

Contract Management Principles and Practices

SUMMARY

Minnesota statutes and Department of Administration guidelines provide a framework for professional/technical contracting that reflects effective contract management principles discussed in the literature. However, we found little evidence that the state agencies we reviewed followed many of these laws or guidelines, and we found few ramifications for agencies as a result of noncompliance. For example, the agencies routinely allowed contractors to start work before contracts were fully signed and often before agencies encumbered the necessary funds, despite statutes or guidelines to the contrary. In addition, the agencies did not adequately document the need for many of their contracts, especially regarding the availability of state employees to provide the needed services. Contracts were often poorly written and frequently did not contain clearly defined deliverables, monitoring tools, or performance expectations. Furthermore, we saw little evidence that the Department of Administration enforced these requirements in the contracts that we reviewed. Nonetheless, agencies reported no major problems with the outcomes from most of the contracts examined. State agencies were generally pleased with the contracts' results and believed that they were a good value for the state.

As discussed in Chapter 1, Minnesota state government spends millions of dollars each year on professional/technical contracts. Legislators have questioned whether state agencies adhere to state laws and guidelines when entering into these contracts and the extent to which the Department of Administration enforces these requirements. This chapter takes a closer look at the contracting practices in six agencies and addresses the following questions:

- What are the principles for effective management of professional/technical contracts?
- To what extent have certain state agencies complied with state laws, Department of Administration guidelines, and contract management principles when entering into professional/technical contracts?
- To what extent have these agencies determined whether they could have obtained similar services using state employees?
- How well have selected state agencies managed professional/technical contracts? How have they used contract results or products?

To answer these questions, we reviewed professional/technical contracts in six state agencies: the departments of Administration; Children, Families, and Learning; Human Services; Natural Resources; Revenue; and Transportation. These agencies were selected based on a variety of factors including legislative interest and their total expenditures for professional/technical contracts. We reviewed ten contracts from each of these six agencies. The contracts were all written for at least \$50,000 (contracts were written for at least \$100,000 in the Department of Transportation), and were in the three “service categories” for which that agency spent the most. Of these contracts, the majority of the files we reviewed were above the median value for each service category. We also selected the maximum-valued contract written between 1999 and 2001 in each of the three service categories.

In addition to reviewing 60 contract files, we interviewed staff in each agency that were most responsible for the oversight of each contract. We also reviewed Department of Administration guidelines, Minnesota statutes, and the national literature on recommended contracting practices. Finally, we spoke with staff from several state agencies responsible for overseeing the contracting process.

CONTRACTING PRINCIPLES, STATUTES, AND GUIDELINES

As discussed in Chapter 1, state government spent about \$358 million in fiscal year 2001 on professional/technical contracts. As with all public spending, the state must be held to a high standard regarding the purpose and cost-effectiveness of these expenditures. It is important that the state’s contracting process is as open, fair, and objective as possible to avoid even the perception of favoritism or wrongdoing. As a result, Minnesota has several statutes that regulate contracting, and the Department of Administration has developed guidelines for agencies to follow when contracting for professional/technical services.

State contracting should conform to the highest standards of good government.

Contracting Principles for State Agencies

Although a well-written contract can yield bad results and a poorly written contract can yield good results, state agency contract management processes and practices should conform to the highest standards of good government. For this evaluation, we developed a list of contracting “principles” for state agencies based on national public administration literature and noteworthy contracting practices in other states.¹ Table 2.1 outlines 18 principles of effective contract management. These principles support the overall goals that agencies should follow when contracting for professional/technical services. Specifically, agencies should:

1. determine that a contract is the best way to obtain a needed service,
2. ensure an objective contractor selection process,

¹ In particular, we reviewed contracting practices in Kentucky, Mississippi, Texas, and Wisconsin.

Table 2.1: Contracting Principles for State Agencies**Assessing the Need for the Contract**

1. Identify what services are needed.
2. Determine why the services are needed and how they will benefit the agency and state.
3. Consider a range of alternatives to determine how the needed services can best be provided.

Selecting the Contractor

4. Develop criteria to objectively evaluate how well potential contractors can meet the needs of the agency and state.
5. Select the “best value” for the state.
6. Ensure that there is no employee or organizational conflict of interest.

Writing the Contract

7. Clearly define roles, responsibilities, and performance expectations of the contractor and agency staff.
8. Identify a variety of tools to monitor contract and contractor performance.
9. Link payment to the satisfactory completion of specific contract tasks or services, which should be spread throughout the life of the contract.
10. Address the extent to which the state owns the final product.

Executing the Contract

11. Obtain all necessary signatures on the contract before work begins.
12. Ensure that funds are available before work begins.

Monitoring the Contract

13. Maintain expertise within the agency to effectively manage contractors.
14. Periodically evaluate the progress of the contract and determine if it is prudent to continue.
15. Follow up on results of monitoring reviews, audits, and investigations.

Closing the Contract

16. Ensure that all deliverables are satisfactorily completed before making final payment.
17. Evaluate the contractor’s performance and make written evaluations available for other state agencies.
18. Use the final work product as intended.

SOURCE: Office of the Legislative Auditor, 2002.

Agencies should determine that using a contract is the most cost-effective way to obtain a service.

3. obtain the “best value” for the state,²
4. hold the contractor accountable for providing the requested services at acceptable quality levels within the given timeframes, and
5. ensure that the contract provides a useful product that serves the needs of the agency and the state.

The first goal encourages agencies to verify that using a contract is the most effective and cost-efficient way to obtain a needed service. Agencies should confirm that the services are necessary for the agency to fulfill its responsibilities and that existing state employees are not able to provide the services. The second goal addresses the importance of a fair and open contractor selection process. If no current employees are able or available to provide the services and agencies must use a contract, this goal encourages agencies to enter into contracts with the most qualified contractors at the most competitive price. In doing so, agencies

² *Minn. Stat.* (2002), §16C.02, subd. 4 defines best value as “a result intended in the acquisition of all goods and services. Price must be one of the evaluation criteria when acquiring goods and services. Other evaluation criteria may include, but are not limited to, environmental considerations, quality, and vendor performance.”

also ensure that all qualified potential contractors are given an equal opportunity to provide services to the state.

The third goal introduces the concept of “best value” when entering into contracts. In other words, contractor selection for professional/technical contracts depends not only on price, but also on the quality of services and the ability to perform the desired tasks. The fourth goal addresses what state agencies should expect from their contractors. The more an agency can include specific expectations in the contract, the more likely an agency is to obtain the desired services. The last goal addresses the usefulness of the product provided through a contract. It is important that agencies only enter into contracts for products they need—either to meet the mission of the agency or to satisfy a legislative requirement.

These goals and the 18 principles that support them are also relevant when discussing privatization of government services. That is, agencies should carefully evaluate the extent to which a service is necessary, alternative ways to provide the service, and whether privatization would provide the best value for the state. Many of the statutes and guidelines discussed below also apply to agencies’ decisions to privatize services.

Statutes and Guidelines for Professional/Technical Contracting

Minnesota statutes make the Department of Administration the state’s central office responsible for all purchasing of goods and services, including professional/technical contracts.³ For the most part, Minnesota statutes regarding contracts are focused on determining the need for a contract, selecting a contractor, and entering into a contract. Statutes generally do not address the actual content of a contract or how agencies should manage them.

Guidelines set forth by the Department of Administration generally supplement contracting statutes. The department has developed a manual for state agencies to use when contracting for professional/technical services. This manual provides an overview of the contracting process as well as checklists for agencies to follow, contract templates, and other sample documents that agencies can use throughout the contracting process.⁴ The department has the manual and supplemental documentation fully available on its website.⁵ Although there are some small discrepancies within the manual, agencies find it and the website very useful.⁶

The Department of Administration has developed contracting guidelines consistent with state law.

³ The Department of Administration purchases all goods and services for state agencies and provides oversight for professional/technical contracts.

⁴ Minnesota Department of Administration, *State Contracting* (St. Paul, September 2001).

⁵ <http://www.mmd.admin.state.mn.us/mn05001.htm>

⁶ For example, the Department of Administration’s guidelines are somewhat contradictory in terms of when agencies are required to notify state agency human resources directors about professional/technical contracting opportunities. In addition, the dollar values associated with different contracting requirements are not always consistent. See Department of Administration, *State Contracting*.

We found that:

- **Taken together, Minnesota statutes and Department of Administration guidelines regarding professional/technical contracting generally reflect effective contracting principles.**

For the most part, the Department of Administration's guidelines provide additional details for successful contracting that are not addressed in Minnesota statutes. For example, statutes do not specify what should be included in the written contract besides identifying an agency staff person to monitor the contract.⁷ However, the department's guidelines suggest that agencies should precisely identify the contractor's duties, the time of performance, the final product quality, and the cost of the service, among other things.⁸

We note, however, that the state cannot rely solely upon the Department of Administration's oversight to ensure that agencies' professional/technical contracting practices conform to relevant statutes, guidelines, and principles. In fact, agency heads themselves have the primary responsibility to ensure that staff follow effective contracting practices. Responsible contracting for professional/technical services requires all parties involved in the contracting process to adhere to the 18 principles of effective contract management outlined earlier in this chapter.

Agency heads should be accountable for good contracting practices in their agencies.

CONTRACTING PRACTICES IN SIX STATE AGENCIES

Table 2.2 provides information on the dollar value of the professional/technical contracts that we sampled in each of the six agencies. As discussed earlier, we examined contracts written for at least \$50,000 in five of the six agencies; contracts in the Department of Transportation were valued over \$100,000. We reviewed contracts that had a scheduled start date on or later than January 1, 1999

Table 2.2: Value of Sample Contracts by Agency

<u>Department:</u>	<u>Original Contract Value</u>	
	<u>Minimum</u>	<u>Maximum</u>
Administration	\$54,350	\$1,000,000
Children, Families, and Learning	50,000	3,147,900
Human Services	55,000	4,500,000
Natural Resources	59,566	900,000
Revenue	52,850	1,475,000
Transportation	103,515	3,249,999

NOTE: The maximum value listed for the Department of Administration was a master contract; work orders for this master contract did not total \$1,000,000. The largest competitively solicited contract that we reviewed in the Department of Administration was for \$290,000.

SOURCE: Office of the Legislative Auditor's review of sample contracts, 2002.

⁷ *Minn. Stat.* (2002), §16C.08, subd. 2(6).

⁸ Department of Administration, *State Contracting*, sec. 5, p. 2.

and an anticipated end date on or before December 31, 2001. Contracts that we reviewed covered a range of service areas including technology, architecture and engineering, general management, education and instruction, legal, and medical services. For this evaluation, we examined the extent to which the 60 contracts conformed to the contracting principles presented earlier in this chapter. We also evaluated the extent to which agencies followed relevant statutes and guidelines.

Because our analysis in this chapter is based on only 60 professional/technical contracts, results are not generalizable to all contracts statewide. Furthermore, any differences that we identified among agencies or types of contracts are not statistically significant and may not be representative of all contracting practices in these six agencies or other agencies not included in our sample.

While the Department of Administration screens contracts for errors and identifies many contracting problems, we found that:

- **The state agencies that we reviewed often did not follow state statutes, Department of Administration guidelines, or effective contracting principles when contracting for professional/technical services.**

For example, all of the agencies that we reviewed allowed work to start prior to having some of their contracts fully signed or having the funds encumbered, despite guidelines and principles to the contrary. Similarly, Minnesota statutes and Department of Administration guidelines require agencies to complete a one-page final report for every professional/technical contract that exceeds \$40,000. As discussed later in this chapter, agencies completed very few of these reports for the contracts that we reviewed.

OLA often reports on contracting problems in financial audits.

It is likely that the problems that we found with these agencies' contracting practices have persisted throughout state government for a long time. We found many similar problems in our 1992 program evaluation of state contracting.⁹ Similarly, our office often uncovers contracting problems when conducting financial audits of agencies.¹⁰ While our evaluation detected no serious consequences as a result of these problems, it is important that the state maintain its commitment to a fair, open, and accountable contracting process. Chapter 3 further discusses these concerns and makes recommendations for focusing the role of the Department of Administration and improving Minnesota's contracting process.

The remainder of this chapter discusses the extent to which the contracts we reviewed conformed to statutes, guidelines, and the principles for effective contracting. The six areas of the contracting principles provide the framework for the discussion. In the following sections, we briefly review the pertinent principles for effective contract management, outline the relevant statutes and guidelines, and then discuss the related contracting practices we observed in the six agencies reviewed.

⁹ Minnesota Office of the Legislative Auditor, *State Contracting for Professional/Technical Services* (St. Paul, 1992).

¹⁰ For example, see Minnesota Office of the Legislative Auditor, *Minnesota Zoological Garden, July 1, 1998, through June 30, 2001* (St. Paul, May 16, 2002), 12-14; *Sentencing Guidelines Commission, July 1, 1998, through June 30, 2001* (St. Paul, March 21, 2002), 6; and *Minnesota Tax Court, Three Fiscal Years Ended June 30, 2000* (St. Paul, August 16, 2001), 7-8.

Assessing the Need for Contracts

Before agencies enter into a contract, it is important to determine that the services are needed and will benefit the state. In addition, agencies should evaluate the extent to which existing state employees can be used to provide the services. By following these principles, agencies can maximize the effectiveness of their resources.

Contract Management Principles for Assessing the Need for Contracts

- Identify what services are needed.
- Determine why the services are needed and how they will benefit the agency and state.
- Consider a range of alternatives to determine how the needed services can best be provided.

Applicable Statutes and Guidelines

Minnesota statutes and guidelines generally reflect the contract management principles for assessing the need for contracts. For example, statutes require the Commissioner of Administration to determine that the work to be performed through a contract is necessary for the agency to fulfill its mission.¹¹ In addition, agencies must confirm to the commissioner that no current state employee is available to do the work when they file a *certification form* with the Department of Administration.¹² The department requires agencies to determine, through cost-benefit analyses, that contracting for a service is the best way to obtain the needed service.¹³ The department provides a template in its manual for agencies to use when conducting the cost-benefit analyses.

The Department of Administration's guidelines also identify certain instances when agencies should use professional/technical contracts. These include when legislation or federal funding requires the use of a contractor or outside party and when legislation requires a task to be done in a time frame that the agency cannot meet. In addition, the department's guidelines state that agencies could use contracts when:

1. an agency requires highly specialized work, for which no qualified state employee is capable or available;
2. state employees do not have the time to perform the work required; or
3. a contract is determined to be the most efficient and least costly method of accomplishing the work.¹⁴

For example, it is appropriate for an agency to use a contract when (1) it needs assistance to implement a computer system, but does not need assistance maintaining the system; (2) a project requires specialized expertise or equipment

Current law requires the Department of Administration, not agencies, to determine that contracts are needed.

¹¹ *Minn. Stat.* (2002), §16C.08, subd. 3.

¹² Agencies must file a certification form prior to entering into a contract written for more than \$5,000. *Minn. Stat.* (2002), §16C.08, subd. 2 and Department of Administration, *State Contracting*, sec. 10, p. 1.

¹³ Department of Administration, *State Contracting*, sec. 9, pp. 1-2.

¹⁴ Department of Administration, *State Contracting*, sec. 9, p. 2.

that the agency will not need on an ongoing basis; or (3) when the Legislature makes a one-time appropriation for a project. In general, using contracts for ongoing services in lieu of hiring permanent staff is not recommended.

Agency Practices

As part of our evaluation, we identified why agencies contracted for professional/technical services. Specifically, we identified if contracts were written (1) to obtain special expertise not readily available in an agency, (2) to address general staff shortages, (3) because the contract was legislatively required, (4) because the agency wanted an objective outside party, or (5) to address seasonal work demands. We also determined whether contracts were written for a one-time or special project, event, or report; an ongoing task or service that would typically be provided by an employee; or a program or system start-up project. We found that:

- **According to state agency staff, most of the contracts that we reviewed were entered into to obtain special expertise not found within the agency's existing workforce.**

Specifically, over three-fourths of the contracts that we reviewed were entered into because agencies said they needed special expertise. For example, agencies used contracts to obtain special expertise for designing websites; to design, develop, and implement part of the Minnesota Comprehensive Assessments for secondary students; to develop, implement, and operate a system to provide fish and game licenses electronically; and to prepare an environmental impact statement for a potential peat mine project.

In addition, over half of the contracts we reviewed were for one-time or special projects, events, or reports. For example, we reviewed contracts to design a bridge, conduct a research study, survey boundaries of state-owned land, and provide expert witness testimony for a trial.

Over half of the contracts we reviewed were for one-time or special projects.

On the other hand, over one-third of the contracts that we reviewed were for ongoing tasks or services such as maintenance on a global information system database or ongoing psychiatric services for residents at a state-operated nursing home. These are the types of services for which agencies



Agencies often use contracts to obtain road and bridge designs.

generally should not use contracts. Several of the contract managers with whom we spoke indicated that they had tried to hire permanent staff to provide these types of services but were unsuccessful.

In addition to determining what services are needed and why, agencies should determine whether a contract is the best way to obtain those services. However, we found that:

- **The agencies that we reviewed provided little documentation of the need for contracts or consideration of alternatives, including the use of state employees.**

Prior to entering into a professional/technical contract, Minnesota statutes require agencies to certify to the Commissioner of Administration that “no current state employee is able and available to perform the services called for by the contract.”¹⁵ In addition, the commissioner must determine that the “work to be performed under the contract is necessary to the agency’s achievement of its statutory responsibilities.”¹⁶ We saw little evidence of agencies seriously looking for qualified staff elsewhere in their department to perform the desired services. We also found very few instances where agencies had conducted cost-benefit analyses to assist with the decision to use contractors rather than state employees, although the Department of Administration provides a cost-benefit template in its contracting manual. Finally, we saw no evidence that the department independently determined that the services provided were necessary.

Agencies seldom formally compared the costs of using contractors with the costs of relying on state employees.

Statutes and Department of Administration guidelines generally require agencies to notify employees in other agencies of their intent to enter into a professional/technical contract valued over \$25,000. This requirement is intended to ensure that no existing state employee is able or available to perform the work in the contract. Contracting agencies can either send notices of the contracting opportunity to other agencies’ human resources offices, post the opportunity in the *State Register*, or post it on the Department of Administration’s website to satisfy this requirement.¹⁷ Contract managers that we spoke with indicated that they regularly comply with this law. However, these managers have rarely received a response, and have never found someone suitable to perform the desired work as a result of the human resources notification. We saw little evidence that agencies went beyond these requirements to identify possible state employees that could provide the needed services.

In addition, we saw little evidence of agencies conducting cost-benefit analyses to assist with the decision to use an outside contractor. The Department of Administration’s contracting guidelines suggest comparing the costs of a professional/technical contract to the anticipated benefits for contracts of all sizes; we think such analyses are especially important for larger, more complex contracts. We note that cost-benefit analyses should play a central role in any decisions agencies make in the future regarding the privatization of services.

¹⁵ Minn. Stat. (2002), §16C.08, subd. 2.

¹⁶ Minn. Stat. (2002), §16C.08, subd. 3.

¹⁷ Minn. Stat. (2002), §16C.07 and Department of Administration, *State Contracting*, sec. 15, p. 2.

Agencies often submitted “boilerplate” language to justify the need for a contract.

For most of the contracts that we reviewed, managers indicated that the need to use a contract was “obvious” based on the needs of the agency and the skill levels of current employees.¹⁸ Agencies certify that they have evaluated the need for the contract and that no current employees are available to do the work when they file a certification form with the Department of Administration. However, agencies that we reviewed routinely submitted non-descriptive, “boilerplate” language to the department to justify the need for a given contract. Although department staff indicated that they often discuss these issues with agency staff, we saw little evidence for the contracts reviewed that the department requested additional documentation demonstrating that agencies have thoroughly evaluated the need for a contract or compared costs for the internal and external provision of the service.

We note, however, that there were a few instances where agencies did document the need for a particular contract. For example, the Minnesota Department of Transportation conducted market research to determine the most effective ways to communicate “real-time” traffic information to the public. As a result of this research, the department determined that providing ongoing traffic reports on cable television would be an effective communication tool. The department subsequently entered into a contract with a cable television station to provide “traffic television.”¹⁹

Selecting Contractors

Because state agencies are spending public dollars and need to avoid even the impression of favoritism, it is important that the contractor selection process be as open as possible. As part of this, it is important that agencies avoid any employee or organizational conflict of interest.²⁰

Applicable Statutes and Guidelines

Minnesota statutes and guidelines largely reflect the principles for selecting professional/technical contractors. For example, statutes require that contracting decisions be based on best value, using evaluation criteria detailed in the solicitation document.²¹ Best

Contract Management Principles for Selecting Contractors

- Develop criteria to objectively evaluate how well potential contractors can meet the needs of the agency and state.
- Select the “best value” for the state.
- Ensure that there is no employee or organizational conflict of interest.

¹⁸ For example: Department of Children, Families, and Learning, contract A01902; Department of Human Services, contract A09519; Department of Natural Resources, contract R29-EG000000083; Department of Revenue, contract A14164; and Department of Transportation, contract A11453.

¹⁹ Department of Transportation, contract A04448.

²⁰ “Employee conflict of interest” means that an employee with “official involvement” in the contracting process may not benefit directly or indirectly in contracts for goods or services used by a department or agency of the state. See *Minn. Stat.* (2002), §15.43. “Organizational conflict of interest” means “that because of existing or planned activities or because of relationships with other persons: (1) the vendor is unable or potentially unable to render impartial assistance or advice to the state; (2) the vendor’s objectivity in performing the contract work is or might be otherwise impaired; or (3) the vendor has an unfair advantage.” *Minn. Stat.* (2002), §16C.02, subd. 10a.

²¹ *Minn. Stat.* (2002), §16C.03, subd. 3.

value incorporates the importance of quality, performance, and price when selecting a contractor for a professional/technical contract. Minnesota statutes also grant the Commissioner of Administration the authority to determine the processes for publicizing the availability of professional/technical contracts.²²

As discussed in Chapter 1, there are different types of processes agencies use when entering into contracts that largely dictate the method they must use to select a contractor. Specifically, agencies may select a contractor (1) through a competitive solicitation process, (2) from a master roster, (3) from a master contract, (4) by identifying a single source, or (5) through an emergency contract process. For example, if an agency uses a competitive solicitation process, it must publicize contracting opportunities over \$5,000. In contrast, if an agency uses a single source contract, it simply needs to justify the use of the single source contractor to the Department of Administration.

Agency Practices

We examined the extent to which agencies used each of these different contractor selection processes. We found that:

- **Over 40 percent of the contracts that we reviewed were not competitively solicited, but, for most of the contracts, the justification for not doing so appeared reasonable.**

Specifically, 25 of the 60 contracts that we reviewed were single source contracts that did not go through a competitive selection process. Although a single source contract is generally quicker to put in place than a competitively solicited contract, agencies risk not identifying the most qualified contractor or entering into a contract at a price higher than the prevailing market rate. Contracts that we reviewed for certain kinds of services had a higher incidence of using the single source process. For example, over half of the contracts that we reviewed for education, legal, and technology services were single source contracts.

Although most single source contracts seemed warranted, several did not.

While it is important to ensure that the contractor selection process is as open and fair as possible, there are often legitimate reasons for using single source contracts. For example, several agencies that we reviewed planned to use master rosters developed by the Office of Technology to select contractors for technology services. However, the rosters were not available when the existing technology services contracts expired. Rather than enter into an extended competitive process for contracts that would last only a few months, several agencies simply continued existing contracts as single source contracts.²³ Similarly, several of the single source legal contracts we reviewed were for expert witnesses in a court case. It may not be reasonable to expect agencies to have an open selection process to obtain expert witnesses for a trial.

On the other hand, we did see several instances where agencies used a single source process to select a contractor when it did not seem warranted. For example, one contract we reviewed was to obtain litigation support services for a

²² *Minn. Stat.* (2002), §16C.06, subd. 1.

²³ Unfortunately, the Office of Technology was slow in developing the master rosters and several of these agencies had to renew these single source technology contracts several times.

The Department of Administration approves nearly all requests for single source contracts.

large trial. The agency tried to find a suitable contractor by calling around to various contacts. The agency ultimately found a contractor who offered what the agency felt was a reasonable price. However, as noted by the contract manager in our interview, there were “a fair number of people doing this work” and they likely could have found other qualified people if the agency had advertised the opportunity. Although the agency thought it likely that other contractors would have been more expensive than the contractor they selected, this would have become clear through a competitive solicitation process.

When entering into a single source contract, agencies must submit a *single source request memo* to the Department of Administration. This request form must be submitted to the department with the certification form for the contract. The single source request form must explain why the given contractor is the only reasonable source of the desired service.²⁴ The Department of Administration approves nearly all requests for single source contracts. According to department staff, the department rejects only about a dozen single-source requests annually for contracts greater than \$50,000.²⁵

In addition to the single source contracts, 18 of the 60 contracts we examined were contracts that went through a competitive solicitation process. For contracts over \$50,000, this process requires agencies to “write a formal request for proposals (RFP) and arrange for public notice in the *State Register* of the agency’s intent to contract.”²⁶ Although this contractor selection method takes longer and requires more staff time than other methods, it helps ensure that agencies have selected the most qualified contractor at a competitive price. For the contracts we saw that went through a competitive solicitation process, agencies generally had specific evaluation criteria and used a panel to select the contractor.



Contractors often provide education and training to state employees.

Agencies selected the contractor from a master roster for ten of the contracts that we reviewed. Selecting a contractor from a master roster allows for competition among contractors on a pre-qualified list that was originally developed using an open, competitive process. The department that oversees the master roster establishes the rules that agencies must follow when selecting a contractor from the roster. Generally, agencies must advertise the contract opportunity to several of the contractors on the roster and go through a limited competitive selection process. While the master roster selection process is likely quicker than a competitive solicitation

²⁴ Department of Administration, *State Contracting*, sec. 10, p. 1.

²⁵ Ms. Barb Jolly, Materials Management Division, Minnesota Department of Administration, interview by author, Telephone conversation, St. Paul, Minnesota, July 16, 2002.

²⁶ Department of Administration, *State Contracting*, sec. 10, p. 4.

process, the opportunity is also generally not made available to as many potential contractors.

Finally, 6 of the 60 contracts we reviewed were master contracts. As outlined in the Department of Administration's guidelines, a master contract is an "umbrella document" that "accomplishes generally identifiable tasks, for which no reasonable determination of actual need can be made."²⁷ For example, one master contract included in our evaluation was for hearing review officers. The Department of Children, Families, and Learning needed to have hearing review officers available for potential hearings, but had no advance knowledge of hearing dates or times. However, once a hearing was requested, the department could contact one of the hearing review officers with a master contract and quickly enter into a work order contract with that person.

A master contract is typically established through a competitive solicitation process. As part of the master contract, agencies must outline how they will distribute the work fairly to all contractors that have master contracts for the same service. When agencies are ready to contract for a service, the agency and contractor enter into a work order contract. The use of master contracts allows for an expedited process since the contract is already negotiated and work order contracts for \$100,000 or less do not have to go through the Department of Administration or the Attorney General's Office. However, with master contracts there is an increased risk of using the same provider for several projects—in effect, having a single source contract without going through the single source justification process.²⁸

Writing Contracts

The written contract is the primary tool agencies have to identify what services they want the contractor to provide and to control the outcome of the project. As such, it is important that the contract be written as clearly and concisely as possible.

Applicable Statutes and Guidelines

For this aspect of contracting, the Department of Administration's guidelines generally follow effective contract management principles, but Minnesota statutes do not. Statutes do not impose significant requirements in this area; they simply require that agencies certify to the Commissioner of

Contract Management Principles for Writing Contracts

- Clearly define roles, responsibilities, and performance expectations of the contractor and agency staff.
- Identify a variety of tools to monitor contract and contractor performance.
- Link payment to the satisfactory completion of specific contract tasks or services, which should be spread throughout the life of the contract.
- Address the extent to which the state owns the final product.

²⁷ Department of Administration, *State Contracting*, sec. 17, p. 1.

²⁸ The Department of Administration indicated that they emphasize the importance of distributing work among master contract holders in training sessions and when working directly with contracting agencies.

Administration that they have assigned a person to monitor the contract and provided for the periodic review of interim reports or products.²⁹ The Department of Administration's guidelines suggest that agencies should precisely identify the services, quality, timeframe, cost, and contractors' duties in each contract.³⁰

Agency Practices

As part of our file review, we examined the extent to which contracts specified:

- (1) contractors' roles and responsibilities,
- (2) roles and responsibilities for the contracting agency,
- (3) required deliverables or work products,
- (4) monitoring tools, and
- (5) performance standards.

We found that:

- **Despite the Department of Administration's review and approval process, a majority of the contracts we reviewed were not well written—they did not contain clearly defined performance standards, monitoring tools, or descriptions of state roles and responsibilities.**

As illustrated in Figure 2.1, we rated over half of the contracts that we reviewed as "weak" for specifying performance standards and for identifying state roles and responsibilities.³¹ Many of the contracts that we reviewed simply did not identify any performance standards or state roles and responsibilities beyond those included in the standard contract language. In addition, 50 percent of the contracts that we reviewed had weak monitoring tools specified in the contract. For example, several agencies simply used the contractor's monthly invoices to monitor the contractor's performance. Furthermore, many of the contracts that we reviewed were written carelessly and included problems such as arithmetic errors that should have been corrected through the review process.

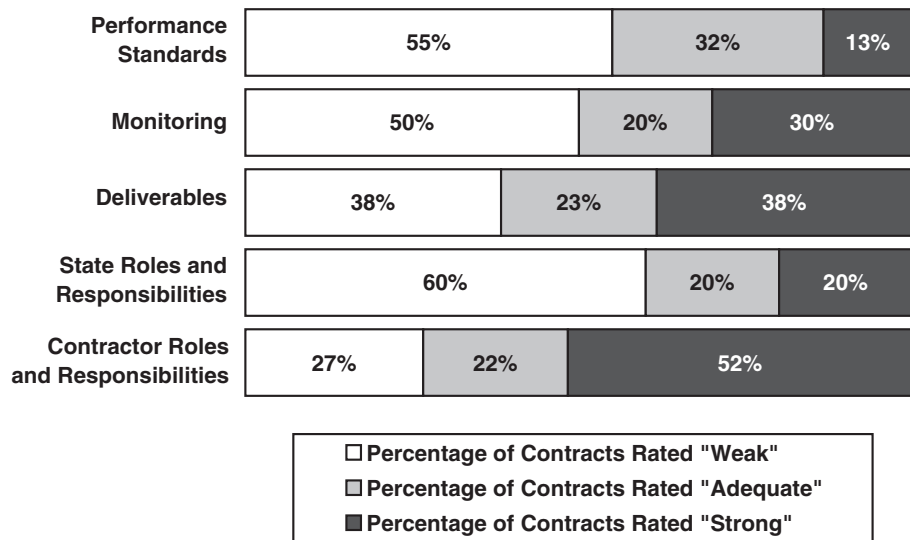
On the other hand, we did see some contracts where agencies had clearly specified monitoring tools, roles and responsibilities, and performance standards. For example, one contract that we reviewed clearly detailed how agency staff would (1) evaluate each phase of the contract, (2) compare deliverables to the original statement of work, (3) assess the timeliness of all work products, (4) receive weekly status reports from the contractor's project manager, and (5) have a team

Many contracts were poorly written and some contained arithmetic errors.

²⁹ *Minn. Stat.* (2002), §16C.08, subd. 2(6). We discuss the extent to which agencies monitor contracts in a later section of this chapter.

³⁰ Department of Administration, *State Contracting*, sec. 5, p. 2.

³¹ We rated each of the five areas on a three-point scale where "one" indicated that a contract was weak in a given area and "three" indicated that a contract was strong in a given area. The 60 sample contracts had an average rating of 1.6 for both performance standards and state roles and responsibilities.

Figure 2.1: Ratings of 60 Sample Contracts

SOURCE: Office of the Legislative Auditor's review of sample contracts, 2002.

of business and technical professionals within the agency review the status reports on a weekly basis.³²

In addition to rating how well contracts were written, we examined the extent to which agencies amended the 60 contracts we reviewed. There are often legitimate reasons for contracts to be amended. Projects may take longer than anticipated, existing data may not be as readily available as expected, there may be staff or contractor turnover, or unexpected issues may arise.³³ We found that:

- **Almost half of the contracts that we reviewed were amended at least once—most often to increase the cost of the original contract.**

Specifically, 29 of the 60 contracts that we reviewed were amended at least once; 8 were amended three or more times. Of the 29 amended contracts, 26 were amended, at least in part, to increase the cost of the contract. While there may be legitimate reasons for costs to increase, several contract amendments significantly increased costs. For example, one nine-month contract was amended to increase the contractor's responsibilities, extend the contract length by 15 months, and increase costs by over 1,000 percent, going from about \$200,000 to about \$2.5 million.³⁴ Another nine-month contract also was amended to increase the contractor's responsibilities, increase the contract length by two months, and

ERRATUM: The example given for contract A18036 is incorrect. While the contract was amended to increase the contractor's responsibilities and extend the contract length by 15 months, costs actually increased by 25 percent, going from \$200,000 to \$250,000, not \$2.5 million as indicated.

³² Department of Transportation, contract A17566.

³³ Agencies must submit contract amendments to the Department of Administration for its approval.

³⁴ Department of Transportation, contract A18036.

increase costs by over 100 percent, going from \$3.2 million to \$6.7 million.³⁵ Amendments such as these may indicate poor planning for the initial contract or a change in scope that should have been addressed through a new contract.

Finally, we examined the extent to which agencies tied payment to the satisfactory completion of tasks or deliverables. We found that 30 of the 60 contracts that we reviewed primarily specified payment based on a “rate-per-hour” for the contractor. To receive payment for the work performed through these contracts, contractors typically would submit an invoice detailing the number of hours worked during the previous pay period. Agencies would then calculate the total amount due based on the number of hours worked and the agreed upon rate-per-hour for each contractor. Agencies tied payment to the completion of deliverables, as recommended in Department of Administration guidelines and our contracting principles, in only one-third of the contracts that we reviewed.

Executing Contracts

Good contract management suggests that it is important to have a fully signed and completed contract prior to starting work. This ensures that the agency and the contractor both understand the expectations before the contract begins. Having a fully executed contract also ensures that neither the state nor the contractor is exposed to any unnecessary risks such as product ownership concerns or data privacy issues.

Contract Management Principles for Executing Contracts

- Obtain all necessary signatures on the contract before work begins.
- Ensure that funds are available before work begins.

Contracts are not valid until they have been fully signed and funds have been obligated or encumbered.

Applicable Statutes and Guidelines

To some degree, Minnesota statutes address the importance of fully executing a contract prior to starting work. Statutes state that contracts are not valid, and the state is not bound to them, unless they have been executed by the agency, approved by the Commissioner of Administration and the Attorney General, and the accounting system shows an obligation in an expense budget or an encumbrance for the contract amount.³⁶ For professional/technical contracts over \$5,000, statutes require that agencies certify to the Department of Administration that they will not allow contractors to begin work before funds have been fully encumbered.³⁷

The Department of Administration’s guidelines require agencies to file a *violation memo* with the department if work on a contract starts before the contract is fully signed (referred to as a 16C violation) or before funds are encumbered (referred to as a 16A violation).³⁸ These violation memos require agencies to explain why the violation occurred and how they will avoid violations in the future.

³⁵ Department of Transportation, contract 78313.

³⁶ *Minn. Stat.* (2002), §16C.05, subd. 2.

³⁷ *Minn. Stat.* (2002), §16C.08, subd. 2(7).

³⁸ Department of Administration, *State Contracting*, sec. 7.

Agency Practices

As noted above, statutes and guidelines require that contracts be fully signed before they are considered valid. We found that:

- **Contrary to effective contract management principles, agencies allowed work to begin before contracts were fully signed for almost two-thirds of the contracts that we reviewed.**

Agencies had completed a 16C violation memo for 52 percent of the contracts that we reviewed, indicating that work had started before these contracts were fully signed. In an additional seven contracts, our review determined that work had started before the contract was fully signed, but a violation memo had not been completed. Furthermore, 10 of the 60 contracts were not fully signed until at least five months after work had started; two contracts were not fully signed until ten months after work had started.³⁹

In addition to our file review, we examined the extent to which the six sample agencies filed 16C violation memos between April 2001 and April 2002 as recorded in the Department of Administration's contract approval database. During this time period, the six agencies in our sample filed 16C violations for about 21 percent of the contracts written for at least \$50,000. This figure may seriously understate the problem. As noted above, we found that work started on some contracts before they were fully signed, yet agencies had not completed a 16C violation memo; these contracts would not be recorded in the department's database as having a 16C violation. Also, the Department of Administration only records as violations those contracts that begin before the department has signed them, even though the Attorney General's Office signs contracts last.

Based on our file review, we also found that:

- **Agencies allowed work to begin before funds were encumbered for over one-third of the contracts that we reviewed.**

Agencies are required to certify to the Department of Administration that they will not allow work to begin on a contract before funds are encumbered.⁴⁰ However, for 16 of the 60 contracts that we reviewed, agencies had completed a 16A violation memo, indicating that work had started before funds were encumbered. Based on our file review, work started before funds were encumbered for an additional five contracts, but 16A violation memos had not been completed. Agencies allowed work to start at least three months prior to encumbering funds for 6 of the 60 contracts we reviewed. One agency did not encumber funds for a nine-month contract we reviewed until two weeks before the contract ended.⁴¹ The funds were never encumbered for another contract

Almost two-thirds of the contracts reviewed were not valid when work began.

³⁹ Department of Administration, contracts A04498 and A04156; Department of Children, Families, and Learning, contracts A01430, A01726, A02612, and A05987; Department of Human Services, contract 423914; Department of Natural Resources, contracts A04625 and A06587; and Department of Transportation, contract A11453.

⁴⁰ *Minn. Stat.* (2002), §16C.08, subd. 2(7).

⁴¹ Department of Administration, contract A04156.

we reviewed; the contractor was ultimately paid directly from the agency's general budget.⁴²

In addition to our file review, we examined the extent to which the six sample agencies filed 16A violation memos between April 2001 and April 2002 as recorded in the Department of Administration's contract approval database. During this time period, the six agencies in our sample filed 16A violations for about 14 percent of the contracts written for at least \$50,000.

As with the 16C violations, the data we collected from our sample regarding 16A violations differ from the data we obtained from the Department of Administration's database. There are several reasons for this discrepancy. Similar to the 16C violation data, the department's database does not identify all instances when a 16A violation memo is required. Furthermore, the department's increased attention to this issue over the past year may have encouraged agencies to better comply with the contracting guidelines.

In a 2002 special review of a Department of Transportation contract, the Office of the Legislative Auditor noted that there is some confusion regarding the requirement to encumber funds before starting work on a professional/technical contract.⁴³ Specifically, some agency staff indicated that it was not clear whether funds must be encumbered before allowing contractors to begin work or whether it was sufficient to have an unencumbered balance in the accounting system that covered the cost of the needed service. However, as we discuss in Chapter 3, it is the Department of Finance's policy that agencies must encumber any expenditure over \$2,500 in the state's accounting system before incurring an obligation.⁴⁴

There are substantial risks associated with starting work before a contract is valid.

Despite the large number of 16A and 16C violations we found, we saw few poor outcomes associated with contracts that started before funds were encumbered or the contracts were fully signed.⁴⁵ However, the Minnesota Attorney General's Office says there are some risks associated with starting work on contracts before they are valid (that is, before funds have been encumbered and contracts have been fully signed).⁴⁶ For example, contract provisions regarding product ownership, data privacy, and liability may not apply unless a contract is valid.

In addition, some contractors have expressed their concern about proceeding too far along in a project without a fully executed contract and therefore being at risk to not receive timely or full payment. For example, one agency that we reviewed wrote a letter to a contractor authorizing work to begin on May 12, 2000, noting that funds were encumbered and "a 16C violation form is being processed. The contract for this work will be fully executed shortly." The contractor signed the

⁴² Department of Children, Families, and Learning, contract A05987.

⁴³ Minnesota Office of the Legislative Auditor, *Department of Transportation Contract for Highway 55/62 Bypass* (St. Paul, May 2002).

⁴⁴ Minnesota Department of Finance, *MAPS Operations Manual Policies and Procedures*, no. 0702-02, June 16, 2000.

⁴⁵ A program evaluation conducted by our office in 1992 also found that work routinely started before contracts were valid. See Office of the Legislative Auditor, *State Contracting*, 15-16.

⁴⁶ Ms. Christie Eller, Assistant Attorney General, Minnesota Attorney General's Office, interview by author, In person, St. Paul, Minnesota, October 7, 2002.

contract and returned it to the agency on May 22, 2000. On July 26, 2000 the contractor sent an e-mail to the agency to check on the status of the contract. The e-mail stated: “As of June 30, 2000 we had over \$32,000 charged to the project. Although we don’t have the July invoice yet because the month is not quite over, I know that this amount has grown significantly during the month of July. We are concerned about continuing to accrue charges on this project without an executed agreement.”⁴⁷

Monitoring Contracts

It is important for agency staff to adequately monitor contracts to ensure that agencies are receiving the services intended by the contract. Adequate monitoring includes periodic contact with the contractor through regular meetings, written progress reports, or regular deliverables.

Contract Management Principles for Monitoring Contracts

- Maintain expertise within the agency to effectively manage contractors.
- Periodically evaluate the progress of the contract and determine if it is prudent to continue.
- Follow up on results of monitoring reviews, audits, and investigations.

Applicable Statutes and Guidelines

Minnesota statutes and Department of Administration guidelines do not address the details of monitoring professional/technical contracts. The department’s guidelines simply require agencies to retain the capacity to monitor and evaluate the work of the contractor.⁴⁸ Statutes specify that agencies must diligently administer and monitor the contracts they have entered into and that contracts must permit the Commissioner of Administration to terminate contracts before completion.⁴⁹ Statutes also require that agencies complete a written plan that details how the agency intends to monitor the contract; agencies are required to certify to the Department of Administration that they have completed this plan prior to entering into a professional/technical contract.⁵⁰

Agency Practices

For the most part, there are few statutes regarding how agencies should monitor their professional/technical contracts. But the agencies that we reviewed generally did not conform to the limited number of statutes that do address contract monitoring. Specifically, we found that:

- **Agencies completed a written monitoring plan for few of the contracts we reviewed, despite statutes requiring them to certify to the Department of Administration that they developed such a plan.**

As noted above, agencies are required to certify to the Commissioner of Administration that they have developed a plan to monitor each

⁴⁷ Department of Transportation, contract A08309.

⁴⁸ Department of Administration, *State Contracting*, sec. 3, p. 3.

⁴⁹ *Minn. Stat.* (2002), §§16C.05, subd. 4 and 16C.08, subd. 5(a).

⁵⁰ *Minn. Stat.* (2002), §16C.08, subd. 2(6).

Performance monitoring should be explicitly written into contracts.

professional/technical contract. However, we saw little evidence of these plans during our file review, and we saw no evidence that the Department of Administration requested to review them.

As noted earlier, we did not see detailed monitoring tools in many of the contracts we reviewed. However, in interviews contract managers indicated that they did more monitoring than was outlined in the contract. For example, many of the contractors that provided ongoing services worked on-site, alongside state agency staff. As a result, agency staff provided constant monitoring of contractors' performance despite the lack of monitoring tools written into the contracts. Contract principles suggest, however, that monitoring tools be written in the contract to ensure that both the contractor and the state understand the expectations of the project.

Finally, in our interviews with contract managers, agency staff seemed aware of the importance of retaining expertise to effectively manage contracts. For example, the Department of Transportation uses contracts for bridge design work on a regular basis. However, the agency makes a concerted effort to retain some bridge design work in-house so that agency staff maintain their knowledge and expertise.

Closing Contracts

At the end of a contract, agencies should assess the final product and make sure the contract provided the intended result. Before the contract is complete, agencies have the ability to request changes and demand satisfactory fulfillment of the contract. Once the contract is completed, it is important for the agency to evaluate the performance of the contract and contractor to determine if changes are required for future contracts. It is also important for the agency to determine if it is willing to use the contractor again for future projects.

Contract Management Principles for Closing Contracts

- Ensure that all deliverables are satisfactorily completed before making final payment.
- Evaluate the contractor's performance and make written evaluations available for other state agencies.
- Use the final work product as intended.

Applicable Statutes and Guidelines

Minnesota statutes and guidelines generally reflect these principles. Specifically, they require agencies to withhold the final 10 percent of contract payment until the agency has reviewed the final product and determined that the contract has been satisfactorily fulfilled. Statutes and guidelines also require agencies to complete and submit to the Commissioner of Administration a final report for all professional/technical contracts over \$40,000.⁵¹ This report must explain the purpose of the contract and why it was cost-effective. Finally, statutes require the

⁵¹ *Minn. Stat.* (2002), §16C.08, subds. 4(c) and 5(b) and Department of Administration, *State Contracting*, sec. 5, p. 6 and sec. 18, p. 1.

Commissioner of Administration to determine that agencies have “specified a satisfactory method of evaluating and using the results of the work to be performed.”⁵²

Agency Practices

As part of our evaluation, we asked contract managers if they had experienced any problems with the contracts that we reviewed. We found that:

- **Despite our concerns regarding agencies’ contracting practices, contract managers reported few major problems with the 60 contracts that we examined.**

For example, none of the contracts that we reviewed were terminated early for poor contractor performance nor were any contractors assessed a penalty due to unsatisfactory performance. Among the 60 contracts we reviewed, only one contract was reduced in scope in response to poor contractor performance. Specifically, the Department of Human Services had concerns that one of its contractors was in breach of the data privacy agreement included in the contract.⁵³ As a result, the agency removed some of the responsibilities from the original contractor and assigned them to a new contractor. In two other contracts that we reviewed, agencies withheld payment from a contractor due to poor performance. For these two contracts, funds were withheld until the agency was satisfied with the final product.

Although contract managers indicated few major problems with the contracts we reviewed, 13 of the 60 contract managers we spoke with told us that they had minor problems with their contract. For example, eight of the contract managers indicated that the contractor provided late or inadequate deliverables and three of the contract managers had a member of their contractor’s team replaced. These problems were largely resolved through communication with the contractor.

One contract that we reviewed led to some significant problems for the state. Specifically, the Department of Children, Families, and Learning entered into a contract for the design, development, and implementation of basic skills assessments of students.⁵⁴ When the contractor reported erroneous test scores for many students, the department had to respond to the concerns of parents, students, and policy makers. Our review of the original contract found that it was poorly written and contained inadequate monitoring tools.

Once a professional/technical contract is completed, the contracting agency must fill out a form, provided by the Department of Administration, explaining the purpose of the contract and why it was cost-effective. Agencies are required to complete the form for all professional/technical contracts over \$40,000 and submit it to the Department of Administration; these forms are ultimately filed at the Legislative Reference Library.⁵⁵ We found that:

⁵² *Minn. Stat.* (2002), §16C.08, subd. 3(6).

⁵³ Department of Human Services, contract 424251.

⁵⁴ Department of Children, Families, and Learning, contract A02612.

⁵⁵ *Minn. Stat.* (2002), §16C.08, subd. 4(c) and Department of Administration, *State Contracting*, sec. 18, p. 1.

One contract related to testing students led to significant problems.

Agencies typically do not report on contracting results.

- **Despite statutes requiring agencies to complete a final report on professional/technical contracts over \$40,000, few agencies did so.**

Specifically, agencies had completed this final report for only 13 of the 60 contracts we reviewed.⁵⁶ Furthermore, several contract managers that we interviewed were not aware that a report on the contract was required. Interestingly, over half of the contract managers we interviewed that had experienced problems with their contractor had not completed this final report. Even when agencies did complete this report, it did not provide useful information. As further discussed in Chapter 3, it may be worthwhile to revise this required report to include contractor performance information.

Finally, as part of our evaluation, we tried to determine to what extent agencies were pleased with the results of the contracts we reviewed. Specifically, we asked contract managers to rate: (1) the performance of the vendor, (2) how successful the contract was in getting what the agency wanted, and (3) the overall value of the contract for the state. For each of these areas, we asked contract managers to use a five-point scale, where “one” was the lowest rating and “five” was the highest. We found that:

- **On average, contract managers thought that the contracts we reviewed were successful and a good value for the state.**

Specifically, contract managers gave the contracts that we reviewed an average rating of 4.6 for both their value for the state and their success. Furthermore, almost all of the contracts we reviewed were rated a “four” or higher for both value and contract success; only three contracts received a “three” for either measure. Contract managers that we interviewed were also pleased with the performance of the contractors, giving the contractors an average rating of 4.3.⁵⁷

Some of the contracts that we reviewed led to agencies hiring the contractors as permanent employees. According to agency staff, the departments of Human Services and Revenue recently hired several new technology services staff that previously worked for them as contractors. When these individuals were contractors, they provided ongoing technology assistance—a service that is generally better provided by regular agency staff. Because of the economy, however, the agencies previously had difficulty hiring permanent technology staff. With the recent downturn in the technology sector, both agencies were able to demonstrate significant cost savings by hiring these contractors as permanent employees. For example, the Department of Revenue anticipates a savings of over \$250,000 per year for fiscal years 2003 and 2004 as a result of hiring a number of contractors as permanent staff.

⁵⁶ An additional four contracts were still in progress when we reviewed the file and managers did not know if the evaluation had been completed for six other contracts.

⁵⁷ Contract managers provided contract value ratings for 57 of the 60 contracts that we reviewed, contract success ratings for all of the contracts that we reviewed, and contractor performance ratings for 59 of the contracts that we reviewed.

