

Financial Audit Division Report

Professional/Technical Services Contracts



Financial Audit Division

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OLA's Financial Audit Division annually audits the state's financial statements and, on a rotating schedule, audits agencies in the executive and judicial branches of state government, three metropolitan agencies, and several "semi-state" organizations. The division also investigates allegations that state resources have been used inappropriately.

The division has a staff of approximately forty auditors, most of whom are CPAs. The division conducts audits in accordance with standards established by the American Institute of Certified Public Accountants and the Comptroller General of the United States.

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- Promote Accountability,
- Strengthen Legislative Oversight, and
- Support Good Financial Management.

Through its Program Evaluation Division, OLA conducts several evaluations each year.

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OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

Financial Audit Division Report

Professional/Technical Services Contracts

April 4, 2008

08-14

FINANCIAL AUDIT DIVISION

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Audit Participation

The following members of the Office of the Legislative Auditor prepared this report:

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Exit Conference

We discussed the results of the audit at an exit conference with the following staff of the departments of Administration and Finance:

Department of Administration:

Dana Badgerow	Commissioner
Sheila Reger	Deputy Commissioner
Lenora Madigan	Financial Management Director
Kent Allin	MMD Director
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Department of Finance:

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OFFICE OF THE LEGISLATIVE AUDITOR
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Representative Rick Hansen, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Dana Badgerow, Commissioner
Department of Administration

Tom Hanson, Commissioner
Department of Finance

We have conducted a review of professional/technical services contracts. During fiscal year 2006, Minnesota spent \$367 million for professional/technical services. Our audit scope included the professional/technical services contracting function of the Materials Management Division of the Department of Administration, and we audited 86 contracts administered by 17 state agencies. Our objectives included internal control over professional/technical services contracts and compliance with applicable legal requirements. The objectives and conclusions of this review are highlighted in the individual chapters of this report.

This report is intended for the information of the Legislative Audit Commission and the management of the Department of Administration and the Department of Finance. This restriction is not intended to limit the distribution of this report, which was released as a public document on April 4, 2008.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Cecile M. Ferkul

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Deputy Legislative Auditor

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Report Summary

Conclusions

The professional/technical contracting processes at the Department of Administration and the agencies included in our audit scope were generally adequate to ensure financial transactions were properly controlled and recorded and that agencies complied with applicable legal requirements. However, we found several weaknesses in control processes and instances of noncompliance with certain legal provisions governing contracts.

Findings:

- Many state agencies included in our scope granted their employees excessive or incompatible access to the state's accounting system, and the Department of Finance did not adequately monitor state agencies' compliance with its accounting system security access policy. ([Finding 6, page 18](#))
- The Department of Administration did not analyze financial transactions recorded in the accounting system to ensure state agencies complied with contracting requirements. ([Finding 1, page 12](#))
- Some agencies did not encumber funds or fully execute contracts prior to receiving services from vendors in some cases, and many state agencies failed to comply with statutory requirements to prepare performance evaluation reports on completed contracts exceeding \$50,000. ([Findings 2 and 3, pages 12 and 13](#))
- The Department of Administration had not promptly updated its state contracting manual for certain statutory changes. ([Finding 4, page 14](#))

- Except for the Department of Administration, state agencies were generally unaware of legal provisions that prohibit contracting with suspended or debarred vendors. ([Finding 5, page 15](#))

Audit Scope:

Period Audited:

- July 1, 2005, through June 30, 2006

Activities Audited:

- Professional/technical contracting oversight responsibilities of the Department of Administration
- Internal control and legal compliance over 86 professional/technical services contracts administered by 17 state agencies
- Security access to accounting applications

Background:

In fiscal year 2006, the state spent \$367 million on professional/technical contractual services. The departments of Administration, Finance, and the Office of Enterprise Technology have significant oversight responsibilities related to the state's professional/technical contracting process. The Department of Administration establishes contracting policies and procedures, and the Department of Finance administers security over the state's accounting system. The Office of Enterprise Technology evaluates state agency information and telecommunications projects.

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Chapter 1. Introduction

Professional/Technical Services Contracts Overview

This report provides a statewide review of internal control and legal compliance over the state's professional/technical services contract expenditures in fiscal year 2006. Professional or technical services are generally intellectual services and include consultation, analysis, evaluation, prediction, planning, programming, or recommendation. The services usually result in the production of a report or the completion of a task. State agencies contract for professional/technical services to obtain special expertise not available in their departments, or to augment current staffing levels to meet seasonal or temporary work demands. Professional or technical services do not include the purchase of supplies or materials, except with the approval of the commissioner of the Department of Administration or as incidental to the procurement of professional or technical services.

Minnesota spent \$367 million for professional/technical services from July 1, 2005, through June 30, 2006. Table 1-1 summarizes these expenditures by the types of professional/technical services obtained.

Table 1-1
Professional/Technical Services Contract Expenditures by Type
(Dollar Amounts in Thousands)
Fiscal Year 2006

Type of Service	Amount	Percent of Total
Architect and Engineering	\$ 73,881	20
Information Technology Development/Maintenance	52,666	14
Educational and Instruction	39,711	11
Health Care	37,175	10
General Management and Fiscal	26,694	7
Environmental, Agricultural, and Science	24,705	7
Offender/Client Supervision	20,030	6
Building Operations/Real Estate/Construction	19,545	5
Legal and Paralegal Services	10,774	3
Program Development and Evaluation	8,378	2
Advertising, Marketing, and Communications	6,945	2
Expense Reimbursements	5,700	2
Other ¹	40,462	11
Total Professional/Technical Contract Expenditures	<u>\$366,666</u>	<u>100%</u>

¹Other professional/technical services expenditures included costs for external administrative hearing judges, court reporters and transcribers, law enforcement and security personnel, and public speakers, among other categories.

Source: Expenditures recorded on the state's accounting system from July 1, 2005, through June 30, 2006.

Several agencies have responsibilities related to contracting for professional and technical services. The commissioner of the Department of Administration has statutory authority to oversee the state's professional/technical services contracting process. The Office of Enterprise

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Technology also has some statewide responsibility for professional/technical services related to information technology contracts. More broadly, the Department of Finance administers security over the state's accounting system that state agencies use to process professional/technical services contract payments.

The Department of Administration's Responsibilities for Professional/Technical Services Contracts

*Minnesota Statutes*¹ give exclusive authority to the commissioner of the Department of Administration to make all decisions regarding acquisition and contracting activities, except those functions specifically assigned to the Attorney General, otherwise provided by law, or delegated by the commissioner to the contracting agency. The statutes generally exempt the constitutional officers and the Minnesota State Colleges and Universities (MnSCU) from the Department of Administration's oversight.

The Materials Management Division of the Department of Administration oversees the state's professional/technical services contracting process. One objective of the division is to assist agencies in successfully negotiating cost-effective contracts that comply with state laws and policies. The division fulfilled its responsibilities in a variety of ways: It developed a state contracting manual to supplement the statutory requirements governing contracts. The manual provides an overview of the contracting process and contains the policies and procedures established by the commissioner of Administration for the supervision, control, and review of all state contracts. The division also maintains a website that contains contracting policies, procedures, and forms.

As part of the state's overall "Drive to Excellence" initiative,² the division took on a more vigorous role regarding professional/technical contracts by (1) implementing a statewide policy that emphasized cost as part of the evaluation of responses to requests for proposals,³ and (2) encouraging aggressive negotiations of professional/technical contracts. Effective August 2005, state policies required that price comprise a minimum of 30 percent of the total available points when evaluating responses to requests for proposals and 40 percent when conducting a multi-tiered evaluation (which involves another step that narrows the number of vendors being considered for final selection).

A significant aspect of the division's responsibilities involved educating state agencies about statutes and policies governing professional/technical services contracts. Every other month, it provided training on a wide variety of topics to contract coordinators employed in state agencies. Recently, it developed training for top management of state agencies to emphasize the importance of compliance with contracting laws and policies. The division also facilitated regular meetings of state contract coordinators for communicating current issues, sharing experiences, and discussing questions.

¹ *Minnesota Statutes* 2006, 16C.03, subdivisions 3 and 4.

² The Drive to Excellence is a Minnesota state-government reform initiative that focuses on serving citizens better by increasing quality and customer service in government and reducing costs.

³ State agencies consider qualitative evaluation criteria as well as cost when awarding contracts to vendors.

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To ensure compliance with contracting laws and regulations, the division created a database that it used to track information by state agency from contract initiation to completion. The database included information on the type of contract, contract pricing, duration, and status. The division used the database to evaluate state agency compliance with certain contract requirements and to produce an annual report on that information for each agency. The report contained information about the number of contracts entered into, the number of single source contracts,⁴ the number of contract amendments, and the number of contracts where agencies violated state statutes by incurring obligations before they encumbered funds or fully executed contracts.

As provided in statutes, the commissioner delegates contracting authority to specific employees of state agencies up to certain dollar thresholds. For example, the Department of Transportation's contract coordinator had delegated authority to authorize contracts up to \$1 million, the highest limit of any state agency. Some employees of other agencies had delegated contracting authority up to \$100,000. The delegations are effective for two years. In order to obtain delegated authority, an employee must receive training in the state's contracting policies and procedures and be certified by the Department of Administration. Regardless of delegated authority, state agencies must provide some information to the Department of Administration as specified in statutes⁵ for contracts exceeding \$5,000.

In addition to these responsibilities, the Materials Management Division coordinates with the Office of Enterprise Technology to review and approve contracts related to information technology services.

The Office of Enterprise Technology's Responsibilities for Professional/Technical Services Contracts

According to statutes,⁶ state agencies may not undertake an information and telecommunications technology project until it has been evaluated by the Office of Enterprise Technology. The evaluation must assess the necessity, design, feasibility, flexibility and cost, and other criteria.

In addition to its statutory responsibilities, the Office of Enterprise Technology initiated a professional/technical services master contract program⁷ in 2005 to assist agencies in contracting for information technology services. It awarded the master contracts based on vendor applications to satisfy needs in 60 different technological skill sets. The end date for the current set of master contracts is March 2010. For those agencies that did not participate in the master contract program and prepared their own information technology contracts, the Office of Enterprise Technology provided review and consultation services to assist agencies in defining their specific contracting needs.

⁴ *Minnesota Statutes* 2006, 16C.02, subd. 18, defines single source as “an acquisition where, after a search, only one supplier is reasonably available for the required product, service, or construction project.”

⁵ *Minnesota Statutes* 2006, 16C.08.

⁶ *Minnesota Statutes* 2006, 16E.03, subd. 3 and 4.

⁷ Master contracts provide the general framework for using services of multiple contractors. They identify, in detail, rates, conditions, and products for each type of service. Agencies must execute work order contracts when using a master contract.

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Audit Approach

We conducted our audit in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we obtain an understanding of management controls relevant to the audit, and that we design the audit to provide reasonable assurance that the State of Minnesota complied with provisions of laws, regulations, and contracts that are significant to the audit. The State of Minnesota's management is responsible for establishing and maintaining the internal control structure and complying with applicable laws, policies, and contracts.

Chapter 2. Oversight, Internal Control, and Legal Compliance

Chapter Conclusions

The Department of Administration generally provided effective oversight of professional/technical services contracts administered by state agencies but could strengthen some of its control procedures. The department should monitor accounting system transactions to ensure state agencies have complied with relevant legal provisions. The department should also timely update the state contract manual for statutory changes. In addition, it should provide state agencies with training on policies and procedures and access to information on contractors that are suspended or debarred from contracting with the state.

State agencies included in our scope had effective controls over their contracting procedures with certain exceptions. Many agencies had inadequate control over employee access to the accounting system, as discussed in Chapter 3. Many agencies failed to comply with statutory requirements to encumber funds and formally execute contracts before receiving services from contractors, and failed to prepare performance evaluation reports on completed contracts. Except for a few isolated cases, the agencies we tested complied with contracting requirements, including bidding procedures, executing contracts, and paying vendors in accordance with contract terms for services provided.

Audit Scope, Objectives, and Methodology

Audit Scope

A primary focus of our audit was the professional/technical services contracting function within the Materials Management Division of the Department of Administration. In addition, we analyzed professional/technical services contract expenditures of \$304 million as recorded in the state's accounting system from July 1, 2005, through June 30, 2006. With certain exceptions,⁸ we performed audit work at agencies that expended about \$3 million or more for professional/technical services contracts in fiscal year 2006. We considered the risk of errors in the accounting records and noncompliance with relevant legal provisions from a statewide perspective. We analyzed accounting data to identify unusual trends or significant changes in financial activity. Based on our analysis, we selected a sample of 86 contracts administered by 17 state agencies. Table 2-1 shows the entities we included in our audit scope.

⁸ We did not test professional/technical services contract expenditures within the Judicial Branch because they are not required to follow executive branch contracting policies. We also did not test federal fund contract expenditures (covered under the Single Audit Act). Finally, we did not test contract expenditures for the departments of Administration and Commerce because we had audited these transactions in the past year.

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Table 2-1
Audit Scope
(Dollar Amounts in Thousands)

<u>State Agency</u>	<u>Fiscal Year 2006 Expenditures</u>	<u>Number of Contracts Tested</u>
1 Agriculture	\$ 3,153	3
2 Corrections	43,387	8
3 Education	23,260	5
4 Employee Relations	6,652	3
5 Employment and Economic Development	13,285	3
6 Explore Minnesota Tourism	4,118	3
7 Health	13,445	4
8 Human Services	29,893	6
9 Iron Range Resources	3,437	3
10 Labor and Industry	7,918	4
11 Minnesota State Colleges and Universities ²	48,053	11
12 Natural Resources	9,514	4
13 Pollution Control Agency	13,770	6
14 Public Safety	7,405	8
15 Revenue	4,017	4
16 Transportation	70,020	8
17 Veterans Home Board	<u>2,943</u>	<u>5</u>
Total	<u>\$304,270</u>	<u>86</u>

¹We selected contracts based on their dollar amount, the type of service being contracted for, and the method the department used to contract with the vendor. We selected additional contracts in some cases to test for certain requirements or to expand our tests when necessary.

²Our review of professional/technical services contracts at MnSCU encompassed Metropolitan State University, Minneapolis Community and Technical College, Minnesota State Community and Technical College, the Office of the Chancellor, and Winona State University.

Source: Expenditures recorded on the state's accounting system from July 1, 2005, through June 30, 2006.

Audit Objectives

This chapter addresses the following questions pertaining to the Department of Administration's responsibility for overseeing the state's professional/technical services contracting process, as well as the specific controls over those financial activities and compliance with legal provisions by state agencies included in our scope:

- Did the Department of Administration provide sufficient information, guidelines, and oversight regarding state agencies' professional/technical contracting activity?
- Did the Department of Administration ensure that state agencies complied with applicable laws and policies when executing professional or technical services contracts?
- Did the agencies within our scope have internal controls that provided reasonable assurance that the agency paid for contractual services actually received, that amounts

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paid were reasonable and within the terms of the contract, and accurately recorded in the accounting system?

- Did agencies within our scope comply with state laws and policies when entering into professional/technical services contracts?

Methodology

To answer these questions, we researched *Minnesota Statutes* to gain an understanding of the legal requirements governing the state's professional/technical services contracting process. Our research addressed both general requirements and the specific statutory responsibilities of the Department of Administration. We also reviewed the Department of Administration's policies and procedures contained in the state contracting manual that state agencies are required to follow. We interviewed Materials Management Division staff to determine the methods used for monitoring state agency compliance with statutes and applicable policies and procedures, and we analyzed the contract management database the division developed and used for monitoring purposes.

We conducted interviews at each agency to gain an understanding of controls over the contracting process and over contract expenditures. As part of our work on internal control, we reviewed employee access to the accounting system. (See Chapter 3 for more information on security access to the accounting system.) We examined supporting documents to assess the adequacy of internal controls and to determine if the department complied with laws, regulations, and contracts. We reviewed contract invoices, original contracts, contract amendments, requests for proposals and responses, and evaluation criteria for vendor selection to complete our testing.

State Agency Professional/Technical Services Contract Process

The professional/technical services contracting process begins when an agency has identified a need for a service that its employees are not available to perform or that requires special expertise. State agencies can use a variety of different types of contracts to obtain professional or technical services, including interagency agreements, joint powers agreements,⁹ or contracts with specific vendors. The contracting agency is responsible for determining the need for a contract, selecting the contractor, executing and monitoring the contract, and encumbering the funds for the contract. As explained in Chapter 1, the Department of Administration also plays a key role in contract management administration.

Agencies may use competitive bidding, master contracts, annual plans, and a single source when contracting for professional/technical services. Master contracts provide a general framework for using services of multiple contractors. The master contract identifies rates, conditions, and products for each type of service and specifies administrative details. Agencies must execute work order contracts when using a master contract. Agencies can submit annual plans for professional/technical services to the Department of Administration at the beginning of the fiscal year that cover low dollar, high frequency types of services. Single source contracts can be used

⁹ A joint powers agreement is an arrangement between a state agency and another governmental unit to share resources, do work for each other, or share work.

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in limited cases where, after a search, only one vendor is determined to be reasonably available to provide the service.

There are different requirements established in statutes and Department of Administration policies, depending on the dollar amount of the contract. The specific dollar thresholds are \$5,000 or less; \$5,001 to \$50,000; and contracts over \$50,000. Each threshold has a different set of criteria for solicitation and other requirements. Table 2-1 outlines the procedural requirements agencies must comply with when entering into competitively bid professional/technical contracts. These requirements do not necessarily apply to other contractor selection methods, such as single source or master contracts. Following the table, we describe each step in further detail.

Table 2-1
Procedural Requirements in Developing Professional/Technical Contracts

	\$5,000 or less	\$5,001-\$50,000	>\$50,000
Submit certification form for Department of Administration approval	Optional	Required	Required
Place notice on a state website or in the State Register	Optional	Required	Required
Prepare Notice for Publication and Formal Request for Proposal,	Optional	Recommended	Required
Advertise in the State Register	Optional	Recommended	Required
Draft contract	Required	Required	Required
Encumber funds	Required	Required	Required
Obtain signatures of contracting parties and the Department of Administration ¹	Required	Required	Required

¹The Department of Administration may delegate the authority to execute contracts to a state agency.

Source: *Minnesota Statutes and Department of Administration State Contracting Manual*.

Before entering into a professional/technical contract valued in excess of \$5,000, agencies must submit a certification form to the Department of Administration. Agencies certify a number of things, including the following: (1) no state employee is available or able to perform the desired service; (2) the agency will make reasonable efforts to publicize the availability of the contract; (3) the agency will assign an individual to monitor and review the project; and (4) the agency will encumber appropriate funds before it allows the contractor to begin work.

Once the Department of Administration approves the certification form, agencies must publicize notice of the contract, select the contractor, and draft the contract. Once the contractor and contracting agency have signed the contract, the Department of Administration must review and approve it unless the contracting agency has delegated authority. Before approving a proposed contract, the department must determine several things, including (1) the contracting agency has complied with state laws and policies; (2) the work called for is necessary and not duplicative of other agencies' efforts; and (3) the contracting agency has specified a satisfactory method for evaluating, monitoring, and using the results of the contract. Once all three parties have signed the contract and the agency has encumbered the necessary funds, the contract is valid.

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During the contract period, the contracting agency's authorized representative is responsible for monitoring the contract and approving the invoices. According to statutes, agencies cannot pay out more than 90 percent of the amount due under the contract until the head of an agency reviews and approves the final product as satisfactory.

Table 2-2 on the following page highlights key contracting statutes and policies state agencies are required to follow. These are the compliance provisions we tested.

Table 2-2
Legal Compliance Requirements¹

Funds should be encumbered prior to contract being fully executed.	Minnesota Statutes 2006, 16A.15, subd. 3 and 16C.05, subd. 2(3)
Creation and validity of contracts and amendments as to form and execution—proper approvals by agency and Department of Administration.	Minnesota Statutes 2006, 16C.05, subd. 2
Contracting agency must certify to the Department of Administration that no current state employee was available to perform the services, and the contractor or agent was not a state employee.	Minnesota Statutes 2006, 16C.08, subd. 2
Contract amendment should not expand the scope of the original contract.	Minnesota Statutes 2006, 16C.05, subd. 2(3)(d)
Contract should be fully executed before work begins unless deemed an emergency by the commissioner of Administration.	Minnesota Statutes 2006, 16C.08, subd. 2(5)
Length of contract, including amendments, not to exceed five years without specific approval.	Minnesota Statutes 2006, 16C.08, subd. 3(5)
If the contract was over \$50,000, a one-page evaluation report must be submitted to the Department of Administration within 30 days.	Minnesota Statutes 2006, 16C.08, subd. 4(C)
No more than 90 percent of the amount due under the contract may be paid until the agency head has certified that the services provided are satisfactory.	Minnesota Statutes 2006, 16C.08, subd. 5
For computer or information technology-related services, Office of Enterprise Technology approves state agency and intergovernmental information, telecommunications technology systems, and services contracts.	Minnesota Statutes 2006, 16E.01, subd. 3(a)(2)
Contracts with a public accountant should be reviewed by the Office of the Legislative Auditor.	Minnesota Statutes 2006, 3.972, subd. 3
Contracts for legal services must have written authorization from the Office of the Attorney General.	Minnesota Statutes 2006, 8.06
State agencies must work with the Department of Finance when contracting for banking services.	State Contracting Manual, Section 9
State agencies must not contract with vendors who have been suspended or debarred from contracting with federal or state government entities.	Minnesota Rules , Chapter 1230, Section 1150
State agencies must comply with the Department of Administration's contracting policies and procedures.	State Contracting Manual

¹Although MnSCU is included in our audit scope, per [Minnesota Statutes](#) 2006, 16C.02, it is not subject to most of the statutes and policies and procedures governing contracts applicable to state agencies. MnSCU's Board of Trustees establish MnSCU's contracting procedures.

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Current Findings and Recommendations

The Department of Administration should improve its oversight and coordination of professional/technical services contracts as identified in the following findings and recommendations. Chapter 3 includes findings on security access to the state's accounting system. Appendix A details all individual findings by agency. It includes a few isolated findings we identified at one or two state agencies, such as noncompliance with requirements to withhold a portion of contract payments until services have been deemed acceptable by agency heads (retainage) and outdated delegations of authority. Also, for additional details on MnSCU findings on professional/technical contracting, see OLA Financial Audit Division report 07-25.

1. The Department of Administration did not review transactions recorded in the accounting system to monitor state agency compliance with legal requirements governing contracts.

The department relied extensively on information submitted by state agencies as the basis for monitoring compliance with statutes and department policies governing contracts. The department entered the information provided by agencies into a database that it used for monitoring purposes. The department used information in its database to analyze contract expenditures on a statewide basis and to track contracts from initiation to completion. However, without an independent analysis of transactions in the accounting system, the department had limited assurance that agencies had not circumvented certain statutory and policy requirements. For example, state agencies could have contracted for professional/technical services without the department's knowledge or involvement. Agencies could also exceed the department's delegated authority or amend contracts for services outside the scope of the original contract rather than initiating a new contract. By comparing the database information to the state's accounting system, it would identify contract transactions not reported by agencies and could determine whether those transactions complied with applicable legal provisions.

Recommendation

- The Department of Administration should develop a cost effective method of periodically analyzing summarized transactions in the state's accounting system associated with professional/ technical services contracts to ensure state agencies comply with the state's legal requirements over contracts. The analysis should be risk-based, could rely on sampling techniques, and should include follow up on significant variances from expectations.*

2. Four state agencies did not always comply with the statutory requirements to encumber funds or fully execute contracts before incurring obligations for services provided by vendors.

Minnesota Statutes require that agencies encumber funds¹⁰ and have fully executed contracts in place¹¹ before vendors provide professional/technical services to the state. The encumbrance

¹⁰ *Minnesota Statutes* 2006, 16A.15, subd. 3.

¹¹ *Minnesota Statutes* 2006, 16C.05, subd. 2.

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requirement ensures the department has sufficient funds available to pay for the contracted services. A fully executed contract protects the state's interests by ensuring both parties have agreed to the terms of the contract before the vendor provides services. The commissioner of Administration has statutory authority to approve exceptions in the case of emergencies when an agency has not finalized a contract. Similarly, the commissioner of Finance has the statutory authority to determine when agencies do not need to encumber funds prior to incurring an obligation. The state contracting manual (Section 7) requires that if violations occur with either statutory requirement, the agency must submit to Administration a "violation memo" authorized by agency management. The violation memo documents the circumstances that resulted in the noncompliance and the necessary corrective action to prevent future noncompliance. Administration may refuse to authorize the contract without either a reasonable explanation for the expenditure or effective corrective action to prevent noncompliance in the future. Some of the agencies did complete the violation form in accordance with the policy, while others did not.

Administration had a process to monitor agency compliance with the statutory requirements to encumber funds and fully execute contracts prior to incurring obligations. The department tracks exceptions and provides periodic reports to state agency department heads.

Recommendations

- *State agencies incurring obligations prior to encumbering funds or executing contracts need to revise their procedures to ensure compliance with statutory requirements when negotiating future professional/technical services contracts. If exceptions occur, agency personnel must file the required violation memo with Administration.*
- *Administration should continue its oversight of agencies that incur obligations prior to encumbering funds or executing contracts and consider progressive disciplinary action, including enforcing its authority to reject contracts or rescind delegated authority, for continued noncompliance.*

3. Many state agencies did not prepare performance evaluation reports on completed contracts exceeding \$50,000, as required by statutes.

Ten of sixteen agencies tested (MnSCU is not subject to this requirement) either did not prepare performance evaluation reports or did not promptly file the reports. *Minnesota Statutes*¹² require agencies to submit a performance evaluation report on completed contracts that exceeded \$50,000¹³ to the Department of Administration within 30 days after the head of the contracting agency certified the services provided as acceptable. Many agencies were unaware of the requirement to complete the performance reports (even though it is contained in the state contract manual). Other agencies did not have processes to ensure that their employees prepared

¹² *Minnesota Statutes* 2006, 16C.08, subd. 4(c).

¹³ *Laws of Minnesota* 2007, Chapter 148, Article 2, Section 84 repealed *Minnesota Statutes* 2006, 16C.08, subd. 4a, that had also required performance evaluation reports be prepared for completed contracts between \$5,000 and \$50,000.

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performance evaluation reports for all completed contracts exceeding \$50,000, or that the evaluations were timely filed. The required one-page report summarizes the purpose of the contract, the amount spent on the contract, and a written evaluation of the contractor's performance. The purpose of the evaluation report is to provide other state agencies with useful information when evaluating future proposals submitted by the contractor.

Recommendations

- *The Department of Administration's Materials Management Division should monitor state agencies' compliance with statutory requirements on completing performance evaluation reports and follow up with state agency management to achieve compliance.*
- *The division should create a database of completed evaluation reports that state agencies can readily access to assist them with future contracting decisions.*

4. The Materials Management Division did not promptly update the state's contracting manual for certain statutory changes.

Several sections of the state contracting manual contained outdated requirements. For example, the manual continued to refer to the Attorney General's authorizations of contracts even though the Legislature repealed that requirement effective July 2003. The manual also did not contain the correct dollar thresholds for certain statutory requirements, such as when the Architect, Engineering and Designer Selection Board needed to approve construction design and planning contracts, and when state agencies needed to obtain approval for information technology contracts or submit performance evaluation reports. The Materials Management Division last published the state's contracting manual in April 2000; the manual is also available on the division's website. Although the division updated certain sections of the manual in September 2001 and January 2004, the revisions were not comprehensive. It is important that the state's contracting manual be up-to-date since the policies and procedures provide a reference to assist state agencies in the administration of professional/technical services contracts.

Recommendation

- *The division should promptly update the state contracting manual to reflect changes in laws, policies, and procedures.*

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5. Except for the Department of Administration, state agencies were generally not aware of legal provisions that prohibit contracting with suspended or debarred vendors and lacked procedures to ensure compliance with those requirements.

*Minnesota Rules*¹⁴ require that the Materials Management Division use the same terms and limits as established by the federal government to debar vendors from contracting with the state. Although the Materials Management Division effectively verified that potential contractors had not been suspended or debarred as part of its contract certification process (required for all contracts exceeding \$5,000), most agencies were unfamiliar with this restriction. Therefore, state agencies may have spent time and resources planning to contract with a suspended or debarred vendor prior to involvement by Materials Management. The federal government maintained an “Excluded Parties List” of suspended and debarred vendors (available at <http://www.epls.gov>), and the division maintained a master list of state suspended and debarred vendors that was available to state agencies on request. However, state agencies did not understand the requirements on suspension and debarment, and the lists were not readily accessible to assist the agencies in planning for professional/technical services contracts, resulting in potential inefficiencies in the contracting process.

Recommendation

- *The Department of Administration should make the lists of state and federal suspended and debarred vendors available to state agencies on its website, should incorporate policies and procedures about suspended and debarred vendors in the state contract manual, including the need to document the verification process, and should provide training on suspended and debarred vendors to state agency personnel.*

¹⁴ *Minnesota Rules* Chapter 1230, Section 1150, subpart 2B(1).

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Chapter 3. Security Access to Accounting Applications

Chapter Conclusions

Many state agencies included in our scope granted their employees excessive or incompatible access to the state's accounting system, thereby increasing the risk to data security and of errors or improper transactions. Most of those agencies did not comply with the Department of Finance's policy that requires documented mitigating controls to address the risks associated with employees having incompatible access to the accounting system, and the Department of Finance did not adequately monitor state agencies' compliance with its accounting system security access policy.

Audit Objective and Methodology

The primary objective of our audit of employee access to the procurement, contract, and accounts payable components of the state's accounting system was to answer the following questions:

- Were agency controls over employee access to the state's accounting system adequate to ensure that employees only had the level of access necessary to perform their job duties?
- If the level of access an agency granted to its employees created an inadequate segregation of duties, did the agency develop and document compensating controls that mitigated the weakness?

To answer these questions, we gained an understanding about the security profiles established in the accounting system. We interviewed agency security officers to identify controls over employee access to the accounting system. On a test basis, we interviewed agency employees to gain an understanding of their job duties and reviewed their security clearances to determine if the level of access granted was appropriate. We also reviewed the security profiles of a sample of employees to determine if their level of access resulted in an inadequate segregation of duties and, if applicable, whether the agency had developed and implemented compensating controls.

Background

The Department of Finance is responsible for administering and maintaining the state's accounting system, setting up the security groups that allow users to access the modules within the system, and developing applicable policies and procedures. Finance policy¹⁵ requires that

¹⁵ Department of Finance Policy 0705-03.

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agencies use the contract financial management system within the accounting system for professional/technical contracts. This module lets state agencies track contracts, generate reports, and make payments for professional/technical service contracts or lease-type contracts.

Another Finance policy,¹⁶ requires each agency to designate at least one employee to be the accounting system security liaison. The assigned individual works with Finance's security officer to obtain accounting system clearance for new employees, change existing access due to changes in job responsibilities, and to delete access for employment terminations. The agency's security liaison is responsible to determine the security profile for an employee based upon position responsibilities and the need for access to the accounting system. Each year, agencies must review the accounting system clearances of their employees and certify the appropriateness of those profiles to Finance.

Agencies had the following weakness and noncompliance with Finance policy in their administration of accounting system security responsibilities. Appendix A provides a more detailed list of security access findings by agency.

Current Finding and Recommendations

6. **Several state agencies increased the risk to data security and the risk of errors or improper transactions by not adequately segregating incompatible duties in the accounting system and/or by allowing certain employees excessive access. Also, the Department of Finance did not adequately monitor state agencies' compliance with its accounting system security access policy.**

Ten of seventeen agencies tested authorized incompatible security profiles and/or did not ensure that employees only had the required security access to the state's accounting system to perform their job duties. The incompatible profiles allowed employees to create and process contracts and purchase orders, encumber funds, and pay invoices. Generally, agencies should assign security clearances over the functions of procurement and processing payments to different employees to achieve appropriate control over expenditures. When functions are segregated, controls would prevent or timely detect errors or unauthorized transactions in the accounting system. Also, the access granted should be limited to only the level necessary for employees to perform their job duties. The risk of errors and improprieties diminishes when duties are segregated, and employees are unable to access incompatible financial functions in the accounting system. Agencies had the following weaknesses over employee access to the accounting system:

- 105 of 237 employees tested had incompatible access without mitigating controls to detect errors or improper transactions.
- 60 of 139 employees sampled had too much access to perform their expenditure-related job duties.

¹⁶ Department of Finance Policy 1101-07.

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The state's accounting system has distinct security profiles that provide the ability to separate incompatible duties and help prevent erroneous or fraudulent transactions. If it is not feasible to segregate duties, for example, because of limited staff, the Department of Finance's policy¹⁷ requires that state agencies develop a written plan identifying compensating controls. The departments with exceptions had not developed the required plan or implemented any compensating controls, and the Department of Finance had not identified these problems. Typically, compensating controls should require an independent person review transactions entered by the individual with access to perform incompatible duties and obtain sufficient evidence to ensure transactions were authorized and appropriate.

Recommendations

- *State agencies should eliminate incompatible employee access to the accounting system or develop mitigating controls that provide independent review of the activity processed by those employees, as required by Finance policy.*
- *State agencies should strengthen their periodic review of employees' security profiles in the accounting system to ensure that access is limited to only the profiles necessary for the employees' assigned job responsibilities.*
- *The Department of Finance should provide more guidance to state agencies on incompatible security profiles in the accounting system and strengthen its oversight of state agencies' compliance with security access policies.*

¹⁷ Department of Finance Policy 1101-07.

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Status of Prior Audit Issues

As of August 31, 2007

Most Recent Audit

Legislative Audit Report 03-02, issued by the Program Evaluation Division in January 2003, dealt with the professional/technical oversight role of the Department of Administration. The report contained 11 recommendations for the department to enhance the administration and processing of professional/technical services contracts. Eight of the recommendations pertained to suggested changes to *Minnesota Statutes* governing professional/technical services contracts. Others dealt with delegations of authority to state agencies for contracting and the certification of contract information by state agencies. Most of the recommendations had been resolved at the time of our audit.

Professional/Technical Services Contracts

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Professional/Technical Services Contracts - Appendix A	
Summary of Findings by Agency	
<u>Department</u>	<u>Finding</u>
Agriculture	Performance evaluation reports not prepared for 1 of 3 completed contracts tested.
Agriculture	28 of 35 employees tested had too much access to the accounting system.
Corrections	Funds not encumbered prior to obligation for 2 of 8 contracts tested (required violation memos on file).
Corrections	Services provided prior to contract execution for 3 of 8 contracts tested (required violation memos on file).
Corrections	Performance evaluation reports not prepared for 2 of 8 completed contracts tested.
Corrections	Paid 2 vendors more than 90 percent of amounts due before services certified as acceptable.
Corrections	Of 20 employees tested, 2 had too much access to the accounting system, 11 had incompatible access, and lack of adequate procedures on compensating controls.
Education	Services provided before contracts executed and funds encumbered for 3 of 3 contracts tested (required violation memos on file).
Education	Outdated delegations of authority.
Employee Relations	5 of 8 employees had incompatible access to the accounting system and lack of adequate procedures on compensating controls.
Employee Relations	Outdated delegations of authority.
Employee Relations	Performance evaluation reports not prepared on completed contracts.
Employment and Economic Development	3 of 4 employees tested had too much access to the accounting system, 32 of 45 employees tested had incompatible access, and lack of adequate procedures on compensating controls.
Employment and Economic Development	Performance evaluation reports not prepared for 3 completed contracts tested.
Explore Minnesota	Paid 2 vendors more than 90 percent of amounts due before services certified as acceptable.
Health	Performance evaluation reports not prepared or not timely submitted for 33 percent of completed contracts tested.
Health	Services provided prior to contract execution for 1 of 4 contracts tested (required violation memos on file).
Human Services	25 of 99 employees had incompatible access to the accounting system and lack of adequate procedures on compensating controls.
Human Services	Performance evaluation reports not prepared for 3 of 4 completed contracts tested.
Iron Range Resources	8 of 12 employees had incompatible access to the accounting system and lack of adequate procedures on compensating controls.
Labor and Industry	No reportable findings.

Professional/Technical Services Contracts - Appendix A	
Summary of Findings by Agency	
<u>Department</u>	<u>Finding</u>
MnSCU	MnSCU's accounting system does not provide the ability to effectively monitor compliance with legal requirements governing contracts.
MnSCU	Funds not encumbered prior to obligation for 4 contracts with 2 vendors (required violation memos on file for 2 exceptions).
MnSCU	Contracts or amendments not executed for some services and 2 contracts not authorized.
MnSCU	2 contracts not approved, not competitively bid, terms not limited, amounts not specified.
MnSCU	4 contracts and 3 amendments with 1 vendor for database services not administered properly.
MnSCU	Procedures did not require: verification that contractors have not been suspended or debarred, retainage on contract payments, performance evaluations be prepared on completed contracts.
Natural Resources	Performance evaluation reports not prepared for 12 of 14 completed contracts tested.
Pollution Control	Performance evaluation reports not prepared for 2 of 6 completed contracts tested.
Public Safety	Of 18 employees tested, 11 had too much access and incompatible access to the accounting system, and lack of adequate procedures on compensating controls.
Revenue	Performance evaluation reports not prepared for completed contracts.
Revenue	Of 25 employees tested, 4 had too much access to the accounting system, 5 had incompatible access, and lack of adequate procedures on compensating controls.
Transportation	Of 10 employees tested, 9 had too much access to the accounting system, 8 had incompatible access, and lack of adequate procedures on compensating controls.
Veterans Home Board	3 of 27 employees tested had too much access to the accounting system.



March 28, 2008

Jim Nobles, Legislative Auditor
Office of the Legislative Auditor
Centennial Office Building, First Floor
658 Cedar Street
Saint Paul, Minnesota 55155

Dear Mr. Nobles:

Thank you for the opportunity to respond to the audit report on statewide professional/technical (P/T) services contracts covering the period July 1, 2005, through June 30, 2006. We appreciate the professionalism of your staff, and particularly, your work to achieve our shared goal of promoting strict adherence to legal and ethical contracting standards.

We are pleased that the overall conclusion of the report finds that the oversight function of the Department is effective. We are also pleased that several of the findings presented are simple administrative matters that were easily addressed soon after they were identified during your field work last year. We are appreciative of the recognition given to the strides the Department has made in promoting and conducting more vigorous contract negotiations which to date has resulted in cost avoidance to state agencies in excess of \$44 million. (This effort has also resulted in recent national attention in Governing Magazine's 2008 "Grading the States" as well as the August 2007 edition of Government Procurement Magazine.)

With respect to the specific findings, we offer the following comments:

Finding 1

The Department of Administration did not review transactions recorded in the accounting system to monitor state agency compliance with legal requirements governing contracts.

Recommendation

The Department of Administration should develop a cost effective method of periodically analyzing summarized transactions in the state's accounting system associated with professional/technical services contracts to ensure state agencies comply with the state's legal requirements over contracts. The analysis should be risk-based, could rely on sampling techniques, and should include follow-up on significant variances from expectations.

Implementation of this recommendation would expand the Department's oversight approach in a manner that is neither statutorily required nor historically employed. The Department implements its statutory role through review of documents that are required to be presented for approval, providing a complement of training options, and addressing problems that are raised by any stakeholders. In performing this work, the Department relies

extensively on representations and written certifications made by the agencies to ensure that they have followed appropriate processes. The overall goal is to achieve the highest level of compliance possible with applicable statutes, rules, policies and best practices through review and approval, education, standard policies and procedures, dialogue, and reliance upon agency certification.

We have found that the best way to promote this objective is to balance our policing role with a unit comprised of staff members who are approachable, non-intimidating, well-informed and helpful in assisting the agencies meet their needs within the confines of the law, consistent with our agency mission to “help our customers succeed” legally and ethically. The establishment of this type of relationship with agency staff promotes candid disclosures and a willingness to acknowledge mistakes, many of which are brought to our attention early enough to mitigate serious legal consequences. Further, the Department’s investigatory role with respect to vendor complaints and protests is another widely-used avenue by which questionable practices and transactions are brought to our attention and resolved.

With this in mind, and while recognizing the authority to do so, the Department has never engaged in this more-aggressive policing and investigatory approach suggested by the OLA. In addition, this recommendation adds strain to an already fully-occupied workforce. When assessed in light of the absence in the audit findings of any specific identified risk against which this audit of MAPS transactions would mitigate, it is concerning to the Department to further tax its limited resources.

However, we recognize that the recommendation is flexible with respect to the scope of implementation. It allows, for example, periodic reviews and the use of sampling techniques. In light of this flexibility, the Department agrees that it will implement this recommendation to the best of its ability with its available resources, and consistent with the real and potential risks.

Finding 2

Four state agencies did not always comply with the statutory requirements to encumber funds or fully execute contracts before incurring obligations for services provided by vendors.

Recommendation

- ***State agencies incurring obligations prior to encumbering funds or executing contracts need to revise their procedures to ensure compliance with statutory requirements when negotiating future professional/technical services contracts. If exceptions occur, agency personnel must file the required violation memo with Administration.***
- ***Administration should continue its oversight of agencies that incur obligations prior to encumbering funds or executing contracts and consider progressive disciplinary action including enforcing its authority to reject contracts or rescind delegated authority for continued noncompliance.***

The Department agrees entirely that state agencies must make all reasonable efforts to avoid incurring an obligation prior to contract encumbrance or execution. The Department emphasizes this issue in its training sessions and in its educational reference materials. The Materials Management Division (MMD) internally tracks these types of violations, runs reports on a quarterly basis, discusses these statistics with Department leadership as needed, provides individualized annual reports to the agencies on the number of violations they have incurred, and takes agency-specific action when the statistics demonstrate negative trends.

Statistics generated prior to the time MMD began providing annual reports to agency heads show statewide FY02 rates for 16A and 16C violations at 8.30 percent and 14.66 percent respectively. More recent (FY07) data shows that these figures have dropped dramatically to 3.13 percent for 16A violations and 5.76 percent for 16C violations. In sum, the data demonstrates that Department and agencies are working diligently to avoid these types of violations and are making great strides. Violations have been reduced by more than half.

Recognizing the occasional dilemma agencies face between allowing critical work to begin and finalizing the contracting process, the Department worked proactively in 2003 to promote legislation that allows work to begin prior to contract execution in limited emergency circumstances. We believe these efforts have resulted in an overall containment of this poor contracting practice which is supported by the finding in the report showing that the vast majority of the agencies examined did not have issues in this area. However, any such violations are too many, and this Department will continue its focus in this area as recommended.

Regarding the second recommendation, the Department has legal concerns with respect to utilizing its contract rejection authority to discipline an agency that has allowed work to begin prior to final contract execution. Once the Department learns that a contractor has begun work with the go-ahead from an agency, the priority of the Department is to get the contractual protections in place immediately. The Department will address the matter sternly with the agency and take appropriate action as the situation demands, but the Department believes that withholding our signature, and depriving the state of the indemnity, insurance and other protective aspects of the contract is not in the best interest of the state.

Finding 3

Many state agencies did not prepare performance evaluation reports on completed contracts exceeding \$50,000, as required by statute.

Recommendation

- ***The Department of Administration's Materials Management Division should monitor state agencies' compliance with statutory requirements on completing performance evaluation reports and follow up with state agency management to achieve compliance.***
- ***The division should create a database of completed evaluation reports that state agencies can readily access to assist them with future contracting decisions.***

As it relates to preparing and submitting contractor performance evaluations, there are a few reasons why we believe agencies sometimes overlook this task:

- (1) Under the current statutory decentralized model for P/T contracts, agencies are the contracting entity as opposed to the Department's central procurement office. The agency therefore is responsible for contract administration and close out. As a result, the Department's last interaction with the agency on any given contract may occur 2-5 years before the agency is required to generate the performance evaluation. The absence of active engagement with the agency on a particular contract at this stage may have an impact on compliance; and
- (2) When agencies do complete the performance evaluation, it is submitted through MMD and forwarded to the Legislative Reference Library. There, it is filed and shelved. We do not believe there is significant use of this information in its present state and this impacts an agency's sense of urgency or commitment to complete the task.

The Department will explore the most efficient ways of monitoring agency compliance in this area and whether there is an affordable way to accomplish the performance of this task. The Department has in the past discussed options with the Legislative Reference Library related to monitoring agency submissions and the creation of a web-based tool to provide ready access to performance data. The Department will reestablish these communications and determine if there is a possibility that resources might be shared to accomplish these tasks.

Another preliminary matter that needs to be addressed with respect to the creation of a public database of this nature is whether it 1) results in an unacceptable chilling effect on the candor exhibited in the reports; and 2) whether the accessibility and resultant use of this data may expose agencies to litigation. In anticipation of the

latter concern, the Department initiated a legislative change in 2007 that precludes legal action against a state employee for completing these performance evaluations unless the employee knew or should have known the information was false and defamatory and acted with malicious intent to injure. Even with this added level of protection, the Department would want to work closely with the Attorney General's Office in implementing a database of this nature to assure the legal interests of those involved are adequately protected.

Finding 4

The Materials Management Division did not promptly update the state's contracting manual for certain statutory changes.

Recommendation

- ***The division should promptly update the state's contracting manual to reflect changes in laws, policies, and procedures.***

The Department fully agrees with this recommendation. Manual provisions pointed out as outdated by the OLA were corrected in February, 2007. Continual upkeep and improvements are ongoing.

Finding 5

Except for the Department of Administration, state agencies were generally not aware of legal provisions that prohibit contracting with suspended or debarred vendors and lacked procedures to ensure compliance with those requirements.

Recommendation

- ***The Department of Administration should make the lists of state and federal suspended and debarred vendors available to other state agencies on its website, should incorporate policies and procedures about suspended and debarred vendors in the state contract manual, including the need to document the verification process, and should provide training on suspended and debarred vendors to state agency personnel.***

The Department agrees with this recommendation. The state accounting and procurement system is programmed to prohibit payments to suspended and debarred vendors. Nevertheless, in June 2007, shortly after this subject was mentioned during the OLA's field work, the Department placed a listing of state suspended and/or debarred vendors on its website along with a link to the federal Excluded Parties List System. Additional information will be added to the contracts manual and incorporated more extensively into the training curriculum.

Again, thank you for the opportunity to provide this response. The report serves to validate the effectiveness of the Department's oversight function and provides helpful direction as we work toward continuous improvement.

Sincerely,

Dana Badgerow, Commissioner
Department of Administration

cc: Sheila Reger, Deputy Commissioner
 Lenora Madigan, Financial Management Director
 Kent Allin, Chief Procurement Officer
 Betsy Hayes, Contracts Manager

March 14, 2008

James R. Nobles, Legislative Auditor
Office of the Legislative Auditor
658 Cedar Street
140 Centennial Office Building
St. Paul, MN 55155-4708

Dear Mr. Nobles:

Thank you for the opportunity to discuss your audit finding related to MAPS security in your Report on Statewide Professional/Technical Services Contracts. We are committed to the security of the statewide accounting system and we will continue to work towards improving our processes.

Finding 6: Several state agencies increased the risk to data security and the risk of errors or improper transactions by not adequately segregating incompatible duties in the accounting system and/or by allowing certain employees excessive access. Also, the Department of Finance did not adequately monitor state agencies' compliance with its accounting system security access policy.

Recommendation:

- *State agencies should eliminate incompatible employee access to the accounting system or develop mitigating controls that provide independent review of the activity processed by those employees, as required by Finance policy.*
- *State agencies should strengthen their periodic review of employees' security profiles in the accounting system to ensure that access is limited to only the profiles necessary for the employees' assigned job responsibilities.*
- *The Department of Finance should provide more guidance to state agencies on incompatible security profiles in the accounting system and strengthen its oversight of state agencies' compliance with security access policies.*

Response: We agree with your recommendations and have recently instituted procedural changes to improve agency understanding and strengthen compliance oversight.

On March 3, 2008, a revised MAPS Security and Access policy was published on our website.

Letter to James R. Nobles, Legislative Auditor
Page Two
March 14, 2008

The updated policy is more specific about the combinations of MAPS security groups that usually reflect incompatible functions. It also stresses that in cases where incompatible functions cannot be separated, compensating controls are mandatory.

We also developed a supplemental security report that lists only the users who are authorized for combinations of security groups that usually reflect incompatible functions. This report, which for a typical agency is just one page long, enables an agency security liaison to see at a glance which users require the most scrutiny. Instructions for using the report have also been written.

These new materials are being used to strengthen our annual MAPS user security certification process. The materials are being provided to MAPS security liaisons at each agency. On February 26, 2008 the materials were sent to half of the agencies; the remainder will be mailed on March 18, 2008. As the certification documents are returned, we will review the access reductions generated by these changes. Follow up steps will be determined after the results of these initial steps are evaluated.

Finally, for those agencies that cannot adequately separate duties, we will provide additional instruction on mitigating controls.

Person responsible: Steve Olson, Department of Finance

Implementation date: July, 2008

Sincerely,

A handwritten signature in black ink, appearing to read "Tom J. Hanson".

Tom J. Hanson
Commissioner