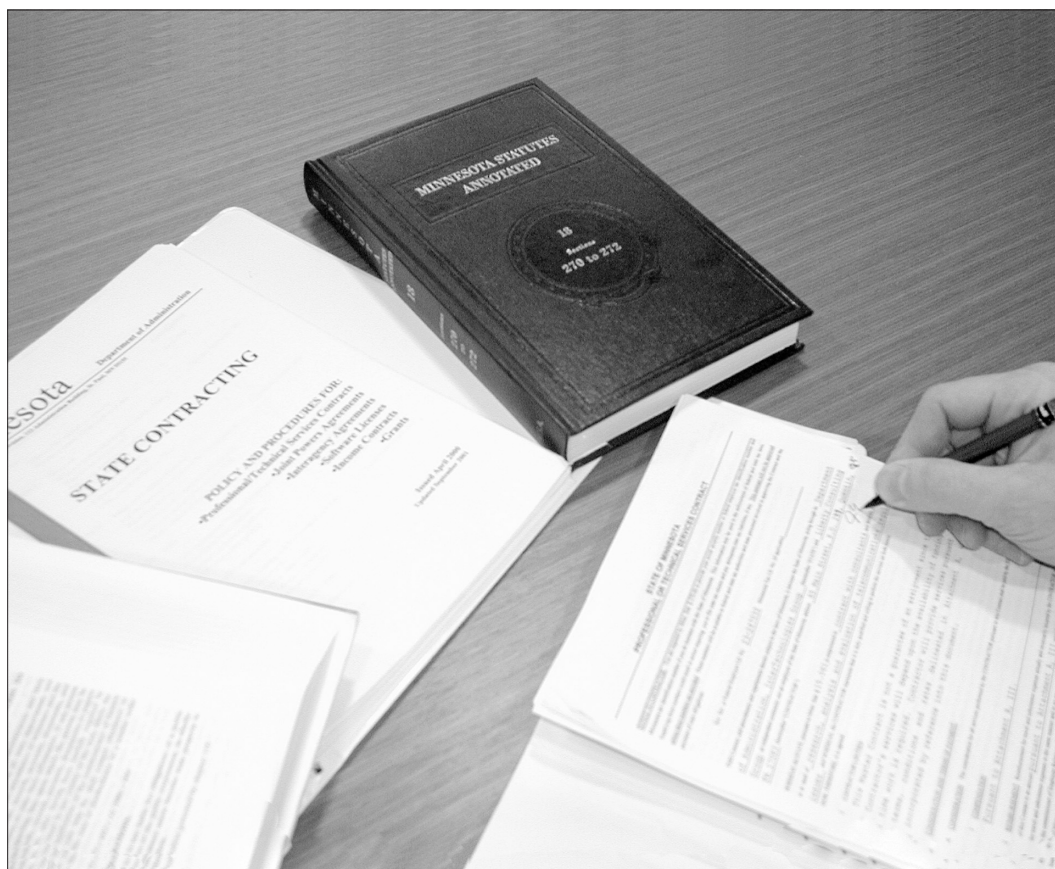




OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

PROGRAM EVALUATION REPORT

Professional/Technical Contracting



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OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

January 2003

Members

Legislative Audit Commission

In April 2002, the Legislative Audit Commission directed us to study state contracting for professional/technical services. Legislators were concerned about the nature and extent of state contracting and the management of contracts.

We found that Minnesota statutes and Department of Administration guidelines generally set forth a good process for professional/technical contracting. Due partly to limited staff resources and few enforcement tools, however, the Department of Administration does not effectively fulfill the strong contracting oversight role it is given in statutes. We also found that the agencies we reviewed in detail often did not follow state statutes, department guidelines, or effective contract management principles when contracting for professional/technical services.

To improve state oversight, we think that the Department of Administration should prioritize its workload by delegating more contracting responsibility to “well-performing agencies” and scrutinizing the others more thoroughly. We also recommend that the Legislature increase the dollar value of contracts for which agencies must seek prior approval from the department. These actions would help streamline the contracting process and allow department staff to focus on problem areas and on the state’s more expensive, challenging, or complicated contracts.

This report was researched and written by Jo Vos (project manager), Valerie Bombach, and Judy Randall. We received the full cooperation of the Department of Administration and the other state agencies that we reviewed in detail.

Sincerely,

/s/ James Nobles

James Nobles
Legislative Auditor

/s/ Roger Brooks

Roger Brooks
Deputy Legislative Auditor

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Summary

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

Major Findings:

- Total spending for professional/technical contracts by all branches of state government was \$358 million in fiscal year 2001, increasing 30 percent since 1996 compared with a 15 percent increase in inflation. Preliminary estimates show that contract expenditures may decrease to less than \$316 million in 2002 (p. 16).
- Between 1996 and 2001, total contract spending increased an average of 5.3 percent annually—less than operating expenditures (6.5 percent) and spending for state employee compensation (5.7 percent), but more than inflation (2.9 percent) (p. 20).
- In the first nine months of the current moratorium on contracts, the Department of Administration approved 94 percent of agency requests for exemptions, 62 percent of which were mandated by the Legislature (p. 23).
- The six state agencies reviewed in detail (the departments of Administration; Children, Families, and Learning; Human Services; Natural Resources; Revenue; and Transportation) often did not follow state statutes, guidelines, or effective management principles when contracting. For example, contractors often started work before contracts were fully signed or funds encumbered (pp. 32, 43).

- With limited staff resources and few enforcement tools, the Department of Administration does not effectively fulfill the strong contracting oversight role it is given in statutes (p. 51).

Key Recommendations:

- To better focus the Department of Administration's efforts, (1) the department should delegate more responsibility for contracting to "well-performing" agencies and improve its data collection efforts to better monitor agency activities and (2) the Legislature should amend *Minn. Stat.* (2002), §16C.08, subd. 2 to require agencies to seek the department's prior approval for contracts over \$20,000, instead of the current requirement of \$5,000 (pp. 55-57).
- The Legislature and the Department of Administration should "clean up" ambiguous, inconsistent, or meaningless statutory and guideline language related to professional/technical contracting (pp. 58-64).

Report Summary

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

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

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

To control spending growth and to help reduce the state's budget deficit, the 2002 Legislature directed the Governor to reduce executive branch agencies' General Fund spending for contracts by at least \$28.3 million. In fiscal year 2001, about one-third of total

expenditures for professional/technical contracts came from the state's General Fund. The Legislature also adopted a moratorium on professional/technical contracts, effective March 1, 2002 through June 30, 2003. The new law outlines several categories of exceptions to the moratorium and allows agencies to apply for contract waivers. During the first nine months of the moratorium, the Department of Administration approved 94 percent of agencies' requests for exceptions and waivers; 62 percent of the approvals granted were mandated by the Legislature.

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

Agencies Often Do Not Comply With Statutes and Guidelines

Minnesota statutes and Department of Administration guidelines set forth a good contract oversight system that generally reflects effective contract management principles discussed in the literature. There is little evidence, however, that state agencies are complying with many of these requirements, perhaps in part because there are few ramifications for noncompliance. For example, a review of 60 contracts in six state agencies found that agencies had little documentation about the need for contracts or consideration of alternatives, including the use of state employees. Agencies said that they

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

entered into most of the contracts examined to obtain special expertise unavailable in state government; most contracts were for one-time or special projects. There was little evidence that agencies seriously looked for state employees outside their departments to do the work outlined in the contracts.

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

The Department of Administration Does Not Perform the Strong Oversight Role Set Forth in Statutes

Minnesota statutes give the Department of Administration broad authority to oversee the professional/technical contracting process in state agencies. But limited staff resources and a lack of viable enforcement tools make it difficult for the department to ensure agency compliance with contracting statutes and guidelines. For example,

the department has not allocated enough staff to ensure that all agencies and contracts comply with state requirements. Two full-time professional staff review a large number of documents annually while fielding questions and providing advice on a daily basis. Furthermore, statutes give the department few tools to help ensure agency compliance with statutes and guidelines.

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

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

Given the state's current budget crisis, it is unlikely that the Legislature will appropriate more funds to the Department of Administration or that the department can allocate additional resources to improve professional/technical contracting oversight. Therefore, the department needs to better prioritize its current workload, which is now heavily focused on low-cost contracts. To this end, the Department of Administration should delegate significantly more responsibility for professional/technical contracting to "well-performing" state agencies, based partly on agencies' commitment to following contracting laws and guidelines. "Poor-performing" agencies should receive more ongoing scrutiny from the Department of Administration. To help in this task though, the

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

To improve its effectiveness, the Department of Administration needs to prioritize its workload.

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

department must improve its data collection efforts so that it has meaningful data with which to monitor agency activities. Also, the Legislature should amend statutes to increase the dollar value of contracts for which agencies must seek prior approval from the Department of Administration from \$5,000 to \$20,000 (the median value of contracts processed by the department). This figure has not been increased—nor adjusted for inflation—for more than ten years. Together, these actions would help streamline the contracting process and allow Department of Administration staff to address problem areas in contracting as well as focus on the state’s more expensive, challenging, or complicated contracts.

Contracting Statutes and Guidelines Need to Be Clarified

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

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

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

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

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

Introduction

Recent budget problems in Minnesota state government have renewed policy makers' interest in how state agencies use professional/technical contracts to obtain needed services. According to Minnesota statutes, professional/technical services are "intellectual in character" and result in the production of a report or the completion of a task.¹ For example, state agencies use contractors to help plan highways, design buildings, identify technology needs, and conduct training.

In fiscal year 2001, total spending for professional/technical contracts by all branches of state government was about \$358 million. During the 2002 legislative session, the Legislature required state agencies to reduce their general fund expenditures on professional/technical contracts by at least \$28.3 million by June 30, 2003.² The Legislature also placed an immediate moratorium on professional/technical contracts except under certain circumstances, such as contracts that protect the public's health, safety, or welfare. It also considered, but did not pass, legislation that would have required our office to examine the contracting activities of six specific state agencies. Instead, in April 2002, the Legislative Audit Commission directed us to evaluate state contracting for professional/technical services. Some legislators were concerned about the length and cost of specific contracts; others questioned how agencies determine that state employees are not able to provide the needed services and how they select contractors. Specifically, our study focused on the following research questions:

**The 2002
Legislature acted
to reduce state
contracting for
professional/
technical
services.**

- **How has overall spending on professional/technical contracts changed over time? How much have individual state agencies spent on such contracts and what kinds of services have they purchased?**
- **How often have agencies used single source and emergency contracts to obtain professional/technical services, and under what circumstances?**
- **To what extent have certain state agencies complied with selected state laws, Department of Administration guidelines, and effective contract management principles when entering into professional/technical contracts?**
- **How well has the Department of Administration overseen the professional/technical contracting process? How could the state improve the contracting process?**

To answer these questions, we reviewed Minnesota statutes and Department of Administration guidelines, contracting studies conducted by other states and the

¹ *Minn. Stat.* (2002), §16C.08, subd. 1.

² *Laws of Minnesota* (2002), ch. 374, art. 7, sec. 10.

federal government, and reports by professional procurement-related organizations. We also reviewed the literature to identify effective contract management principles and practices. We talked with contracting professionals in the Department of Administration, the state's central procurement office, as well as contracting professionals in other state agencies.³ We also surveyed the state's 52 contract coordinators to obtain their opinions about the professional/technical contracting process and their recommendations for change.⁴ To examine contracting practices in detail, we reviewed a small sample of contracts (60) in six state agencies.⁵ Finally, we analyzed contract approval and expenditure databases in the departments of Administration and Finance respectively.

Our ability to answer many of the questions that legislators raised about professional/technical contracts was limited by the quality and type of data that the state collects. For example, we were not able to compare the relative cost of using contractors rather than state employees because contracts do not always provide information on the number of full-time equivalent staff that work on each contract. Also, although we examined a small number of contracts in six agencies, we did not specifically examine each agency's contracting policies and procedures, organizational arrangement, or staffing levels.

Currently, many policy makers are considering whether to privatize more government services to help deal with the state's budget problems. Greater privatization could involve using more contractors rather than state employees to provide certain services or having the state stop providing some services altogether. Although our study did not specifically focus on privatization, it did examine the extent to which the state's framework ensures that (1) contracts are needed; (2) the contracting process is open, fair, and objective; and (3) contractors are held accountable—information that policy makers may find useful as they consider increasing state reliance on contractors.⁶

This report is divided into three chapters. Chapter 1 defines several terms commonly used when discussing professional/technical contracts and provides information on the number, cost, and characteristics of professional/technical contracts. Chapter 2 compares Minnesota statutes and Department of Administration guidelines for contracting with effective contract management principles that we identified in the literature. It then examines how well six agencies complied with the relevant state laws and guidelines. Chapter 3 discusses the Department of Administration's overall role in contracting and makes several recommendations to improve state oversight.

Now, some policy makers are asking whether increased contracting could help with the state's budget problems.

³ Unless otherwise specified, the Department of Administration refers to the Materials Management Division of the Department of Administration.

⁴ We received responses from 50 of the 52 contract coordinators. Coordinators in the Attorney General's Office and the Minnesota Amateur Sports Commission did not respond to our survey.

⁵ Specifically, we reviewed contracts in the departments of Administration; Children, Families, and Learning; Human Services; Natural Resources; Revenue; and Transportation.

⁶ Our 1992 evaluation of state contracting looked at the costs and benefits of providing some services through private contractors rather than state employees. See Minnesota Office of the Legislative Auditor, *State Contracting for Professional/Technical Services* (St. Paul, 1992).

Contracting and Expenditure Trends

SUMMARY

Total state spending for professional/technical contracts was about \$358 million dollars in fiscal year 2001, which was less than 2 percent of total state government expenditures. Between 1996 and 2001, expenditures for professional/technical contracts increased at an average annual rate of 5.3 percent—less than state operating expenditures (6.5 percent) and spending for employee compensation (5.7 percent), but more than inflation (2.9 percent). Due in part to the state's budget problems, preliminary estimates show that contract expenditures may decrease at least 12 percent between 2001 and 2002. Between 1996 and 2001, the number of contracts that state agencies wrote increased significantly, although most of the contracts were for relatively small amounts of money. During a one-year period beginning in April 2001, about 80 percent of the contracts that the Department of Administration reviewed and approved were valued at \$100,000 or less, but they represented only 15 percent of the total value of contracts approved. To help control growth in contracting and reduce the state's budget deficit, the 2002 Legislature adopted a moratorium on contracts, effective March 1, 2002 through June 30, 2003. In addition, the Legislature directed the Governor to reduce General Fund spending on contracts by at least \$28.3 million during the current biennium.

State government has routinely contracted with the private sector to provide a wide range of public services. For example, the departments of Administration and Transportation contract with architects and engineers to help design state buildings, highways, and bridges. Similarly, the Department of Human Services uses professional/technical contracts to provide security and treatment services at the Anoka-Metro Regional Treatment Center. In light of recent budget constraints, policy makers have expressed concern about the extent to which agencies contract for professional/technical services and at what cost. This chapter addresses the following research questions:

- **How many professional/technical contracts have state agencies written and what kinds of services have they obtained? What was the value of contracts written?**
- **How often have agencies used single source and emergency contracts to obtain professional/technical services and under what circumstances?**

- **How has spending on professional/technical contracts changed over time?**

To answer these questions, we examined state laws and Department of Administration guidelines for professional/technical contracting. We also talked with staff at the departments of Administration and Finance and surveyed 52 state agency contract coordinators. We used data that the Department of Administration collects to analyze the number of contracts processed and approved for state agencies and the kinds of services that contracts provided. We based our analysis of expenditure trends on data from the Minnesota Accounting and Procurement System (MAPS), which was developed by the departments of Administration and Finance.

This chapter is organized into four sections. The first section defines terms frequently used when discussing professional/technical contracts and briefly describes the overall contracting process. The second section presents data on the number of contracts that state agencies write and the kinds of services that they purchase.¹ The third section presents data on contracting expenditures and compares those expenditures with other types of spending. Finally, the fourth section provides preliminary information about the results of the 2002 moratorium on professional/technical contracting.

DEFINITIONS AND OVERVIEW

In this report, we use a number of terms unique to state contracting. For example, the term “contract” refers to a document containing the legal elements of offer, acceptance, consideration, and performance.² In general terms, an offer is a proposal to provide a service, acceptance indicates agreement with the offer, consideration is typically the payment of money for the service, and performance means the provision of services outlined in the contract.³

**Professional/
technical services
are intellectual
in character,
resulting in a
report or
completed task.**

In Minnesota, there are several types of contracts that agencies can utilize, including professional/technical contracts, service contracts, commodity contracts, and capital project contracts. This evaluation focuses only on professional/technical contracts. Statutes define professional/technical services as “intellectual in character, including consultation, analysis, evaluation, prediction, planning, programming, or recommendation that result in the production of a report or the completion of a task.”⁴ Our evaluation does not include service contracts (such as building maintenance and repair), commodity contracts (such as the purchase of materials or equipment), or capital project contracts that are exclusively building construction. Similarly, our evaluation does not include road construction contracts, although it does include contracts for road design.

¹ Unless otherwise specified, we use the term “agency” to refer to boards, commissions, and departments in the executive branch.

² Minnesota Department of Administration, *State Contracting* (St. Paul, September 2001), sec. 5, p. 1.

³ *Ibid.*

⁴ *Minn. Stat.* (2002), §16C.08, subd. 1.

Agencies can bypass the competitive solicitation process by using certain types of contracts.

Table 1.1 briefly outlines the different processes that agencies can use to select professional/technical contractors. For example, selecting contractors through a competitive solicitation process requires agencies to publicly advertise for contractors. This generally requires agencies to prepare a request for proposals (RFP); contractors must respond to the RFP to be considered for the contracting opportunity. The contracting agency must then select the best contractor based on a combination of factors identified in the RFP, including contractor qualifications, understanding of the project, and price. Single source, emergency, and work order contracts, as well as annual plans, do not have to go through the RFP process.

Table 1.1: Professional/Technical Contractor Selection Processes

| | |
|-----------------------------------|---|
| Competitively Solicited Contracts | Contracts for which agencies publicly solicit potential contractors to provide a needed service. |
| Single Source Contracts | Contracts where agencies have determined that, after a search for qualified contractors, only one contractor is reasonably available to provide a needed service. |
| Master Rosters | Lists of pre-qualified contractors from which agencies solicit contractors and write contracts for specific work. |
| Master Contracts | Contracts with pre-qualified contractors that provide the general framework for using services of multiple contractors. |
| Emergency Contracts | Contracts for the repair, rehabilitation, and improvement of state-owned property in the event of an emergency. Emergencies are generally defined as an unforeseen occurrence or circumstance that calls for immediate action in the public interest. |
| Annual Plans | Memoranda that allow agencies to directly write work order contracts for services under a certain dollar value. |
| Work Order Contracts | Contracts written with specific contractors solicited from a master contract or annual plan. |

SOURCE: Office of the Legislative Auditor’s summary of Minnesota Department of Administration, *State Contracting* (St. Paul, September 2001).

Master contracts are initially established using an open, competitive solicitation process whereby contractors must submit proposals for particular kinds of services they are able to provide. Once master contracts are established for a specific service, agencies may then directly select a contractor and write a work order contract for the needed services. When selecting contractors for a particular service, agencies must follow certain guidelines to distribute work among the contractors on the list. Agencies can write work order contracts for services valued at \$100,000 or less from a master contract without obtaining approval from the Department of Administration. Similarly, agencies can write work order contracts from annual plans without following an open, competitive solicitation process. As a rule, individual contractors typically may not receive more than \$500 per year through annual plan work orders, unless specifically permitted by the Department of Administration.

Three agencies have a direct role in the contracting process—the contracting agency, the Department of Administration, and the Attorney General’s Office. The contracting agency is responsible for determining the need for a contract; selecting a contractor; and writing, monitoring, and encumbering funds for a contract. Minnesota statutes give the Department of Administration broad authority to oversee contracting for professional/technical services by the executive branch.⁵ Staff in the Attorney General’s Office review contracts for “form and execution” to ensure that contract language meets legal requirements and that the appropriate representatives have signed them.⁶

Table 1.2 outlines the requirements with which agencies must comply when entering into a competitively solicited professional/technical contract. These requirements do not necessarily apply to other contractor selection methods, such as single source, master rosters, or master contracts. As is evident from the table, the requirements vary based on the dollar value of the contract. For example, before entering into a professional/technical contract valued in excess of \$5,000, agencies must submit a *certification form* to the Department of Administration. On this form, agencies must certify a number of things, including that (1) no state employee can perform the desired service, (2) reasonable efforts were made 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.⁷

Table 1.2: Professional/Technical Contracting Requirements for Competitively Solicited Contracts

Contracting requirements vary by dollar value.

| | <u>\$5,000 Or Less</u> | <u>\$5,000-\$50,000</u> | <u>>\$50,000</u> |
|---|----------------------------|-------------------------|---------------------|
| Prepare certification form for Department of Administration approval | Optional | Required | Required |
| After the Department of Administration signs the certification form, place notice on the department’s website or in the <i>State Register</i> | Optional | Required | Recommended |
| Prepare a formal request for proposals for Department of Administration approval | Optional | Recommended | Required |
| Advertise in the <i>State Register</i> | Optional | Recommended | Required |
| Draft Contract | Required | Required | Required |
| Encumber money | Required | Required | Required |
| Obtain signatures from the contractor, contracting agency, Department of Administration, and Attorney General’s Office | Required | Required | Required |

SOURCE: Office of the Legislative Auditor’s summary of Minnesota Department of Administration, *State Contracting* (St. Paul, September 2001).

⁵ *Minn. Stat.* (2002), §16C.08, subd. 3.

⁶ *Minn. Stat.* (2002), §16C.05, subd. 2.

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

Once the certification form is approved by the Department of Administration, agencies must publicize notice of the contracting opportunity, 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. Before approving a proposed contract, the department must determine several things, including that (1) certain contracting laws have been complied with; (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.⁸ Finally, after the Department of Administration approves and signs the contract, Attorney General staff review the contract for form and execution. Once all four parties have signed the contract and the agency has encumbered the necessary funds or has sufficient funds set aside, the contract is valid.

TRENDS IN PROFESSIONAL/TECHNICAL CONTRACTS

As part of our analysis, we used the Department of Administration's contract approval database to examine the number of professional/technical contracts and amendments that the department processed and approved during a calendar year. The database provides basic record-keeping information about contracts, such as receipt and approval dates, contracting agency, kinds of services, and the original value of individual contracts. We found that:

- **The contract approval database that the Department of Administration relies upon is of limited usefulness for evaluating agencies' contracting practices.**

The Department of Administration's databases do not facilitate contract monitoring.

We found the department's database of limited usefulness for two major reasons. First, the database does not provide a complete picture of agencies' contracting activities because it only includes those contracts that must be approved by the Department of Administration. As such, it does not include work order contracts written from master contracts or annual plans. Thus, we could not use this database to determine how often agencies actually use master contracts to obtain professional/technical services. In addition, the department's database shows the total value for which contracts and amendments are written, not the actual amount spent. Because the department does not uniquely identify master contracts in this database, the total value of contracts approved grossly overestimates the contracting plans of state agencies.⁹ Finally, the database does not indicate whether an agency actually used a contract or encumbered the necessary funds.

Second, the department's database does not easily allow the department to monitor agencies' contracting activities, such as tracking a contract from beginning to end. For example, information about contract certifications is not linked to contract review and approval data. Also, agencies sometimes submit

⁸ *Minn. Stat.* (2002), §16C.08, subd. 3.

⁹ As we discuss later, master contracts are typically not used to the full value for which they are written. Some expenditure data regarding master contract work orders are available through the state's Minnesota Accounting and Procurement System (MAPS).

incomplete contract information, such as missing contract numbers, to the Department of Administration, which makes it difficult to track contracts and any related amendments.

According to the Department of Administration, the contract approval database was developed to generate statutorily-required reports, not to evaluate or monitor agencies' contracting activities.¹⁰ Department staff indicated that the Minnesota Accounting and Procurement System (MAPS) contains more comprehensive contracting data, including expenditures for master contracts, annual plans, and work order contracts, from which summary reports could be generated. However, department staff do not use this database to monitor or track agencies' contracting practices. Staff told us that they have concerns about the accuracy of some of the data in MAPS because not all of the data have been audited.¹¹ In addition, MAPS does not provide information about certification or single source contract approvals that is recorded in the department's contract approval database. Individually, each of these systems—MAPS and the contract approval database—provides only partial information about the state's professional/technical contracts. Department of Administration staff do not combine information from both databases to obtain a more complete picture of agencies' contracting activities.

Use of Professional/Technical Contracts

Agencies say they primarily use contracts to obtain special expertise.

There are a variety of reasons why state agencies contract for professional/technical services. For example, agencies use contracts to obtain special expertise not otherwise available in their department, augment current staffing levels, satisfy state or federal requirements, or meet seasonal or temporary work demands. In our survey of contract coordinators, we asked them to rank the top three reasons why their agency used professional/technical contracts. Eighty percent of the contract coordinators that responded to our survey indicated that obtaining special expertise was the primary reason their agency used contracts. Other reasons why agencies contracted were to augment current staffing levels and to continue to receive services traditionally obtained through contracts.

We also asked contract coordinators to identify the type of work most frequently obtained through professional/technical contracts. More than one-half of the contract coordinators (56 percent) indicated that contracts most often provided one-time or special projects, events, or reports. A significant percentage (30 percent) said that contracts primarily provided ongoing tasks or services to their agency. The remaining 14 percent said that they used contracts most often to help their agency with program or system start-up projects or for other reasons.

As a result of agency contracting activities, the Department of Administration reviewed and approved nearly 2,200 contracts (including over 300 master

¹⁰ *Minn. Stat.* (2002), §16C.08, subd. 4. Specifically, the Department of Administration is required to submit an annual report to the Legislature that identifies all professional/technical contracts executed. For each contract, the report must identify the contractor, cost, length, and kind of services provided.

¹¹ Staff from the departments of Administration and Finance told us that they are addressing these issues by providing more training to agency staff.

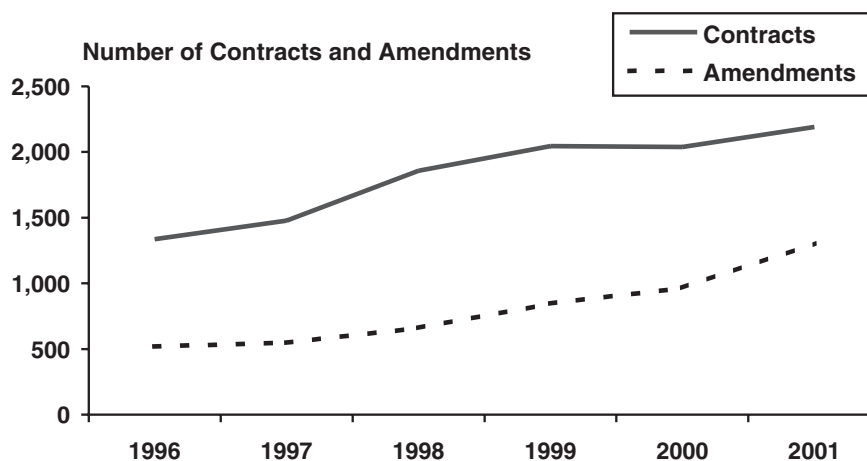
contracts), 1,300 contract amendments, and 67 annual plans and amendments in 2001. According to data collected by the Department of Administration:

- **The number of professional/technical contracts and amendments processed by the Department of Administration increased significantly between 1996 and 2001.**

Figure 1.1 shows how the number of contracts and amendments processed by the Department of Administration has changed over time. The department reviewed and approved 1,337 contracts in 1996 compared with 2,191 in 2001—an overall increase of 64 percent. The number of contracts processed by the department increased at an average annual rate of over 10 percent. However, this fairly large increase does not necessarily mean that agencies are contracting for more services. Growth may be partly due to changes in agencies’ contracting practices, such as using multiple contractors for various components of a single project, or including more contractors on master contract lists.

The Department of Administration processed about 2,200 contracts and 1,300 amendments in 2001.

Figure 1.1: Contracts and Amendments Processed by the Department of Administration, 1996-2001



NOTE: The data include master contracts but exclude annual plans and work order contracts.

SOURCE: Office of the Legislative Auditor’s analysis of Department of Administration professional/technical contract data.

During the same period, the number of contract amendments processed increased at an even greater rate than the number of contracts—averaging about 20 percent annually or 152 percent overall. State agencies wrote 518 amendments in 1996 compared with 1,306 in 2001. Agencies generally write amendments to modify the tasks, cost, or timeline of a project. Agency practices, however, vary. For example, rather than develop a new contract, some agencies choose to write amendments simply for convenience. On the other hand, if a project is near the

end of a fiscal year some agencies may choose to write an entirely new contract rather than amend an existing contract for bookkeeping purposes.¹²

In addition to looking at the statewide trends, we also looked at individual agencies' use of professional/technical contracts. We found that:

Although the Department of Corrections wrote more contracts than other agencies, they were generally for small amounts of money.

- **A small number of state agencies wrote most of the professional/technical contracts that the Department of Administration reviewed and approved.**

Table 1.3 shows the number of contracts and amendments written by each agency for a one-year period beginning April 2001. As these data show, five agencies accounted for about 52 percent of all contracts approved by the Department of Administration: the departments of Corrections (15 percent), Transportation (13 percent), Administration (12 percent), Human Services (8 percent) and Natural Resources (5 percent).¹³ These agencies also accounted for 64 percent of the amendments that the department reviewed and approved. In contrast, several agencies wrote ten or fewer contracts during this time period, including the Office of Strategic and Long-Range Planning and the Department of Labor and Industry.

Kinds of Professional/Technical Services Obtained

We also identified the kinds of services obtained through professional/technical contracts for a one-year period beginning in April 2001. The services for which contracts were written ranged widely, from bridge design and water quality monitoring, to actuarial services and surveying the homeless population. According to data collected by the Department of Administration:

- **State agencies most frequently used professional/technical contracts to obtain education and training, architectural and engineering, and computer systems development services.**

As shown in Figure 1.2, one-fourth of the contracts processed by the Department of Administration during a one-year period beginning in April 2001 were for education and instruction services, such as training state employees on media interview skills or report writing. A large number of contracts were also written for architectural and engineering services, such as bridge and highway design, land planning and development, and storm sewer inspection. Similarly, computer systems development accounted for a large share of the contracts written during this time period.

¹² Ms. Barb Jolly, Materials Management Division, Department of Administration, interview by author, Telephone conversation, St. Paul, Minnesota, August 20, 2002.

¹³ Many of the contracts written by the Department of Administration were master contracts that can be used by all state agencies.

Table 1.3: Contracts and Amendments Processed by the Department of Administration, April 2001-April 2002

| Agency | Number of Contracts | Share of Contracts | Median Value | Number of Amendments | Share of Amendments | Median Value |
|---|---------------------|--------------------|-----------------|----------------------|---------------------|-----------------|
| Corrections | 265 | 14.5% | \$ 4,800 | 69 | 5.6% | \$ 930 |
| Transportation | 239 | 13.1 | 53,500 | 179 | 14.5 | 0 |
| Administration | 213 | 11.7 | 10,600 | 382 | 30.9 | 250 |
| Human Services | 148 | 8.1 | 30,600 | 127 | 10.3 | 0 |
| Natural Resources | 92 | 5.0 | 25,000 | 33 | 2.7 | 2,400 |
| Children, Families, and Learning | 76 | 4.2 | 24,630 | 35 | 2.8 | 3,000 |
| Health | 74 | 4.1 | 23,250 | 44 | 3.6 | 10,700 |
| Pollution Control | 68 | 3.7 | 40,210 | 26 | 2.1 | 0 |
| Agriculture | 62 | 3.4 | 11,690 | 17 | 1.4 | 2,000 |
| Public Safety | 52 | 2.8 | 20,500 | 35 | 2.8 | 11,045 |
| Employee Relations | 43 | 2.4 | 170,000 | 27 | 2.2 | 25,000 |
| Commerce | 36 | 2.0 | 24,000 | 17 | 1.4 | 4,940 |
| Housing Finance | 34 | 1.9 | 30,000 | 9 | 0.7 | 32,400 |
| Economic Security | 30 | 1.6 | 40,000 | 51 | 4.1 | 1,090 |
| Trade and Economic Development | 23 | 1.3 | 47,250 | 14 | 1.1 | 0 |
| Military Affairs | 18 | 1.0 | 25,190 | 11 | 0.9 | 2,500 |
| Revenue | 17 | 0.9 | 25,000 | 25 | 2.0 | 3,400 |
| Finance | 15 | 0.8 | 25,500 | 9 | 0.7 | 7,000 |
| Iron Range Resources and Rehabilitation | 10 | 0.5 | 39,250 | 11 | 0.9 | 0 |
| Office of Strategic and Long-Range Planning | 8 | 0.4 | 6,525 | 2 | 0.2 | -9,590 |
| Labor and Industry | 4 | 0.2 | 7,710 | 2 | 0.2 | 30,000 |
| Human Rights | 1 | 0.1 | 2,000 | 0 | 0 | 0 |
| All other small agencies, boards, and commissions | <u>294</u> | <u>16.1</u> | <u>15,000</u> | <u>115</u> | <u>9.2</u> | <u>10,000</u> |
| Total Contracts | 1,825 | 100.0% | \$20,000 | 1,238 | 100.0% | \$ 1,130 |

NOTE: Because contract amendments may exclusively address project timelines or tasks, and not costs, the median value of some agencies' amendments may equal \$0. Data exclude the master and work order contracts that we could identify.

SOURCE: Office of the Legislative Auditor's analysis of Department of Administration professional/technical contract data.

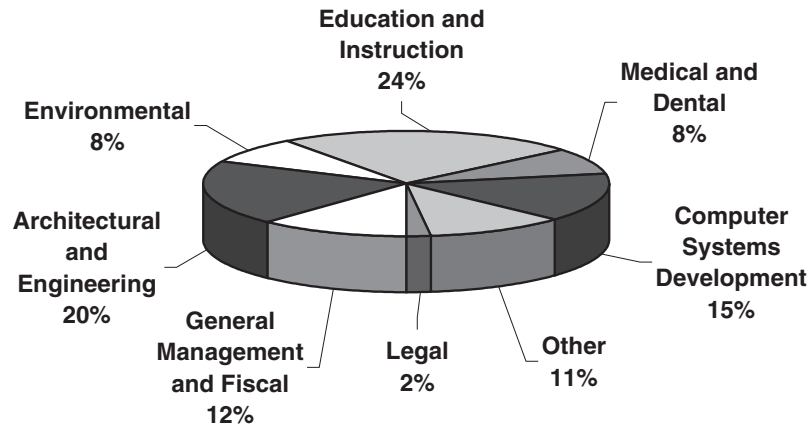
On average, the Department of Transportation wrote more high-cost contracts than other agencies.

Dollar Value of Professional/Technical Contracts

Because state requirements regarding contractor selection vary depending on the dollar value of the contract, we also examined the number of professional/technical contracts processed according to the original contract amount. As described earlier, agencies must follow different contractor selection processes for contracts valued at \$5,000 or less; between \$5,000 and \$50,000; and greater than \$50,000.

During a one-year period beginning in April 2001, the Department of Administration approved 3,461 contracts (including master contracts), contract amendments, and annual plans for a total value of nearly \$1.1 billion. Excluding annual plans and the master contracts that we could identify, the total dollar value

Figure 1.2: Professional/Technical Contracts Processed by the Department of Administration by Service Area, April 2001-April 2002



NOTE: Data exclude master and work order contracts.

SOURCE: Office of the Legislative Auditor's analysis of Department of Administration professional/technical contract data.

of the contracts and contract amendments approved during this one-year period was about \$295 million.¹⁴ The original value of the contracts alone totaled \$242 million (with a median value of \$20,000) and the amendments were valued at \$53 million (with a median value of \$1,130).

A small share of contracts, 19 percent, accounted for 85 percent of the total value of approved contracts.

The original dollar value of individual professional/technical contracts varied widely. For example, individual contract amounts ranged from an \$80 contract for educational services to a \$10.8 million contract for a library program management system. According to our analysis of data collected by the Department of Administration:

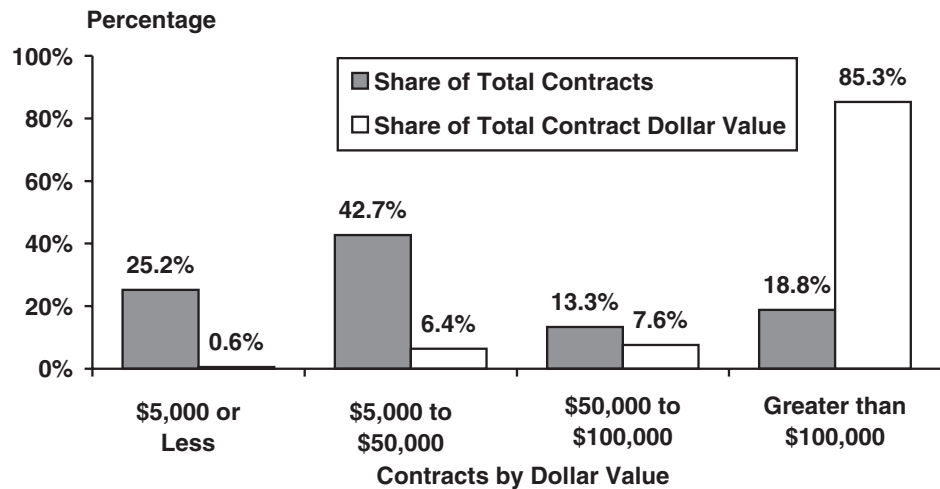
- **Most of the professional/technical contracts approved by the Department of Administration were written for relatively small dollar amounts.**

As shown in Figure 1.3, 68 percent of the contracts that the Department of Administration approved during a one-year period beginning in April 2001 were for \$50,000 or less. More specifically, about 25 percent of the contracts were written for \$5,000 or less, 32 percent were between \$5,000 and \$25,000, and 10 percent were valued between \$25,000 and \$50,000.

A small share of the contracts approved (19 percent) accounted for a large share (85 percent) of the total value of the approved contracts. These contracts—each

¹⁴ Annual plans and master contracts are typically not used to the full value for which they are written. During this one-year period, the value of each of the more than 330 individual master contracts ranged from \$25,000 to \$5 million. Agencies' annual plans totaled about \$27.5 million and ranged from \$1,000 to \$10.7 million in value.

Figure 1.3: Professional/Technical Contracts Processed by the Department of Administration by Dollar Value, April 2001-April 2002



SOURCE: Office of the Legislative Auditor's analysis of Department of Administration professional/technical contract data.

valued at more than \$100,000—are likely more complex and may require greater scrutiny by the Department of Administration to ensure compliance with contracting requirements.

Types of Contracts

As presented earlier in Table 1.1, agencies can use a variety of methods to select a contractor. We tried to examine the extent to which agencies used master contracts, master rosters, single source contracts, and emergency contracts—alternatives to competitively solicited contracts. We surveyed contract coordinators to supplement the department’s information on these contracts. For example, we asked contract coordinators about the extent to which their agencies developed and maintained their own master contracts and rosters. However, we were not able to obtain information on how often agencies actually used master contracts or master rosters.¹⁵ On the other hand, we were able to collect information from contract coordinators about their agencies’ use of emergency contracts.

Master Contracts

As discussed earlier, master contracts are umbrella documents that provide the general framework for using the services of multiple contractors. During a one-year period beginning in April 2001, agencies wrote more than 300 master

¹⁵ According to staff at the departments of Administration and Finance, MAPS is designed to identify expenditures for master contracts. However, they have concerns about the accuracy of these data.

The Department of Administration does not monitor agencies' use of master contracts.

contracts valued at more than \$800 million. The value of these contracts ranged from \$25,000 to \$5 million—many were developed by the Office of Technology for computer systems development services.

Contract coordinators in 11 state agencies reported maintaining master contracts in fiscal year 2002. These contracts covered more than 33 kinds of services, including land planning for golf courses, advertising, asbestos abatement, and investigation of workers' compensation claims. These contracts are generally used only by the agency that develops them. For example, the Department of Natural Resources has master contracts to obtain interpretive services for park visitors. On the other hand, some master contracts may be used by multiple agencies. For instance, other agencies may use the Department of Employee Relations' master contracts for drug testing and health promotion services. Currently, the Department of Administration develops and writes most of the state's master contracts and makes them available for other agencies to use. As an example, the department has master contracts with over 100 architects and engineers for building design services.

Master Roster Contracts

As described previously, agencies can develop and use master rosters to identify pre-qualified contractors. The Department of Administration does not, however, track the extent to which agencies use master rosters. Our survey of contract coordinators found that only two state agencies—the departments of Administration and Transportation—maintained master rosters in fiscal year 2002. Similar to master contracts, the Department of Administration maintains master rosters that other agencies can use. These include the State Building Construction Division's roster of architects and engineers and the Office of Technology's roster for technology-related services. The Department of Transportation maintains master rosters in six areas: architect design, bridge design, land survey, market research, public relations and advertising, and land title attorneys.

Single Source Contracts

We also examined the extent to which agencies used single source contracts. Because the Department of Administration only recently began recording information on single source contracts in its contract approval database, we limited our analysis to a one-year period beginning in April 2001.¹⁶ According to these data:

- **During a one-year period beginning April 2001, nearly one out of four contracts approved by the Department of Administration were single source contracts.**

During this period, the Department of Administration approved 415 single source contracts, representing about 23 percent of all approved contracts. About two-thirds of the single source contracts were for \$50,000 or less.

¹⁶ Our analysis includes only those contracts that required an agency to submit a single source justification form to the Department of Administration for approval.

The departments of Finance and Human Services wrote more single source contracts than other agencies.

In contrast to the statewide figures, Department of Administration data also show that between one-third and one-half of some agencies' professional/technical contracts were single source contracts. The agencies with the highest percentage of single source contracts as a share of their total contracts were the departments of Finance (47 percent); Human Services (47 percent); Children, Families, and Learning (42 percent); Health (38 percent); and Economic Security (37 percent).¹⁷ The service areas for which agencies used single source contracts followed the use of professional/technical contracts in general. That is, single source contracts were most frequently written for education and instruction, architectural and engineering, and computer systems development services. In Chapter 2, we further discuss the use of single source contracts by six state agencies.

Emergency Contracts

As described previously, agencies write emergency contracts to provide critical services immediately, which allows agencies to bypass the solicitation process. Although the Department of Administration must approve such requests, the department does not compile information on the number of emergency contracts approved, their cost, or services obtained.¹⁸ Again, we contacted contract coordinators to collect some basic information on the use of these contracts. According to our survey, seven agencies reported that they wrote, in total, more than 20 emergency contracts for professional/technical services in fiscal year 2002.

These emergency contracts covered a range of services, including ensuring rapid response to hazardous waste spills and obtaining firefighting services. The Department of Administration wrote eight emergency contracts to obtain personnel, such as professional nurses at treatment centers, to ensure the continuation of services during the 2001 state employee strike.

EXPENDITURE TRENDS FOR PROFESSIONAL/TECHNICAL CONTRACTS

In addition to the number and types of professional/technical contracts that agencies used, we looked at trends in agency expenditures. First, we examined total state and executive branch expenditures for professional/technical contracts for fiscal years 1996 through 2002. We then compared professional/technical spending with other types of government expenditures, including operating expenditures and spending through interagency agreements.

To analyze expenditure trends, we used data from the Minnesota Accounting and Procurement System (MAPS), which represents most state expenditures. In contrast to our analysis of the Department of Administration's contract approval database, which records the number of contracts approved and processed during a calendar year, we analyzed expenditures on a fiscal year basis. In addition,

¹⁷ Agencies must have had ten or more contracts approved during this time period to be included in our analysis.

¹⁸ According to Department of Administration staff, most emergency contracts are service contracts and not professional/technical contracts.

MAPS data include contract expenditures on contracts not included in the Department of Administration's contract approval database, such as work orders written from master contracts. We note that it is difficult to determine agencies' total expenditures per contract, since contracts may be in effect for several years.

Professional/Technical Contract Expenditures

We looked at spending for professional/technical contracts in two ways. First, we examined total expenditures for all branches of state government, including executive branch agencies, the Minnesota State Colleges and Universities system, and several judicial and legislative offices.¹⁹ Second, we examined expenditures by executive branch agencies alone.

Table 1.4 presents expenditures for professional/technical contracts by all branches of state government for fiscal years 1996 through 2002. Overall:

- **Total expenditures for professional/technical contracts were about \$358 million in fiscal year 2001, increasing at twice the rate of inflation since 1996.**

As shown in Table 1.4, nominal expenditures (that is, spending unadjusted for inflation) varied widely between 1996 and 2001, ranging from a low of \$241 million in 1997 to a high of \$358 million in 2001. Contract spending grew

Table 1.4: Expenditures for Professional/Technical Contracts, FY 1996-2002

Spending for contracts will likely decrease to less than \$316 million in 2002.

| Fiscal Year | Total Professional/Technical Contract Expenditures (in millions) | | Executive Branch Professional/Technical Contract Expenditures (in millions) | |
|-------------|--|---|---|--|
| | Unadjusted for Inflation | Adjusted for Inflation in 2002 Dollars ^a | Unadjusted for Inflation | Adjusted for Inflation in 2002 Dollars |
| | 1996 | \$276 | \$322 | \$222 |
| 1997 | 241 | 275 | 220 | 250 |
| 1998 | 299 | 332 | 254 | 283 |
| 1999 | 325 | 355 | 293 | 321 |
| 2000 | 325 | 342 | 279 | 294 |
| 2001 | 358 | 362 | 316 | 320 |
| 2002 | 290 ^b | 290 | Unavailable | Unavailable |

^aFor our analysis of expenditures, we adjusted spending to 2002 dollars. We accounted for inflation by using the State and Local Government Index published by the United States Bureau of Economic Analysis. Bureau of Economic Analysis, National Income and Products Accounts Table 7.1, Quantity and Price Indices for Gross Domestic Product; <http://www.bea.gov/bea/dn/nipaweb/TableViewFixed.asp?SelectedTable=144&FirstYear=2001&lastyear=2002&Freq+Qtr>; accessed June 3, 2002.

^bDepartment of Finance data show that expenditures totaled \$290 million in fiscal year 2002. This number is likely to change as agencies meet their obligations for 2002 and may increase to as much as \$316 million.

SOURCE: Office of the Legislative Auditor's analysis of Department of Finance professional/technical contract expenditure data, November 26, 2002.

¹⁹ Judicial and Legislative offices include the Minnesota Trial Courts, Court of Appeals, Supreme Court, Public Defense Board, and Office of the Legislative Auditor.

Spending for contracts makes up less than 2 percent of total state government expenditures.

30 percent compared with a 15 percent increase in inflation over this period. Preliminary estimates from the Department of Finance show that contracting expenditures should decrease significantly in 2002, likely falling between \$290 and \$316 million. Overall, spending for professional/technical contracts is only a small share, less than 2 percent, of total state government spending.²⁰

Because of the wide variation in annual expenditures, we also calculated the average annual rate of increase to determine overall growth in spending between fiscal years 1996 and 2001. Although professional/technical expenditures increased a total of 30 percent overall between fiscal years 1996 and 2001, the average annual increase was about 5.3 percent. During this same time period, while inflation increased a total of 15 percent, the average annual rate of inflation was about 2.9 percent. Preliminary estimates show that contract expenditures will likely decrease anywhere from 12 to 19 percent between 2001 and 2002.

Table 1.4 also shows executive branch spending for professional/technical contracts. As noted earlier, the Department of Administration generally must approve executive branch contracts. On average, state agencies account for about 88 percent of total state government spending on professional/technical contracts. Overall, state agencies spent 42 percent more for these contracts in fiscal year 2001 than they did in fiscal year 1996. As noted previously, the overall rate of inflation increased 15 percent between these two years. As shown, nominal agency expenditures (unadjusted for inflation) ranged from a low of \$220 million in 1997 to a high of \$316 million in 2001.

Again, because of the wide fluctuation in expenditures, we calculated the average annual rate of increase in contract expenditures for executive branch agencies. State agency spending for professional/technical contracts increased, on average, at a faster rate than total state government spending for similar contracts—7.3 percent annually compared with 5.3 percent. As noted earlier, the average annual rate of inflation between fiscal years 1996 and 2001 was 2.9 percent.

We also looked at how individual state agencies varied in the amount they spent on professional/technical contracts, as shown in Table 1.5. According to our analysis of MAPS data from the Department of Finance:

- **Between fiscal years 1996 and 2001, the departments of Human Services and Transportation together accounted for over 30 percent of executive branch expenditures for professional/technical contracts.**

The Department of Human Services spent almost \$210 million (unadjusted for inflation) on professional/technical contracts between fiscal years 1996 and 2001; the Department of Transportation spent over \$285 million. In contrast, the Department of Veterans Affairs spent only \$471,000 on professional/technical contracts during the same time period.

Although executive branch spending for professional/technical contracts increased, on average, 7.3 percent annually, Table 1.5 indicates that some agencies

²⁰ Minnesota Department of Finance, *Comprehensive Annual Financial Report 2001* (St. Paul, Minnesota, 2002), pp. 152-153. Total state government spending includes current expenditures, capital outlay, debt service, grants and subsidies, and transfers for the state general revenue, special revenue, and debt service funds.

Table 1.5: Executive Branch Expenditures for Professional/Technical Contracts by Agency, FY 1996-2001

| Agency | Expenditures Unadjusted (in Thousands) | | | Average Annual Percentage Change | |
|---|---|-----------------------|-----------------------|-------------------------------------|--|
| | 1996-1997 Biennium | 1998-1999 Biennium | 2000-2001 Biennium | Unadjusted for Inflation | Adjusted for Inflation in 2002 Dollars |
| Human Services | \$ 71,243 | \$ 77,084 | \$ 60,612 | -3.0% | -5.7% |
| Transportation | 61,727 | 93,161 | 131,901 | 23.7 | 20.2 |
| Administration | 36,967 | 23,348 | 24,828 | -25.5 | -27.6 |
| Corrections | 34,130 | 38,123 | 44,172 | 11.7 | 8.6 |
| Pollution Control | 26,229 | 32,778 | 19,945 | -7.9 | -10.5 |
| Natural Resources | 10,938 | 17,810 | 11,816 | 5.5 | 2.5 |
| Children, Families, and Learning | 10,738 | 22,287 | 26,186 | 31.3 | 27.6 |
| Revenue | 10,543 | 11,216 | 20,005 | 20.4 | 17.0 |
| Health | 9,908 | 13,180 | 20,118 | 17.3 | 14.0 |
| Employee Relations | 7,148 | 9,573 | 13,620 | 27.2 | 23.6 |
| Trade and Economic Development | 6,949 | 6,522 | 9,700 | 1.7 | -1.1 |
| Finance | 6,600 | 8,395 | 6,738 | 4.0 | 1.1 |
| Commerce | 6,587 | 9,476 | 7,702 | 2.4 | -0.5 |
| Economic Security | 5,712 | 10,419 | 13,866 | 25.5 | 22.0 |
| Public Safety | 5,184 | 6,862 | 10,053 | 23.6 | 20.2 |
| Labor and Industry | 4,183 | 2,098 | 1,769 | -16.2 | -18.5 |
| Agriculture | 3,102 | 5,058 | 5,205 | 19.4 | 16.1 |
| Iron Range Resources and Rehabilitation | 3,044 | 5,295 | 6,207 | 22.2 | 18.8 |
| Housing Finance | 1,837 | 3,158 | 4,871 | 36.0 | 32.2 |
| Military Affairs | 1,452 | 1,449 | 1,952 | 17.3 | 14.0 |
| Strategic and Long- Range Planning | 1,065 | 932 | 1,293 | 34.4 | 30.6 |
| Human Rights | 402 | 132 | 64 | -8.9 | -11.5 |
| Mediation Services | 140 | 126 | 143 | -2.7 | -5.5 |
| Veterans Affairs | 73 | 36 | 362 | 37.0 | 33.0 |
| All other small agencies, boards, and commissions | <u>115,761</u> | <u>148,622</u> | <u>152,293</u> | 5.8 | 2.8 |
| Total Expenditures | \$441,662 | \$547,140 | \$595,421 | 7.3% | 4.3% |

SOURCE: Office of the Legislative Auditor's analysis of Department of Finance professional/technical contract expenditure data for executive branch agencies, November 13, 2002.

Although some agencies decreased their contract spending, most did not.

decreased their nominal spending on contracts between 1996 and 2001. For example, the Department of Human Services experienced an average annual decrease of 3 percent. Similarly, although Pollution Control Agency expenditures on professional/technical contracts exceeded \$78 million between 1996 and 2001, the agency's overall spending decreased almost 8 percent annually.

On the other hand, some agencies with much lower total contract expenditures had significant increases during this time period. For example, expenditures for professional/technical contracts by the Office of Strategic and Long-Range Planning increased at an average annual rate of about 34 percent between 1996 and 2001. Similarly, the Department of Veterans Affairs' spending increased at an

average annual rate of 37 percent during this time period. These large increases were typically due to spending on computer systems development.

Professional/Technical Contract Spending by Fund

We also wanted to know how agencies paid for professional/technical contracts. To determine this, we looked at spending from the following types of funds: general, special revenue, capital projects, enterprise and internal service, fiduciary, trunk highway, and federal. While the trunk highway and federal funds are considered “special revenue” funds, we analyzed them separately because of the large number of contracts that receive money from these types of funds. We found that:

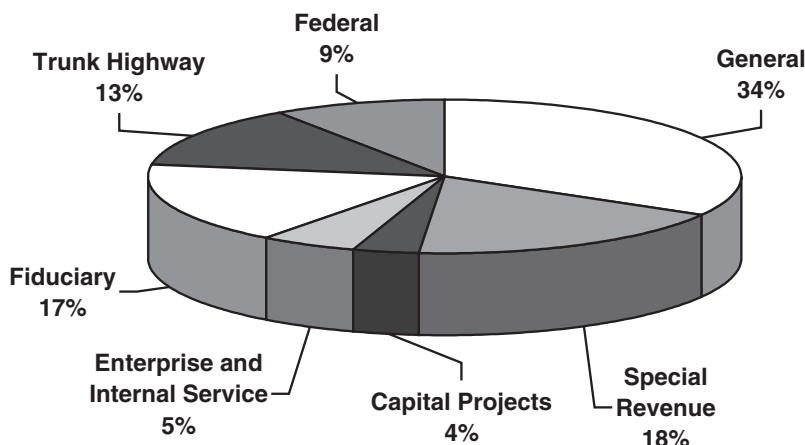
- **In general, agencies most often contracted for professional/technical services from their general and special revenue funds.**

About one-third of contract expenditures comes from the General Fund.

Figure 1.4 shows the percentage of professional/technical contract expenditures by fund type for the 2000-2001 biennium. During this time period, 34 percent of contract expenditures were paid for with money from the General Fund. Spending from special revenue funds, excluding the trunk highway and federal funds, comprised 18 percent of total expenditures. Less than 10 percent of contract expenditures came from either the capital projects or enterprise and internal service funds.

We also looked at how expenditures by fund type changed annually between fiscal years 1996 and 2001. On average, spending for professional/technical contracts

Figure 1.4: Share of Expenditures for Professional/ Technical Contracts by Fund Type, 2000-2001 Biennium



SOURCE: Office of the Legislative Auditor's analysis of Department of Finance professional/technical contract expenditure data for all branches of state government.

(unadjusted for inflation) from the general and trunk highway funds increased the most, each about 15 percent annually. Average annual spending for contracts from federal funds increased 13 percent while spending for both the fiduciary and enterprise and internal funds increased just over 5 percent annually. Spending for contracts from all special revenue funds, except trunk highway and federal funds, increased almost 7 percent annually. During the same time period, the average annual rate of inflation was 2.9 percent. Capital project funds were the only type of funds to experience a decrease in average annual spending for professional/technical contracts. Contract expenditures from this type of fund varied widely, ranging from a high of \$62 million in 1996 to a low of \$1.5 million in 2001, with an average annual decrease of almost 53 percent.

Total State Operating Expenditures

We also examined how different types of state government expenditures have changed over time. Specifically, we looked at operating expenditures, employee compensation, and professional/technical contract expenditures.²¹ Operating expenditures typically include items such as state employee salaries and benefits, employee training, and activities to administer state government. Employee compensation includes salaries, health and unemployment insurance, workers' compensation, expenses, and separation expenditures.

The state spent \$2.8 billion for employee compensation and \$358 million for contracts in 2001.

Operating expenditures for state government totaled about \$2.8 billion in fiscal year 1996 and \$3.8 billion in fiscal year 2001 (unadjusted for inflation). In 1996, state government spending for employee compensation and professional/technical contracts was \$2.1 billion and \$276 million respectively. In 2001, spending for state employee compensation and professional/technical contracts was about \$2.8 billion and \$358 million respectively.

Our analysis of spending data from the Department of Finance shows that:

- **Between fiscal years 1996 and 2001, total spending for professional/technical contracts increased an average of 5.3 percent annually—less than operating expenditures (6.5 percent) and spending for state employee compensation (5.7 percent), but more than inflation (2.9 percent).**

During this time period, data show that average annual spending for operating expenditures grew at more than twice the rate of inflation. At the same time, annual spending for employee compensation grew at nearly twice the rate of inflation.

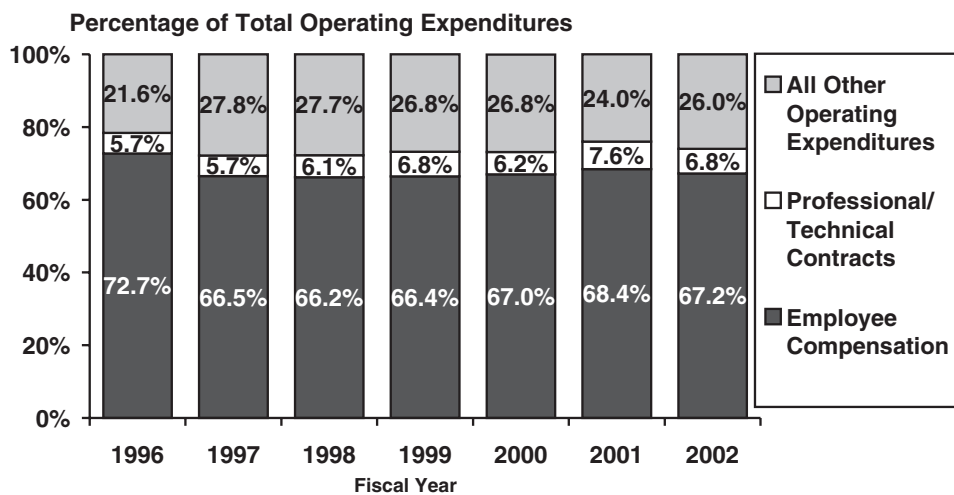
Because professional/technical contracts are generally considered part of the state's operating expenditures, we also looked at contract spending as a share of

²¹ We used audited data from the Minnesota Department of Finance, *Comprehensive Annual Financial Report 2001* (St. Paul, 2002) for our analysis. We defined operating expenditures as general governmental expenditures from the general, special revenue, and debt service funds. However, for this analysis, employee compensation and professional/technical contracts include all state government funds.

total state operating expenditures.²² Figure 1.5 shows how the share of spending for the different components of state operating expenditures has changed over time. Expenditures for contracts as a share of total operating expenditures ranged from a low of 5.7 percent in both fiscal years 1996 and 1997 to a high of 7.6 percent in 2001. State employee compensation ranged from a low of about 66 percent in both 1998 and 1999 to a high of 73 percent in 1996. Preliminary estimates show that 2002 expenditures for both contract and employee compensation as a share of total operating expenditures decreased from the previous year.

Contract spending made up 8 percent of state operating expenditures in 2001, while employee compensation made up 68 percent.

Figure 1.5: Major Components of Total State Operating Expenditures, FY 1996-2002



NOTE: For this figure, operating expenditures include spending by all branches of state government from the general, special revenue, and debt service funds, but excludes capital outlay, debt service, grants and subsidies, and intergovernmental transfer expenditures from these three funds.

SOURCE: Office of the Legislative Auditor's analysis of Department of Finance data.

Interagency Agreement Expenditures

Because policy makers and state employee groups have questioned the extent to which agencies use outside contractors rather than existing resources to meet their needs, we examined total expenditures by all branches of government for professional/technical services obtained through interagency agreements. Interagency agreements are arrangements between state agencies to share resources, do work for each other, or share work.²³

²² Unlike the former analysis, this analysis only uses spending data from the general, special revenue, and debt service funds for employee compensation and professional/technical contract expenditures.

²³ *Minn. Stat.* (2002), §471.59. Expenditure data for interagency agreements initiated by some legislative offices, the University of Minnesota, the Minnesota Historical Society, and some other small offices are excluded.

Overall, spending through interagency agreements was relatively low compared with expenditures for professional/technical contracts. In fiscal year 2001, spending on contracts (\$358 million) was more than seven times greater than spending on interagency agreements (\$49.5 million). However, according to our analysis of data from the Department of Finance:

- **Between fiscal years 1996 and 2001, spending for professional/technical services obtained through interagency agreements increased much faster than spending for professional/technical contracts.**

In 2001, agencies spent nearly \$50 million on interagency agreements for professional/technical services.

Total spending by all branches of state government through interagency agreements increased more than 500 percent between fiscal years 1996 and 2001. As shown in Table 1.6, agencies spent \$8 million in fiscal year 1996 and almost \$50 million in 2001 on interagency agreements (unadjusted for inflation). Between 1996 and 2001, interagency agreement expenditures for professional/technical services increased at an average annual rate of 44 percent, compared with 5.3 percent for contracts. During the same time period, the average annual

Table 1.6: Interagency Agreement Expenditures for Professional/Technical Services, FY 1996-2001

| Fiscal Year | Expenditures (in millions) | |
|----------------------------|----------------------------|--|
| | Unadjusted for Inflation | Adjusted for Inflation in 2002 Dollars |
| 1996 | \$ 8.0 | \$ 9.4 |
| 1997 | 11.2 | 12.8 |
| 1998 | 22.5 | 25.1 |
| 1999 | 27.9 | 30.5 |
| 2000 | 39.8 | 41.9 |
| 2001 | 49.5 | 50.1 |
| Average Annual Growth Rate | 44% | 40% |

NOTE: Expenditures include spending by all branches of state government.

SOURCE: Office of the Legislative Auditor's analysis of Department of Finance expenditure data, November 13, 2002.

rate of inflation was 2.9 percent. According to staff at the Department of Administration, the large increase in interagency agreement spending may be due to changes in agencies' fund transfer practices, such as using interagency agreements in lieu of grants.²⁴

MORATORIUM ON PROFESSIONAL/TECHNICAL CONTRACTS

In an effort to confront the state's growing budget deficit, the 2002 Legislature adopted a moratorium on professional/technical contracts, effective March 1,

²⁴ Ms. Kathy Connelly, Materials Management Division, Department of Administration, interview by author, Telephone conversation, St. Paul, Minnesota, October 10, 2002.

**The 2002
Legislature
created several
exemptions to
the current
contract
moratorium.**

2002 through June 30, 2003.²⁵ In addition, the Governor must reduce state agencies' planned General Fund expenditures for professional/technical contracts by at least \$28.3 million during the current biennium.

As shown in Table 1.7, the new law outlines several categories of contracts that are exempt from the moratorium, including contracts funded entirely with federal or non-state funds and contracts related to threats against the public's health, safety, or welfare. In addition, state agencies may apply to the Department of Administration for a contract waiver based on necessity. Agencies may request a "categorical" exception or waiver, which allows them to proceed with the contracting process for a group of related contracts without having to seek the Department of Administration's approval on an individual basis.

Table 1.8 shows the number of exceptions and waivers processed by the Department of Administration through the first nine months of the moratorium. As these data show:

- **The Department of Administration approved 94 percent of agency requests for exemptions from the current moratorium on professional/technical contracts, 62 percent of which were mandated by the Legislature.**

Table 1.7: Exemptions to the Professional/Technical Contract Moratorium

Exceptions

- Projects related to a threat to public health, welfare, or safety that threatens the functioning of government, the protection of property, or the health or safety of people.
- Projects paid for entirely with federal funds or whose costs will be entirely recovered from non-state sources.
- Projects paid for entirely with funds from the state airport funds, trunk highway funds, county-state aid highway fund, or the municipal state-aid street fund.
- Trunk highway projects of a type described in *Laws of Minnesota* (2000), ch. 479, art. 1, sec. 2, subd. 3(a)(1)-(3).
- Projects authorized by four bonding bills: *Laws of Minnesota* (2002), ch. 393, *Laws of Minnesota* (first special session, 2001), ch. 12, *Laws of Minnesota* (2000), ch. 492, and *Laws of Minnesota* (1999), ch. 240.
- Projects that (1) are necessary to avoid a disruption of essential state functions, (2) will reduce state costs, or (3) are needed to avoid legal liability.

Waivers

- Projects due to necessity.

SOURCE: *Laws of Minnesota* (2002), ch. 374, art. 7, sec. 11.

²⁵ In February 2002, the Legislature passed a law placing a moratorium on professional/technical contracts. The law listed specific exceptions to the moratorium and gave the Commissioner of Administration the authority to grant waivers based on need. Later in the session, the Legislature amended this law to include more exceptions and also moved the waiver-granting authority to the Governor's Office. The Governor's Office delegated the waiver-granting authority back to the Department of Administration. *Laws of Minnesota* (2002), ch. 220, art. 10, sec. 36-37, 39, and *Laws of Minnesota* (2002), ch. 374, art. 7, sec. 10-11, 14.

Table 1.8: Requests for Exceptions and Waivers to the Professional/Technical Contract Moratorium

Nearly half of the approved exemptions to the moratorium do not involve state funds.

| | |
|---|------------|
| Total Requests Received and Processed ^a | 2,343 |
| Total Disapproved | 134 |
| Approved | |
| Exceptions | |
| Public Health, Welfare or Safety | 202 |
| Federal or Non-State Funding | 1,085 |
| Legislative Pre-Authorization for Special Projects | 24 |
| Provide Essential Services/Reduce Costs/Avoid Legal Liability | 56 |
| Other ^b | <u>7</u> |
| Total Exceptions | 1,374 |
| Waivers | |
| Individual | 667 |
| Categorical | <u>168</u> |
| Total Waivers | <u>835</u> |
| Total Approved Waivers and Exceptions | 2,209 |

^aTotal requests received and processed from March 1, 2002 through November 30, 2002.

^bOther includes exception requests citing use of transportation state funds, trunk highway funds, or specific environmental or natural resources funds.

SOURCE: Department of Administration; <http://www.mmd.admin.state.mn.us/pdf/PTWaiverMonthlyReport.pdf>; accessed December 13, 2002.

The Department of Administration processed about 2,340 requests for exceptions and waivers from March through November 2002, approving 94 percent of them. Of the approvals granted, 62 percent were legislatively mandated, mostly because the needed services would be funded entirely with non-state dollars. The remaining 38 percent represented agency waivers based on need. In approving these waivers, the department relied “strongly on the representations made by the agency,” expecting that “as a general rule, contracts that do not meet a reasonable interpretation of “necessary” (as opposed to “convenient”) will be halted at the agency level.”²⁶

Of the 134 requests that the department denied, more than two-thirds were submitted within the first three months of the moratorium—before the Legislature authorized five additional categories of exceptions.²⁷ According to Department of Administration staff, agencies likely resubmitted some of these requests, which the department later processed and approved as exceptions.

It is too early to determine the extent to which the contract moratorium will decrease spending. As noted earlier, state law also requires the Governor to reduce planned executive branch General Fund spending on professional/technical

²⁶ Minnesota Department of Administration, *Professional/Technical Contract Moratorium and Waiver Process Questions and Answers* (St. Paul, June 21, 2002), 3.

²⁷ *Laws of Minnesota* (2002), ch. 374, art. 7, sec. 11. The additional categories included exceptions for projects related to specific transportation, trunk highway, and environmental funds; special projects; and projects to avoid legal liability or to reduce costs.

The total value of contracts approved by the Department of Administration has changed little since implementing the moratorium.

contracts by at least \$28.3 million.²⁸ Preliminary estimates from the Department of Finance show that total state government spending on contracts from all funds will likely decrease between \$42 and \$68 million between fiscal years 2001 and 2002. On the other hand, a recent analysis by the Department of Administration suggests that the overall value of contracts that the department has approved since the moratorium was enacted appears to have changed very little. The department looked at the total value of professional/technical contracts approved from April through June in 2000, 2001, and 2002. According to the Department of Administration's data, the estimated value of contracts approved over a three-month period after the Legislature adopted the moratorium was \$83 million—less than the \$91 million approved over the same time frame in 2000, but more than the \$77 million approved in 2001.²⁹

To help us assess the impact of the 2002 contract moratorium, we asked contract coordinators whether their agency had changed its professional/technical contracting practices. Slightly more than 25 percent of survey respondents said that the moratorium added another step to the contracting process while 20 percent said that the moratorium increased the amount of time required to write contracts. About 18 percent of coordinators said that their agencies had increased their internal scrutiny of proposed contracts as a result of the moratorium while an almost equal percentage said that the moratorium had little or no effect on their agencies' operations. Less than 10 percent said that their agency was contracting less because of the moratorium.

²⁸ *Laws of Minnesota* (2002), ch. 374, art. 7, sec. 10.

²⁹ Minnesota Department of Administration, Summary 2 Professional/Technical Contract Detail Without Master Contract Estimates, October 9, 2002, unpublished.

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

| Department: | Original Contract Value | |
|----------------------------------|-------------------------|-------------|
| | Minimum | Maximum |
| 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

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.

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

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

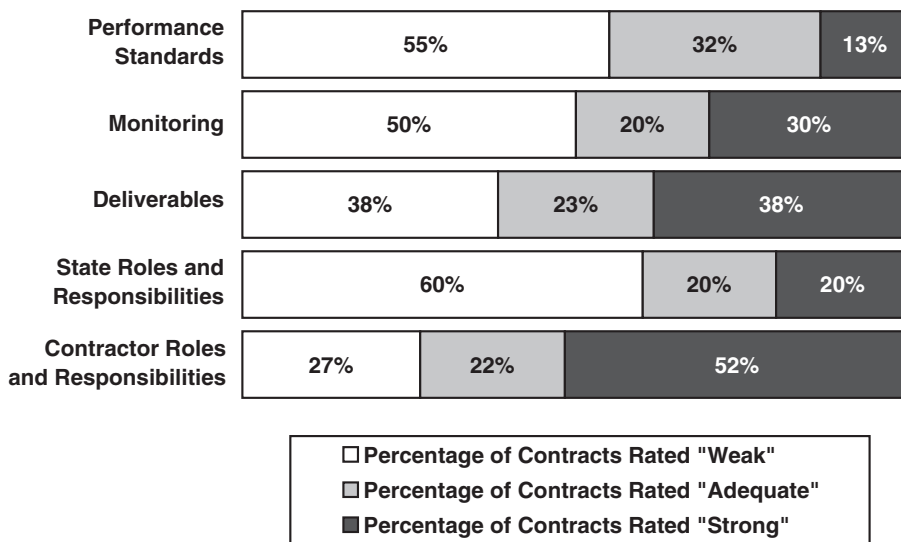
Many contracts were poorly written and some contained arithmetic errors.

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.

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.

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

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 underestimate 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).

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.

Performance monitoring should be explicitly written into contracts.

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.

Options for Change

SUMMARY

Minnesota statutes give the Department of Administration a stronger role in overseeing the professional/technical contracting process than the department actually performs—or can perform. Limited staff resources and a lack of enforcement tools make it difficult for the department to ensure agency compliance with contracting laws and guidelines. To improve professional/technical contracting, the department should refocus its contract review and approval activities to more strategically oversee agency practices. Specifically, we recommend that the department delegate more responsibility for professional/technical contracting to “well-performing” state agencies, based upon their individual needs, abilities, and performance. While the department should periodically monitor these agencies and continue to give assistance when requested, it should provide more ongoing scrutiny to the contracting process in “poor-performing” agencies. Also, the Legislature should amend Minnesota statutes to increase the dollar value of contracts for which agencies must seek prior approval from the Department of Administration from \$5,000 to \$20,000. Finally, we recommend several changes in Minnesota statutes and Department of Administration guidelines to address inconsistent, ambiguous, or meaningless contracting requirements. In total, these actions would help streamline the contracting process and allow department staff to focus on problem areas identified in our report as well as on the state’s more expensive, challenging, or complicated contracts.

As noted earlier, recent budget problems have renewed legislators’ interest in how state agencies use contracts to obtain professional/technical services. In fiscal year 2001, state government spent about \$358 million on contracts that agencies generally said were needed because they lacked special expertise to perform various services. At the same time, our review of a small number of contracts in selected state agencies suggests that agencies may not always adhere to contracting laws, guidelines, or effective contract management principles. This chapter discusses different ways the state could better focus its oversight of professional/technical contracting to ensure a fair, open, and accountable contracting process. It addresses two major research questions:

- **How well has the Department of Administration overseen the professional/technical contracting process?**

- **How could the state improve the professional/technical contracting process?**

To answer these questions, we reviewed Minnesota statutes and Department of Administration guidelines, contracting studies conducted by other states and the federal government, and reports by professional procurement-related organizations. We also talked with contracting professionals in the Department of Administration and various state agencies and reviewed a sample of 60 contracts in selected state agencies. Finally, we surveyed the state's 52 contract coordinators to obtain their opinions about the contracting process and their recommendations for change.

This chapter has three sections. First, we discuss Minnesota's current model for reviewing and approving professional/technical contracts. Second, we present our recommendations for improving state oversight of contracts. Finally, we identify some alternative ways to provide oversight that we also considered, but did not recommend for various reasons.

CURRENT ROLE OF THE DEPARTMENT OF ADMINISTRATION

According to a recent survey by the National Association of State Procurement Officials, about two-thirds of the states give their central procurement office the authority to establish or approve professional/technical contracts for state agencies.¹ In this respect:

- **Minnesota is similar to most other states in that its central procurement office has the authority to establish or approve professional/technical contracts for state agencies.**

Statutes give the Department of Administration strong authority to oversee contracting.

In Minnesota, state law gives the Commissioner of Administration broad authority to oversee and approve the professional/technical contracts entered into by state agencies. For example, statutes require that the Commissioner of Administration conduct all contracting "by, for, and between agencies and perform all contract management and review functions for contracts, except those functions specifically delegated" to contracting agencies.² Although the commissioner can delegate contracting duties to other agencies, the agencies must conduct these activities under the commissioner's direct supervision and control.³ Furthermore, statutes require the Commissioner of Administration to determine that agencies have complied with certain contracting laws before it approves proposed contracts.⁴ Although statutes permit agency heads to enter into contracts to obtain

¹ National Association of State Procurement Officials, *2001 Survey of State and Local Government Purchasing Practices* (Lexington, KY, 2001), 76-77.

² *Minn. Stat.* (2002), §16C.03, subd. 4.

³ *Minn. Stat.* (2002), §16C.03, subd. 16. As we discuss later, the department has delegated some specific contracting responsibilities to three state agencies.

⁴ *Minn. Stat.* (2002), §16C.08, subd. 3. This subdivision lists seven items that the Commissioner of Administration must determine prior to approving proposed contracts.

professional/technical services, they may do so only with the Commissioner of Administration’s approval.⁵

In practice, however, the Department of Administration does not perform specifically as outlined in statutes. In our opinion:

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

There are two major reasons why it is difficult for the Department of Administration to perform as outlined in statutes. First, the department has not assigned sufficient staff to ensure compliance with all current professional/technical contracting laws and guidelines. The department has two full-time equivalent professional staff assigned to processing and approving professional/technical contracts, plus a documents assistant who enters information into the department’s contract approval database.⁶ These staff processed approximately 4,600 contract-related documents in 2001, including 1,100 contract certifications, 2,200 contracts, and 1,300 amendments. The number of full-time staff assigned to professional/technical contracting has not changed significantly over the last few years even though staff processed 64 percent more contracts and 152 percent more amendments in 2001 than they did in 1996. Also, given the department’s limited staff resources, some statutory expectations are unrealistic. For example, although statutes require the Department of Administration to determine that a proposed contract is needed, the department thinks—and we concur—that agencies are best able to determine whether the work obtained under a contract is necessary.⁷

Second, the department’s ability to regulate agency contracting is hindered by a lack of viable enforcement tools. For example, we noted in Chapter 2 that agencies frequently allowed contractors to begin work before contracts were fully signed and often before funds were encumbered. Although this is contrary to contracting guidelines or statutes, the department has little recourse but to sign contracts once agencies have allowed contractors to begin work. To refuse to sign or honor such contracts might expose the state to legal and financial risks.

To try to ensure agency compliance with contracting laws and guidelines, the Department of Administration focuses on facilitation—that is, providing education, training, and technical assistance to state agencies. As such, department staff function primarily as “consultants” who work with contract coordinators to guide agencies through the contracting process. State agencies generally have a positive view of the department’s role as a facilitator. We asked contract coordinators how much help the Department of Administration gave them in a variety of areas related to professional/technical contracting. As shown in Table 3.1, depending on the specific area, anywhere from 65 to 96 percent of contract coordinators who needed assistance said that the department gave them at

The department focuses on education, training, and technical assistance to ensure agency compliance with contracting laws and guidelines.

⁵ *Minn. Stat.* (2002), §15.061.

⁶ Additional staff may be assigned on an as-needed basis, such as during vacations.

⁷ *Minn. Stat.* (2002), §16C.08, subd. 3(2). We discuss this issue and other statutory requirements in more detail later in this chapter.

Table 3.1: Percentage of Contract Coordinators Who Received Needed Assistance From the Department of Administration

| Area of Assistance | Percentage of Contract Coordinators ^a |
|---|--|
| Ensuring compliance with laws and guidelines | 96% |
| Training agency staff in the contracting process | 94 |
| Providing expertise writing requests for proposals | 86 |
| Ensuring best value | 83 |
| Training agency staff in contract management responsibilities | 83 |
| Ensuring that contracts are needed | 82 |
| Providing expertise writing contracts | 81 |
| Offering alternatives to contracting | 76 |
| Offering advice on contract monitoring | 75 |
| Providing performance-related information | 65 |

^aThe total number of contract coordinators needing assistance varied by subject area.

SOURCE: Office of the Legislative Auditor Survey of Contract Coordinators, September 2002.

least some help. For example, 94 percent of the coordinators who identified their agency as needing training related to the contracting process said that the Department of Administration provided at least some help in this area.

Although we recognize the importance of providing education, training, and technical assistance, we think that the department needs to place greater emphasis on its oversight function. We found that the state agencies we reviewed often failed to comply with selected state laws, guidelines, or effective contract management principles when contracting for professional/technical services. As discussed in Chapter 2, the agencies rarely conducted formal analyses to determine the need for the contracts that we reviewed and they routinely allowed work to begin before contracts were fully signed or funds encumbered. Also, agencies often submitted “boilerplate” language to the Department of Administration when they described why state employees were unavailable or unable to perform the needed services or when they explained the alternatives to contracting that they considered. Furthermore, many of the contracts we reviewed did not clearly indicate contract deliverables or timetables, contain adequate monitoring tools, or specify performance expectations.

Department staff review and approve about half of the contracts they receive within one day.

Nevertheless, almost one-half of the contracts that we judged unsatisfactory in terms of having clearly defined deliverables, monitoring tools, or performance expectations were approved by the Department of Administration within one day of receipt. According to data collected by the department over a one-year period beginning April 2001, staff returned only 7 percent of contracts and amendments to agencies before ultimately signing them, and they approved about one-half of agency contracts and amendments within one day of their receipt. In a recent report on professional/technical contracting by the Department of Administration, some department staff expressed concern that the agency was

placing too much emphasis on speed, efficiency, and customer service, which they felt could undermine the department’s oversight role.⁸

Overall, we think that:

- **Individual agency heads must assume greater responsibility for ensuring that their agencies’ professional/technical contracting practices comply with statutes and guidelines.**

Ultimately, the Governor needs to ensure that agency heads are dedicated to achieving their agencies’ missions in an environment that recognizes the importance of complying with all applicable laws and guidelines. A recent report on contracting by the Department of Administration found that, of all groups interviewed, agency heads had the poorest understanding of the Department of Administration’s role and responsibilities regarding agency contracting.⁹ In addition, when disputes arise between state agencies regarding contracting practices, Department of Administration staff need to know that they have the full weight of the Governor’s Office behind them as they enforce requirements related to the expenditure of public funds.

RECOMMENDATIONS FOR OVERSEEING PROFESSIONAL/TECHNICAL CONTRACTING

The department should be more focused and strategic in its contracting oversight.

Considering the state’s current budget crisis, it is unlikely that the Legislature will appropriate more funds to the Department of Administration or that the department can allocate additional resources to improve state oversight of professional/technical contracting. Therefore, the department needs to refocus its contract review and approval activities, which are currently focused on low cost contracts. This section presents our recommendations to give more weight to the department’s oversight responsibilities without increasing its staffing level or costs. We recommend doing this in two ways: (1) by delegating more responsibility for small or routine professional/technical contracts to state agencies and (2) by “cleaning up” ambiguous, inconsistent, or meaningless statutory and guideline language.

Delegate Contracting Responsibilities

We think that the Department of Administration needs to better focus its resources by limiting its involvement in small or routine contracts so that it can pay more attention to the problem areas that we identified earlier, especially with agencies’ more expensive or complicated contracts. As noted previously in Chapter 1,

⁸ Minnesota Department of Administration, Management Analysis Division, *Draft Report: Review of Materials Management Division’s Professional/Technical Contract Review and Approval Process* (St. Paul, December 6, 2002), 6.

⁹ *Ibid.*, 12.

about two-thirds of the contracts that the department reviewed in 2001 were written for \$50,000 or less; one-fourth were valued at \$5,000 or less. Furthermore, the department does not formally prioritize its contract review and approval activities by considering each contract's schedule, estimated cost, degree of risk, or substance—a problem that we noted in our 1992 evaluation of professional/technical contracting.¹⁰ It was our thinking then—and it remains so today—that the department should prioritize its review and approval activities so that it has more time to spend on ensuring that large, non-routine, or complicated contracts comply with state contracting laws and guidelines. Instead, the Department of Administration allows state agencies to prioritize the department's work for it by designating certain contracts as “rush.” According to the department, agencies designate about one-third of the contracts as “rush,” and Department of Administration staff review them the day that they arrive.¹¹

Greater delegation would allow department staff to focus on problem areas and more expensive or challenging contracts.

To help focus its review and approval efforts, the Department of Administration should delegate more responsibility for professional/technical contracting to “well-performing” state agencies. Because agencies vary regarding the size and complexity of their contracts and how well they adhere to contracting laws, guidelines, and principles, delegation should be tailored to individual agencies' needs, abilities, and performance. “Well-performing” agencies should be given more latitude and authority to act on their own with the department periodically monitoring the results. In contrast, the contracting process in “poor-performing” agencies should receive more strategic, ongoing scrutiny from the department. This would help streamline the contracting process, reduce the department's workload, and permit Department of Administration staff to focus more attention on problem areas. Allowing some agencies to take more responsibility for small or routine contracts would give department staff more time to focus on expensive, challenging, or complicated contracts that might pose more risks for the state. It would also allow the department to play a greater role in helping agencies address future privatization decisions if policy makers decide that the state should increase its reliance on private contractors.

Several contract coordinators support greater delegation. In our survey, we asked contract coordinators what changes, if any, were needed to improve Minnesota's professional/technical contracting process. Almost one-third of the coordinators that suggested changes (9 of 30) said that the Department of Administration should delegate more contracting responsibilities to state agencies. Currently, the department has delegated some limited professional/technical contracting duties to the departments of Transportation and Public Safety and to the Pollution Control Agency. For example, the Pollution Control Agency has the authority to issue work order contracts up to \$1 million for Superfund clean-up without the Department of Administration's approval. In contrast, other agencies must obtain the department's approval for all work order contracts that exceed \$100,000.

On the other hand, there might not be a great deal of cabinet-level support for, or interest in, increased delegation. In Spring 2001, the Department of

¹⁰ Minnesota Office of the Legislative Auditor, *State Contracting for Professional/Technical Services* (St. Paul, 1992), 43. Department of Administration staff told us that they more closely scrutinize contracts that deviate from the department's contract template.

¹¹ Minnesota Department of Administration, *Project Charter for the Contracting Process Review Project* (St. Paul, July 19, 2002), 5.

Administration asked agency commissioners to notify the department if they were interested in having some professional/technical contracting responsibilities delegated to them; few agencies responded. In addition, a recent report on contracting by the Department of Administration found that small agencies were not interested in delegation and preferred having the department review their contracts.¹²

RECOMMENDATION

The Department of Administration should delegate significantly more responsibility for professional/technical contracting to “well-performing” state agencies, based upon individual agencies’ needs, abilities, and performance.

The department should base its decision to delegate, in part, on the amount of training that an agency has received and the agency’s commitment to following professional/technical contracting laws and guidelines. Over the past few years, the Department of Administration has provided training in the contracting process to state agencies. Recognizing that agencies need more training in contract management issues, the department is considering establishing an academy that provides such training to agency staff. To date, the department has provided contract management training to staff in the Department of Natural Resources. In addition, the department recently began holding regular contract coordinator meetings to discuss contracting problems, concerns, and issues.¹³

The biggest impediment to greater delegation lies in the Department of Administration’s ability to effectively monitor agency compliance with contracting laws and guidelines. At a minimum, the department would need to improve its data collection activities to ensure that it collects meaningful data that can be used to monitor agencies’ contracting activities. As we noted in Chapter 1, the department’s contract approval database does not provide information that would enable the department



The Department of Administration enters contract information into its contract approval database.

¹² Department of Administration, *Draft Report*, 9.

¹³ It should be noted that the department’s website and professional/technical contracting manual provide valuable information and step-by-step instructions for agency staff.

to adequately monitor or track agencies' contracting activities.¹⁴ For example, the database does not identify master contracts nor does it track how often agencies use them. In addition, it does not easily link professional/technical contracts with their certification forms. Because the Department of Administration does not consistently collect information in its contract approval database that can be easily linked with the state's database on contract expenditures, department staff cannot easily monitor agencies' contracting practices, such as the extent to which approved contracts were actually used or the extent to which work started on contracts before funds were encumbered (16A violations). Similarly, the manner in which the department's contract approval database identifies whether work started before contracts were fully signed (16C violations) only measures violations that occur before administration staff sign contracts even though contracts are not fully executed until they are approved by the Attorney General's Office, which is the last signatory.

The department should develop performance indicators to help oversee state contracting.

To help the department monitor and regulate professional/technical contracting on both a statewide and agency level, it needs to develop a few key performance indicators.¹⁵ For example, performance indicators could identify agencies that have a higher than average percentage of 16A or 16C violations, single source contracts, or contract amendments, or agencies that have experienced a higher than average increase in professional/technical contracting costs. Such indicators might also yield information on statewide trends that legislators and other policy makers might find useful as they set agency budgets.

RECOMMENDATION

The Department of Administration should improve its data collection efforts to ensure that it collects meaningful data that can be used to monitor contracting activities on both an agency and statewide level.

To further prioritize the Department of Administration's workload and allow staff to better focus their review and approval activities, we think that the Legislature should amend statutes to increase the dollar value for contracts that need the department's prior approval. Statutes currently require that the Commissioner of Administration approve all certification forms for professional/technical contracts over \$5,000.¹⁶ Increasing this amount to \$20,000, which is the median value of contracts approved by the department over a one-year period beginning April 2001, would permit staff to focus more attention on the problem areas that we identified as well as on higher valued or more complex contracts.¹⁷ The statutory

¹⁴ As noted in Chapter 1, the Department of Administration developed its contract approval database to generate specific reports that are required by statute, not to help the department manage its workload or to monitor agency contracting practices.

¹⁵ According to Department of Administration staff, the Minnesota Accounting and Procurement System (MAPS) has the capacity to track performance measures related to contracting. However, the department has not used MAPS for this purpose.

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

¹⁷ In our 1992 report on professional/technical contracting, we recommended raising the dollar limit to \$10,000, which was the median value of professional/technical contracts at that time. See Office of the Legislative Auditor, *State Contracting*, 42.

limit has not been adjusted in more than ten years. About 26 percent of the contracts that the department approved in 2001 were valued between \$5,000 and \$20,000.

RECOMMENDATION

The Legislature should amend Minn. Stat. (2002), §16C.08, subd. 2 to require agencies to seek prior approval from the Department of Administration before writing professional/technical contracts in excess of \$20,000, instead of the current requirement of \$5,000.

“Clean Up” Statutory and Guideline Language

We think that the Legislature and the Department of Administration should “clean up” ambiguous, inconsistent, or meaningless statutory and guideline language as it relates to professional/technical contracts. We identified problems in the following areas: determining the need for a contract; requiring approval from the Attorney General’s Office; allowing contractors to start work before contracts are valid (that is, before funds are encumbered and contracts fully signed); and reporting requirements. We briefly discuss each of these areas below.

Determining the Need for a Contract

Before entering into a professional/technical contract, agencies must certify to the Commissioner of Administration that state employees are either unable or unavailable to perform the needed services or that using state employees would be less efficient or more costly than using contractors. To help ensure that state agencies give due consideration to using state employees, Minnesota statutes and Department of Administration guidelines set forth a variety of requirements.

For example, statutes require that the Department of Employee Relations develop a directory of services that state agencies commonly provide that are professional or technical in nature.¹⁸ In theory, agencies contemplating a contract could contact the employee relations department or review the directory to find out whether staff in other state agencies would be able to provide the needed services.¹⁹ However, state laws and guidelines do not require agencies to consult the directory prior to contracting, nor do they require the department to distribute such a directory. Even if such requirements were in place, employee relations staff told us that they do not have a directory of services and have no immediate plans to develop one.

We think that it would be difficult to develop a meaningful inventory of services provided by state agencies and even more difficult to keep it current. We support the directory’s goal—encouraging agencies to obtain professional/technical services through interagency agreements rather than contracts whenever feasible.

Agencies are required by law to determine whether state employees can provide a needed service before they contract.

¹⁸ Minn. Stat. (2002), §16C.07.

¹⁹ Department of Administration staff told us that they sometimes refer agencies to the department’s Management Analysis Division if proposed contracts are for certain types of management-related services, such as focus groups or organizational analysis.

However, there are likely better ways to achieve this goal and we encourage the departments of Administration and Employee Relations to jointly address this problem.

RECOMMENDATION

The Legislature should delete language in Minn. Stat. (2002), §16C.07 that requires the Department of Employee Relations to develop a directory of professional/technical services provided by state agencies.

State employees rarely respond to contracting opportunities in other agencies.

State statutes and Department of Administration guidelines also require that agencies publicize the availability of professional/technical contracts expected to exceed \$25,000 by posting notice, electronically if possible, at appropriate worksites in state agencies.²⁰ Two relatively easy ways agencies satisfy this requirement are to post notice of contracting opportunities on the Department of Administration’s website or in the *State Register*. However, the department does not require that all types of contracts be publicized this way. For example, agencies planning to write single source contracts or work order contracts valued at more than \$25,000 must notify all state agency human resources directors directly through a mailing.²¹ Although agencies must consider all employee responses received within five working days of the notification, only one contract manager that we interviewed could remember ever receiving a response from the routing to human resources directors. One contract coordinator who responded to our survey said that the state should “eliminate public notices to state agencies altogether or at least make exceptions for certain contracts and work order contracts. We have advertised hundreds and hundreds of contracts and received no response.”

Although we agree with the spirit of the law requiring state employee notification, the Department of Administration could explore better ways to ensure that employees—and more importantly agency heads—are notified of prospective contracts. It might make more sense for state agencies to look for employees in other agencies when the professional/technical services are valued at less than \$25,000. Agencies might be more willing or able to “loan” employees for less expensive or shorter projects. In this respect, work order contracts that agencies write from their annual plans might offer more opportunities for inter-agency cooperation than large professional/technical contracts.²²

²⁰ *Minn. Stat. (2002), §16C.07* and Minnesota Department of Administration, *State Contracting* (St. Paul, September 2001), sec. 10, p. 7.

²¹ Department of Administration, *State Contracting*, sec. 10, p. 7. We noted that the department’s guidelines are somewhat contradictory in terms of when agencies are required to notify state agency human resources directors.

²² As we discussed in Chapter 1, agencies develop annual plans that identify routine, repetitive needs for certain kinds of professional/technical services. These plans have specific expenditure limits per contractor, most frequently approved at \$5,000 by the Department of Administration. Agencies write work order contracts to obtain specific services off their annual plans.

RECOMMENDATION

The Department of Administration should examine the effectiveness of the various methods that are required to notify state employees and agencies about the availability of professional/technical contracts and suggest statutory changes or revise its guidelines accordingly.

Finally, Minnesota statutes require that, before approving a professional/technical contract, the Department of Administration determine that: (1) the work to be performed is necessary for the agency to achieve its statutory responsibilities and the agency has the statutory authority to enter into a contract and (2) no other agency has performed or contracted for work that would be substantially duplicative.²³ The department indirectly satisfies the first requirement by having agencies explain the need for a proposed contract on the *certification form*. Department staff told us that it is very difficult for them to determine whether agencies need to perform the proposed work. They believe that responsibility for determining need should reside with the contracting agency because the agency is best able to weigh the merits of a contract against its other needs. We agree, and think that statutes should require the contracting agency, not the Department of Administration, to document how the particular services are necessary to meet its statutory responsibilities. The Department of Administration's role at this point in the process should focus on whether agencies have successfully documented their need and whether a professional/technical contract is the best vehicle to obtain a needed service.

RECOMMENDATION

The Legislature should repeal Minn. Stat. (2002), §16C.08, subd. 3(2) and instead amend Minn. Stat. (2002), §16C.08, subd. 2 to require that agencies seeking approval for a professional/technical contract over \$20,000 certify to the Department of Administration that the work to be performed under the contract is necessary for the agency to achieve its statutory responsibilities and that it has the statutory authority to enter into a contract.

The Department of Administration also has no mechanism for directly satisfying the second statutory requirement concerning duplication of services. The department's contract approval database, as well as the Minnesota Accounting and Procurement System (MAPS), do not yield detailed enough information to easily indicate whether contracts duplicate other contracts or other agencies' work. Instead, the department currently requires that agencies certify that the needed work is not available from a previous contract. However, agencies have no mechanism to help them easily determine whether a contract would be duplicative. As a result, the requirement is somewhat meaningless in practice and should be repealed.

²³ *Minn. Stat.* (2002), §16C.08, subd. 3(2) and (5). In contrast, *Minn. Stat.* (2002) §16C.08, subd. 2(3) requires that agencies certify to the Department of Administration that the product of the services received under a contract will be original in character.

RECOMMENDATION

The Legislature should repeal Minn. Stat. (2002), §16C.08, subd. 3(5) that requires the Department of Administration to determine whether other agencies or contracts have substantially performed the tasks outlined in a proposed contract. The Department of Administration should revise its guidelines and certification form accordingly.

Reviews by the Attorney General's Office

Another issue involves the role of the Attorney General's Office in the contract review and approval process. As noted in Chapter 1, the Attorney General's Office must review and approve all professional/technical contracts.²⁴ Staff from that office told us that their review of smaller professional/technical contracts that use the Department of Administration's standard contract template is quite limited. According to statutes, contracts are not valid unless the Attorney General's Office has approved them for "form and execution."²⁵ "Form" simply refers to whether the document has been written as a contract with all of the proper terms, phrases, and attachments, while "execution" refers to whether the proper signatures have been obtained. The Attorney General's Office does not have the express authority to disapprove contracts on other grounds even though it might have concerns about the need for a contract, the work to be performed, deliverables, timetables, monitoring tools, or contract costs. During the 1997-1998 legislative session, legislation was introduced that would have removed the Attorney General's Office from the approval process—a move that both the Attorney General's Office and the Department of Administration supported.²⁶ The proposed legislation did not pass.

The Attorney General's review for "form and execution" is very narrow.

We think that the Attorney General's involvement in routine contracts needs to be revisited. Not only does it add extra time to the overall contract approval process, attorney general staff told us that they seldom disapproved a professional/technical contract that used the Department of Administration's standard template. As an alternative, we suggest that the Attorney General's Office be required to review and approve only those professional/technical contracts that differ from the "boilerplate" contract language provided by the Department of Administration. The department encourages state agencies to use its professional/technical contract template, which was developed with input from the department's legal staff. The template ensures that all contracts contain standard language concerning items such as liability, data practices, financial auditing, and intellectual property rights. It makes sense to have staff from the Attorney General's Office continue to review and approve all contracts that stray from standard language to ensure that the state's interests in areas such as these are protected. It also makes sense to continue having staff from the Attorney General's Office work with agencies as they write large or very complicated professional/technical contracts.

²⁴ Other signatories, in order, include the contractor, contracting agency, and the Department of Administration. The Attorney General's Office is the last signatory.

²⁵ *Minn. Stat.* (2002), §16C.05, subd. 2(3).

²⁶ *S.F. 726*, Minnesota Legislature (1997).

RECOMMENDATION

The Legislature should repeal Minn. Stat. (2002), §16C.05, subd. 2(3) that requires the Attorney General’s Office to approve all professional/technical contracts and instead direct the Department of Administration and Attorney General’s Office to develop a policy that requires the Attorney General’s Office to review and approve contracts that do not use the standard language contained in the department’s contract template.

Allowing Contractors to Start Work Before Contracts Are Valid

According to state law, professional/technical contracts are not valid until (1) they have been signed by all of the required parties and (2) the accounting system shows an obligation in an expense budget or encumbrance for the amount of the contract.²⁷ 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.²⁸ The Department of Administration requires agencies to file a violation memo whenever they allow contractors to begin work before a contract has been fully signed or funds fully encumbered. Finally, it is the Department of Finance’s policy that agencies cannot incur an obligation over \$2,500 without first encumbering the money in the state’s accounting system.²⁹

As we noted in Chapter 2, our review of a small number of professional/technical contracts in selected state agencies found that agencies frequently allowed contractors to begin

work before contracts were fully signed, and often before agencies had encumbered the necessary funds. We saw few agency ramifications aside from having to file violation memos.

Although we were not able to document any major problems



The Department of Transportation was asked to file a 16C violation memo for work related to the light rail transit project.

²⁷ *Minn. Stat.* (2002), §16C.05, subd. 2. The Department of Administration’s contracting manual indicates that funds must be encumbered in order for a contract to be valid. See Department of Administration, *State Contracting*, sec. 7, p. 1.

²⁸ *Minn. Stat.* (2002), §16C.08, subd. 2(7). Statutes do not expressly forbid agencies from allowing contractors to begin work before contracts have been fully signed (even though such contracts are not valid).

²⁹ Minnesota Department of Finance, *MAPS Operations Manual Policies and Procedures*, no. 0702-02, June 16, 2000.

that resulted from these actions, we are concerned that such practices place the state at risk. For example, contract provisions regarding product ownership, data privacy, and liability may not apply unless a contract is recognized as valid. In addition, incurring obligations without prior recording in the state's financial accounting database may make it difficult for agencies to accurately anticipate or report professional/technical contract expenditures or obligations. Although we recognize that there may be circumstances where it is in the state's best interest for a contractor to begin work early, such cases should be the exception rather than the rule. We think that statutes and agency practices should clearly and concisely reflect effective contract management principles by requiring that agencies not allow contractors to begin work until a contract has been fully signed and the necessary funds have been encumbered.

RECOMMENDATION

The Legislature should amend Minn. Stat. (2002), §16C.05 by adding language that specifically prohibits agencies from allowing contractors to begin work on a professional/technical contract until the contract has been fully signed and the necessary funds fully encumbered.

There have been few negative consequences for agencies that allow work to begin before contracts are valid.

At the same time, we think that the Department of Administration needs to improve monitoring regarding 16A violations (allowing contractors to start work before funds have been encumbered) and 16C violations (allowing contractors to begin work before contracts have been fully signed). Currently, there are few, if any, practical ramifications from such violations. Although Minnesota statutes say that knowingly causing the state to incur financial obligations without first encumbering the necessary funds is just cause for an employee's removal, we have not found evidence that this provision has ever been applied.³⁰ We think that our earlier recommendation involving greater delegation of contracting authority coupled with the development of performance indicators to help guide the Department of Administration's delegation decisions might help decrease the number of 16A and 16C violations. State agencies might be more reluctant to allow contractors to start work before funds have been encumbered or contracts have been fully signed if there were some direct consequences. For example, the department could withhold delegation authority from those agencies with a large number of 16A or 16C violations.

Finally, individual agency heads must assume more responsibility for ensuring that contractors do not begin work until contracts have been fully signed and the necessary funds encumbered. As we noted earlier, agency heads need to create a working environment that stresses the importance of achieving an agency's mission while complying with applicable laws and guidelines.

Reporting Requirements

As noted in Chapter 2, Minnesota statutes and Department of Administration guidelines require that contracting agencies submit a report to the department

³⁰ Minn. Stat. (2002), §16A.15, subd. 3.

A final report on a contractor’s performance could be useful for future contracting decisions.

that discusses the purpose and cost-effectiveness of all completed professional/technical contracts over \$40,000.³¹ We found that few of the contract managers for the contracts that we examined submitted these reports, and only one contract manager indicated that he had ever used them to help select a contractor. Department of Administration staff do not read the reports before they forward them to the Minnesota Legislative Reference Library. Staff told us that overall compliance with this requirement is poor; they estimated that they receive these reports only 10 percent of the time.³²

We think that compliance with this law would improve if the report provided more meaningful information and if the reporting requirement was better enforced. First, having a performance evaluation of the contractor would be more meaningful than the report currently required and could better assist other agencies with their contracting decisions. The evaluation could contain information about contractors’ timeliness, professionalism, overall quality of work, and other indicators that agencies think would be useful. These reviews could then be made available to other agencies making contractor selection decisions. Staff at the Minnesota Attorney General’s Office indicated that such evaluations would be permissible, although agencies would have to be careful to link any comments regarding poor performance directly to expectations detailed in the contract.³³

Some state agencies have already developed more meaningful evaluations. For example, the Department of Transportation has a *Consultant Performance Evaluation* that staff use upon completion of professional/technical contracts. Contract managers are asked to rate areas such as product quality, work performance, and project-related cooperation, among others. The evaluation ultimately is factored into future contractor selection procedures.

Also, to simplify the contracting process as much as possible, we think that such evaluations should be done for contracts over \$50,000 rather than \$40,000. Aside from the final report, the \$40,000 figure does not trigger any other contracting requirement. In contrast, agencies must go through a formal request for proposals (RFP) process for contracts greater than \$50,000.

RECOMMENDATION

The Legislature should amend Minn. Stat. (2002), §16C.08, subd. 4(c) to require that agencies submit a contractor performance evaluation for professional/technical contracts over \$50,000, including an appraisal of contractors’ timeliness, quality of deliverables, and overall performance.

In addition, we think that the Department of Administration could improve compliance with this reporting requirement if it adopted a stricter stance with

³¹ *Minn. Stat. (2002), §16C.08, subd. 4(c) and Department of Administration, State Contracting, sec. 18, p. 1.*

³² Mr. Paul Stembler, Assistant Director, Materials Management Division, Department of Administration, interview by author, In person, April 19, 2002.

³³ Ms. Christie Eller, Assistant Attorney General, Minnesota Attorney General’s Office, interview by author, In person, St. Paul, Minnesota, October 7, 2002.

ramifications for noncompliance. For example, the Minnesota Office of Technology does not allow agencies to use its master contracts or roster until they have submitted the statutorily-required report for contracts over \$40,000 for those contractors previously selected from its lists. As a result, staff told us that they have no problem with agency compliance. As we discussed earlier, the Department of Administration could use compliance with this requirement as one of its indicators of agency performance. The department could then use this measure to make delegation decisions or to permit agencies access to its master contracts or master roster.

Another reporting requirement calls for the Department of Finance to report information about professional/technical contracts in agency biennial budget documents, including the number of full-time equivalent employees in the agency and the total number of people hired under professional/technical contracts.³⁴ In theory, such information could shed light on the “true” size of the state workforce, which would include a count of both state employees and all the people that work for an agency under professional/technical contracts. However, the Department of Finance does not check agency-reported numbers regarding the number of people working under contracts for accuracy or consistency. Furthermore, because the numbers cannot be translated into full-time equivalents, they are of little use in making comparisons with state employee counts.

It should be noted that, contrary to statutes, the Department of Finance does not report professional/technical contract data in its detailed budget documents. Instead, the department reports these data in a separate document altogether, partly because the department has considerably less confidence in the quality of contract data than it has in the quality of its other budgetary data.

RECOMMENDATION

The Legislature should repeal provisions of Minn. Stat. (2002), §16A.11, subd. 3(b) that require the Department of Finance to collect and report data on the number of consultants hired under professional/technical contracts.

OTHER OPTIONS FOR MODIFYING OVERSIGHT

In developing our recommendations, we considered a number of other alternatives that would change state oversight of professional/technical contracting activities. These options include (1) establishing a legislative oversight commission, (2) extending the moratorium on professional/technical contracts, (3) requiring the Department of Administration to audit state agency contracts once they are complete, and (4) completely decentralizing the professional/technical contracting process. We ultimately rejected these options for reasons that we discuss below.

³⁴ *Minn. Stat. (2002), §16A.11, subd. 3(b)*. Statutes use the word “consultant” to refer to the actual number of people hired through a professional/technical contract.

Establish a Legislative Oversight Commission

This alternative adds another level of review to the contracting process. To this end, the Legislature could create a special committee or commission to review professional/technical contracts over a specific dollar amount, such as \$50,000, or of a certain type, such as contracts for ongoing services. For example, some contracts in Kentucky are reviewed at both the executive and legislative level. Although the Secretary of the Finance and Administration Cabinet is Kentucky's chief procurement officer, a statutory committee of Kentucky's General Assembly also reviews personal service contracts for \$10,000 or more.³⁵ The committee's review focuses primarily on the stated need for the contract and whether state employees should be used to perform the needed services. Although the committee can disapprove a contract, its decision can be overridden by the executive branch.

More legislative oversight of contracts would have benefits, but also disadvantages.

An advantage of this approach is that it would increase legislators' awareness of staffing problems in state agencies while educating legislators about specific contracts. In addition, state agencies might document their needs analyses more carefully if they had to defend them before a legislative body. Likewise, this approach could have a dampening effect on agencies' willingness to start work on contracts before they have been fully signed or before funds have been encumbered. This option would likely have the support of state employee unions. In the past, employee unions have raised questions, as have some legislators, about the amount of work done by contractors rather than state employees.

A major disadvantage of this approach is the increased amount of time required to add another level of review to the contracting process. When we asked contract coordinators to identify aspects of the current contracting process that did not work well for them, about one-fourth cited the amount of time needed to enter into a professional/technical contract. This approach might also require a significant amount of time on the part of legislative staff to make the reviews meaningful. Also, the Legislature has, at times, preferred to use standing committees rather than special commissions to oversee state agency activities. For example, the Legislature gradually reduced the authority of the Legislative Commission to Review Administrative Rules, which it established in 1974, in favor of increased rule review by standing legislative committees, until it was ultimately abolished in 1997.³⁶ The Advisory Commission on Intergovernmental Relations, established in 1991 in part to review unfunded state mandates on local governments, suffered a similar fate in 1994.³⁷

³⁵ Kentucky Legislative Research Commission, *Executive Branch Contracting for Services: Inconsistent Procedures Limit Accountability and Efficiency* (Frankfort, October 2001), 3-4. Personal service contracts are used to obtain professional services that require skill or judgment for a specified period of time and at an agreed upon price. Contracts below the threshold must be filed with the committee and may be reviewed at the committee's prerogative.

³⁶ *Laws of Minnesota* (1997), ch. 98 moved the Legislative Commission to Review Administrative Rules' remaining authority over agency rules to the Legislative Coordinating Commission.

³⁷ *Laws of Minnesota* (1993), ch. 375, art. 15 created the Board of Government Innovation and Cooperation, which established some of the programs that the advisory commission recommended to ease state-local government relations. The Legislature abolished the commission the following year.

Extend the Contract Moratorium

Another option would be for the Legislature to continue the exception and waiver process outlined in the moratorium on professional/technical contracts past its expiration date of July 1, 2003. As discussed in Chapter 1, the moratorium was designed to help resolve the state's current budget problems. It creates another level of review by having the Department of Administration grant exceptions and waivers before agencies can proceed with the contracting process.

Currently, the Department of Administration is developing new guidelines for agencies to use as they request exceptions and waivers. In our opinion, however, many of the new guidelines in the department's draft document reflect requirements already in place.³⁸ For example, the department recommends that agency requests for contract waivers meet two requirements already in statutes and guidelines: (1) that agencies certify that state employees are currently unavailable or unable to perform the needed services, and (2) that proposed contracts cannot exceed two years (or five years with amendments) without prior approval. The draft guidelines further recommend that agencies' proposed waivers meet one of the following requirements: (1) include a clear plan for transferring the knowledge, skills, and abilities required in a contract to state employees; (2) provide for unique or one-time services not likely to be required on an ongoing basis; or (3) represent a best value for the state. The department's contracting guidelines already recommend that agencies adhere to these three criteria, and statutes require that agencies' contracting decisions be based on best value.

In our opinion, it is too early to tell how the moratorium will affect agency contracting activities and expenditures. However, we noted in Chapter 1 that the Department of Administration approved 94 percent of the requests for exceptions and waivers that it received during the first nine months of the moratorium, generally because the needed services would not be paid for with state funds. In addition, a recent analysis by the Department of Administration suggests that the moratorium may be having little effect on the total dollar value of professional/technical contracts approved by the department.

Conduct Post-Audits

Another option that we considered would remove the Department of Administration from the professional/technical contract approval process and instead have the department ensure compliance through auditing contracts after-the-fact. Although the department would still provide assistance upon request, this option would require a complete realignment of Department of Administration priorities and maximum delegation of contracting responsibilities.

This approach has many of the same advantages as increased delegation of contracting responsibilities (which we recommended), including a more streamlined contracting process and more time for the Department of

³⁸ David Fisher, Commissioner, Department of Administration, draft memorandum to agency heads, *Department of Administration Recommendations Regarding Professional/Technical Contract Necessity*, October 10, 2002.

The Department of Administration should not be removed from the contracting process.

Administration to focus on contracting problems and priority contracts. On the other hand, completely changing the department's role to a post-audit function would require significant improvements in its data collection activities and increased training for agency staff.

Overall, we think that this approach is too extreme given state agencies varying needs and abilities. Also, there is little assurance that some agencies would comply with laws, guidelines, or effective contract management principles without some oversight or ramifications for noncompliance. Finally, a recent Department of Administration report on professional/technical contracting indicated that legislators and agency staff are among the strongest advocates for having an independent agency that can say "no" to agencies or "take the heat" when agency staff face internal pressure to approve inappropriate contracts.³⁹ Ultimately, we think that our previous recommendation to increase delegation would allow department staff to post-audit more professional/technical contracts as part of its enhanced monitoring program while still addressing agency problems related to determining the need for contracts; selecting contractors; and writing, executing, and monitoring contracts.

Decentralize Professional/Technical Contracting

Finally, the Legislature could completely decentralize the professional/technical contracting process, thereby removing the Department of Administration's oversight role completely. Under this option, oversight would be provided through the legislative appropriations process and through routine financial auditing of state agencies. Some states have few laws, rules, and policies related to professional/technical contracting. For example, each state agency in North Dakota generally issues contracts according to its own policies and procedures.⁴⁰

In our opinion, the disadvantages of this approach outweigh any advantages that complete decentralization might have to offer. Agencies would have to develop their own policies and procedures—which few have done. When we asked contract coordinators whether their agency had developed its own written policies and procedures, we found that most relied on the Department of Administration's guidelines. Also, agencies that write only a few contracts each year would have no agency to turn to for assistance and the Legislature would not have a central source of information on the state's contracting activities. Furthermore, we believe that it is appropriate to have a third party review state agency contracting activities, especially for very large, challenging, or complicated contracts.

³⁹ Department of Administration, *Draft Report*, 3 and 5.

⁴⁰ North Dakota Office of the State Auditor, *Performance Audit Report of Contracts for Services* (Bismarck, March 27, 2000), 4.

Summary of Recommendations

- The Department of Administration should delegate significantly more responsibility for professional/technical contracting to “well-performing” state agencies, based upon individual agencies’ needs, abilities, and performance (p. 55).
- The Department of Administration should improve its data collection efforts to ensure that it collects meaningful data that can be used to monitor contracting activities on both an agency and statewide level (p. 56).
- The Legislature should amend *Minn. Stat. (2002)*, §16C.08, subd. 2 to require agencies to seek prior approval from the Department of Administration before writing professional/technical contracts in excess of \$20,000, instead of the current requirement of \$5,000 (p. 57).
- The Legislature should delete language in *Minn. Stat. (2002)*, §16C.07 that requires the Department of Employee Relations to develop a directory of professional/technical services provided by state agencies (p. 58).
- The Department of Administration should examine the effectiveness of the various methods that are required to notify state employees and agencies about the availability of professional/technical contracts and suggest statutory changes or revise its guidelines accordingly (p. 59).
- The Legislature should repeal *Minn. Stat. (2002)*, §16C.08, subd. 3(2) and instead amend *Minn. Stat. (2002)*, §16C.08, subd. 2 to require that agencies seeking approval for a professional/technical contract over \$20,000 certify to the Department of Administration that the work to be performed under the contract is necessary for the agency to achieve its statutory responsibilities and that it has the statutory authority to enter into a contract (p. 59).
- The Legislature should repeal *Minn. Stat. (2002)*, §16C.08, subd. 3(5) that requires the Department of Administration to determine whether other agencies or contracts have substantially performed the tasks outlined in a proposed contract. The Department of Administration should revise its guidelines and certification form accordingly (p. 60).
- The Legislature should repeal *Minn. Stat. (2002)*, §16C.05, subd. 2(3) that requires the Attorney General’s Office to approve all professional/technical contracts and instead direct the Department of Administration and Attorney General’s Office to develop a policy that requires the Attorney General’s Office to review and approve contracts that do not use the standard language contained in the department’s contract template (p. 61).

- The Legislature should amend *Minn. Stat.* (2002), §16C.05 by adding language that specifically prohibits agencies from allowing contractors to begin work on a professional/technical contract until the contract has been fully signed and the necessary funds fully encumbered (p. 62).
- The Legislature should amend *Minn. Stat.* (2002), §16C.08, subd. 4(c) to require that agencies submit a contractor performance evaluation for professional/technical contracts over \$50,000, including an appraisal of contractors' timeliness, quality of deliverables, and overall performance (p. 63).
- The Legislature should repeal provisions of *Minn. Stat.* (2002), §16A.11, subd. 3(b) that require the Department of Finance to collect and report data on the number of consultants hired under professional/technical contracts (p. 64).

Further Reading

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January 3, 2003

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Dear Mr. Nobles:

The Department of Administration would like to thank you for the review you have conducted over the past months on the subject of professional/technical contracts. We recognize that this has been a large-scale endeavor involving multiple agencies and we appreciate the effort that has been expended.

As you have pointed out, heightened scrutiny has been placed on the use of outside consulting services given the State's recent budgetary shortfalls. In response to the legislature's call for a comprehensive study of professional/technical contracts, the Management Analysis Division (MAD) has also conducted a review of Admin's Materials Management Division's (MMD) internal process intended to supplement the OLA's broader review.

We were pleased to see that both reports complement each other in many respects. For example:

- Both reports conclude that the review process at MMD is efficient. In fact, the reports suggest that the review process may be too fast at times for a thorough review. This contradicts notions held by some that MMD has been a barrier to the contracting process.
- Both reports verify that MMD catches errors and offers assistance that the agencies value. The reports were complimentary of MMD's resource materials such as the contract manual and other online forms and information. The OLA report further added that these resources reflect effective contracting principles.
- Both reports address the potential for further opportunities with respect to delegation of the Commissioner's authority. We have supported expanded delegation with appropriate accountability. However, both reports point out that agency interest in taking on delegated authority has been relatively low, especially among smaller agencies that prefer the support they receive from MMD. Additional rationale provided for lack of interest in increased delegated authority relates to the benefits received from independent oversight as addressed below.
- Both reports recognize the value of having an independent agency that is free from internal pressures and has the ability to say "no" to agencies that are not proceeding

- in accordance with law or policy. Further, both reports note that agency staff that are faced with internal pressures value having an outside entity that can “take the heat” for them when they are asked to push contracts forward inappropriately.
- Both reports recognize the sizeable workload handled by a few individuals within MMD.
- Both reports recognize the need for high-level support and education regarding the professional technical contracting process. The OLA stressed that individual agency heads must assume greater responsibilities in this area and that “Department of Administration staff need to know that they have the full weight of the Governor’s Office behind them as they enforce requirements related to the expenditure of public funds.”

One of the major recommendations in the OLA report was to shift from a role that emphasizes facilitation to a more compliance-orientated regulatory function. We think it is important to recognize that MMD’s function as a facilitator has been a philosophical approach supported by the current administration and should not be depicted as a shortcoming. Facilitation of sound and legally compliant contracts is a critical, value-added function that Admin should provide. Consultation, education and problem-solving with agencies are all components of helping agencies to do things right in the first place. We would always prefer to “win compliance” through education and persuasion, before resorting to more coercive methods.

Nevertheless, the OLA has recommended a greater emphasis on regulation. In the event that approach is supported by the incoming administration, we agree with the OLA report that stronger statutory tools will be necessary to effectively support such an outcome. Without such tools, Admin often has little choice but to execute contracts after work has begun to avoid placing the State at even greater risk. The report recommends adding language to statute that specifically prohibits agencies from allowing contractors to begin work until a contract has been fully executed and the necessary funds encumbered. The Department strongly supports this recommendation but believes that the lack of specified consequences will minimize its impact. While a wide array of consequences are possible ranging from employee discipline to criminal sanctions, the Department believes that potential financial penalties for noncompliant agencies should be explored, especially if those funds could then be used to implement the stronger regulatory approach suggested by the OLA.

Another major recommendation in the report involved raising the current \$5,000 certification level to \$20,000. The rationale of the OLA was to allow MMD staff to focus on “problem areas...as well as on higher valued or more complex contracts.” The certification level is determined by statute. While we do believe a higher dollar level may diminish the workload, we also need to point out that such a change would not be without debate. Advocates for small and minority-owned businesses may be adversely affected by decreased scrutiny on these contracts. Further, the OLA report did not recognize that low value is not synonymous with low risk. As such, even low dollar contracts need adequate levels of oversight.

Improvement of the Department’s data collection efforts was also recommended in the report. The priority of the Department, particularly given the budget realities, has been to collect the data necessary to respond to specific legislative requirements. Although we agree that enhancements to the Department’s data collection capabilities would be a positive improvement, the database

was not created or intended to act as a tool to monitor agency activities or track agency compliance. In the event a shift in approach to a greater regulatory function is implemented, the Department would anticipate enhancing its data collection abilities to the extent the fiscal constraints allow.

Despite the concerns addressed, the Department does agree with many of the recommendations of the OLA. We concur that agency heads must assume greater responsibility and that state employee notification of professional/technical work opportunities needs to be enhanced. We continue to believe that with respect to the latter, the Department of Employee Relations is best equipped to lead this initiative. We also agree that the Department is not the best situated to make an independent assessment of the need for an agency to enter into a contract and that certain reporting requirements need to be amended or eliminated.

Above all, we are pleased that the level of dedication of the Admin employees involved in the process is recognized and that agencies find value in the work performed. One of the key missions of the Department is to ensure that all state agency procurement – whether processed internally or through the commissioner’s delegated authority – meets the highest ethical standards, represents the best value to the taxpayers, and demonstrates commitment to legislative policy priorities.

Again, we appreciate the opportunity to respond.

Sincerely,

/s/ Kirsten Cecil for

David Fisher
Commissioner

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