



OFFICE OF THE LEGISLATIVE AUDITOR

STATE OF MINNESOTA

Professional/Technical Contracting

January 2003

Major Findings:

- Total spending for professional/technical contracts by all branches of state government was about \$358 million in fiscal year 2001, increasing 30 percent since 1996 compared with a 15 percent increase in inflation. Preliminary estimates show that contract expenditures may decrease to less than \$316 million in 2002.
- Between 1996 and 2001, total contract spending increased an average of 5.3 percent



The state needs to improve its oversight of professional/technical contracting.

annually—less than operating expenditures (6.5 percent) and spending for state employee compensation (5.7 percent), but more than inflation (2.9 percent).

- In the first nine months of the current moratorium on contracts, the Department of Administration approved 94 percent of agency requests for exemptions, 62 percent of which were mandated by the Legislature.
- The six state agencies reviewed in detail (the departments of Administration; Children, Families, and Learning; Human Services; Natural Resources; Revenue; and Transportation) often did not follow state statutes, guidelines, or effective

management principles when contracting. For example, contractors often started work before contracts were fully signed or funds encumbered.

- With limited staff resources and few enforcement tools, the Department of Administration does not effectively fulfill the strong contracting oversight role it is given in statutes.

Key Recommendations:

- To better focus the Department of Administration's efforts, (1) the department should delegate more responsibility for contracting to "well-performing" agencies and improve its data collection efforts to better monitor agency activities, and (2) the Legislature should amend *Minn. Stat.* (2002), §16C.08, subd. 2 to require agencies to seek the department's prior approval for contracts over \$20,000, instead of the current requirement of \$5,000.
- The Legislature and the Department of Administration should "clean up" ambiguous, inconsistent, or meaningless statutory and guideline language related to professional/technical contracting.

The full evaluation report, *Professional/Technical Contracting* (#pe03-02), includes the agency's response and is available at 651-296-4708 or:
www.auditor.leg.state.mn.us/ped/2003/pe0302.htm

Report Summary

Recent budget problems in Minnesota state government have renewed policy makers' interest in how state agencies use contracts to obtain professional/technical services. Statutes define such services as "intellectual in character" and resulting in a report or completed task. Among other things, agencies use contractors to help plan highways, design buildings, identify technology needs, and conduct training. Statutes require the Department of Administration to review and approve all executive branch contracts for professional/technical services.

The state generally has a good contracting process on paper, but not in practice.

Prior to FY 2002, Contract Expenditures Grew Faster Than Inflation, but Less Than Other Areas of State Spending

Between fiscal years 1996 and 2001, total spending for professional/technical contracts by all branches of state government increased an average of 5.3 percent annually, compared with an annual increase in inflation of 2.9 percent. This is less than the annual average growth rate in both operating expenditures (6.5 percent) and spending for state employee compensation (5.7 percent). Due in part to the state's budget problems, preliminary estimates show that contract expenditures may decrease at least 12 percent between 2001 and 2002. Spending for contracts as a share of total operating expenditures increased from 5.8 percent in 1996 to 7.6 percent in 2001, while the share attributable to state employee compensation decreased from 73 percent in 1996 to 68 percent in 2001.

To control spending growth and to help reduce the state's budget deficit, the 2002 Legislature directed the Governor to reduce executive branch agencies' General Fund spending for contracts by at least \$28.3 million. In fiscal year 2001, about one-third of total expenditures for professional/technical contracts came from the state's General Fund. The Legislature also adopted a moratorium on professional/technical contracts, effective

March 1, 2002 through June 30, 2003. The new law outlines several categories of exceptions to the moratorium and allows agencies to apply for contract waivers. During the first nine months of the moratorium, the Department of Administration approved 94 percent of agencies' requests for exceptions and waivers; 62 percent of the approvals granted were mandated by the Legislature.

Between 1996 and 2001, the number of contracts and amendments that the Department of Administration processed increased 64 and 152 percent respectively. However, most contracts have been for relatively small amounts of money. During a one-year period beginning in April 2001, about two-thirds of the contracts processed were written for \$50,000 or less. These contracts represented only 7 percent of the total value of the contracts that the department approved. Conversely, 19 percent of the contracts were written for more than \$100,000, but they represented 85 percent of the total value of approved contracts.

Agencies Often Do Not Comply With Statutes and Guidelines

Minnesota statutes and Department of Administration guidelines set forth a good contract oversight system that generally reflects effective contract management principles discussed in the literature. There is little evidence, however, that state agencies are complying with many of these requirements, perhaps in part because there are few ramifications for noncompliance. For example, a review of 60 contracts in six state agencies found that agencies had little documentation about the need for contracts or consideration of alternatives, including the use of state employees. Agencies said that they entered into most of the contracts examined to obtain special expertise unavailable in state government; most contracts were for one-time or special projects. There was little evidence that agencies seriously looked for state employees outside their departments to do the work outlined in the contracts.

The contracts we reviewed often lacked clearly defined monitoring tools, deliverables, or performance standards.

In addition, professional/technical contracts often lacked ways for agencies to hold contractors accountable. About one-half of the contracts examined did not include adequate monitoring tools, such as written progress reports or periodic work products, to help ensure that contracts would yield useful and timely information. More than one-half did not detail measurable performance standards that contractors were expected to meet in terms of quality, timeliness, and quantity, and more than one-third did not clearly specify contract deliverables or timetables. Furthermore, in two-thirds of the contracts examined, agencies allowed contractors to start work before the contracts were fully signed and, in more than one-third of the contracts, contractors were allowed to begin work before the necessary funds were encumbered—two practices that place the state at risk. Nevertheless, agencies reported no major problems with the outcomes from most of the contracts examined. They were generally pleased with the results and believed that the contracts were a good value for the state.

To improve its effectiveness, the Department of Administration needs to prioritize its workload.**The Department of Administration Does Not Perform the Strong Oversight Role Set Forth in Statutes**

Minnesota statutes give the Department of Administration broad authority to oversee the professional/technical contracting process in state agencies. But limited staff resources and a lack of viable enforcement tools make it difficult for the department to ensure agency compliance with contracting statutes and guidelines. For example, the department has not allocated enough staff to ensure that all agencies and contracts comply with state requirements. Two full-time professional staff review a large number of documents annually while fielding questions and providing advice on a daily basis. Furthermore, statutes give the department few tools to help ensure agency compliance with statutes and guidelines.

At the same time, agency heads must assume greater responsibility for ensuring that their agencies' contracting practices comply with applicable statutes and guidelines. Ultimately, the Governor needs to ensure that agency heads are dedicated to achieving their agencies' mission within the current regulatory framework. When disputes arise, Department of Administration staff need to know they have the full weight of the Governor's Office behind them as they enforce contracting requirements related to the expenditure of public funds.

The Department Should Refocus Its Efforts to More Strategically Oversee Contracting Practices

Given the state's current budget crisis, it is unlikely that the Legislature will appropriate more funds to the Department of Administration or that the department can allocate additional resources to improve professional/technical contracting oversight. Therefore, the department needs to better prioritize its current workload, which is now heavily focused on low-cost contracts. To this end, the Department of Administration should delegate significantly more responsibility for professional/technical contracting to "well-performing" state agencies, based partly on agencies' commitment to following contracting laws and guidelines. "Poor-performing" agencies should receive more ongoing scrutiny from the Department of Administration. To help in this task though, the department must improve its data collection efforts so that it has meaningful data with which to monitor agency activities. Also, the Legislature should amend statutes to increase the dollar value of contracts for which agencies must seek prior approval from the Department of Administration from \$5,000 to \$20,000 (the median value of contracts processed by the department). This figure has not been increased—nor adjusted for inflation—for more than ten years. Together, these actions would help streamline the contracting process and allow Department of Administration staff to address problem areas in contracting

Oversight should focus on the most expensive, challenging, or complicated contracts.

as well as focus on the state's more expensive, challenging, or complicated contracts.

Contracting Statutes and Guidelines Need to Be Clarified

Finally, several changes should be made in state contracting statutes and Department of Administration guidelines to address inconsistent, ambiguous, or meaningless contracting requirements. A number of requirements are of limited usefulness, including (1) the Attorney General's review and approval of all contracts, (2) the Department of Employee Relations' directory of all professional/technical services performed by state agencies, and (3) contracting agencies' final report on the purpose and cost-effectiveness of completed professional/technical contracts over \$40,000.

Statutes require that the Attorney General's Office review and approve all professional/technical contracts for "form" (whether the document has been written as a contract with the proper terms, phrases, and attachments) and "execution" (whether the proper signatures have been obtained). The office does not have the express authority to disapprove contracts on other grounds. It would be better to require the Attorney General's involvement only for

those contracts that do not use the standard contract language provided by the Department of Administration. This standard language concerns liability, data practices, financial auditing, and intellectual property rights.

Although required by law, the Department of Employee Relations has not developed a directory of agency services and has no immediate plans to do so. In theory, agencies planning to enter into a contract would consult the directory to determine whether other state agencies would be able to provide the needed services. Because it is likely difficult to develop such a directory and keep it current, policy makers should look for other ways to encourage agencies to use state employees to obtain professional/technical services rather than contractors when appropriate.

Finally, few agencies submit the statutorily-required final report on contracts over \$40,000. Even when completed, the required information is not very useful. The final report should instead be a performance evaluation of the contractor that would include an appraisal of the contractor's timeliness, quality of deliverables, and overall performance. Other agencies could use the evaluation as a reference tool when selecting future contractors.

Summary of Agency Response:

In a January 3, 2003 letter, Commissioner of Administration David Fisher agreed with several OLA recommendations: amending statutes to prohibit agencies from allowing contractors to begin work before contracts are fully signed and funds encumbered; enhancing employee notification about contracting opportunities; requiring agencies, not the department, to determine the need for contracts; and amending or eliminating certain reporting requirements.

Regarding OLA's recommendation to place greater emphasis on regulation rather than facilitation, the commissioner wrote that "MMD's function as a facilitator has been a philosophical approach supported by the current administration and should not be depicted as a shortcoming. Facilitation of sound and legally compliant contracting is a critical, value-added function that Admin should provide" and the department "would always prefer to 'win compliance' through education and persuasion, before resorting to more coercive methods." If the incoming administration supports greater regulation, stronger statutory tools would be necessary, he noted, and potential financial penalties for agency noncompliance should be explored. The commissioner agreed that raising the certification level from \$5,000 to \$20,000 may reduce the department's workload, but said that "low value is not synonymous with low risk" and "even low dollar contracts need adequate levels of oversight." Although the department's database was not created to monitor or track agency compliance, he agreed that enhancing the department's data collection abilities would be a positive improvement. He anticipated doing so "to the extent the fiscal constraints allow" if the department shifted toward greater regulation.