



AUDIT AND ADVISORY SERVICES

Business Contracts
Audit
Project No. 11-565

September 7, 2011

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September 7, 2011

Ron Coley
Associate Vice Chancellor
Business and Administrative Services

Associate Vice Chancellor Coley:

We have completed our audit of Business Contracts as per our annual audit plan in accordance with the Institute of Internal Auditors' *Standards for the Professional Practice of Internal Auditing* and the University of California Internal Audit Charter.

The purpose of the audit was to assess controls to ensure that business contracts for goods and services are executed in accordance with relevant UC policies to ensure that the awarding of the contract is properly authorized. Also, we evaluated the effectiveness of controls established to administer contract compliance with contractual obligations by both the University and contractors and ensure that there are adequate performance measurement criteria to enforce deliverables.

As a result of our fieldwork, we note that our observations can be grouped into the following categories.

- Failure to consistently obtain contracts signed by the counterparty for the campus system of record;
- Lack of process for campus to centrally track completion of contracts;
- Non-routine contracts not systematically forwarded to University counsel for review; and
- Lengthy published turnaround times for Business Contracts Office contract review may potentially impair business needs.

As part of our audit, we obtained management responses to our observations. We assessed these responses and believe that address the exceptions noted and promote compliance going forward.

The aforementioned and other observations with management action plans are expounded upon in the accompanying report. Please destroy all copies of draft reports and related documents.

Please do not hesitate to call on Audit and Advisory Services if we can be of further assistance in this or other matters.

Respectfully reported,

Wanda Lynn Riley
Director

cc: Vice Chancellor John Wilton
Business Contracts Administrator Brian Donohue
Senior Business Contracts Officer Bill Brauer
Senior Vice President Sheryl Vacca
Associate Chancellor Linda Morris Williams
Interim Associate Vice Chancellor and Controller Delphine Regalia

University of California, Berkeley
Audit and Advisory Services
Business Contracts

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OVERVIEW

Executive Summary

The objective of this audit was to evaluate business processes and controls designed to ensure compliance with requirements outlined in the Campus Administrative Memo, *Business Contracts Office: Roles and Responsibilities*, dated September 14, 2000, and UC Regents' Business & Finance Bulletins BUS-34, 63, and 77. Responsibility for the business contracts process is shared by the campus departments, the Business Contracts Office (BCO), University Counsel, the Office of Ethics, Risk and Compliance Services (OERCS), the Office of Marketing and Business Outreach (OMBO), and other campus departments, as necessary. Audit and Advisory Services examined activity across the business contracts lifecycle from contract request through contract close-out.

As a result of our fieldwork, we note that our observations can be grouped into the following categories.

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Purpose of the Audit

The purpose of the audit was to assess controls to ensure that business contracts for goods and services are executed in accordance with relevant UC policies to ensure that the awarding of the contract is properly authorized. Also, we evaluated the effectiveness of controls established to administer contract compliance with contractual obligations by both the University and contractors and ensure that there are adequate performance measurement criteria to enforce deliverables.

Scope of the Audit

The audit scope included all 4,459 business contracts recorded in the Business Contracts Management System (BCMS), the campus' business contracts system of record, as of October 14, 2010 and since inception in 2000. BCMS enables BCO and the campus departments to document and track the progress of the contracting process and is designed to facilitate BCO's communication with these departments and other oversight campus units. BCMS maintains non-research related contracts, such as, revenue producing contracts including licensing of University business intellectual property and copyrights, agreements to support continuing and professional

education, organizational development consultant agreements, and sponsorship agreements. BCMS does not maintain contracts related to real estate activities and procurement activities.

Audit Methodology

The Principal Auditor met with management from BCO, OERCS, Office of Legal Affairs, and OMBO to discuss and identify potential risks associated with business contracts. Additionally, the Principal Auditor surveyed 20 campus departments and interviewed cognizant management and staff regarding their current processes related to the lifecycle of the business contract (i.e., request, development, execution, management, and close-out). The 20 surveyed campus departments were selected from the 134 departments with business contract data in BCMS as of October 14, 2010. BCMS data and IDEA (data analytical software) were utilized to identify campus departments with the highest total dollar amount of business contracts. Collectively these departments represent 81.9% of the number of contracts recorded in BCMS and 95.4% of the total dollar amount of these contracts.

Our objective of surveying these campus departments was to assess the current processes and controls and to identify potential areas of improvement related to the business contracts process based on the current practices implemented by these departments. Additionally, we reviewed University policies related to business contracts to gain an understanding of specific campus requirements related to these types of activities and non-campus resources for practices related to the management of business contracts.

Background Information

According to the Campus Administrative Memo, *Business Contracts Office: Roles and Responsibilities*, dated September 14, 2000, the vision of the BCO is to be an integral, effective, and responsive "partner in service" to the various campus departments in executing non-research business contracts. The mission of the BCO is to provide campus departments in a timely manner with professional, high-quality business contracting services that protect and further the interests of the campus departments and the University. In FY2009-10, the BCO received 1,117 business contract requests and for FY2010-11, as of February 9, 2011, BCO received 736 contract requests.

BCO coordinates the contracting activities of the various campus units, from the initial departmental request to the completed and signed contract. BCO is responsible for the final preparation and execution of the contract document including the appropriate business, policy and legal review and is also the office of record where the original executed contract is maintained. In the contracting process, BCO partners with the department requesting the contract, as well as with other oversight departments such as University Counsel (Office of General Counsel and/or Office of Legal Affairs), OERCS, OMBO, and other campus departments, as necessary.

In addition to BCO's role and responsibilities, the following business contracts roles and responsibilities of the oversight departments are also documented in Attachment 1 of the memo:

Campus Departments

Campus departments requesting contract assistance from BCO are responsible for obtaining approval at the appropriate level prior to submitting the *Business Contracts Office Request Form*. Departments are responsible for providing the scope and objectives of the proposed contract, the institutional interests to be served, and an assessment of any potential risk and financial impact. Departments are further responsible for making business and programmatic decisions regarding the contract and contract performance. Departmental participation in the contracting process may vary significantly depending on the nature of the contract and as described in the *Business Contracts Office Road Map*.

Some large departments with a high volume of contracts, such as Intercollegiate Athletics and the Lawrence Hall of Science, have designated a "Departmental Contracts Coordinator." This individual serves as a liaison between the department and BCO, works actively with BCO staff on departmental contracts, monitors the status of all contracts in progress, and participates in the completion of the contract.

University Counsel

As required by University of California policy, University Counsel must review business contracts, as appropriate. University Counsel provides review of legal ramifications of the contracts in their entirety and approves the contracts as to legal form. The purpose of the review is to identify legally-objectionable provisions, to improve precision and clarity, and to detect unanticipated areas of potential institutional exposure. Non-routine contracts, such as those containing material changes from standard formats or requiring Regental approval under Standing Orders, require approval by University Counsel for legal form prior to execution of the contract.

Risk Management (renamed the Office of Ethics, Risk and Compliance Services)

Risk Management is responsible for providing an accurate assessment of risks and liabilities to the University resulting from a proposed contract. Risk Management is also responsible for approving in the contract appropriate indemnification and insurance clauses that are acceptable to the University.

Office of Marketing and Management of Trademarks (renamed Office of Marketing & Business Outreach)

The Office of Marketing and Management of Trademarks (OMMT) is responsible for ensuring compliance with University policy and for approving language in contracts associated with the use of the University's name, trademarks, trade names, and logos, as well as with adherence to the code of conduct for trademark licensees.

Other Oversight Departments

Other University departments, such as Sponsored Projects Office (SPO), Office of Technology Licensing (OTL), Office of Environment, Health and Safety (EH&S), Capital Projects, and others may be consulted as appropriate during the contracting process, on an as-needed basis.

The memo also outlines the business contracts stages from contract request to execution highlighting BCO forms, contract priority assignments, and the purpose of BCMS.

All contracts must be executed in accordance with the applicable University policies and procedures governing the particular transaction, including but not limited to Business and Finance Bulletins, University policies, and relevant guidelines issued by the appropriate functional areas within the Office of the President. The following University policies provide the guiding principles and governance for the business contracts function:

- UC Business & Finance Bulletin BUS-34 for Independent Consultants;
- UC Business & Finance Bulletin BUS-63 regarding Insurance Requirements; and
- UC Business & Finance Bulletin BUS-77 contains policy that is pertinent to Consultants who are independent contractors

Conclusion

The business contracts process requires collaborative effort by campus units and departments to ensure that the executed contract meets the business objectives of the campus department and contracting party. Additionally, clear communication and timely performance of responsibilities by campus units and departments will assist in mitigating risks associated with the lifecycle of the business contract process that could potentially jeopardize the success of the contractual relationship unnecessarily leaving the University unprotected from reputational degradation, punitive damages, or unidentified and unfulfilled contractual obligations.

We noted, through assertions by BCO, that post-execution contract management is the responsibility of the individual departments. However, this responsibility does not appear to be clearly articulated in current campus policies. Nonetheless, we observed that central units appear aware of business contracts policies and responsibilities and campus departments appear to have a general understanding of the business contracts process.

In addition, based on our survey of sampled departments, we observed that the processes implemented to monitor business contracts post-execution appears to vary across departments as there is no campus-wide guidance related to contract life-cycle administration. Anecdotally, representatives from several departments indicated that they would welcome centralized guidance and best practices on this topic.

Furthermore, as a result of our fieldwork, we identified opportunities for improvement of internal controls. Our specific observations can be grouped into the following categories.

- Failure to consistently obtain contracts signed by the counterparty for the campus system of record;
- Lack of process for campus to centrally track completion of contracts;
- Non-routine contracts not systematically forwarded to University counsel for review; and
- Lengthy published turnaround times for BCO contract review may potentially impair business needs.

A detailed description of our observations and management responses follows.

SUMMARY OF OBSERVATIONS & MANAGEMENT RESPONSE AND ACTION PLAN(S)

Failure to Consistently Obtain a Contract Signed by the Counterparty for the Campus System of Record

Observation

As the office of record for business contracts, BCO is charged with keeping official records of hard copy contracts and supporting documentation. According to BCO's internal procedures, when a contract has been finalized, BCO sends two signed copies to department with instructions to send them to the contracting party and return one fully-signed original to the BCO after a signature by the counterparty is obtained. The responsible BCO Specialist follows up with the department for the fully executed agreement and, if after one month the fully signed contract has not been received, the BCO Specialist stores the contract file and updates the BCMS request status to "Stored" and no further follow-up is performed by BCO.

During the audit, we identified 352 contracts in the BCMS as of October 14, 2010 with the "Issued" status for which a copy signed by the counterparty appears to not have been collected and retained by BCO in the campus system of record.

We observed, given the observation above, that there is a risk that the campus may not be able to produce a mutually executed contract as a business record in the event of a document request, discovery process or subpoena. In addition, there is a risk that additional language may be inserted into the contract by the other party which may change the previously approved terms and conditions in a manner unfavorable to the University. As a result, it would be difficult to determine whether the University agreed to the amended terms.

Management Response and Action Plan

The end user department is responsible for obtaining a fully executed agreement and returning it to the Business Contracts Office (BCO) or for scanning it directly into the Business Contracts Management System (BCMS), with notification to the responsible BCO Specialist. Ensuring that a signed agreement is in the files is the primary responsibility of the end user department and not BCO. BCO is expected to do all that it can to facilitate the closing of this administrative loop; BCO does not have operational or compliance control over campus departments.

Frequently the agreement may not be immediately signed and returned, and this is often due to delays by the outside company which cannot be controlled by anyone at the University. To follow up, BCO uses the BCMS to produce a monthly "Issued Contracts" report. This report lists BCMS records showing BCO signatures older than thirty days for which BCO has not received a fully signed contract. The responsible BCO Specialist contacts the department with a request for the fully executed agreement. In the event that the fully signed agreement has not been received after

two months despite BCO's follow up, BCO stores the file. Because BCO signed the agreement first, under California law the signed agreement by UCB is the offer---and performance of work by the outside party constitutes agreement to the terms and conditions of the offer, creating a binding contract on UCB's terms and conditions. As BCO executes over 1,000 contracts each year and is currently operating with four staff at 85% time, BCO does not have available resources to perform the follow up needed to ensure it has fully executed copies of all agreements. However, in an effort to ensure, to the greatest extent possible, that the University obtains fully executed agreements (signed by both parties), the following practice will be instituted by BCO:

- BCO will continue to advise the involved department that it is the responsibility of the department to obtain a fully executed agreement,
- BCO will further prominently display a warning on the BCO web site and the Business Contract Management System (BCMS) web page: "Work may not be commenced on this agreement until the agreement is fully executed",
- BCO will generate a BCMS report of the agreements which have not been fully executed within 30 days of being signed,
- BCO will generate an email notifying the department that the agreement has not been fully executed and that an exception report is being prepared for the Associate Vice Chancellor – Business and Administrative Services which lists those departments which have not completed this requirement, and
- If the department does not perform and cause the BCMS record to be updated with the fully executed agreement, then office of the Associate Vice Chancellor – Business and Administrative Services will be given the name of the departmental person who is out of compliance so that additional corrective action may be taken.

A&AS has reached agreement with management on an expected date for completion of this action plan of April 1, 2012.

Lack of Process for Campus to Centrally Track Completion of Contracts

Observation

Although BCO states that they are responsible for BCMS, the system of record for campus business contracts, we observe that there is no formal business process for following up with campus departments to determine whether the contract or agreement was completed and subsequently closed-out, releasing the University and contracting party from further potential obligations. As a result, although BCO's system of record indicates that a contract has been reviewed by BCO, it does not track whether the terms of the contract have been completed, if the contract has been cancelled prior to its stated end date, or if the contract has been extended or renewed.

In addition, our departmental survey noted variation across departmental procedures for monitoring ongoing compliance with contractual terms or to ensure that contract terms and deliverables have been met prior to closeout. As a result, in the absence of central tracking of the completion and closeout, it would be difficult for the central administration to obtain an overview of the status of all contracts. In addition, since BCO is also the custodian of record for campus business contracts, the lack of centralized tracking would impede the ability to apply appropriate

document retention schedules in the event that contracts are terminated early, extended, or renewed without proactive notification by individual departments.

Furthermore, failure to comply with the terms of a contract on the part of the campus may lead to additional financial or legal liability. Alternatively, non-compliance by the counterparty may result in the campus not receiving contracted goods or services at the agreed-upon price.

Management Response and Action Plan

BCO's reach is limited to the drafting, negotiating and signing of contracts. It is beyond BCO's purview and ability to involve itself in the administration or completion of contracts. The campus units (BCO'S clients), not BCO, have access to factual information as to how and whether contracts have been performed and completed.

The audit report indicates a concern for "inconsistency in the management of contracts across campus units." Although, as stated, BCO does not have any way of controlling the management of contracts across campus units, BCO does provide a tool for achieving greater consistency in contract management: the Management tab of the BCMS. This may be used to track milestones in the administration of contracts, including revenue/payments, renewal, and any other event desired by the campus unit. The tool provides, *inter alia*, for entry of described actions (nine pre-described, plus "other"), payments due or to be received, due date, completed date, and automatic reminder of future actions by email. This is available to all campus units that use BCMS. In the past 6 months, training on BCMS has been broadened to include training on the "Management" screens. Departments are trained in using BCMS as time permits.

With respect to the updated training on BCMS "Management" screens, A&AS has reached agreement with management on an expected date for completion of this action plan of October 1, 2011.

Non-Routine Contracts Not Systematically Forwarded to University Counsel for Review

Observation

According to the Campus Administrative Memo, *Business Contracts Office: Roles & Responsibilities*, dated September 14, 2000, all contracts must be executed in accordance with the applicable University policies and procedures governing the particular transaction, including but not limited to Business and Finance Bulletins, University policies, and relevant guidelines issued by the appropriate functional areas within the Office of the President. The memo also states that University Counsel is responsible for providing a review of the legal ramifications of contracts in their entirety and approving the contracts as to legal form.

According to BCO management, the decision to submit non-routine contracts for review and approval by University Counsel is based upon the discretionary judgment of the BCO manager reviewing the contract, rather than as a matter of course for all non-routine contracts containing material changes from standard formats or requiring Regental approval under Standing Orders.

We observe that there is a risk that contracts that would normally require review by University or campus counsel are not being reviewed because of the discretionary judgment of the BCO manager reviewing the contract. We inquired of Julie Conner with the Office of Legal Affairs who indicated her impression that BCO contacts her office on an as-needed basis. We noted that, based upon this observation, that BCO may be accepting risk beyond its delegated authority, exposing the campus to unanticipated legal or financial exposure.

Management Response and Action Plan

BCO maintains a close relationship with the Office of Legal Affairs (OLA) and seeks legal counsel where needed. BCO is staffed with three licensed attorneys who have combined legal experience actually practicing law of approximately 75 years so the BCO staff is well trained and experienced in identifying legal issues and seeking legal counsel when needed. BCO sends agreements to the Office of General Counsel (OGC) when, in the judgment of the BCO staff, legal review is warranted.

The primary substantive clauses which comprise the BCO templates have been approved by campus counsel and the OGC. Once the clauses are approved, BCO interchanges the clauses to fit the needs of the transaction. For example, the Office of Ethics, Risk, and Compliance Services, Office of Marketing and Business Outreach and OLA have approved the insurance, indemnity and trademark clauses of BCO contracts, and these provisions are inserted into various contract templates. Some of the more basic terms of the templates, such as introduction, "Whereas" clauses, and governing law, are drafted by BCO.

I have asked Julie Conner of OLA to produce a first draft of a revised September 14,-2000 Dean and Directors memo. Work on the revised memo has already begun. When OLA completes the revised memo, it will be distributed to BCO staff for comments and suggestions. We expect this process to take place over the next six months. It is our intention that this revised memorandum will include language that will provide more clarity around the circumstances that would warrant OLA review of a BCO contract.

A&AS has reached agreement with management on an expected date for completion of this action plan of April 1, 2012.

Lengthy Published Turnaround Times for BCO Contract Review May Potentially Impair Business Needs

Observation

According to the Campus Administrative Memo, *Business Contracts Office: Roles and Responsibilities*, dated September 14, 2000, an established priority and timeline for working on submitted BCO Request Forms has been documented. The memo outlines three categories, Fast Track, Routine, and Complex for which it documents general descriptions of the complexity of the contract, approval level, and estimated length of processing time. The estimated time to execute a contract identified as one in the "Fast Track" category is 3 working days from the receipt of a completed and signed BCO Request Form, for the "Routine" category, 30 working days, and for the "Complex" category, it is contingent upon the complexity of the contract. BCO tries to

provide initial comments to the department within 10 working days from the receipt of a completed and signed BCO Request Form.

We observed that 30 working days to execute a "routine" contract appears lengthy and may potentially impair the business needs of the units requesting BCO review. Anecdotally, our inquiries with campus departments we sampled included several comments (5 out of 20 surveyed) regarding the length of time it takes for BCO to return an executed contract.

Management Response and Action Plan

The Deans and Directors memo of September 14, 2000 provides that for routine contracts:

- "Initial comments are provided by BCO within five working days from receipt of a completed and signed Business Contracts Office Request form," and
- "Estimated time to execute a contract is 30 working days from receipt of a completed and signed Business Contracts Office Request Form."

The business needs of the units requesting BCO review have not in actual fact been impaired, because in practice, it is rare for a routine contract to take as long as 30 working days from completion of the BCO Request form to signing.

The stated 30 working days for execution of a routine contract may, however, be misleading. In revising the Deans and Directors memo (as mentioned in #3 above), this issue will be addressed by reviewing and possibly reducing the published turnaround time for BCO contract review. See the above response for anticipated timing of the memo revision.

A&AS has reached agreement with management on an expected date for completion of this action plan of April 1, 2012.