (CSA) report identifies both strengths and areas for improvement with respect to oversight of service contracts and guidelines on the displacement of current employees. I appreciate your acknowledgement of the areas in which UC and its campuses have complied with policies, and will focus on your recommendations as we work diligently to further shore up our procedures.

I believe it is important that the recommendations be framed within the context of the University of California, the state's third largest employer — behind federal and State governments — with some 190,000 employees at its 10 campuses, five medical centers, three affiliated national laboratories, the division of Agriculture and National Resources (ANR), and UCOP. The University is extremely proud of its staff, who play a critical and ongoing role in carrying out UC's education, research, and public service missions. One of the greatest challenges for UC, and for all higher education institutions, is striking an optimal balance of simultaneously reducing costs, increasing access, achieving higher levels of academic excellence, and investing in its large, diverse workforce.

* California State Auditor's comments begin on page 53.

State Auditor Howle
August 7, 2017
Page 2

Rather than ignore this challenge, the University has addressed it directly. In 2015, UC unveiled its Fair Wage/Fair Work plan, which mandated that all University employees who work at least 20 hours a week be paid at least \$15 an hour, to be implemented over the course of three years. The minimum increased to \$13 in October 2015 and \$14 in October 2016, and will increase to \$15 by October 2017. As I stated at the time, this forward-thinking program is the right thing to do for UC workers and families, for our mission and values, and for furthering UC's leadership role by becoming the first university in the United States to voluntarily establish a minimum wage program that would reach \$15 an hour. As an institution, we are deeply proud of this accomplishment, as it underscores a difficult balancing act for a steward of public dollars — reducing UC's operating costs while fairly compensating hardworking employees.

A similar challenge is effectively negotiating the composition of our employee population and supplementing their work with service contracts. Maintaining a balance of contract and campus-based services helps locations maximize efficiency within resource constraints, while allowing for new methods and best practices. UC and its individual locations contract out for services in cases where, among other reasons, there is a need for special expertise or experience, for short-term or temporary staffing needs, or for services and equipment not available or not regularly performed internally.

①

It is important to note that UC's Fair Wage/Fair Work policy also applies to employees of contractors providing services to UC. As part of the plan, the University instituted stronger oversight of its contracts and subcontracts, requiring that companies with which UC contracts pay a wage that meets or exceeds UC's new minimum wage. In addition, the University expanded its monitoring and compliance efforts related to service contractors' wages and working conditions. This includes a new phone hotline and a central online system for contract workers to report directly to the Office of the President any complaints and issues.

UC Procurement and Maximizing Benefits

Similar to the review of service contracts, I am grateful that your report identified strengths in our procurement policies and practices, as well as areas on which we will focus attention as we continue to progress and improve.

The University's department of Procurement Services has transformed the way we purchase goods and services to improve quality and service to our campuses and partners, while maximizing systemwide benefits such as cash savings, streamlined processes, and enhanced efficiencies. Launched in 2012 as part of the systemwide

State Auditor Howle
August 7, 2017
Page 3

Working Smarter Initiative, the P200 program leveraged the purchasing power of 10 campuses to more competitively bid for goods and services, automate business processes for increased efficiency, and enhance collaboration with vendors for better transactions. It has proven to be a tremendous success. The program is on track to exceed \$300 million in calculated annual benefits by the end of fiscal year 2016-17, funds that will now be available to support UC's teaching, research, and service missions. ②

UC's 10 campuses are collaborating to build an integrated, sustainable and systemwide procurement framework. By developing competitive contracts, innovative supply chain strategies and robust reporting and analytics, UC will capture yet more benefits that will further support our core missions.

In summary, I appreciate CSA's time and diligence in assessing UC's operations and identifying areas for further improvement. We take your recommendations seriously and believe they are constructive to our goals of continued improvement, progress, and success.

Yours very truly,



Janet Napolitano
President

Attachment:
Response - CSA Contracting Recommendations

Responses to CSA Contracting Recommendations

1. To ensure that campuses and medical centers adequately justify the necessity of contracts that will displace university employees, the Office of the President should do the following:

- **Actively enforce compliance with the displacement guidelines by monitoring university locations for compliance, providing regular training on the displacement guidelines to university locations, and amending the displacement guidelines to state that the Office of the President Human Resources has the authority to approve or reject displacement decisions.**
- **Revise contracting policies to address situations in which university locations are contemplating entering into service contracts instead of hiring of new university employees to perform an activity. In these situations, the Office of the President should require university locations to perform an analysis that is similar to the one it requires when current university employees are displaced.**
- **Ensure that staff with the necessary business and financial skills at the Office of the President review and approve the cost analyses that university locations submit.**
- **Revise the cost analysis requirements in the displacement guidelines to mitigate the risk of university locations incorrectly estimating savings by requiring a threshold level of savings as part of its business and financial necessity analysis and require that the university locations periodically reevaluate the savings after the service contract takes effect to inform future contracting decisions.**

UC will revise the displacement guidelines. Revisions will include language identifying the appropriate review and approval authorities. They will also include a template to document appropriate approvals and to document formal notice that complies with the requirements of the revised guidelines. The revised guidelines will require analysis and consideration of the anticipated benefits, cost, personnel, and mission implications of proposed displacement arrangements. They will also include compliance provisions.

Page 2

UC campuses and medical centers utilize service contracts as an important supplement to existing resources. A balance of contract and campus-based services helps locations maximize efficiency within resource constraints. In assessing whether to contract out for services or to perform the work with UC employees, locations take into account a number of considerations on an ongoing basis, including whether the work is within the scope and capabilities of current staff; whether contracting out for services would improve the methods or practices of service delivery or facilitate the development of internal expertise; and the immediacy of the need for the services as well as the expected duration of such need. UC manages its head count on an ongoing and periodic basis to accomplish existing or anticipated work. UC will reiterate to locations that they need to more carefully determine whether it is more economical and efficient to perform the work with UC employees or with service contracts, and will work to strengthen and standardize procedures to facilitate these efforts.

UCOP will advise the locations to incorporate into existing, applicable trainings an overview of the revised displacement guidelines.

2. To ensure that the university achieves its goals of obtaining services for the lowest cost and best value and of providing vendors with fair access to contracting opportunities, the Office of the President should do the following:

- **Direct university locations, including its own local procurement office, to implement controls to ensure staff better comply with the university contract manual's requirements for using standard terms and conditions, obtaining the proper contract approvals, and awarding of sole source contracts.**
- **Revise the university's contract manual to incorporate the best practices found in the *State Contracting Manual* for limiting the use of amendments to repeatedly extend existing contracts.**
- **Revise the university's contract manual to narrow the exemption from competition to only selected professional services similar to the *State Contracting Manual*.**
- **Direct all university locations to implement controls in their online procurement systems to prevent staff from avoiding the requirement to competitively bid a contract when individual purchases of the same good or service accumulate to \$100,000 or more within a fiscal year.**

Page 3

Over the past few years, the Procurement Policy and Legal Documents Team (“PPLDT”), a systemwide team led by UCOP, has developed a set of systemwide template documents that represent a substantial improvement over prior documents. These documents have been accompanied by buyer tools such as annotated templates that explain the risk of amending or deleting various provisions, and inform buyers who has the authority to approve such changes. UCOP has sponsored regular webinars on how to use the template documents. This effort has resulted in greater use of the template documents, and UCOP will continue to reinforce this process.

With regard to the extension of existing contracts, UC agrees that it is appropriate to establish a baseline standard on this subject, from which justifiable deviations may be granted. Accordingly, UC will initiate an analysis and benchmarking process to determine appropriate contract lengths and amendment parameters. If that analysis identifies a need for a change in the University’s contract manual and/or the issuance of a new policy, it will be disseminated to the campuses.

UC agrees that the current definition for sole sourcing in contracting policy (BUS-43) can be improved. It provides two reasons that sole sourcing is possible: 1) the existence of only one solution to a supply/service need (as does the Public Contract Code), and 2) circumstances where alternate solutions may exist but lead time does not allow for a competitive process. UC agrees that the second circumstance should not be included as a reason for permitting “sole sourcing.” More appropriately, as is the case in the Federal Acquisition Regulations (FARS), such an exception to the competitive bidding requirement should be addressed under a separate provision titled “Unusual and Compelling Urgency.” BUS-43 will be amended to eliminate the issue of urgency from the current definition of sole source, while adding a new paragraph covering the “unusual and compelling urgency” circumstance, effective November 2017.

Although UC believes the BUS-43 definition of professional services to be adequate, we agree that this policy could be clarified to encourage consideration of multiple options when contracting for professional services. Accordingly, the PPLDT will develop a systemwide training webinar that will focus on the appropriate classification of professional services and the documentation required to not pursue competitive bidding. Training delivery expected by November 2017.

All heads of procurement at the University will be instructed to implement quarterly reviews of their site’s transactions to ensure that multiple orders at the site for the same goods or services totaling \$100,000 or more (in aggregate) are competitively bid, or that an exception is appropriately documented.

The Associate Vice President & Chief Procurement Officer will advise procurement heads at each location to implement quarterly reviews, as noted above, by November 2017.

Page 4

- 3. To help ensure that the university will implement its central contract database for tracking and monitoring all university contracts in a timely manner, the Office of the President should develop a detailed project implementation plan by October 2017 that outlines a schedule of the specific activities that will need to occur to complete this effort.**

UCOP began implementing its newly contracted software suite, including contracts management, on July 14, 2017. UCOP anticipates completion of a detailed project plan for contracts management by October 2017.

- 4. To maximize benefits from the systemwide procurement initiative and to ensure that the university uses those benefits for its academic, research, and public service missions, the Office of the President should do the following:**

- Direct all university locations to provide better documentation to substantiate actual benefits they claim related to their procurement decisions.**
- Revise its guidance to ensure the benefits that university locations claim results from only procurement-related activities.**
- Implement a process to centrally direct these benefits to ensure that university locations use them to support the university's core missions.**
- Study ways to measure actual procurement benefits – possibly focusing this effort on benefits from larger dollar amounts – and if such measurement is not possible, it should clearly disclose to the regents and the public that the amounts it reports are based on estimates.**
- If actual benefits are measurable, implement a process to monitor and report annually to the regents the estimated and actual benefits.**

During the past five years, the University has invested in its procurement systems and trained staff across the system to provide better documentation and to track benefits associated with the procurement initiative. UC believes it has demonstrated \$298 million of benefits associated with P200. We respectfully disagree with the audit report on this point. Going forward, when reporting savings associated with the initiative, UC will more clearly identify which benefits are realized and which are based on the best contract utilization data available, as well as provide better support of the documentation to substantiate those savings.

Page 5

- ③ With regard to the tracking and potential redirection of savings achieved on a campus and within units, UC appreciates the sentiment of the recommendation and the goal of enhancing our investment in the core missions of UC. That said, implementing such a recommendation would not only place a significant administrative burden on campus units to track savings and document expenditures from those savings, but also create a dynamic that would limit the incentive for units to generate savings in the face of UC either prescribing the use of those funds or ultimately shifting them to another unit or campus altogether. In addition to the disincentives, it is not in the best interests of a campus to have UCOP direct how it spends these savings, as that determination is properly and best left to the campus.

Comments

CALIFORNIA STATE AUDITOR'S COMMENTS ON THE RESPONSE FROM THE UNIVERSITY OF CALIFORNIA OFFICE OF THE PRESIDENT

To provide clarity and perspective, we are commenting on the response from the Office of the President. The numbers below correspond to the numbers we have placed in the margin of the Office of the President's response.

Although using services contract workers instead of university employees is justifiable under the circumstances that the university president describes, we found that the university locations entered into services contracts that resulted in the avoidance of hiring employees. As shown in Table 3 on page 21, we determined that for 9 of the 31 services contracts we reviewed, university locations could have hired employees to perform the services. Therefore, we recommended that the Office of the President revise its displacement guidelines to address not only the displacement of existing employees but also the avoidance of hiring new employees. By doing so, the Office of the President could better ensure university locations make thoughtful decisions when using services contracts and also allow the Office of the President to monitor these decisions.

①

We noted several concerns with the accuracy of the benefits amount that the Office of the President claimed for fiscal year 2015–16. As we state on pages 37 and 38, the Office of the President lacked supporting information to substantiate nine of 10 benefits we reviewed, which totaled \$109 million of the \$269 million of claimed benefits for fiscal year 2015–16. Further, we found that the Office of the President calculated some benefits based on estimated rather than actual usage of the contracts and that it claimed benefits in fiscal year 2015–16 even though it would not begin to receive those benefits until the following fiscal year. We did not review the benefits of \$300 million that the university president claims for fiscal year 2016–17. However, we have similar concerns with the accuracy of this amount because the Office of the President used the same methodology to calculate those benefits. Further, several of the benefits that we were unable to substantiate had a multiple-year impact and would be included in the \$300 million benefit claimed for fiscal year 2016–17.

②

Despite its claim on page 40 that the Office of the President would redirect any benefits from its systemwide procurement program toward its core missions, we found the Office of the President has not developed a policy or provided direction to university locations on how to reallocate these procurements, as we indicate on that same page. Lacking measures of accountability over the uses of these benefits and its unwillingness to adopt our recommendation,

③

the Office of the President's assertion that university locations have redirected these benefits to the university's core missions lacks credibility.



The University of California Office of the President

Increasing Costs and Scheduling Delays Have
Hampered the UCPATH Project and Originally Anticipated
Savings Are Unlikely to Materialize

Report 2016-125.2





CALIFORNIA STATE AUDITOR

621 Capitol Mall, Suite 1200 | Sacramento | CA | 95814



916.445.0255 | TTY 916.445.0033



For complaints of state employee misconduct,
contact us through the **Whistleblower Hotline:**

1.800.952.5665

Don't want to miss any of our reports? Subscribe to our email list at auditor.ca.gov 

August 24, 2017

2016-125.2

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the California State Auditor presents this audit report concerning the University of California's (university) planned systemwide payroll and human resources system known as the University of California Payroll, Academic Personnel, Timekeeping, and Human Resources (UCPath). This report concludes that the University of California Office of the President has failed to keep UCPath on budget and on schedule, and that originally anticipated cost savings from UCPath's implementation are unlikely to materialize.

In 2011 the Office of the President estimated that the cost to implement UCPath would total \$306 million and it would be completed by February 2014. The Office of the President also projected that UCPath's implementation would save the university \$753 million, primarily from staff reductions. However, the project's cost has escalated and its schedule has slipped; the Office of the President's current cost projection is \$504 million and its planned implementation date is June 2019. Further, the full cost to the university to implement UCPath is much higher than the Office of the President has reported—an estimated \$942 million—when including the cost of the campuses' development activities, project financing, and a shared services center. Finally, because the planned staff reductions will not occur, the \$753 million in savings that the Office of the President anticipated would result from UCPath's implementation will not materialize.

Despite the significant departures from the originally estimated cost, schedule, and savings for UCPath, the Office of the President has not consistently informed the University of California Board of Regents (regents) of UCPath's challenges. For example, in July 2014, the UCPath project director told the regents that UCPath's cost estimate was \$220 million, yet the Office of the President's internal records from one month earlier show the project's cost estimate was \$345 million. In July 2017, the Office of the President expanded its project governance approach to establish instances in which it will update the regents. However, in our view, the governance does not go far enough in recognizing the regents' role as an oversight body. Moreover, weaknesses in the Office of the President's project management likely contributed to UCPath's escalating cost and schedule delays. For example, the Office of the President set aggressive schedules that were susceptible to delays caused by project scope changes or staffing constraints.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

Blank page inserted for reproduction purposes only.

Contents

Summary	1
Introduction	5
Audit Results	
UCPath's Cost Has Soared, and Its Expected Savings Are Unlikely to Materialize	15
The Office of the President Did Not Keep the Regents Apprised of the Significant Cost Increases and Schedule Delays That Have Plagued UCPath	18
Weaknesses in the Office of the President's Project Management Likely Contributed to UCPath's Cost Increases and Schedule Delays	24
Although Invoice Approval Processes Were Followed, Some Campuses Could Better Define IT Deliverables	27
Recommendations	29
Responses to the Audit	
Regents of the University of California	33
University of California Office of the President	35
California State Auditor's Comments on the Response From the University of California Office of the President	41

Blank page inserted for reproduction purposes only.

Summary

Results in Brief

The University of California (university) Office of the President has failed to keep its planned systemwide payroll and human resources system on budget and on schedule. The University of California Payroll, Academic Personnel, Timekeeping, and Human Resources (UCPath) system will replace the university's existing legacy system, which is several decades old and has been highly customized by campuses to the degree that the university is operating 11 different payroll and human resources systems. UCPath is the university's attempt to integrate these functions into one system.

In its initial business case for UCPath in 2011, the Office of the President estimated that implementing the project itself would cost \$170 million, and with other related costs, it would total \$306 million. It also estimated that the project would be completed by August 2014. However, as the project's cost has escalated and its schedule has slipped, the Office of the President has revised these estimates. The Office of the President currently projects the implementation cost of UCPath to be \$504 million—\$334 million over its original estimate of \$170 million—and it has delayed the date of UCPath's implementation by nearly five years, to June 2019. Moreover, the \$504 million estimate does not represent the full cost of the project because it includes just a fraction of the cost associated with the campuses' implementation efforts and a shared services center, known as the UCPath Center. The full cost to the university of adopting UCPath is likely to be at least \$942 million.

At the same time that UCPath's cost has increased, the savings that the Office of the President anticipated would result from UCPath will not materialize. The Office of the President conceived UCPath in 2009 and it later became part of its Working Smarter initiative, an effort it led to achieve administrative efficiencies systemwide by reducing costs or increasing revenues. The Office of the President's initial business case in 2011 asserted that UCPath would result in \$753 million in cost savings, primarily from staffing reductions at the campuses. However, the UCPath project director told us that the Office of the President no longer expects to realize those projected savings. Several campuses also reported to us that they do not anticipate the staff reductions that the 2011 business case promised. In fact, in a status update to the University of California Board of Regents (regents) in July 2017, the Office of the President did not discuss any offsetting savings but rather discussed creating efficiencies and avoiding costs.

Audit Highlights . . .

Our audit concerning the University of California's (university) planned systemwide payroll and human resources system, known as UCPath, and other information technology (IT) systems revealed the following:

- » *The Office of the President currently projects UCPath's implementation cost to be \$504 million—\$334 million over its original estimate of \$170 million—but the full cost to the university is likely to be at least \$942 million.*
- » *The Office of the President originally estimated that it would complete UCPath by August 2014, but it has delayed the implementation date by nearly five years, to June 2019.*
- » *The \$753 million in cost savings, primarily from staff reductions, that the Office of the President anticipated would result from UCPath's implementation, will not materialize.*
- » *Despite the significant departures from the original estimated cost, schedule, and savings for UCPath, the Office of the President has not consistently informed the regents of UCPath's challenges.*
- » *Weaknesses in the Office of the President's project management contributed to UCPath's escalating cost and schedule delays.*
 - *It set aggressive schedules that are susceptible to delays caused by project scope changes or staffing constraints.*
 - *It did not establish rigorous change management processes that would have allowed it to assess how changes to the project's scope would impact its cost and schedule.*

continued on next page . . .

» *Of the three campuses we reviewed concerning their IT contract management, two of the campuses had vaguely worded deliverables for milestones, hindering them from effectively measuring whether the vendors had met their obligations for payment.*

In addition to not keeping the regents apprised of the uncertainty associated with the announced \$753 million in savings, the Office of the President has only rarely apprised the regents of schedule and budget changes. As a result, the regents have not had the opportunity to participate in critical project decisions. This lack of transparency is particularly troubling in light of UCPath's importance to the university system, its soaring cost, and its delayed implementation. The reporting lapses occurred in part because until recently, the Office of the President lacked criteria defining the circumstances that warranted updates to the regents. Although the Office of the President expanded the UCPath governance structure in July 2017 to include updating the regents when the project's cost increases by more than \$20 million or its schedule is delayed by more than three months. However, the planned communication is one-way only: apprising the regents of progress rather than engaging them in decision making. This governance approach, although expanded, does not go far enough in recognizing the regents' role as an oversight body.

This sort of oversight is particularly important because we identified weaknesses in the Office of the President's project management that likely contributed to UCPath's escalating cost and schedule delays. For example, our information technology (IT) project management expert identified that the Office of the President set aggressive schedules for the UCPath project that are susceptible to delays caused by project scope changes or staffing constraints. In addition, the Office of the President did not establish rigorous change management processes that would have allowed it to assess how changes to the project's scope would impact its cost and schedule. Notwithstanding its project management weaknesses, the next important UCPath milestone is a multicampus deployment the Office of the President currently has scheduled for December 2017, and it will serve as an indicator of the project's ability to meet its current budget and schedule goals.

In addition to the UCPath project, we reviewed three campuses' management of their contracts for campus-specific IT systems. Although we found that each campus reviewed and approved vendor invoices before payment, two of the campuses had vaguely worded deliverables for milestones, an approach that does not align with industry best practices. Because the contracts provided insufficient detail about the deliverables for milestones, the campuses could not effectively measure whether the vendors had met their obligations for payment.

Selected Recommendations

Regents

To ensure that they can exercise necessary oversight, the regents should develop by December 2017 status reporting standards for the university's significant IT projects that the Office of the President and the university locations must follow.

Office of the President

To ensure that it fully reports the cost of IT projects, the Office of the President should develop by December 2017 cost reporting guidelines for UCPATH and other significant IT projects. These cost guidelines should identify cost categories at both the Office of the President and university locations to ensure that the Office of the President's estimates capture and communicate all development and implementation costs. In addition, the Office of the President should produce cost reports to share at least quarterly with stakeholders.

To ensure that it consistently follows best practices related to project management, the Office of the President should develop and implement guidelines for IT project development by June 2018. The guidelines should apply to IT projects undertaken by any university location with a cost estimate of \$5 million or more. The guidelines should include, but not be limited to, advising project managers on ensuring that schedules are realistic and implementing rigorous change management processes that establish a means of assessing the implications of changes to a project's scope, cost, and schedule.

The Office of the President should require by December 2017 that all university locations follow the best practice of including well-defined deliverables in contracts related to the development of IT projects.

Agency Comments

In its response to the audit, the regents stated that they welcomed the constructive input on IT project oversight and agreed to implement the recommendation in the time frame specified. Similarly, the Office of the President stated that our recommendations are helpful and constructive and align with its efforts to improve the university's operations, policies, and transparency. The Office of the President agreed with most of the recommendations in the report and expressed its intent to implement them.

Blank page inserted for reproduction purposes only.

Introduction

Background

Founded by the Legislature in 1868 as a public, state-supported, land-grant institution, the University of California (university) is an extensive business enterprise. It has 10 campuses, five medical centers, numerous auxiliary organizations, and more than 200,000 employees. It is also involved in the management of three national laboratories and several research centers. Each year, it receives more than \$30 billion in revenues from a variety of public and private sources, including \$3 billion in state funding and \$10 billion generated from its medical centers.

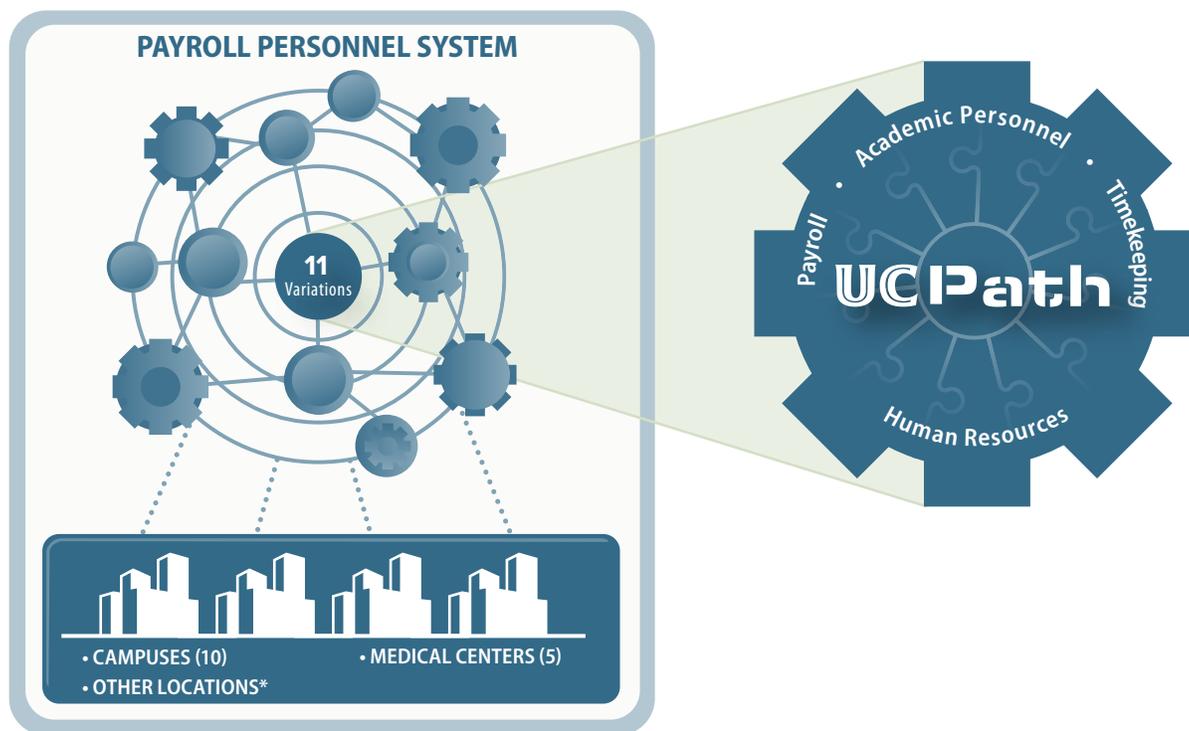
The California Constitution established the university as a public trust to be administered by the University of California Board of Regents (regents). As a result, the Legislature's oversight of the university is limited to certain circumstances, such as specifying provisions that the university must meet before it can spend state appropriations. The head of the university is the president, to whom the regents have granted full authority and responsibility over the administration of all the university's affairs and operations. In 2010 the regents passed a policy directing the president to achieve administrative efficiencies which included, among other initiatives, designing and implementing new information technology (IT) systems, such as student information systems, financial systems, human resources systems, and payroll systems. The California Department of Technology does not oversee development of the university's IT projects. Rather, the university follows its own policies.

The Office of the President Intended UCPATH to Replace the University's Outdated Payroll System and Achieve Significant Cost Efficiencies

The Office of the President intends for its Payroll, Academic Personnel, Timekeeping, and Human Resources project, or UCPATH, to integrate numerous payroll and human resource functions into one system. The Office of the President conceived UCPATH in 2009, and it became a part of its Working Smarter initiative, an effort led by the Office of the President to achieve administrative efficiencies systemwide by reducing costs or increasing revenues. As Figure 1 on the following page shows, the Office of the President anticipated that when fully operational, UCPATH would replace its existing Payroll/Personnel System (legacy payroll system), which has evolved into 11 variations in use across the campuses. In its 2011 business case supporting the implementation of UCPATH, which was created two years before the current university leadership took office, the Office of the President noted that the legacy payroll system was

more than 30 years old and was at significant risk of breakdown because of its aging technology. The legacy payroll system also has serious limitations, including high maintenance costs, limited reporting functions, reliance on manual processing, and inadequate capability for the university's current payroll environment. In 2011 the university awarded a contract to Oracle Corporation (Oracle) to develop UCPATH. At the time, the Office of the President estimated that development of UCPATH would take three years and would cost \$170 million to implement, and with other related costs, the project would total \$306 million.

Figure 1
The Office of the President Envisioned UCPATH as a Systemwide Payroll and Human Resources IT Solution



Sources: California State Auditor's analysis of the PPS Initiative: Final Report, dated August 2011, and other university publications.

* The other locations include the following: Lawrence Berkeley National Laboratory; Associated Students of University of California, Los Angeles; Division of Agriculture and Natural Resources; Office of the President; and Hastings College of Law.

The Office of the President also envisioned that UCPATH would allow it to restructure the number of staff handling payroll and human resources tasks systemwide. Specifically, the Office of the President assumed that UCPATH would allow it to reduce

the number of employees performing those tasks from 2,743 to 1,224 full-time employees, which would result in significant savings for the university. In fact, 90 percent of UCPATH's projected \$753 million in savings was based on this staff reduction and on the creation of a shared services center, known as the UCPATH Center. The Office of the President intended the UCPATH Center to take over payroll and human resources functions for all university employees from all university locations.

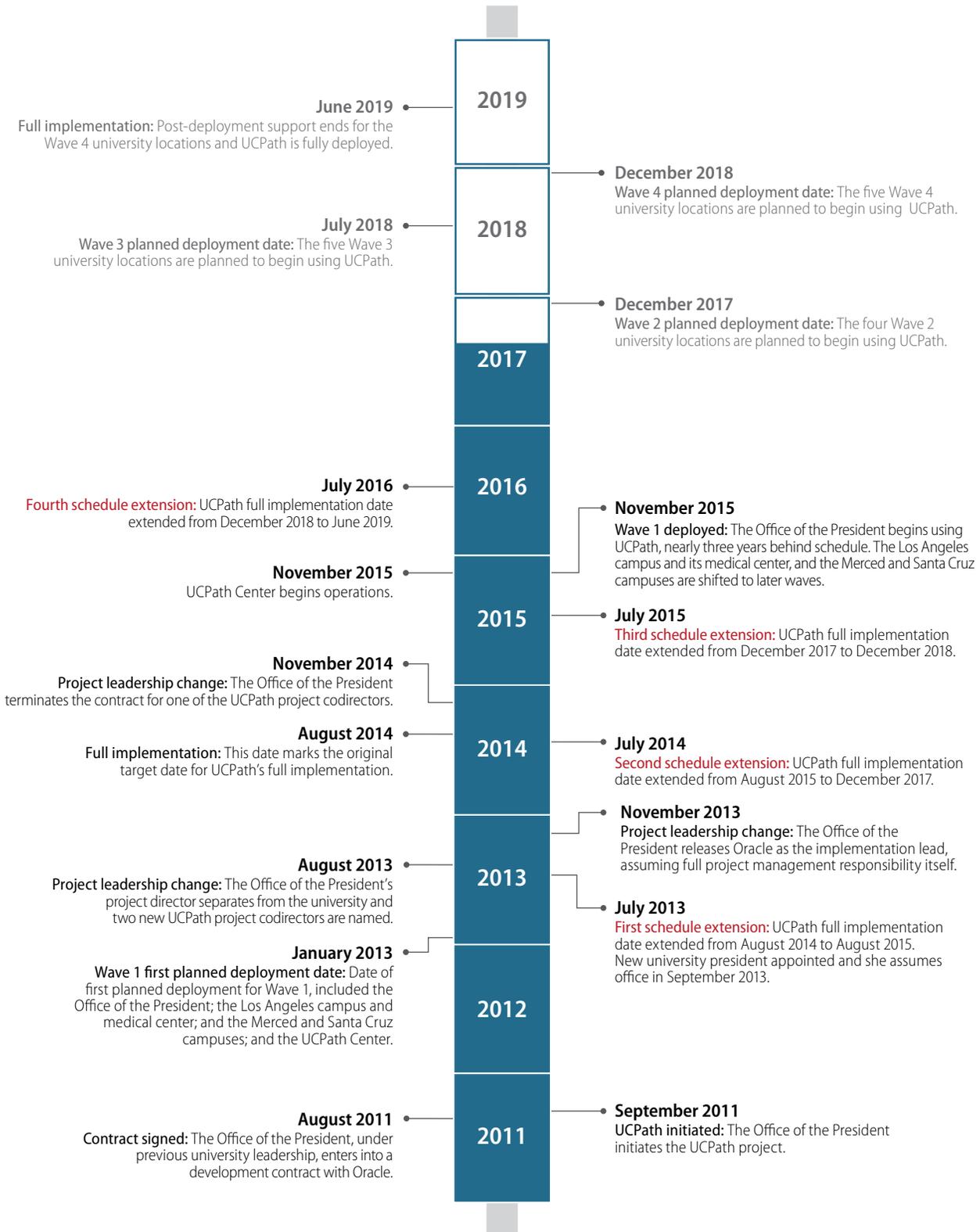
The Office of the President Has Repeatedly Delayed Implementation of UCPATH, and the Project's Estimated Cost Has Increased Significantly

The UCPATH project has experienced several setbacks that have delayed the system's planned implementation and increased its cost significantly. Figure 2 on the following page depicts a timeline of some of the events and decisions related to UCPATH's implementation. In early 2012, the Office of the President informed the regents that the first phase of UCPATH's rollout would begin in January 2013 with Wave 1¹—the system's deployment to the Office of the President, the Los Angeles campus and its medical center, and the Merced and Santa Cruz campuses as well as the deployment of the UCPATH Center. Instead, in 2013 problems with UCPATH's development led the Office of the President to extend the project's timeline by 12 months and to increase its budget to \$221 million. Later that same year, the initial project leader left for reasons unrelated to the project. According to the UCPATH's current project director, the Office of the President released Oracle from its role as the implementation lead on the project in 2013 for failure to perform under its implementation contract and the Office of the President took over management of the project. Figure 2 also shows that once the Office of the President took over leadership, it extended the project implementation date three times.

Various Office of the President executives and staff, and campus-based leadership form a governance structure for the UCPATH project. As Figure 3 on page 9 shows, the Office of the President maintains a project management office and under the leadership of the project director, it oversees the day-to-day management of the UCPATH project. The UCPATH steering committee is responsible for making decisions on issues related to systemwide business processes. The steering committee refers issues that materially impact UCPATH's scope, cost, timeline, or deliverables to UCPATH's executive leadership team, which includes the chief financial officer and chief operating officer who are also the UCPATH project sponsors, other Office of

¹ The Office of the President refers to the four deployments of the project as Office of the President, Pilot, Deployment 1, and Deployment 2. However, we use the term *wave* for clarity.

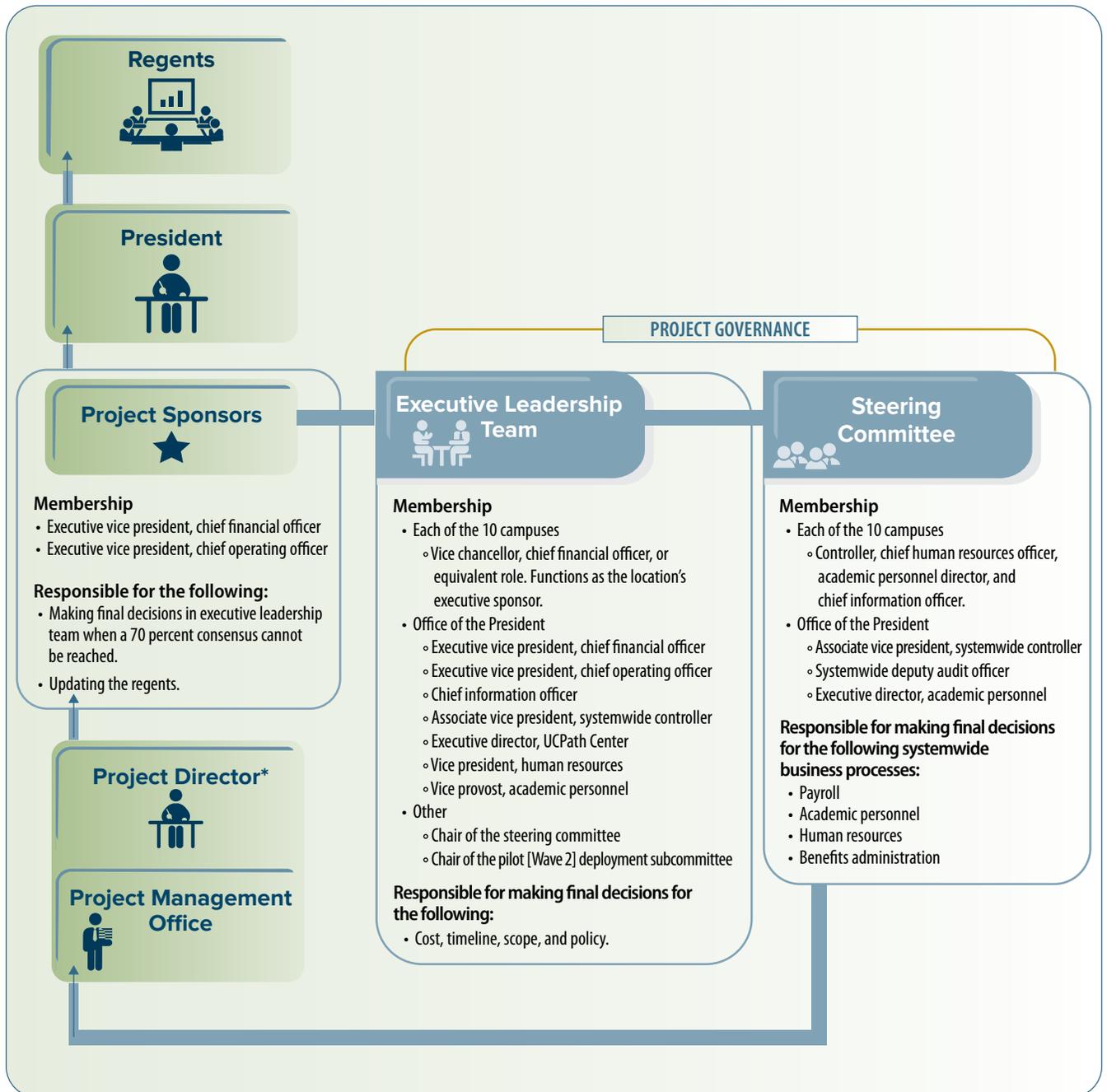
Figure 2
The Office of the President’s Timeline for UCPATH Has Been Affected by Leadership Changes and Schedule Slips



Sources: California State Auditor’s analysis of various UCPATH-related documents, including the current deployment sequence as of June 2017 and various Office of the President reports to the regents.

the President staff, and representatives from each campus. In their role as project sponsors, the chief financial officer and chief operating officer are the executives with overall accountability for the project.

Figure 3
The Office of the President Has Established a Governance Structure for the UCPATH Project



Sources: California State Auditor's analysis of UCPATH project governance documents and UCPATH organization charts.

* In November 2014, leadership over the UCPATH project management office changed from two codirectors to one director.

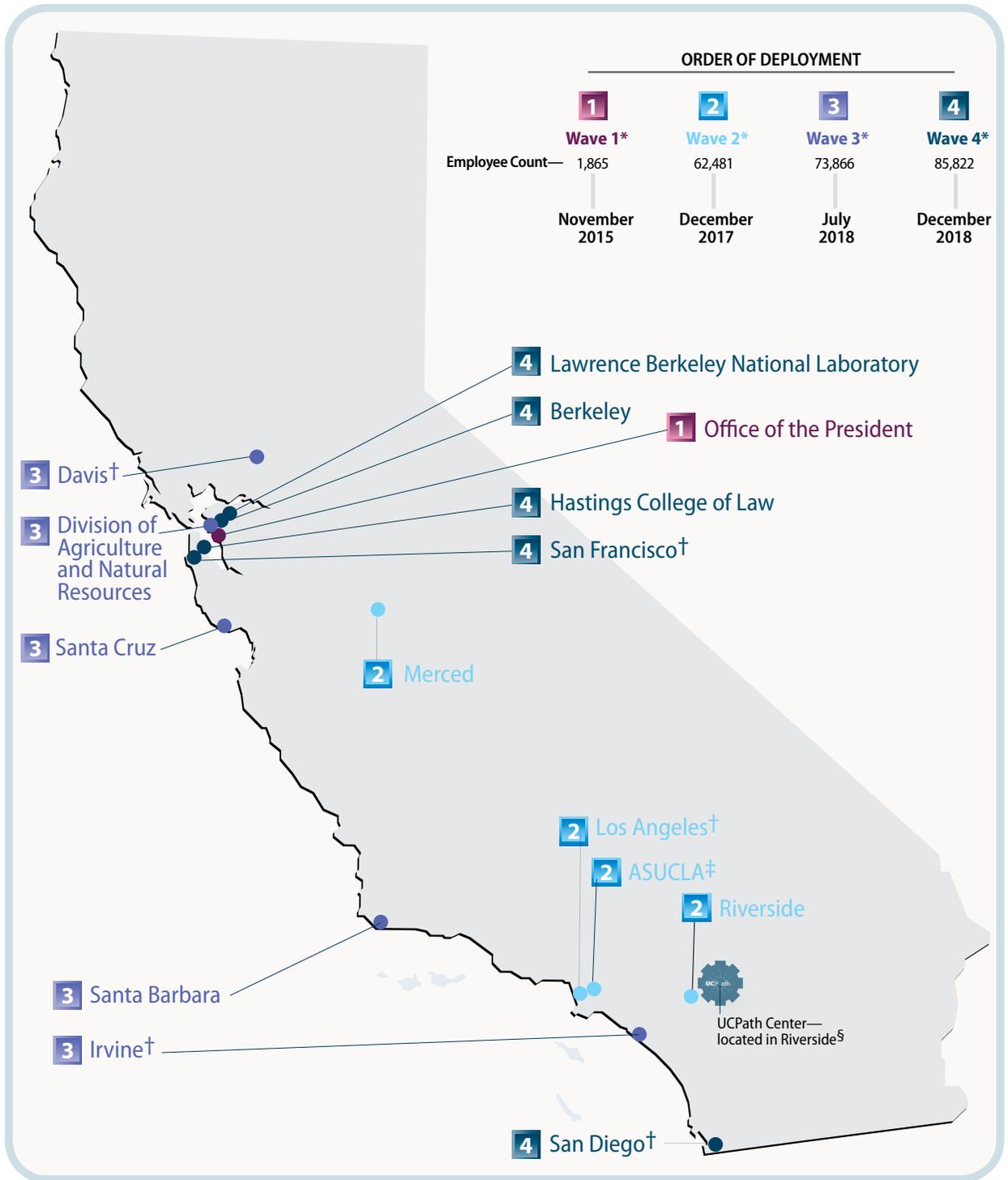
The Office of the President has delayed UCPATH's deployment several times. Although the Office of the President originally projected that it would accomplish Wave 1 by 2013, it did not complete this deployment until November 2015 and then only to the Office of the President's employees, as Figure 4 shows. The Office of the President currently plans to deploy UCPATH at four university locations by the end of 2017 (Wave 2)—which our IT project management expert indicates will be an important milestone in the project's ability to meet its cost and schedule goals. Currently, the Office of the President anticipates that it will complete the UCPATH project by June 2019, after providing post-deployment support for the university locations. It estimates that the project's implementation cost will be \$504 million, \$334 million above its original cost estimate. We discuss the reasons for the project's cost increases and schedule delays in the Audit Results.

As UCPATH's Cost Has Increased, the Office of the President's Project Funding Strategy Has Evolved

The Office of the President has employed a variety of funding sources to pay for the UCPATH project as its cost has grown over time. Initially, the Office of the President borrowed \$131 million through an internal loan program called CapEquip, which allows the university to finance capital projects; however, its maximum repayment period is seven years because CapEquip is a short-term financing option. As UCPATH's cost escalated and its implementation schedule was delayed, the Office of the President required a longer repayment period and greater flexibility in structuring the project's financing. Consequently, in 2014 the Office of the President received the regents' approval to obtain \$221 million in external financing for the project through a bond issuance in 2016. The Office of the President used a portion of the bond proceeds to repay CapEquip for early UCPATH project costs and used the remainder to fund the ongoing project cost. As Table 1 on page 12 shows, the university will pay bond interest and principal from fiscal year 2019–20 through fiscal year 2035–36, for a total of \$331 million.

Although the Office of the President anticipated that the bond financing would be adequate, UCPATH's cost has far exceeded those available funds. To make up the funding shortfall, in fiscal year 2015–16 the Office of the President created an assessment to charge the campuses for project implementation funding and the debt associated with the \$221 million bond. Beginning in fiscal year 2016–17, the Office of the President created a second assessment on the campuses. The UCPATH operations assessment is for the cost to operate the UCPATH Center and to maintain the legacy payroll system as the various waves deploy UCPATH. Previously, these

Figure 4
The Office of the President Plans to Deploy UCPATH in Waves



Source: California State Auditor’s analysis of UCPATH’s current deployment sequence, as of June 2017.

Note: The UCPATH project refers to the remaining deployments as *pilot*, *deployment 1*, and *deployment 2*.

* Employee count represents the number of employees UCPATH will serve in total for the university locations included in the various waves. The employee count is current as of October 2016.

† Five medical centers are deploying with their campuses—University of California, Davis, Irvine, Los Angeles, San Diego, and San Francisco.

‡ Associated Students University of California, Los Angeles.

§ The UCPATH Center began operating in fiscal year 2013–14 to provide services for the legacy payroll system to the Santa Cruz and Los Angeles locations. In November 2015, the UCPATH Center began providing the Office of the President with UCPATH-related services.

costs were included in a general assessment the Office of the President charged the campuses. As Table 1 shows, the Office of the President had assessed the campuses a total of \$174 million to pay a variety of UCPATH project-related costs through fiscal year 2016–17. Through June 2019, the Office of the President has planned to assess the campuses an additional \$252 million for project costs, bond interest, and operations costs. If the Office of the President moves forward with this plan, its current project forecasts show that the assessment for implementation costs will end in fiscal year 2018–19 with only bond principal and interest payments remaining.

Table 1
The Office of the President Has Levied Assessments on the Campuses for UCPATH’s Implementation and Operations Cost (In Millions)

	ASSESSMENTS CHARGED THROUGH FISCAL YEAR 2016–17	ASSESSMENTS PROJECTED THROUGH DEPLOYMENT (FISCAL YEARS 2017–18 AND 2018–19)	BOND REPAYMENT AFTER DEPLOYMENT (FISCAL YEARS 2019–20 TO 2035–36)	TOTAL
Assessment—Project Implementation	\$143	\$122	—	\$265
Assessment—UCPath Center*	31	125	—	156
Bond Interest†	—	5	\$110	115
Bond Principal	—	—	221	221
Totals	\$174	\$252	\$331	\$757

Sources: California State Auditor’s analysis of UCPATH’s cost allocation 10-year forecast from fiscal years 2015–16 through 2026–27, dated March 2017, and a bond amortization schedule.

* Once UCPATH is fully deployed, the cost to operate the UCPATH Center becomes an ongoing operating cost that is not included in the Table.

† Total bond interest is \$121 million; \$6 million is included in the project implementation assessment.

For fiscal year 2019–20 and beyond, the Office of the President has planned that the campuses will pay the UCPATH Center’s ongoing operations cost through an additional assessment. This cost is estimated to start at a total of \$74 million a year in fiscal year 2019–20 and increase by approximately 3 percent annually. However, the Legislature recently made changes to the way it provides funding to the university that may affect the Office of the President’s plans. Specifically, the State’s Budget Act of 2017 (Budget Act) directly appropriates funds to the Office of the President, including an appropriation for UCPATH of \$52 million. That appropriation was contingent on the university president certifying in writing that the campuses would not be assessed to support the Office of the President’s operations for fiscal year 2017–18 and that overall campus revenues would be greater than the previous fiscal year.² The UCPATH project’s 10-year cost forecast shows that

² In our report April 2017 titled *The University of California Office of the President: It Failed to Disclose Tens of Millions in Surplus Funds, and Its Budget Practices Are Misleading*, Report 2016-130, we describe the Office of the President’s process for levying on campuses an annual financial assessment to support its operations.

the Office of the President estimates it will cost \$52 million in fiscal year 2017–18 to operate the UCPath Center, provide system support, pay for software license and maintenance agreements, and operate the legacy payroll system for those campuses that have not yet deployed onto UCPath. The Budget Act provides an appropriation for the UCPath Center operations, and according to the UCPath financial analyst and the project director, the Office of the President will continue to assess the campuses for project implementation funding and the debt associated with the \$221 million bond.

Scope and Methodology

The Joint Legislative Audit Committee (Audit Committee) directed the California State Auditor to conduct an audit of the university’s contracting practices. The analysis the Audit Committee approved contained eight separate objectives, one of which focused on the university’s management of UCPath and IT contracts. This report addresses that one objective. We list that objective and the methods we used to address it in Table 2. This audit did not require a data reliability assessment. We report on the other audit objectives in our report *The University of California Office of the President: It Has Not Adequately Ensured Compliance With Its Employee Displacement and Services Contract Policies*, 2016-125.1.

Table 2
Audit Objectives and the Methods Used to Address Them

AUDIT OBJECTIVE	METHOD
1 Review and evaluate the laws, rules, and regulations significant to the audit objectives.	We identified and reviewed the relevant university policies and procedures, state guidelines, and industry best practices pertaining to IT project management.
2 Determine whether the university and its campuses’ contracting policies and procedures are in compliance with applicable federal and state laws and regulations as well as with best practices for procurement.	See <i>The University of California Office of the President: It Has Not Adequately Ensured Compliance With Its Employee Displacement and Services Contract Policies</i> (Report 2016-125.1).
3 For a selection of services contracts, determine the university’s compliance with applicable laws, regulations, policies, and procedures.	See published report 2016-125.1
4 For the past five years for the Office of the President—and to the extent possible for its campuses—determine the types of contracts, procurement methods, and types of goods and services purchased via contracts.	See published report 2016-125.1

continued on next page...

AUDIT OBJECTIVE	METHOD
5 For services contracts, to the extent possible, compare the compensation and benefits of university employees to those of service workers in comparable positions and identify trends. Include an analysis of per-employee cost based on the total contract amount.	See published report 2016-125.1
6 Analyze how the university is managing IT contracts, including the contract for UCPATH, by doing the following: a. Determine what contract oversight exists to ensure IT projects are delivered on time and on budget. b. For UCPATH, assess the reasonableness of the project's increased cost and schedule delays. c. Determine if UCPATH is adequately communicating project risks, costs, and delays to the regents.	<p>We obtained and reviewed a list of IT projects with costs of \$10 million or more that each of the 10 university campuses and five medical centers had undertaken. We selected a total of three IT projects from the Berkeley, Irvine, and Riverside campuses. In making our selections, we considered factors such as the projects' location, the value of their contracts, and their current implementation phases.</p> <p>For the selection of the three IT projects, we did the following:</p> <ul style="list-style-type: none"> • Obtained and reviewed the related IT contracts and various project documents, including vendor milestones and vendor payment approval processes. • Selected five vendor payments for each IT project and assessed whether those payments adhered to the projects' established payment approval process. • In consultation with an IT project management expert, assessed whether the campuses had established adequate vendor milestones that aligned with industry best practices. <p>For UCPATH, we did the following:</p> <ul style="list-style-type: none"> • Interviewed university officials, UCPATH project leadership, and UCPATH Center staff. • Obtained and reviewed project budget and cost summaries and forecasts, as well as various project planning documents, to determine the cost reasonableness of the UCPATH project and the UCPATH Center. • Used an IT project management expert to assess the Office of the President's project management practices related to UCPATH's schedules, planning, change management, risk management, and adherence to industry best practices. • Reviewed the minutes, videos, and discussion documents from the regents' meetings as well as UCPATH's budget, cost schedules, and deployment schedules to determine the frequency with which the Office of the President updated the regents about the UCPATH project's cost and schedule changes.
7 To the extent possible, assess actions the university is taking to overcome contracting challenges and cost efficiencies.	See published report 2016-125.1
8 Review and assess any other issues that are significant to the audit.	None noted.

Sources: California State Auditor's analysis of the Audit Committee's audit request number 2016-125 and information and documentation identified in the table column titled *Method*.

Audit Results

UCPath's Cost Has Soared, and Its Expected Savings Are Unlikely to Materialize

Escalating cost estimates and eliminating a plan to reduce staff have negated all the estimated savings the Office of the President originally expected from implementing UCPath, resulting in the original expected *net savings* of \$447 million becoming an estimated *cost* of \$942 million. In its 2011 business case outlining the cost and benefits of implementing the new system, the Office of the President stated that the cost to implement UCPath would be significantly less than the savings from it. As Figure 5 on the following page shows, the Office of the President estimated UCPath's implementation cost at \$170 million, including software licenses, hardware and infrastructure, project staffing, vendor services, and start-up cost for the UCPath Center. It also forecasted \$48 million for software hosting and maintenance and for technology cost, and \$15 million for facility and equipment cost for the shared service center. In addition, because of the expected reductions in payroll, human resources, and IT staff, the Office of the President included a cost of \$73 million for staff severance and job transition. Together, these costs totaled \$306 million, a significant investment of funds, particularly at a time when the university was experiencing financial constraints. However, the Office of the President assumed staff reductions would create significant savings to more than offset these costs.

Nonetheless, as the UCPath project encountered delays and other difficulties, its estimated implementation cost increased significantly, more than doubling by April 2017. At that time, the Office of the President reported that the estimated implementation cost for UCPath had risen from \$170 million to \$504 million, an increase of \$334 million. Additionally, the Office of the President purchased the UCPath Center building and improved it at a cost of \$53 million while its estimates show the cost to operate the UCPath Center through Wave 4 deployment at another \$130 million. Although the university will no longer incur the staff severance cost of \$73 million because the Office of the President no longer foresees a reduction in university staff, that savings is offset by the Office of the President's greatly underestimating the cost that each of the 10 campuses will incur to implement UCPath. In its 2011 business case, the Office of the President estimated campus costs at \$56 million of the implementation cost of \$170 million; however, the 10 campuses reported to us that they expect to incur total costs of \$193 million, minus \$53 million in reimbursements from the Office of the President, as Table 3 on page 17 shows. The Office of the President recently surveyed the campuses and other university locations and arrived at implementation costs of about \$217 million,

excluding the \$53 million in reimbursements. Even using the more conservative cost total the campuses reported to us, the total estimated cost of UCPATH stands at \$942 million as Figure 5 shows. Should the UCPATH project encounter further delays—which our IT project management expert believes is a risk given the project management weaknesses we discuss later in this report—the project’s cost will most likely increase further.

Figure 5
The UCPATH Project Will Not Realize Cost Savings From Staffing Reductions as the Office of the President’s 2011 Business Case Projected
(In Millions)

	2011 BUSINESS CASE	2017 STATUS
COST		
Implementation	\$170	\$504
Implementation financing	\$0	\$115*
Recurring technology	\$48	†
UCPath Center acquisition and financing	\$0	\$53
UCPath Center facility and equipment, and operations‡	\$15	\$130
Staff severance	\$73	\$0
Additional campus implementation	\$	\$140
Estimated Cost	\$306	\$942
BENEFITS		
Reductions in staffing	\$753	\$0
Efficiencies—Increased productivity, functionality, and convenience through standard business practices	★	★
IT stability—Replaces a more than 30-year-old legacy payroll system	★	★
Unified system—Centralizes 11 IT systems into one system	★	★
Estimated Cost Savings	\$753	\$0
Net Savings / Cost	\$447	\$942

Sources: California State Auditor’s analysis of the university’s PPS Initiative: Final Report, dated August 2011; the Office of the President’s net present value analysis supporting the PPS initiative; various cost reports; and the UCPATH website. The 2017 status is as of April 2017.

* The Office of the President issued bonds and the total bond interest is \$121 million. However, \$6 million is accounted for in the \$504 million implementation cost estimate.

† The Office of the President asserted that recurring technology costs of \$57 million are included in the \$504 million implementation cost estimate.

‡ 2017 UCPATH operations costs are through Wave 4 deployment planned for December 2018.

§ The Office of the President asserted that additional campus implementation costs of \$56 million are included in the implementation cost estimate.

★ = The university did not monetize these benefits.

Table 3
The Campuses Will Incur Significant Cost as a Result of UCPATH's Implementation
(In Thousands)

	FY 2011-12	FY 2012-13	FY 2013-14	FY 2014-15	FY 2015-16	FY 2016-17*	FORECAST		TOTAL
							FY 2017-18	FY 2018-19	
Wave 2 (December 2017)									
Los Angeles	\$1,227	\$4,363	\$5,250	\$4,961	\$9,203	\$9,726	\$8,444	NA	\$43,174
Merced	408	640	2,239	1,784	1,339	1,843	1,227	NA	9,480
Riverside†	134	651	834	1,016	2,447	6,967	8,713	NA	20,762
Wave 3 (July 2018)									
Davis	\$209	\$1,139	\$3,766	\$3,405	\$2,910	\$3,923	\$6,447	\$2,995	\$24,794
Irvine	423	616	1,327	1,769	1,849	3,186	5,117	2,408	16,695
Santa Barbara‡	111	406	834	1,294	1,474	2,359	5,140	3,218	14,836
Santa Cruz	242	1,341	2,604	3,915	1,823	1,078	5,850	3,150	20,003
Wave 4 (December 2018)									
Berkeley	\$260	\$728	\$833	\$180	\$0	\$86	\$8,742	\$9,178	\$20,007
San Diego	764	1,331	1,331	858	931	1,022	3,395	3,941	13,573
San Francisco	87	176	603	860	1,030	497	4,919	1,477	9,649
Totals	\$3,865	\$11,391	\$19,621	\$20,042	\$23,006	\$30,687	\$57,994	\$26,367	\$192,973
								Less reimbursements	\$53,000
									Net total \$139,973

Sources: California State Auditor's analysis of expenditure data and attestations provided by the 10 campuses.

Note: Costs include expenditures the Office of the President reimbursed. We excluded the Office of the President and auxiliary university locations from our survey.

NA = Not applicable because UCPATH is scheduled for implementation in the fiscal year stated.

* Amounts for fiscal year 2016-17 include actual and projected costs (Los Angeles, Merced, Davis, Irvine, San Diego, Santa Barbara), incomplete cost (Santa Cruz), or budgeted cost (San Francisco).

† Riverside's cost does not include cost related to existing staff working on UCPATH.

‡ Santa Barbara's forecast for fiscal year 2018-19 consists of only the first half of that fiscal year.

In its 2011 business case, the Office of the President asserted that UCPATH, as one of the projects under the Working Smarter initiative, would achieve sustainable long-term cost savings including the \$753 million saved from staff reductions. Additionally, the 2011 business case indicated that UCPATH would provide significant benefits that were not monetized, including making the university's payroll process more efficient, improving its payroll stability by replacing the legacy payroll system, and unifying its payroll and human resources into one IT system. The Office of the President viewed UCPATH as part of a larger vision to improve the university's administrative and operational effectiveness and as a platform for its campuses to adopt new and effective business processes.

Although the Office of the President still expects to achieve UCPATH's nonquantifiable benefits, it no longer expects to realize the projected savings of \$753 million from its implementation.

Although the Office of the President still expects to achieve the nonquantifiable benefits, it no longer expects to realize the projected savings of \$753 million from UCPATH's implementation. The project director indicated that it was not clear whether campuses would make any staff reductions or if such reductions—if they did occur—would be quantifiable. The three campuses we visited confirmed that they would not make staff reductions when implementing UCPATH. For example, the former UCPATH pilot director at the Riverside campus said that his campus has no plans for staffing reductions; rather, the campus plans to use any staff reduction from UCPATH to offset the need for additional staff as the campus grows. Similarly, the Berkeley and Irvine campuses both indicated that they had no immediate plans for staff reductions and told us that they would better understand the impact of UCPATH on their current staffing levels as they neared deployment.

Without the staffing reductions the Office of the President's 2011 business case outlined, UCPATH is not likely to result in significant savings in the near future, if at all. The failure of this \$753 million in savings to materialize is a major change in the economic impact of the project on the university, since the Office of the President projected UCPATH would provide a net quantifiable benefit of \$447 million after its implementation cost as shown in Figure 5 on page 16. Now UCPATH will cost at least \$942 million, placing further strain on the university's financial condition. In July 2017, the Office of the President presented to the regents a UCPATH project status report that included a section titled "Validating the Business Case for UCPATH." At present, the Office of the President is not generally focused on UCPATH resulting in savings but rather on it creating efficiencies and avoiding unnecessary costs. In the status report, the Office of the President indicated that the campuses could identify efficiencies from centralizing and automating business practices. However, as noted previously, the three campuses we visited do not expect staff reductions that would drive the level of savings the 2011 business case envisioned.

The Office of the President Did Not Keep the Regents Apprised of the Significant Cost Increases and Schedule Delays That Have Plagued UCPATH

Although the UCPATH project has significantly exceeded its original cost estimate and schedule goals, the Office of the President has not provided timely or consistent updates of these changes to the regents. With cost increases of \$334 million—from \$170 million to \$504 million—and four time extensions on completion—totaling nearly five years, from August 2014 to June 2019—we expected the Office of the President to have regularly updated the regents and any other stakeholders. However, in most instances, the Office of

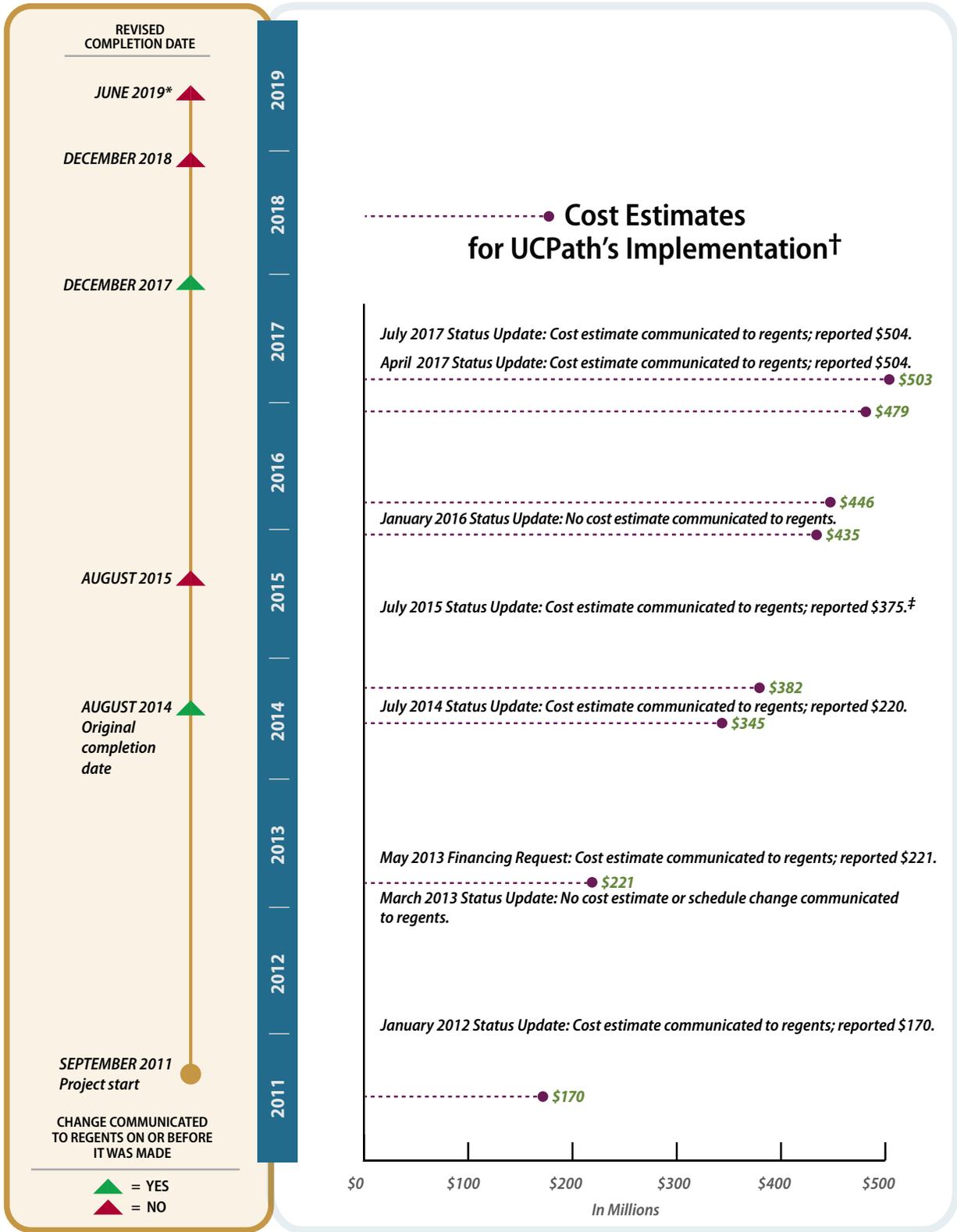
the President did not communicate these changes to the regents either before or at the time it made them. As a result, the Office of the President has effectively limited the regents' governance role and impeded their ability to critically evaluate UCPATH and whether committing hundreds of millions of dollars to an IT system was in line with the university's financial goals.

The regents meet at least six times a year, in two-day meetings every other month. These meetings have provided the Office of the President ample opportunity to communicate with the regents about UCPATH. Although the Office of the President provided us a list of 79 communications to the regents that reference UCPATH, we were able to find only five status updates on UCPATH among these 79 communications. In the remaining 74 communications, the Office of the President either mentioned UCPATH in relation to other issues or did not report any substantive details about the project's status, cost, and schedule. In addition, the Office of the President updated the regents twice more after it provided us the list of 79 communications. The Office of the President provided a written update in April 2017, following our inquiries into why it had not updated the regents on UCPATH's cost increases and schedule delays. The Office of the President also updated the regents at the July 2017 regents meeting. All seven of these updates are reflected in Figure 6 on the following page, along with a financing request the Office of the President made in May 2013, which mentioned UCPATH's then-current cost estimate. The infrequency with which the Office of the President provided the regents with updates is troubling given the complexity of the UCPATH project and its escalating cost.

Further, the Office of the President did not disclose in any of the seven updates or in the financing request that it no longer believed the cost savings of \$753 million would materialize. The absence of discussion on failed cost savings in the updates is a serious omission given that the Office of the President directly aligned UCPATH with its Working Smarter initiative, through which it sought administrative efficiencies systemwide by reducing costs or increasing revenues.

The Office of the President has not provided timely or consistent updates of UCPATH's cost estimate and schedule changes to the regents, thereby limiting the regents' governance role and impeding their ability to critically evaluate UCPATH.

Figure 6
The Office of the President Did Not Consistently Inform the Regents of Changes to UCPATH’s Implementation Cost and Schedule



Sources: California State Auditor’s analysis of UCPATH project financial statements and schedules, as well as documents and minutes from regents’ meetings.

* June 2019 is the date when post-deployment support ends and UCPATH is fully deployed.

† Cost estimates shown are related to budget increases of \$10 million or more.

‡ For June 2015, the UCPATH internal cost estimate was reduced to \$375 million; thus, the cost estimate reported to the regents was consistent with the project’s cost estimate.

Moreover, our review of the Office of the President's limited communications with the regents found that the Office of the President did not always clearly identify UCPATH's current cost estimate or the timeline for completion. The Office of the President's March 2013 status update to the regents referred to the UCPATH project as "7 or 8 percent over budget" when in actuality it was 30 percent over its cost estimate, or about \$51 million, at that time. Two months later, in May 2013, the Office of the President sought the regents' approval for financing to fund the project's escalating cost and revealed that UCPATH's cost estimate had increased to \$221 million. The Office of the President discussed the status of UCPATH three more times with the regents between July 2014 and January 2016 but was not forthcoming in two of these meetings. In July 2014, the UCPATH project director told the regents that UCPATH's cost estimate was \$220 million, yet the Office of the President's internal records from one month earlier show the project's cost estimate was \$345 million. The UCPATH project director also told the regents that the Office of the President would propose a final budget in the regents' January 2015 meeting, but it failed to do so. The Office of the President did not provide the regents with the next status update until July 2015, when it reported the estimated cost of the project had increased to \$375 million, which was in line with the Office of the President's then-current internal cost estimates.

In July 2015, the regents expressed concern about the rising cost of UCPATH and directed the Office of the President to keep it informed about the project's progress. Despite this specific direction from the regents, the Office of the President did not make its next status report until six months later, in January 2016. Further, in this status report, the Office of the President made no mention of the project's cost estimate, which its internal records indicate had increased by another \$60 million, or 16 percent, to \$435 million. In fact, the Office of the President failed to inform the regents of UCPATH's escalating cost estimate and schedule delays until after we asked in February 2017 why it had not communicated this critical information. In April 2017, it finally sent a status update to the regents, its first substantive communication on UCPATH's status since the regents' directive in July 2015.

The Office of the President's April 2017 update revealed its lack of transparency on reporting UCPATH's true cost and schedule. In this update, the Office of the President reported that the estimated cost for UCPATH had risen to \$504 million, which it generally attributed to the need for increased time for campus readiness activities, additional staff for deployment activities, modest software customizations, and a four-month extension for the pilot deployment. In a footnote to that update, the Office of the President noted having not reported UCPATH's cost estimate to the regents for

In July 2014, the UCPATH project director told the regents that UCPATH's cost estimate was \$220 million, yet the Office of the President's internal records from one month earlier show the project's cost estimate was \$345 million.

On four occasions, the Office of the President extended the UCPATH project schedule by six to 28 months, but it did not apprise the regents of three of these extensions or the reasons for the delays.

nearly two years, with its last update occurring in July 2015 when it reported that UCPATH would cost \$375 million. The footnote offered no explanation as to why the Office of the President failed to keep the regents informed about the escalating cost of UCPATH. Further, although the April 2017 update discussed the timeline for deploying UCPATH at the campuses, it did not disclose that it had already pushed back UCPATH's final completion date to June 2019, which is when post-deployment support ends and UCPATH is fully deployed.

Figure 6 on page 20 shows that the Office of the President did not regularly communicate its decisions to change UCPATH's implementation schedule. On four occasions, the Office of the President extended the UCPATH project schedule by six to 28 months, but it did not apprise the regents of three of these extensions or the reasons for the delays. In total, the Office of the President extended the length of the UCPATH project from three years to over seven years. Although its status updates did provide estimated deployment dates for different campuses and other university entities and included some general reasons for extending the timeline, the updates were frequently vague about the project's final completion date, again limiting the regents' opportunity to critically evaluate UCPATH's direction.

We believe the Office of the President's lack of transparency with the regents can largely be attributed to a weakness in the project's governance structure, which has not included a process to keep the regents informed about UCPATH's progress. The project's governance structure invests a great deal of autonomy and authority in the project's executive leadership team (leadership team), which consists of the project sponsors, representatives from the Office of the President, and representatives of the campuses. Figure 3 on page 9 shows the project governance structure. The bylaws of the leadership team state that it is responsible for final decisions regarding the UCPATH project's cost, schedule, scope, and policy. However, the bylaws contain no mention of communication with the regents: for example, they do not establish how frequently the leadership team must update the regents or what events should trigger updates about the project's progress. In addition, the communication plans that the project's governance and communications lead provided us lacked mention of periodic, structured communication with the regents. We find the absence of such a reporting relationship surprising, given the significant impact of UCPATH on the university. The project director and the project sponsors confirmed that until recently the Office of the President did not have guidelines for communicating with the regents about the status of UCPATH. While the project director acknowledged that the project sponsors have primary

responsibility for updating the regents at significant implementation points, our findings show that they have not adequately fulfilled this responsibility.

In July 2017, the Office of the President informed the regents of a change in the UCPATH project governance approach that it believes will address its lack of communication. Specifically, the Office of the President updated the UCPATH Governance Materiality and Escalation document (governance document) to include the regents in the governance. The approach recognizes the regents as providing institutional oversight and identifies three situations that will require the project sponsors to update the regents about UCPATH's status. At the July 2017 meeting with the regents, the project director acknowledged that project governance decisions about UCPATH had previously stopped with the project sponsors. He stated that in modifying the project's governance document and acknowledging the regents' oversight role, the Office of the President was responding to changes that the regents had made in 2016 to the charter for the Finance and Capital Strategies committee—a committee of the regents with oversight of the university's fiscal and financial affairs and business operations, among other matters—to reflect that committee's oversight of UCPATH as a large-scale enterprise system. We note that the timing of the governance change coincided with this audit and the inquiries we made about the Office of the President's infrequent communications with the regents about the status of UCPATH.

Although the Office of the President has now acknowledged the regents as part of the governance for UCPATH, this expanded governance approach may not go far enough to ensure that the regents can participate in critical decisions. The governance document states that updates to the regents must occur when the project meets significant implementation milestones, including deployments; when the project experiences adverse cost impacts of more than \$20 million; or when the schedule is delayed by more than three months. However, the governance document makes clear that the regents will be informed or "kept apprised of progress or changes via one-way communication" rather than consulted. In our view, this governance approach does not adequately recognize the regents' role as an oversight body. We believe the Office of the President should address the need for the regents to have timely, critical information in order for them to participate in decision making and to provide the project with guidance. Although the Office of the President has committed to informing the regents of certain project events, which may cause it to report more frequently to the regents than in the past, the planned approach will not engage the regents on a decision-making level that would truly allow them to fulfill their oversight role.

Although the Office of the President has committed to informing the regents of certain project events, the planned approach will not engage the regents on a decision-making level that would truly allow them to fulfill their oversight role.

The Office of the President could have mitigated cost and schedule increases to the UCPATH project through better project management practices.

Weaknesses in the Office of the President's Project Management Likely Contributed to UCPATH's Cost Increases and Schedule Delays

Our review found that the Office of the President could have mitigated cost and schedule increases to the UCPATH project through better project management practices. Specifically, our IT project management expert identified the following five weaknesses in the Office of the President's project management processes:

- Maintaining an overly aggressive project schedule.
- Not maintaining an integrated schedule and resource management plan (integrated plan).
- Not assessing all budget and schedule implications resulting from change management.
- Not establishing effective risk-management processes.
- Not using independent verification and validation (IV&V).

The Office of the President maintained an overly aggressive project schedule, which became susceptible to delays because of project scope changes and staffing constraints. When our IT project management expert reviewed the UCPATH project's risk log, the project sponsors' briefings to the president, and the project director's briefings to the project sponsors, he identified a pattern: the UCPATH project schedule became too aggressive and then slipped. In fact, the project briefing materials demonstrate that the Office of the President was aware that the schedule was aggressive: mentions of it appear time and again in those materials. For example, an August 2014 briefing prepared for the president stated, "Allotted time to prepare for [the Office of the President] go-live is aggressive." According to our expert, go-live refers to the point in time that a new IT system is put into use, or production; thus, this briefing reveals that the Office of the President was aware that it might not be able to deploy UCPATH as planned. Similar concerns show up in many briefings, yet the Office of the President continued to set aggressive schedule goals.

Additionally, when the project director provided monthly briefings to the project sponsors, he often indicated that there was no *schedule slack*—a term that refers to the amount of time that critical tasks can be delayed before the schedule is jeopardized. For example, in August 2016, the project director reported that the numerous changes that the campuses had requested could cause schedule delays. And a January 2017 briefing indicated that the project had no slack in the schedule and that significant overlapping work might cause problems. Overlapping work in the

UCPath schedule is a concern because it indicates that the Office of the President has scheduled the same core staff to perform two different tasks at the same time. These issues led our IT project management expert to conclude that the project's overly aggressive schedule factored into the project's repeated delays.

Further, our IT project management expert found that the Office of the President did not maintain an integrated plan. According to our expert, building and maintaining an integrated plan is critical for a project of UCPath's size and complexity. Such a plan captures the timing of each project task and identifies which staff will perform that task and helps identify and resolve instances where staff have overlapping work before they impact the project's schedule. When our expert reviewed the project briefing materials, he found that the Office of the President had acknowledged the risks associated with overlapping schedules and had identified the lack of an integrated plan as a risk to the UCPath project schedule. According to the current project director, between 2013 and 2014 his former codirector attempted to develop and maintain an integrated plan, but the planning software that the Office of the President was using, as implemented, could not support the level of detail the plan required. Subsequently, the plan was abandoned. Our expert found no evidence that the Office of the President attempted to adopt a subsequent integrated plan. Further, he observed that many other large IT projects have used integrated resource and schedule planning without the technology problems that the Office of the President encountered.

Our IT project management expert also observed that the Office of the President lacked a rigorous process for assessing the budget and schedule implications of proposed scope changes to the UCPath project. Although the project has a defined process for large changes, those changes that are believed to be smaller are approved at the lowest project levels without assessment of higher or global implications. Over time, small changes accumulate and have more significant project impacts. Without a detailed analysis of how changes may affect the broader project context, staff or management may approve small changes without understanding that those changes will have ramifications that threaten the project's larger goals. Changes to UCPath's scope were likely to have implications for its cost and schedule because it has operated with aggressive schedules, without the necessary staff to accomplish all planned work, and with a work plan that involves overlapping tasks.

The Office of the President also demonstrated weaknesses in its risk-management processes. The purpose of risk management is to decrease the likelihood and impact of negative events threatening project goals. Risk management is accomplished through processes that identify, prioritize, and develop responses to threats to those

The Office of the President did not maintain an integrated plan, which is critical for a project of UCPath's size and complexity.

Although the Office of the President tracked risks, it did not review or monitor all risks periodically. Without regular monitoring of identified risks, the Office of the President may not detect which risks have passed, which have been mitigated or resolved, or which may become more significant threats.

goals. Although the Office of the President tracked risks, it did not review or monitor all risks periodically. Specifically, our IT project management expert found that the project risk logs identified many medium-severity risks to the project's schedule, yet many of those risks sat for hundreds of days without evidence of reassessment—often at the same time that the project schedule was slipping. For example, the risk manager logged in September 2016 that a specific testing environment had not been fully evaluated before use and could result in defects during testing. However, this risk went unmonitored for more than four months with no apparent actions or updates. Without regular monitoring of identified risks, the Office of the President may not detect which risks have passed, which have been mitigated or resolved, or which may become more significant threats.

Finally, the Office of the President also failed to use IV&V as part of its project oversight. IV&V helps to ensure that an IT system will perform as intended and meet its users' needs. As an IT system is developed and implemented, IV&V can provide early warnings of process and technical discrepancies, issues, and problems that may otherwise go undetected or be detected too late. According to our IT project management expert, UCPath's size, complexity, and risk warranted using IV&V for identifying and mitigating technical and project management issues. For example, IV&V could have detected the issues UCPath experienced with staff being over allocated. One of the project sponsors asserted that the Office of the President's internal auditors and a consultant have been providing oversight that is equivalent to IV&V. Specifically, she confirmed that the internal auditor works with the consultant to create a report of any significant risks to the UCPath project. However, our expert concluded that neither of these entities provided oversight that was equivalent to IV&V, as IV&V provides a more robust analysis of technical activities and is embedded in the project as opposed to occurring periodically.

In addition to the project management issues that our IT project management expert identified, the Office of the President provided several factors that it believes contributed to its exceeding its initial UCPath cost estimate and schedule goals. Specifically, the UCPath project director acknowledged that the Office of the President greatly underestimated UCPath's size and complexity, particularly in terms of the changes required to adapt the system to each campus's business processes. Our expert concurs and indicates that the significant challenges the project has encountered were indicative of the Office of the President's poor initial understanding of the UCPath project's scope. These challenges have not only included missed schedules and a growing budget, but also an increase in the predicted number of necessary system interfaces between

UCPath and other IT systems from 75 to over 120. Each interface requires analysis and software programming, which added to the project's complexity.

The Office of the President also did not fully understand the amount of effort required to standardize business processes across all campuses. One of the project sponsors, the chief financial officer, told us that a main lesson the Office of the President has learned is that UCPath is a business transformation project—meaning the university has to change its business processes systemwide—as well as an IT implementation project. He indicated that the Office of the President made the mistake of procuring a technological solution for the university's payroll and human resources activities before it had standardized its business processes and developed a shared service center model for those activities.

The project director also explained that schedule delays and cost estimate increases are closely related because labor costs account for the majority of UCPath's implementation cost; thus, a delay in the overall schedule results in an increase in UCPath's cost estimate. Further, he indicated that the Office of the President is constrained by the university's business calendar, which offers four optimal dates to shift from one IT system to another. These dates coincide with the end of each tax reporting quarter and the project director stated that deploying UCPath at the end of a tax quarter minimizes the need to convert employees' tax balances. Thus, when the schedule slips, it slips in three-month increments, which means the university incurs labor costs for three more months, resulting in large increases in UCPath's cost estimate. Ultimately, although the Office of the President is aware of some of the factors that led to the project's cost increases and schedule delays, such awareness has not prompted addressing the project management weaknesses that our IT management expert identified. The Office of the President needs to develop and implement IT project management guidelines that will help ensure that IT projects are completed on time and within approved budgets.

Although Invoice Approval Processes Were Followed, Some Campuses Could Better Define IT Deliverables

To assess the university's management of its IT contracts, we reviewed one IT project at each of the Berkeley, Irvine, and Riverside campuses. We found that while the campuses followed their established vendor payment practices, the Berkeley and Irvine campuses could improve their IT contracting practices. The projects we reviewed included fixed price contracts

The chief financial officer asserted that the Office of the President made the mistake of procuring a technological solution for the university's payroll and human resources activities before it had standardized its business processes and developed a shared service center model for those activities.

The Berkeley and Irvine campuses had only vaguely worded deliverables for project milestones, increasing the risk that the campuses will inadvertently pay for work that does not meet their expectations or needs.

with development vendors (Berkeley and Irvine campuses) and a time-and-materials contract with a development vendor (Riverside campus). The costs of the three projects ranged from \$11 million to \$93 million. Our review of five project invoices from each campus found that the campuses had required that vendor invoices be reviewed and approved before payment. However, the Berkeley and Irvine campuses had only vaguely worded deliverables for project milestones. According to our IT project management expert, these types of vaguely worded deliverables do not align with industry best practices and increase the risk that the campuses will inadvertently pay for work that does not meet their expectations or needs.

The State has established guidance on IT contracting that helps ensure that IT contracts contain well-defined deliverables. For example, the *State Contracting Manual* states that agencies must develop a “clear, concise, and detailed description of the IT services to be performed.” Further, the State’s *Project Management Framework* (management framework) provides guidance for how to define deliverables to ensure that the agency and the vendor possess a mutual understanding of the content and scope of the deliverables. This sort of clear definition helps to ensure that the agency gets what it is paying for: an IT system that functions as intended. The management framework recommends that the agency develop a deliverable expectations document that defines the scope, content, entrance criteria, acceptance criteria, and development schedule for each deliverable. The entrance criteria should define what the vendor must achieve before it begins work on activities associated with the development of the deliverable, and the acceptance criteria should define what the vendor must achieve before the agency will accept the deliverable. Finally, the deliverable schedule should document the key tasks and dates associated with the deliverable.

Our review found that the deliverables for the Berkeley and Irvine campus projects did not always align with the management framework’s guidance. Although state law does not require the university to comply with these guidelines, they represent best practices that it would likely benefit from. We found that the Berkeley and Irvine campuses paid their vendors on the completion of milestones; however, they did not have deliverable expectation documents, and the deliverables for milestones as described in the vendor contracts did not provide enough detail to effectively measure whether the vendors had met their obligations for payment. For example, although the contracts had defined dates for the completion of milestones, they did not include entrance or acceptance criteria. Therefore, the Berkeley and Irvine projects did not have sufficient criteria to determine if the milestones had actually been completed.

Absent sufficient criteria, it is difficult to determine whether the vendor achieved a deliverable and whether that deliverable was acceptable. For example, in January 2016, the Berkeley campus's vendor submitted an invoice of \$593,000 for a milestone titled Enrollment History Converted, and the Berkeley campus subsequently paid that vendor for completing the milestone. However, the Berkeley campus's basis for making this payment is unclear because the contract does not define the deliverables that would satisfy the milestone. Further, the contract leaves in question what level of data conversion is acceptable, such as whether the campus will accept a certain percentage of errors in the data or a certain percentage of data that are not successfully converted.

The executive director of the Berkeley campus project responded that the Berkeley campus has a comprehensive process for accepting milestones and is aware of what each milestone includes based on what he stated is a highly detailed project plan and a readiness assessment. Similarly, the director for the Irvine campus's project stated that the Irvine campus uses the project schedule and the statement of work to determine whether to pay its vendor for achieving milestones. Further, he told us that the Irvine campus had not made payments for some of its vendor's invoices because the campus did not believe that the vendor had satisfactorily completed certain milestones. Despite the processes that the Berkeley and Irvine campuses assert that they follow, our IT project management expert found that their contracts did not have defined milestones, which puts them at risk for contractual disputes with their vendors.

The Berkeley campus's opting not to employ best practice in its process for deliverable review did not appear to affect the cost of its project. In 2017 the Berkeley campus completed most of the project development activities within its budget of \$93 million. In contrast, the Irvine campus is in the early stages of developing its Student Information System and has struggled to keep the project on track, which is projecting a \$12 million overage from its initial budget and a one-year delay. Thus, it could benefit from improving its deliverable review practices.

The Irvine campus is in the early stages of developing its Student Information System and has struggled to keep the project on track and it could benefit from improving its deliverable review practices.

Recommendations

Regents

To ensure that they are able to exercise necessary oversight for the university's significant IT projects, the regents should develop status reporting standards for the Office of the President and all university locations to follow by December 2017. Such reporting

standards should apply to all university IT projects with more than a specified cost and, at a minimum, should establish the following:

- The frequency with which the Office of the President and all university locations must report to the regents. Such updates should occur at least three times per calendar year and coincide with regents' meetings to allow for oral discussion.
- The types of disclosures the Office of the President and all university locations must present about each IT project including, but not limited to, changes in scope, projected cost, and schedule.
- The types of significant project risks the Office of the President and all university locations must disclose. The updates should also describe the actions the Office of the President and all university locations are taking to mitigate risks and the potential effects of those risks on a project's cost, schedule, and scope.

Office of the President

To ensure that it fully reports the cost of IT projects, the Office of the President should develop cost reporting guidelines by December 2017 for UCPath and other significant IT projects across all university locations. These cost guidelines should identify cost categories at both the Office of the President and university locations to ensure that the estimates capture and communicate all development and implementation costs. In addition, the Office of the President should produce cost reports to share with stakeholders at least quarterly.

To ensure that it consistently follows best practices related to project management, the Office of the President should develop and implement guidelines for IT project development by June 2018. The guidelines should apply to all IT projects undertaken by any university location with a cost estimate of at least \$5 million or more and should include the following elements:

- A means to assess schedules for reasonableness, and requirements for the creation and maintenance of an integrated schedule and resource plan for each project.
- Requirements for rigorous change management processes that establish a means of assessing the implications of changes to a project's scope, cost, and schedule.

- Procedurally sound requirements for identifying, reviewing, and resolving risks to a project.
- IV&V to oversee the technical aspects of project development.

The Office of the President should require that all university locations follow best practices by ensuring that each location creates a deliverable expectations document for each IT contract similar to the documents the State's management framework describes. The Office of the President should establish this requirement by December 2017. The deliverable expectations document should, at a minimum, identify the deliverables for each milestone and define the scope, content, entrance criteria, acceptance criteria, and development schedule for each deliverable.

We conducted this audit under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives specified in the Scope and Methodology section of the report. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

Date: August 24, 2017

Staff: John Baier, CPA, Audit Principal
Sharon L. Fuller, CPA
Idris H. Ahmed

IT Project Management Expert: Catalysis Group

Legal Counsel: Joseph L. Porche, Staff Counsel

For questions regarding the contents of this report, please contact Margarita Fernández, Chief of Public Affairs, at 916.445.0255.

Blank page inserted for reproduction purposes only.



THE REGENTS OF THE UNIVERSITY OF CALIFORNIA

1111 Franklin Street, 12th Floor
Oakland, CA 94607-5200
(510) 987-9220
Fax: (510) 987-9224

August 7, 2017

Ms. Elaine Howle
California State Auditor
621 Capitol Mall, Suite 1200
Sacramento, CA 95814

State Auditor Howle:

Thank you for the opportunity to respond to the recommendation made to the Board of Regents in the draft audit report on UCPath and IT contracting. The Regents welcome this constructive input on oversight of IT projects at the university. Please find our response to the recommendation below.

Recommendation

To ensure that they can exercise necessary oversight for the university's significant IT projects, the regents should develop by December 2017 status reporting standards for the Office of the President and all university locations to follow. Such reporting standards should apply to all university IT projects more than a specified cost and, at a minimum, should establish the following:

- The frequency with which the Office of the President and all university locations must report to the regents. Such updates should occur at least three times per calendar year and coincide with regents meetings to allow for oral discussions.
- The types of disclosures the Office of the President and all university locations must present about each IT project including, but not limited to, changes in scope, projected costs, and schedule.
- The types of significant project risks the Office of the President and all university locations must disclose. The updates should also describe the actions the Office of the President and all university locations are taking to mitigate risks and the risks' potential effects on the project's cost, schedule, and scope.

Ms. Elaine Howle
California State Auditor
Page 2

Response

By December 2017, the Regents will implement reporting standards for significant systemwide IT projects based on a dollar threshold mutually agreed upon with UCOP. These standards will require oral or written updates at least three times per calendar year. The standards will also establish the types of required disclosures relating to changes in scope, projected costs and schedule, as well as significant project risks and related mitigation actions.

Respectfully,



George Kieffer
Chair, UC Board of Regents



Charlene Zettel
Chair, Compliance and Audit Committee

UNIVERSITY OF CALIFORNIA

BERKELEY • DAVIS • IRVINE • LOS ANGELES • MERCED • RIVERSIDE • SAN DIEGO • SAN FRANCISCO



SANTA BARBARA • SANTA CRUZ

1111 Franklin Street
Oakland, CA 94607-5200
Phone: (510) 987-9074
<http://www.ucop.edu>

August 7, 2017

Ms. Elaine M. Howle*
California State Auditor
621 Capitol Mall, Suite 1200
Sacramento, California 95814

State Auditor Howle:

I write in response to your draft audit report University of California Office of the President — Contracted Employees and Contracting Practices, as it pertains to UCPath and information technology projects. The recommendations are helpful and constructive, and align with our proactive efforts to continually improve UC's operations, policies and transparency to the Legislature and the public at large.

Our responses to specific recommendations are in the attachment to this letter, but I would like to take this opportunity to provide important information about UCPath, one of the main projects discussed in the audit. The University launched UCPath in 2011 to modernize and standardize its payroll system for more than 190,000 UC employees at 11 locations.

When I arrived at UC in September of 2013, UCPath was already well underway. At that time and as I do now, I view it as a necessary project to standardize UC's business practices, improve accuracy and service quality, and create efficiencies across our system – and not necessarily as a tool for generating immediate savings.

I would like to emphasize some important context that speaks to the implementation and effectiveness of UC Path:

- **UCPath is a large-scale and complex undertaking that improves how UC delivers key administrative services.** Once implemented systemwide, the upgrade will standardize over 100 processes for payroll, human resources, and benefits through upgraded technology, a centralized database, and a shared services center to serve employees. The challenges of managing a project of this scale and complexity are reflected in the efforts of comparably-

* California State Auditor's comments begin on page 41.

State Auditor Howle
August 7, 2017
Page 2

sized institutions and organizations that have attempted similar massive-data upgrades, which have resulted in major delays or failure.

- ① • **An upgrade is not only prudent, but unavoidable.** UC's 11 current systems are 35 years old and vary among locations. They're disconnected, outdated, expensive to maintain, and require manual calculations. It has become increasingly challenging for UC to manage employee records and ensure payroll accuracy. An estimated \$100 million is spent annually on manual rework and fixing errors. A systemwide upgrade will ensure that our resource-constrained campuses will be able to avoid building their own respective systems, at an estimated cost of more than double the current projected costs of UCPATH.
- **UC has become more effective at managing this project over time.** Significant changes were made to the management of UCPATH in 2013, after UC concluded that the IT consulting firm contracted to manage UCPATH and oversee the transformation of business processes had failed to perform as expected and to achieve sufficient progress on implementing the project. UC then conducted an exhaustive assessment of the project, instituted better controls, and revamped the deployment approach. As a result, we revised the original business case, cost estimates, and projected timelines. And as we continue to move forward on our implementation, the accuracy of the projections delivered by the reconstituted project team has and will continue to improve. Many of the recommendations contained in the report will help us further that progress.
- **UC has already made significant progress.** Since November 2015, UCPATH has been providing payroll, human resources, and benefits services for UCOP employees. Significantly, 70 percent of the functionality that will be needed at our campuses and medical centers was achieved with this rollout. This greatly reduces the implementation efforts that will be required on the campuses. Finally, we are well on track to deploy the system later this year at UCLA, UC Riverside, UC Merced, and the Associated Students of UCLA.
- ② • **UCPATH benefits from governance that is diversified and rigorous.** Various stakeholders oversee UCPATH, including the UC Board of Regents,

State Auditor Howle
August 7, 2017
Page 3

UCOP leadership and policy experts, and campus leaders – including vice chancellors, controllers, chief human resource officers, chief information officers, and academic personnel directors. The multiple governance bodies, along with the UC Board of Regents, oversee project progress, scope, schedule, and budget.

- **UC continually improves oversight and communication of UCPATH.** Since the start of the UCPATH project, the project leadership has made 79 presentations about and references to UCPATH at public Regents' meetings. This number does not reflect additional discussions, briefings, and consultations with individual board members and, in particular, committee and board leaders, in between the formal meetings. Nor does it include the public-facing website that we have created to provide important milestones and updates on the project. As a result of the recent restructuring of the committees of the UC Board of Regents, we have updated our practices for briefing The Regents on the project, which receives oversight from the Finance and Capital Strategies Committee. ②

I have complete confidence in UC's ability to continue successful implementation of UCPATH, a necessary project with significant, expansive, and long-term benefits to the University. As with any extremely complex undertaking, we are constantly finding ways to improve and be more efficient. That is why we welcome your recommendations and appreciate the time and diligence your staff spent in identifying ways in which we might further our substantial progress.

Yours very truly,



Janet Napolitano
President

Attachment:
Response - CSA UCPATH and IT Projects Recommendations

Responses to CSA UCPATH and IT Projects Recommendations

- 1. To ensure it fully reports the cost of IT projects, the Office of the President should develop cost reporting guidelines by December 2017 for UCPATH and other significant IT projects across all university locations. These cost guidelines should identify cost categories at both the university and campus levels to ensure that estimates capture and communicate all development and implementation costs. In addition the Office of the President should produce cost reports to share with stakeholders on at least a quarterly basis.**

UCOP will provide project sponsors and managers with guidelines for reporting standards and project risk management practices to formalize what is currently an informal practice. By December 2017, UC will develop cost reporting guidelines for UCPATH and large systemwide projects/programs with budgets of \$25M or greater. The guidelines will include cost reporting direction.

- 2. To ensure it consistently follows best practices related to project management, the Office of the President should develop and implement guidelines for IT project development by June 2018. The guidelines should apply to all IT projects undertaken by any university location with a cost estimate of at least \$5 million or more and should include the following elements:**

- A means to assess schedules for reasonableness, and requirements for the creation and maintenance of an integrated schedule and resource plan for each project.**
- Requirements for a rigorous change management process that establishes a means of assessing the implications of changes to a project's scope, cost and schedule.**
- Sound requirements for identifying, reviewing, and resolving risks to a project.**
- IV&V to oversee the technical aspects of project development.**

UCOP agrees that there are opportunities to strengthen and improve the project management approach for systemwide projects over \$25M and will develop guidelines for IT project development by June 2018. All projects can benefit from the discipline and rigor contained in best practices; however, best practice in one context and at one moment in the process might not be applicable in another.

- ③ We disagree with statements made by CSA that IV&V practices should be run throughout any and every systemwide program. This would create a parallel management structure to the program, which would add cost and complexity while

Page 2

diluting the effectiveness of such a function. It is our current and proposed continued practice to use diligent governance as a way to identify and bring in IV&V third-parties for specific topics and situations as appropriate or necessary.

- 3. The Office of the President should require that all university locations follow best practices by ensuring the university creates a deliverable expectations document for each IT contract similar to the documents the State's management framework describes. The Office of the President should establish this requirement by December 2017. The deliverable expectations document should, at a minimum, identify the deliverables for each milestone and define the scope, content, entrance criteria, acceptance criteria, and development schedule for each deliverable.**

UCOP agrees with CSA's conclusion that our campuses follow established vendor payment practices. By December 2017, we will build upon the current practice by establishing a requirement for each large IT project of \$25M or greater to produce a "deliverable expectations document." We will review the State's management framework to inform the development of this required document.

Blank page inserted for reproduction purposes only.

Comments

CALIFORNIA STATE AUDITOR'S COMMENTS ON THE RESPONSE FROM THE UNIVERSITY OF CALIFORNIA OFFICE OF THE PRESIDENT

To provide clarity and perspective, we are commenting on the response from the Office of the President. The numbers below correspond to the numbers we have placed in the margin of the Office of the President's response.

Although the university president asserts in her response that the university spends \$100 million annually for manual rework and error corrections for the legacy payroll system, we were unable to substantiate the Office of the President's claim that UCPATH will result in savings. In August 2017 the Office of the President sent us an email asserting that the elimination of manual rework would result in annual savings of \$100 million. It based this assertion on a 2010 consultant study that formed the basis of its 2011 business case for the UCPATH project and its original estimate that UCPATH would result in savings of \$753 million. In addition, the Office of the President claims that the retirement of the university's payroll legacy system will result in savings of \$13 million annually based on its 2011 business case. The Office of the President requested that we include these estimated savings in Figure 5 on page 16. However, because the Office of the President stated that it no longer believed that UCPATH would achieve the savings of \$753 million and because it was unable to demonstrate that its new savings assertions would result in an actual reduction of university staff, we were unable to conclude that any savings would materialize.

①

Further, the Office of the President asserted that additional savings would result from its reduction of the projected staffing of the UCPATH center from 568 positions to 440 positions, as well as its expectation of lower than projected salary levels for the staff filling the 440 positions. The Office of the President requested that we also add this claimed savings to Figure 5. However, we did not do so because the 2017 status cost of \$130 million for "UCPATH Center facility, equipment, and operations" in Figure 5 is already based on the projected staffing level of 440 positions at the lower staffing cost, during fiscal year 2018-19, which is when the Office of the President projects that the UCPATH Center will be fully staffed. Therefore, we stand by Figure 5 on page 16 as it is presented.

The Office of the President overstates the UCPATH project's level of communication with the regents and the project's governance. As noted on page 19, our review of the Office of the President's 79 communications to the regents determined that only five status updates provided the regents with substantial information

②

about UCPATH's status, cost, or schedule. We display those five status updates, along with an additional two updates and a financing request in Figure 6 on page 20. The remaining 74 of the 79 communications either mentioned UCPATH in relation to another issue or did not provide any substantive information on the project. Further, it was not until July 2017 that the Office of the President recognized the regents' role in governance and expanded the project's governance approach to include communicating critical decisions to the regents as we describe on pages 22 and 23. However, as we also note, the expanded governance approach does not go far enough in engaging the regents in decision making to truly allow them to fulfill their oversight role.

- ③ Although the Office of the President correctly acknowledges that our recommendations, including the use of IV&V, are best practices, it incorrectly concludes that IV&V would create a parallel management structure and add complexity. IV&V, when properly employed, helps to ensure that an IT system will perform as intended and meet its users' needs, as well as provide an early warning of process and technical discrepancies, and problems that may go undetected or be detected too late. Further, our IT project management expert indicates the benefits that IV&V provides generally outweigh its cost. Given UCPATH's size, complexity, and risk, our IT project management expert believes that it would be prudent for the university to employ IV&V to mitigate weaknesses the Office of the President has already displayed in its project management of UCPATH. Moreover, according to our expert, the Office of the President's current and proposed continued practice to employ "IV&V third parties for specific topics and situations" does not represent the best practice definition of IV&V. As noted on page 26, our IT project management expert concluded that the Office of the President's approach results in oversight that is not equivalent to IV&V, which provides a more robust analysis of technical activities, and is embedded in the project as opposed to occurring periodically.