

# STATE OF NORTH CAROLINA

**PERFORMANCE AUDIT**

**DEPARTMENT OF ADMINISTRATION**

**DIVISION OF PURCHASE AND CONTRACT**

**SERVICE CONTRACT MONITORING PRACTICES**

**NOVEMBER 2010**

**OFFICE OF THE STATE AUDITOR**

**BETH A. WOOD, CPA**

**STATE AUDITOR**

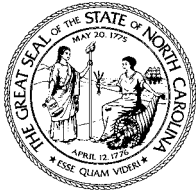
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Beth A. Wood, CPA  
State Auditor

STATE OF NORTH CAROLINA  
**Office of the State Auditor**

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November 9, 2010

The Honorable Beverly Eaves Perdue, Governor  
Members of the North Carolina General Assembly  
Mr. Moses Carey Jr., Secretary, Department of Administration  
Mr. James Staton, State Purchasing Officer, Division of Purchase and Contract  
Mr. Jerry Fralick, State Chief Information Officer, Office of Information Technology Services  
Mr. Eugene Conti, Secretary, Department of Transportation  
Mr. Robert Kucab, Executive Director, North Carolina Housing Finance Agency

Ladies and Gentlemen:

We are pleased to submit this performance audit titled *Service Contract Monitoring Practices*. The audit objectives were to determine if selected state agencies (1) have established the necessary structural support for monitoring service contracts, (2) perform planning necessary to monitor service contracts, and (3) use contract terms and conditions necessary to facilitate service contract monitoring. Heads of the agencies engaged for this audit have reviewed a draft copy of this report. Their written comments are included in the appendix.

The Office of the State Auditor initiated this audit to improve state contract monitoring practices for service contracts.

We wish to express our appreciation to the staff of the Department of Administration, Office of Information Technology Services, Department of Transportation, and the North Carolina Housing Finance Agency for the courtesy, cooperation, and assistance provided us during the audit.

Respectfully submitted,

A handwritten signature in cursive script that reads "Beth A. Wood".

Beth A. Wood, CPA  
State Auditor

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### **SUMMARY**

#### **PURPOSE**

This audit report evaluates monitoring practices for service contracts at selected state agencies and makes recommendations so Department of Administration and state agency management can take appropriate corrective action.

#### **RESULTS**

The Division of Purchase and Contract has not issued written guidance on contract monitoring training and procedures as recommended by the National Association of State Procurement Officials.<sup>1</sup> As a result, state agencies have developed their own varying contract monitoring practices and some agencies have not established the necessary structural support, performed adequate planning, or included contract terms and conditions necessary for effective monitoring of service contracts to ensure that the State receives the services for which it paid.

State agencies do not always ensure that the necessary structural support for monitoring is available. Necessary structural support includes training so that contract administrators have the skills and knowledge necessary to effectively monitor agency service contracts. Structural support also includes contract files that are organized and complete so that it is clear what work the contractor has completed and what work remains to be done. Structural support also requires the agency to establish written monitoring policies and procedures, create written contract close-out procedures, and perform post-contract reviews to ensure that contracts are monitored consistently and comprehensively.

State agencies do not always perform and document the planning that is necessary for effective contract monitoring. Specifically, state agencies do not always develop and conduct risk assessments for each service contract to assess the risk that the vendor may fail to perform and the risk that the agency may fail to accomplish its objectives. Additionally, state agencies do not always develop risk mitigation and contingency plans to prepare the agency to takeover or replace contracted services in case a vendor fails to perform or defaults. Furthermore, state agencies do not always develop contract administration plans that document specifics about expected contractor performance and how the agency will evaluate and assess performance for the service contract. Without proper planning, state agencies may not be prepared to address vendor performance problems when they occur, may experience unexpected service disruptions and incur additional costs to achieve agency objectives, and may not ensure that the State receives the benefits for which it contracted and paid.

Finally, state agencies do not always include contract terms and conditions necessary for effective contract monitoring. State agencies often do not include detailed statements of work which may limit an agency's ability to properly monitor vendor performance and hold the vendor accountable for nonperformance. State agencies often do not include performance measures which can result in a lack of clear criteria for evaluating vendor performance and holding vendors accountable. Also, state agencies frequently do not include a *right to audit* clause in their contracts which can prevent an agency from having access to the records and documents it needs to effectively monitor a contract.

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<sup>1</sup> The National Association of State Procurement Officials is a non-profit association dedicated to strengthening the procurement community through education, research, and communication. It is made up of the directors of the central purchasing offices in each of the 50 states, the District of Columbia and the territories of the United States.

## **PERFORMANCE AUDIT**

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### **RECOMMENDATIONS**

The Division of Purchase and Contract should provide written guidance on contract monitoring training, maintaining contract files, contract monitoring practices, contract closeout procedures, and post-contract review procedures to state agencies.

Based on guidance from the Division of Purchase and Contract, state agencies should provide contract administrators with contract monitoring training, ensure that contract files are organized and contain all necessary contract documentation, establish written contract monitoring policies and procedures, create written closeout procedures, and perform post-contract reviews.

State agencies should establish procedures to ensure that written policies and procedures are executed.

State agencies should prepare and document contract risk assessments, risk mitigation and contingency plans, and contract administration plans.

State agencies should ensure that contracts include detailed statements of work, performance measures, and *right to audit* clauses.

### **AGENCY RESPONSES**

The Agency's response is included in the appendix.

## **INTRODUCTION**

### **BACKGROUND**

*North Carolina General Statute 143-49* establishes the Department of Administration as the central purchasing authority for North Carolina. Located within the Department, the Division of Purchase and Contract's mission is to "develop and implement sound procurement practices and provide quality service through teamwork and communication with State Agencies, Institutions, Universities, Community Colleges, and Vendors." However, neither state law nor Division of Purchase and Contract policy outline contract monitoring policies that state agencies should follow to protect the interest of the State.

Several reports issued by the Office of the State Auditor demonstrate that inadequate contract monitoring procedures for service contracts have contributed to the State making millions of dollars in unplanned payments to vendors. Audit reports that identified inadequate contract monitoring practices include, but are not limited to:

- E-Commerce Project Office and Statewide Portals Contract;
- State Health Plan FY2008 Projected Versus Actual Results;
- Office Supplies Term Contract Administered by the Division of Purchase and Contract; and
- Oversight of the Mental Health Services Utilization Review Contract.

There is no comprehensive state database that lists the number or dollar amounts of state agency service contracts. However, an auditor review of state budget and North Carolina Accounting System data indicates that state agencies spent about \$3.7 billion on purchased services for state fiscal year 2009.

### **OBJECTIVES, SCOPE, AND METHODOLOGY**

The audit objectives were to determine if selected state agencies (1) have established the necessary structural support for monitoring service contracts, (2) perform planning necessary to monitor service contracts, and (3) use contract terms and conditions necessary to facilitate service contract monitoring.

The Office of the State Auditor initiated this audit to improve state contract monitoring practices for service contracts.

The audit scope included a review of current state agency service contract monitoring practices. The scope specifically excluded contracts for the purchase of goods and commodities. The scope also excluded personal service contracts which are contracts for temporary employees. We conducted the fieldwork from June 2009 to July 2010.

To achieve our audit objectives, we reviewed North Carolina General Statutes and interviewed Department of Administration personnel to gain an understanding of state purchasing laws, rules, and regulations. We administered a questionnaire to 21 executive

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branch state agencies to determine current service contract monitoring practices. We selected three of the 21 agencies (the Department of Transportation, the Office of Information of Technology Services, and the Housing Finance Agency) for detailed audit procedures which included testing a sample of contract files at each agency. We performed limited audit procedures at the remaining 18 state agencies which included onsite interviews with contract personnel and a review of one or two contract files to verify responses. We researched contract monitoring best practices from the National Association of State Procurement Officials and the National State Auditors Association. We also reviewed contract monitoring practices recommended by the State Auditor of Texas, Georgia, and Florida.

Because of the test nature and other inherent limitations of an audit, together with limitations of any system of internal and management controls, this audit would not necessarily disclose all performance weaknesses or lack of compliance.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We conducted this audit under the authority vested in the State Auditor of North Carolina by *North Carolina General Statute 147.64*.



## FINDINGS AND RECOMMENDATIONS

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### 1. AGENCIES LACK STRUCTURAL SUPPORT FOR CONTRACT MONITORING

The Division of Purchase and Contract has not issued written guidance about the training and procedures necessary for effective contract monitoring as recommended by the National Association of State Procurement Officials.<sup>2</sup> State agencies have developed their own varying contract monitoring practices, and some have not established the necessary structural support for effective contract monitoring. Specifically, state agencies have not provided contract administrators with training in contract monitoring, ensured that contract files are organized and contain all necessary contract documentation, established written contract monitoring policies and procedures, created written contract close-out procedures, and performed post-contract reviews.

#### **Lack of Contract Monitoring Training**

State agencies have not provided formal training to help employees develop, maintain, or improve their competence in contract monitoring. The Office of Information Technology Services (ITS) reported oversight responsibility for about \$543.9 million in contracts. None of the 32 ITS contract administrators interviewed had documented contract monitoring training. The Department of Transportation (DOT) reported oversight responsibility for about \$4.1 billion in contracts. None of the 121 DOT contract administrators interviewed had documented contract monitoring training. The Housing Finance Agency (HFA) reported oversight for about \$3.2 billion (99.92% of dollars) in program contracts and \$1.7 million (.02% of dollars) in operational contracts.<sup>3</sup> Neither of the two contract administrators had documented contract monitoring training. Of the remaining 18 state agencies contacted, only five agencies had documentation indicating that their contract administrators were trained in contract monitoring.

Proper training is necessary to ensure that contract administrators effectively monitor contracts. The National State Auditor Association's "Best Practices in Contracting for Services" states, "To properly monitor a contract, the agency should ensure that the contract manager possesses adequate skills and has the necessary training to properly manage the contract." For example, contract training for Florida state agencies includes the following topics:

- Procurement process and contract documents;
- Contract manager and contract administrator roles and responsibilities;
- Skills required for effective contract management;
- Contract monitoring;
- Contract manager and contract administrator files;
- Contract management and administrator resources; and
- State procurement and contract tracking system.

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<sup>2</sup> National Association of State Procurement Officials. [State & Local Government Procurement: A Practical Guide](#). 2008

<sup>3</sup> HFA has two types of contracts: program and operational. Program contracts relate to HFA's main business and include contracts for mortgage origination and mortgage loan servicing. Operational contracts are secondary to HFA's main business and include contracts for audit services, software licenses, software and hardware maintenance, and temporary services.

## **FINDINGS AND RECOMMENDATIONS**

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Personnel who lack training are less likely to properly and consistently monitor vendor performance. The lack of contract monitoring training increases the risk that contract administrators will fail to detect vendor noncompliance with contract terms and conditions. The lack of contract monitoring training also increases the risk that the State will not receive the benefits for which it contracted.

### **Lack of Organized and Complete Contract Files**

State agencies do not maintain complete and organized contract files. ITS did not have organized and complete files for any of the 75 contract files reviewed. DOT did not have organized and complete files for 181 of the 184 contract files reviewed. HFA had organized and complete files for 45 program contracts reviewed but not for any of the 23 operational contracts reviewed. Of the remaining 18 state agencies contacted, only four agencies had organized and complete files.

Complete and organized contract files are critical for effective contract monitoring. The Georgia State Auditor recommends:<sup>4</sup>

“Contract files should be organized in a manner that allows someone to reconstruct the contract and understand its history in the absence of the contract administrator. Contract files should hold all the information necessary to know what was expected and what was received under the contract.”

The Georgia State Auditor further recommends that contract files should contain, at a minimum:

- Signed copy of the contract and purchase order;
- Modifications to the contract;
- Contract monitoring plan;
- Contingency plan;
- Sources solicited;
- Method of evaluation and award;
- Meeting minutes;
- Contract correspondence;
- Reports from any on-site visits;
- Performance reports;
- Records of complaints and vendor disputes; and,
- All invoices and vouchers.

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<sup>4</sup> Georgia State Auditor. Components of an Effective Contract Monitoring System. July 2003.

## FINDINGS AND RECOMMENDATIONS

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Unorganized contract files can result in poor-quality monitoring because contract administrators may be unable to determine what services have been delivered, what services remain to be delivered, what amounts have been paid, and what amounts remain to be paid. Additionally, incomplete contract files may result in poorly documented agreements that prevent the State from holding vendors accountable for performance.

### **Lack of Written Contract Monitoring Policies and Procedures**

State agencies have not formally identified, defined, and documented the policies and procedures necessary to effectively monitor service contracts. ITS did not have written contract monitoring policies and procedures for any of the 75 contract files reviewed. DOT did not have written contract monitoring policies and procedures for 181 of the 184 contract files reviewed.<sup>5</sup> HFA had written contract monitoring policies and procedures for 45 program contracts reviewed but not for any of the 23 operational contracts reviewed. Of the remaining 18 state agencies contacted, only five agencies had written contract monitoring policies and procedures.

Written contract monitoring policies and procedures help ensure that monitoring activities are performed consistently to protect the State's interest. Written policies and procedures that define and describe monitoring activities such as site visits, desk reviews, and document reviews should be readily available to contract administrators. The Florida Auditor General notes:<sup>6</sup>

“Throughout the life of a contract, monitoring is necessary to ensure contractors provide high quality products and services in accordance with contract terms. It is essential that written policies, procedures, and standards be developed and communicated to contract managers to ensure that contract monitoring is performed in a consistent and comprehensive manner.”

The lack of written policies and procedures may result in inconsistent and poor-quality monitoring. Contract administrators may not understand what is expected of them and may not monitor sufficiently to ensure that the State achieves its objectives.

### **Lack of Written Contract Closeout Procedures**

State agencies have not established written closeout procedures for service contracts. ITS did not have written contract closeout procedures for any of the 75 contract files reviewed. DOT did not have written contract closeout procedures for 181 of the 184 contract files reviewed. HFA did not have written contract closeout procedures for any of the 68 contracts reviewed. None of the remaining 18 state agencies contacted had written contract closeout procedures.

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<sup>5</sup> Written procedures exist for contracts in HiCams, DOT's construction project management software program. DOT policy mandates use of this software for management of all construction projects in excess of \$1.2 million in total expenditures. This software contains the means to limit the risk to the state by having detailed contract specifications, material estimates, material receipts, and minimum material specifications programmed into the system. The resident engineer or designee inputs inspection information to generate invoices and payments to the contractor based on actual performance and inspections.

<sup>6</sup> Florida Auditor General. State Board of Administration, Contract Administration. October 2005.

## FINDINGS AND RECOMMENDATIONS

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Written contract close-out procedures help ensure that vendors have fulfilled all obligations and the State has received the benefits for which it contracted. The Texas State Auditor writes:<sup>7</sup>

“The contract close-out process is usually a simple but detailed administrative procedure. The purpose is to verify that both parties to the contract have fulfilled their contractual obligations and there are not responsibilities remaining. In addition, contract close-out is the time to assess the success of the contract and determine if there are any lessons learned for future contracting.”

Additionally, the Georgia State Auditor writes, “Formal, written closeout procedures are recommended at the completion of the contract so that important elements are not overlooked.”<sup>8</sup>

Without standard closeout procedures, state agencies may not ensure that the contractor has fulfilled all contractual obligations and that there are no unresolved issues.

### **Lack of Post-Contract Reviews**

State agencies do not always perform post-contract reviews for service contracts. ITS did not perform a post-contract review for any of the 25 applicable contract files reviewed.<sup>9</sup> DOT did not perform a post-contract review for 170 of the 184 contracts. HFA did not perform a post-contract review for any of the 68 contracts reviewed. None of the remaining 18 state agencies provided evidence that they performed post-contract reviews.

Post-contract reviews can help state agencies identify necessary improvements in the contracting process. The Georgia State Auditor recommends, “At the end of a contract period, agencies should evaluate the vendor’s performance and their own method of monitoring the vendor.”<sup>10</sup>

Without post-contract reviews, state agencies may miss an opportunity to identify and prevent poor performing vendors from obtaining future contracts. Agencies may also miss an opportunity to identify needed improvements in their contract monitoring process.

***Recommendation:*** The Division of Purchase and Contract should provide written guidance on contract monitoring training, maintaining contract files, contract monitoring practices, contract closeout procedures, and post-contract review procedures to state agencies.

Based on guidance from the Division of Purchase and Contract, state agencies should provide contract administrators with contract monitoring training, ensure that contract files are organized and contain all necessary contract documentation, establish written

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<sup>7</sup> Texas State Auditor. State of Texas Contract Management Guide. Version 1.4

<sup>8</sup> Georgia State Auditor. Components of an Effective Contract Monitoring System. July 2003.

<sup>9</sup> Fifty of the ITS contracts selected for testing were perpetual contracts with no end date. Consequently, post-contract reviews were not applicable.

<sup>10</sup> Georgia State Auditor. Components of an Effective Contract Monitoring System. July 2003.

## FINDINGS AND RECOMMENDATIONS

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contract monitoring policies and procedures, create written closeout procedures, and perform post-contract reviews.

State agencies should establish procedures to ensure that written policies and procedures are executed.

### 2. AGENCIES LACK PLANNING NECESSARY FOR CONTRACT MONITORING

The Division of Purchase and Contract has not issued written guidance about the planning necessary for effective contract monitoring as recommended by the National Association of State Procurement Officials.<sup>11</sup> State agencies have developed their own varying contract monitoring practices and some do not document the planning that is necessary for effective contract monitoring. Specifically, state agencies do not document contract risk assessments, risk mitigation and contingency plans, and contract administration plans.

#### **Lack of Contract Risk Assessments**

State agencies do not always include contract risk assessments in the contract file to demonstrate that a risk assessment was performed. The Office of Information Technology Services (ITS) only had a risk assessment documented for one of 75 contract files reviewed. The Department of Transportation (DOT) did not have a risk assessment documented for any of 184 contract files reviewed. The Housing Finance Agency (HFA) had a risk assessment for 45 program contracts reviewed but not for any of the 23 operational contracts reviewed. None of the remaining 18 state agencies contacted had written policies requiring contract risk assessments.

State agencies should develop and conduct risk assessments for each service contract to assess the risk that the vendor may fail to perform and the risk that the state agency may fail to accomplish its objectives. State agencies should also assess the risk of overpayments, fraud, and abuse. The Texas State Auditor writes:<sup>12</sup>

“Limited resources require the use of risk assessment because there is not sufficient time to oversee all aspects of a contract. An effective risk assessment model will help focus monitoring resources on contractors with the highest risk of noncompliance.”

Without proper risk assessments, agencies may not be prepared to prevent service delivery problems from arising, detect problems early enough to prevent significant losses, or react to significant problems in a quick and decisive manner to prevent further losses.

#### **Lack of Risk Mitigation and Contingency Plans**

State agencies do not always document plans for mitigating contract risks in the contract file. ITS only had a risk mitigation and contingency plan documented for one of 75

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<sup>11</sup> National Association of State Procurement Officials. State & Local Government Procurement: A Practical Guide. 2008

<sup>12</sup> Texas State Auditor. State of Texas Contract Management Guide. Version 1.4

## FINDINGS AND RECOMMENDATIONS

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contract files reviewed. DOT had a risk mitigation or contingency plan documented for 3 of 184 contract files reviewed. HFA had a risk mitigation and contingency plan documented for 45 program contracts reviewed but not for any of the 23 operational contracts reviewed. None of the remaining 18 state agencies provided evidence of written risk mitigation and contingency plans.

Risk mitigation and contingency plans can prepare state agencies to takeover or replace contracted services in case a vendor fails to perform or defaults. The Georgia State Auditor writes:<sup>13</sup>

“Contingency planning is a necessary component of the overall planning process that is often overlooked by agencies. It addresses how the agency would respond in the event of an interruption of service delivery. Contingency planning allows the program or service to be quickly resumed.”

The Georgia Auditor further writes:

“A number of options are available for a default contingency plan: contracting with the next lowest bidder from the original solicitation; using another current vendor; in-house delivery of the service; and contracting with another government entity.”

Without risk mitigation and contingency plans, agencies may experience service disruptions and incur additional costs to achieve agency objectives.

### **Lack of Contract Administration Plans**

State agencies do not always include contract administration plans in the contract file. ITS did not have a documented contract administration plan for 71 of 75 contract files reviewed. DOT only had a documented contract administration plan for three of 184 contract files reviewed. HFA had a documented contract administration plan for 45 program contracts reviewed but not for any of the 23 operational contracts reviewed. None of the remaining 18 state agencies provided evidence of written contract administration plans during site visits.

Contract administration plans improve contract monitoring by documenting specifics about expected contractor performance and how the agency will evaluate and assess performance for the service contract. Gregory A. Garrett writes, “Before the award of a contract, each party should develop a contract administration plan and assign the responsibility of administering the contract to a contract manager.”<sup>14</sup>

Without a contract administration plan, vendor responsibilities, deliverables, and schedules may not be clearly defined and met.

***Recommendation:*** The Division of Purchase and Contract should provide written guidance on planning procedures and documentation necessary for contract monitoring.

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<sup>13</sup> Georgia State Auditor. Components of an Effective Contract Monitoring System. July 2003.

<sup>14</sup> Gregory A. Garrett. World Class Contracting. 2001.

## FINDINGS AND RECOMMENDATIONS

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State agencies should prepare and document contract risk assessments, risk mitigation and contingency plans, and contract administration plans.

### 3. AGENCIES DO NOT USE TERMS AND CONDITIONS NECESSARY FOR MONITORING

The Division of Purchase and Contract has issued instructions requiring some terms and conditions necessary for contract monitoring.<sup>15</sup> However, state agencies do not always include terms and conditions that form the basis for effective contract monitoring in their contracts. Specifically, state agencies do not always ensure that contracts include detailed statements of work, performance measures, and *right to audit* clauses.

#### **Lack of Detailed Statements of Work**

State agencies generally include detailed scopes of work in their contracts. However, there is room for improvement. The Office of Information Technology Services (ITS) did not have a detailed scope of work for 14 out of 75 contracts reviewed. The Department of Transportation (DOT) did not have a detailed scope of work for 81 out of 184 contract files reviewed. The Housing Finance Agency (HFA) did not have a detailed scope of work for 7 out of 68 contracts reviewed. Contracts reviewed at the remaining 18 state agencies had detailed scopes of work.

A well-defined service contract scope of work (1) protects the interest of the State, (2) identifies the responsibilities of the parties to the contracts, (3) defines what is to be delivered, and (4) documents the mutual agreement, the substance, and parameters of what was agreed upon. The National State Auditor Association's "Best Practices in Contracting for Services" states, "The contract should clearly state and define the scope of work, contract terms, allowable renewals, and procedures for any changes."

Without a detailed scope of work, essential requirements and responsibilities may be unclear. As a result, the state may be unable to properly monitor vendor performance or hold the vendor legally accountable for nonperformance.

#### **Lack of Performance Measures**

State agencies do not always include performance measures in their contracts. ITS did not include performance measures in 59 out of 75 contracts reviewed. DOT did not include performance measures in 121 out of 168 applicable contract files reviewed. HFA did not include performance measures in 23 out of 68 contracts reviewed. Nine of the remaining 18 state agencies did not provide evidence that they use performance measures in their contracts.

Performance measures in service contracts can improve contract monitoring if the agency receives regular programmatic reports from the vendor and payments are linked directly to the vendor's performance. The National State Auditor Association's "Best Practices in

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<sup>15</sup> The State Purchasing Manual and the RFP template issued by the Division of Purchase and Contract require state agencies to include a detailed scope of work and a right to audit clause for the State Auditor in agency service contracts.

## FINDINGS AND RECOMMENDATIONS

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Contracting for Services” states, “The contract should contain performance standards, performance incentives and/or clear penalties and corrective actions for non-performance, with a dispute resolution process. The contract should include a requirement for a performance bond when appropriate.”

Without clear performance measures, state agencies may not have clear criteria for evaluating vendor performance and holding vendors accountable. Furthermore, state agencies could be required to pay vendors for substandard performance if payments are not linked directly to contractor performance.

### **Lack of Right to Audit Clauses**

State agencies do not always include *right to audit* clauses in their contracts. ITS did not include *right to audit* clauses in 40 out of 75 contracts reviewed. DOT did not include *right to audit* clauses in 159 out of 184 contract files reviewed. HFA included *right to audit* clauses for 45 program contracts reviewed but not for any of the 23 operational contracts reviewed. In response to our survey, 13 of the remaining 18 state agencies indicated that they do not include a *right to audit* clause in their contracts.

A *right to audit* clause can give a state agency the right to access and audit vendor records in order to properly monitor and verify vendor performance. The National State Auditor Association’s “Best Practices in Contracting for Services” states, “The contract should contain inspection and audit provisions.” On the subject of *right to audit* clauses, the Florida State Auditor writes:<sup>16</sup>

“Agencies have a responsibility to verify the information that the vendor reports to them and to ensure that funds are expended properly. This is especially important when there is a high degree of risk involved due to the type of contract or service, a high degree of liability exists for the state, or the potential for severe consequences in the event of poor vendor performance. Because the records are the property of the vendor, the contract must include an agreement that the agency has access to and can audit those records. The ability of agencies to audit vendor records should also extend to the records of any subcontractors.”

Without *right to audit* clauses, state agencies may not have access to information necessary to evaluate vendor performance. Additionally, state agencies may not be able to identify overcharges or unallowable costs if the contract does not include a *right to audit* clause.

**Recommendation:** State agencies should ensure that contracts include detailed statements of work, performance measures, and *right to audit* clauses.

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<sup>16</sup> Georgia State Auditor. Components of an Effective Contract Monitoring System. July 2003.





North Carolina  
Department of Administration

Beverly Eaves Perdue, Governor  
Moses Carey, Jr. Secretary

Division of Purchase & Contract  
James D. Staton, State Purchasing Officer

October 12, 2010

The Honorable Beth A. Wood  
State Auditor  
Office of the State Auditor  
20601 Mail Service Center  
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Dear Ms. Wood,

Thank you for sharing the results of the recent performance audit of the North Carolina Department of Administration's Division of Purchase and Contract and State Agencies' Service Contract Monitoring Practices. We appreciate the opportunity to hear your perspective on how we may improve our performance and operations in not only the Division of Purchase and Contract, but throughout the many purchasing offices in North Carolina. As you are aware, the Department of Administration was in the process of initiating efforts related to improving procurement in the State at the time this audit was underway, and the findings in the audit support the reasons we had initiated an RFP to undertake a review of all procurement activities statewide. As such, we find ourselves in agreement with your recommendations, some of which apply to P&C, and which we can begin now, and some of which we will refine over the coming months.

Per your request, please find below our responses to your audit findings and recommendations which pertain to what this Department can do:

**FINDING 1:** Agencies Lack Structural Support for Contract Monitoring, including Lack of Contract Monitoring Training, Lack of Organized and Complete Contract Files, Lack of Written Contract Monitoring Policies and Procedures, and Lack of Written Contract Close-out Procedures

**AUDIT RECOMMENDATION #1 (portion which pertains to P&C):** The Division of Purchase and Contract should provide written guidance on contract monitoring training, maintaining contract files, contract monitoring practices, contract closeout procedures, and post-contract review procedures to state agencies.

**NCDOA RESPONSE:** The Division of Purchase and Contract, Department of Administration agrees that proper training is necessary to ensure that contract administrators effectively monitor contracts. With the passage of Session Law 2010-194/Senate Bill 1213 during the 2009 session of the General Assembly, we feel confident that working in conjunction with the Office of State Personnel and the University of North Carolina School of Government to develop a formal procurement training program will provide the resources we need to teach purchasers and contract administrators to learn how to effectively and efficiently monitor contracts of all types.

We also concur that agency contract files are a problem. Our Compliance Section within the Division of Purchase and Contract consistently includes this same finding in a large portion of the reviews that are completed. In fact, the North Carolina Administrative Code provides specific requirements of what our purchasing files should contain.

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We hope with the above-referenced training that we will be able to address this in a consistent and more complete fashion in the future. Likewise, related to the issue of agency procedures for monitoring, we plan to train purchasers in the proper way to monitor contracts. We have established a working group to develop the policies and procedures needed in each agency, including our Division for this. Until this Session Law passed, we were not afforded the resources necessary for a formal training certification and compliance program.

And finally, related to Contract Close-Out procedures, we are aware that close-out procedures are required for Information Technology projects, and we agree that close-out procedures would be a good practice to implement in other areas, and will include this in the development of our formal training program.

**FINDING 2:** Agencies Lack Planning Necessary for Contract Monitoring, including Lack of Contract Risk Assessments, Lack of Risk Mitigation and Contingency Plans, Lack of Contract Administration Plans

**AUDIT RECOMMENDATION #2:** The Division of Purchase & Contract should provide written guidance on planning procedures and documentation necessary for contract monitoring. State agencies should prepare and document contract risk assessments, risk mitigation and contingency plans, and contract administration plans.

**NCDOA RESPONSE:** The Division of Purchase and Contract agrees with your recommendation, and we realize more training is required in this area and will incorporate this in the development of our new training program. In the agencies, contract administration, specifically for service and consultant contracts, are not always administered by the purchasing professionals, but by the end users who in most cases are not familiar with purchasing rules and procedures. As we pursue other ways to improve procurement in the state, we will seek to address how to ensure the full recommendation can be best implemented in light of your findings.

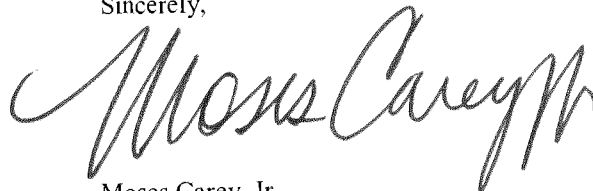
**FINDING 3:** Agencies Do Not Use Terms and Conditions Necessary for Monitoring, including Lack of Detailed Statements of Work, and Lack of Performance Measures

**AUDIT RECOMMENDATION #3:** State agencies should ensure that contracts include detailed statements of work, performance measures, and right to audit clauses.

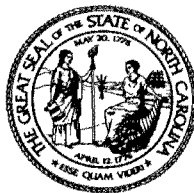
**NCDOA RESPONSE:** The Division of Purchase and Contract agrees with your recommendation that agencies should include these in their contracts, and as we work to transform procurement in the state, P&C will ensure that guidance and training will be included to assist agencies in these areas.

We appreciate the feedback and the professionalism exhibited by your staff during this audit. This audit provided good recommendations and support for new initiatives by the Division of Purchase and Contract, as well as the purchasing agencies throughout the State. We look forward to your continued support of improving our business operations.

Sincerely,



Moses Carey, Jr.



**State of North Carolina  
Office of Information Technology Services**

**Beverly Eaves Perdue  
Governor**

**Gerald L. Fralick  
State Chief Information Officer**

October 8, 2010

The Honorable Beth Wood  
North Carolina State Auditor  
20601 Mail Service Center  
Raleigh, North Carolina 27699-0601

Dear Ms. Wood:

This letter constitutes the response of the Office of Information Technology Services (ITS) to the draft report of a performance audit received on September 23, 2010, entitled *Service Contract Monitoring Practices*. In general, ITS agrees with the recommendations in the report, and we already have begun taking steps to improve the agency's service contract monitoring procedures.

Specifically, ITS will welcome receipt and looks forward to compliance with written guidance from the Division of Purchase and Contracts on contract monitoring procedures and training. We have obtained copies of the reference, *Best Practices in Contracting for Services*, recommended in the audit report, and we will review and consider the recommendations and procedures contained in that work.

Also, the agency has begun a review of those particular services contracts examined by your office in this audit in order to establish the origin of the deficiencies identified and to determine how those problems can be avoided in the future. The Standard Terms and Conditions for IT procurement agreements includes a Right-to-Audit provision, and ITS will work to ensure that this provision is included in all appropriate contracts.

Please let us know if we can expand on anything in this letter or if you would like to discuss this response in greater detail. We appreciate the assistance of your staff in helping ITS identify specific contract monitoring issues and look forward to working with your office on audit and other matters in the future.

Sincerely,

A handwritten signature in cursive script that reads "Gerald L. Fralick".

Gerald L. Fralick



STATE OF NORTH CAROLINA  
DEPARTMENT OF TRANSPORTATION

BEVERLY EAVES PERDUE  
GOVERNOR

1501 MAIL SERVICE CENTER, RALEIGH, N.C. 27699-1501

EUGENE A. CONTI, JR.  
SECRETARY

October 8, 2010

The Honorable Beth A. Wood  
Office of the State Auditor  
2 South Salisbury Street  
20601 Mail Service Center  
Raleigh, North Carolina 27699-0601

Dear Auditor Wood:

Thank you for the opportunity to respond to the Performance Audit of Service Contract Monitoring Practices. I have reviewed the report and offer the following comments:

1. **Agencies Lack Structural Support for Contract Monitoring**

**Recommendation:** The Division of Purchase and Contract should provide written guidance on contract monitoring training, maintaining contract files, contract monitoring practices, contract closeout procedures, and post-contract review procedures to state agencies.

Based on guidance from the Division of Purchase and Contract, state agencies should provide contract administrators with contract monitoring training, ensure that contract files are organized and contain all necessary contract documentation, establish written contract monitoring policies and procedures, create written closeout procedures, and perform post-contract reviews.

State agencies should establish procedures to ensure that written policies and procedures are executed.

**Response:** The Department concurs with the recommendation and will use guidance from the Division of Purchase and Contract to ensure that written policies and procedures are utilized in all service contract procurements. Follow-up to ensure compliance will be provided by the Department's Office of Inspector General.

**2. Agencies Lack Planning Necessary for Contract Monitoring**

**Recommendation:** The Division of Purchase and Contract should provide written guidance on planning procedures and documentation necessary for contract monitoring.

State agencies should prepare and document contract risk assessments, risk mitigation and contingency plans, and contract administration plans.

**Response:** The Department concurs with the recommendation and will use guidance from the Division of Purchase and Contract to ensure that contract risk assessments, risk mitigation and contingency plans, and contract administration plans are prepared and documented. Follow-up to ensure compliance will be provided by the Department's Office of Inspector General.

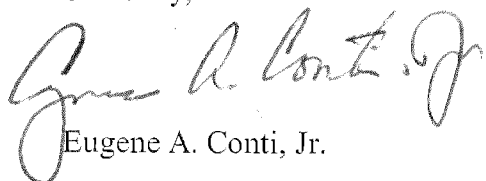
**3. Agencies Do Not Use Terms and Conditions Necessary for Monitoring**

**Recommendation:** State agencies should ensure that contracts include detailed statements of work, performance measures, and *right to audit* clauses.

**Response:** The Department will make all contracting officers aware of the requirement that contracts include detailed statements of work, performance measures, and *right to audit* clauses. Follow-up to ensure compliance will be provided by the Department's Office of Inspector General.

Thank you again for the opportunity to respond to the recommendations in the report and for the expertise and professionalism demonstrated by your staff in conducting this performance audit. I appreciate the work of the Office of the State Auditor to help the Department achieve its goals and become aware of additional opportunities to improve its operations.

Sincerely,



Eugene A. Conti, Jr.

EAC/mf

The Honorable Beth Wood

October 8, 2010

Page 3 of 3

cc: Jim Trogdon, Chief Operating Officer  
Ellis Powell, Chief of Staff  
Terry Gibson, Highway Administrator  
Victor Barbour, Administrator of the Technical Services Division  
Jim Westmoreland, Deputy Secretary for Transit  
Anthony Roper, Deputy Secretary for Administration  
and Business Development  
Susan Coward, Deputy Secretary for Intergovernmental  
Affairs and Budget Coordination  
Bruce Dillard, Inspector General



November 3, 2010

A self-supporting  
public agency

The Honorable Beth A. Wood, State Auditor  
Office of the State Auditor  
2 South Salisbury Street  
20601 Mail Service Center  
Raleigh, North Carolina 27699-0601

A. Robert Kucab  
Executive Director

Dear State Auditor Wood:

PO Box 28066  
Raleigh, NC  
27611-8066

We appreciate the professional work of the State Auditor's staff and this opportunity to comment on the September 2010 Performance Audit of Service Contract Monitoring Practices.

3508 Bush Street  
Raleigh, NC  
27609-7509

We agree with the recommendations of the performance audit and we have already acted on the principal recommendations (i.e., inclusion of State Auditors' right to audit, centralized filing in our legal and finance groups, checklist for key elements, clear performance measures, close-out documentation). We will include all of this in our formal contracting plan.

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Many changes were made while the State Auditor's staff was on site in response to his suggestions.

We will continue to assess our contracts for complexity, dollar amount, and risk to decide what level of monitoring to consistently apply. As recommended, we will adopt a formal threshold for smaller operational contracts that require less oversight. As noted in the report, the dollar value of the program contracts was about \$3.2 billion (99.92% of dollars) and operational contracts were about \$1.7 million (.02% of dollars).

We are self supporting and we maintain a lean staff who must handle multiple functions to keep our operating costs low. The two senior staff members who oversee contracts are highly credentialed as a CPA and an attorney. We will ensure that they participate in contract monitoring training.

We are exceptionally proud of having consistently clean financial audits by our private audit firm (BDO) and consistently favorable performance audits by the U.S. Departments of Housing and Urban Development and Treasury.

Our management team considers contract management a very high priority.

Sincerely,

A handwritten signature in black ink, appearing to read "A. Robert Kucab".

A. Robert Kucab  
Executive Director

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