



Executive Branch Contracting for Services: Inconsistent Procedures Limit Accountability and Efficiency

Research Report No. 303

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**EXECUTIVE BRANCH CONTRACTING
FOR SERVICES:
INCONSISTENT PROCEDURES LIMIT
ACCOUNTABILITY AND EFFICIENCY**

Adopted by Program Review and Investigations

**PROGRAM REVIEW & INVESTIGATIONS COMMITTEE
STAFF REPORT**

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Research Report No. 303

LEGISLATIVE RESEARCH COMMISSION

Frankfort, Kentucky

Committee for Program Review and Investigations

Adopted: October 11, 2001

FOREWORD

In September 2000, the Program Review and Investigations Committee approved a study to examine executive agencies' use of contracts to obtain services. The overall goal of the study was to evaluate whether the use of service contracts is an efficient and accountable method of delivering government services and to assess the impact of extensive use of service contracts on regular executive agency employment.

The Program Review and Investigations Committee adopted the staff report and recommendations on October 11, 2001.

This study represented a major undertaking, and it would have been much more difficult to complete without the cooperation and assistance of many individuals, both throughout the Executive Branch and within the Legislative Research Commission.

First, staff would like to thank the officials of the Finance and Administration Cabinet who spent many hours providing the requested information and explanations. Specific individuals whose cooperation and assistance were invaluable include Secretary Kevin Flanery, Commissioner Don Speer, Chief Information Officer Chris Clark, General Counsel Karen Powell, Darla Hershey, and Larry Kiefer.

Staff also would like to acknowledge the help received from Personnel Cabinet Secretary Carol Palmore and General Counsel Dan Egbers, and Kentucky Retirement Systems General Manager Bill Hanes.

Agency personnel responsible for contract administration provided valuable assistance and information during the course of our field work.

Finally, the tasks associated with the sample of contracts and the contractors' survey could not have been completed without the aid of numerous LRC staff, including Michael Meeks and the Government Contract Review Committee staff, Margaret Doyle and the Project Center staff, and the following individuals: Emily Bottoms, Doug Huddleston, Jack Jones, Melvin LeCompte, Mac Lewis, Ann Mayo, Alisha Miller, Ann Seppenfield, Susan Viers, and Lisa Whittaker.

Robert Sherman
Director

Frankfort, Kentucky
October 19, 2001

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MEMORANDUM

TO: The Honorable Paul E. Patton, Governor
 The Legislative Research Commission, and
 Interested Individuals

FROM: Senator Katie Stine, Chair
 Representative H. "Gippy" Graham, Co-Chair

SUBJECT: Adopted Committee Staff Report: Executive Branch Contracting for
 Services: Inconsistent Procedures Limit Accountability and Efficiency

DATE: October 2001

In September 2000, the Program Review and Investigations Committee approved a study to examine executive agencies' use of contracts to obtain services. The overall goal of the study was to evaluate whether the use of service contracts was an efficient and accountable method of delivering government services and to assess the impact of extensive use of service contracts on regular executive agency employment.

Committee staff examined documentation from a random sample of contracts, surveyed contracts, and reviewed regulations, statutes, and contracting literature. Based on a review of this information, the Committee came to the conclusion that improvements are possible in the procedures Executive Branch agencies use to obtain contract services. This report details the reasons for that conclusion and outlines the Committee's recommendations for improvement, which are summarized below.

MAJOR CONCLUSIONS

- **The Executive Branch is spending an increasing share of its total personnel resources on service contracts.** In FY 1992, personnel expenditures on service contracts equaled just over nine percent of total personnel costs. That figure grew to seventeen percent by FY 2000.
- **In FY 2000 approximately \$350 million was spent on service contracts in the Executive Branch.** That amount could have paid the average \$40,600 total compensation for approximately 8,600 additional state employees. This equals roughly twenty percent of the total 44,500 employee positions approved for that year.
- **The greatest strength of the contracting system appears to be the integrity and professionalism of agency contract managers, which Program Review staff found to be uniformly high.**
- **Inconsistency and weakness in the contracting system and procedures limit overall accountability and efficiency. Four major types of problems were identified.**
 - ◇ **Several key aspects of the contracting system have not been formalized in statutes or regulation. Existing statutes, administrative regulations, and published contracting procedures are often vague and inconsistent.** Several key aspects of the contracting system have not been formalized in statutes or regulations. These problems have led to confusion and frustration on the part of agency managers who use the contracting system. One result is that payments on contracts in some cases can exceed the “not-to-exceed” amount approved by the Government Contract Review Committee.
 - ◇ **Analysis and documentation of the need for services is inadequate.** Agency managers report that salary and hiring limitations in the state personnel system are a major reason they obtain services through contract. Inadequate analysis of the relative costs of obtaining a service on contract, compared to the cost of obtaining the service from regular employees, calls into question the efficiency of the current system.
 - ◇ **There is insufficient advertising of contract opportunities.** Just under half of state contractors reported that they learned of contracting opportunities only by being contacted by agency personnel or from having a similar contract in the past. This limits competition, the Commonwealth’s best guarantee of receiving the highest quality service at the lowest price. It also opens the contracting process to the perception of favoritism, in contrast to the fairness emphasized by the merit system for state employees.
 - ◇ **There is inconsistent, and often inadequate, monitoring of the work performed on service contracts, particularly sole source contracts.** Based on a random sample

of contracts, nearly thirty percent of the contracts were subject to the least effective form of monitoring. Only four percent were subject to the most effective form of monitoring. These percentages are worse, fifty percent and zero percent respectively, for sole source contracts. Inadequate monitoring of contractor performance throughout the course of the contract limits agencies' ability to determine if the Commonwealth is receiving quality services at a fair price. This is particularly true for sole source contracts that were issued without the benefit of competition.

Questions or requests for additional information should be directed to Dr. Ginny Wilson, Committee Staff Administrator for the Program Review and Investigations Committee.

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EXECUTIVE SUMMARY

The Program Review and Investigations Committee instructed its staff to review the accountability and efficiency of Executive Branch methods of contracting for services. This report presents the results of that review.

MAJOR CONCLUSIONS

- **The Executive Branch is spending an increasing share of its total personnel resources on service contracts.** In FY 1992, personnel expenditures on service contracts equaled just over nine percent of total personnel costs. That figure grew to seventeen percent by FY 2000.
- **In FY 2000 approximately \$350 million was spent on service contracts in the Executive Branch.** That amount could have paid the average \$40,600 total compensation for approximately 8,600 additional state employees. This equals roughly twenty percent of the total 44,500 employee positions approved for that year.
- **The greatest strength of the contracting system appears to be the integrity and professionalism of agency contract managers, which Program Review staff found to be uniformly high.**
- **Inconsistency and weakness in the contracting system and procedures limit overall accountability and efficiency. Four major types of problems were identified.**
 - ◇ **Several key aspects of the contracting system have not been formalized in statutes or regulation. Existing statutes, administrative regulations, and published contracting procedures are often vague and inconsistent.** Several key aspects of the contracting system have not been formalized in statutes or regulations. These problems have led to confusion and frustration on the part of agency managers who use the contracting system. One result is that payments on contracts in some cases can exceed the “not-to-exceed” amount approved by the Government Contract Review Committee.
 - ◇ **Analysis and documentation of the need for services is inadequate.** Agency managers report that salary and hiring limitations in the state personnel system are a major reason they obtain services through contract. Inadequate analysis of the relative costs of obtaining a service on contract, compared to the cost of obtaining the service from regular employees, calls into question the efficiency of the current system.
 - ◇ **There is insufficient advertising of contract opportunities.** Just under half of state contractors reported that they learned of contracting opportunities only by being contacted by agency personnel or from having a similar contract in the past. This limits competition, the Commonwealth's best guarantee of receiving the highest quality service at the lowest price. It also opens the contracting process to the perception of favoritism, in contrast to the fairness emphasized by the merit system for state employees.

- ◇ **There is inconsistent, and often inadequate, monitoring of the work performed on service contracts, particularly sole source contracts.** Based on a random sample of contracts, nearly 30 percent of the contracts were subject to the least effective form of monitoring. Only four percent were subject to the most effective form of monitoring. These percentages are worse, 50 percent and zero percent respectively, for sole source contracts. Inadequate monitoring of contractor performance throughout the course of the contract limits agencies' ability to determine if the Commonwealth is receiving quality services at a fair price. This is particularly true for sole source contracts that were issued without the benefit of competition.

SPECIFIC CONCLUSIONS AND CORRESPONDING RECOMMENDATIONS

This section offers brief summaries of specific conclusions and the corresponding recommendations. They are presented in the order in which they appear in the report.

Chapter 2 – The Contracting System

Conclusion. Not all payments to contract vendors can be traced to the particular contract. This undermines the enforceability of the “not to exceed” amount that is approved by Finance and the Government Contracts Review Committee.

Recommendation 2.1

System modifications should be made to eliminate or minimize the use of contract payments that do not tie back to specific contracts. While stand-alone invoices are a necessary part of the payment system, they should not be necessary to make contract payments.

Conclusion. The new practices and terminology related to MARS have not been formally added to either KRS or KAR citations, and the processes described in the various regulations are not always consistent. Required changes also have not been incorporated into the Finance and Administration Cabinet's policies and procedures. In fact, none of the definitions or procedural changes that occurred when MARS was deployed in July 1999 have been incorporated into statute or administrative regulation. The absence of precise, clear, and consistent definitions and procedures has left agency personnel confused about the correct way to submit contract information.

Recommendation 2.2

The Finance and Administration Cabinet should recommend statutory language that legally implements the main features of the MARS system. The Cabinet should then promulgate administrative regulations that are consistent with the adopted statutes and implement those with a more detailed set of procedure directives.

Recommendation 2.3

The criteria used to designate a service as professional should be determined by the Finance and Administration Cabinet, in cooperation with the Government Contract Review Committee. These criteria should then be used to develop a formalized list of professional services that is distributed to agency contracting personnel.

Conclusion. Many agencies have had difficulty entering contract data correctly due to implementation problems with MARS. Correct means of paying on contracts as covered in initial training classes were not fully functional. Also, procurement reporting has not been fully implemented. In response, agencies have adopted their own procedures and developed stand-alone systems, such as spreadsheets (or even paper and pencil) to track contract expenditures. Continued use of these inconsistent procedures and dual systems causes much frustration for agency personnel, undermines the accuracy and usefulness of the data contained in MARS, and limits the efficiency gains that were the system's goal.

Recommendation 2.4

Once procurement reporting capabilities are in place, and the need for stand-alone invoices on contracts has been removed, the Finance and Administration Cabinet should develop clear and consistent policies and procedures and train staff in their use.

Conclusion. Without additional clarification, there will be continuing errors and misclassifications of contracts because of the different interpretations of statutes, administrative regulations, and policies and procedures. Such errors could lead to exclusion of some contracts that should be reviewed by the Government Contract Review Committee.

Recommendation 2.5

The General Assembly should consider revising the definitions for KRS 45A.690 to 45A.725 relating to memoranda of agreement in order to clarify any misunderstanding of what constitutes appropriate use of the contract type. The Finance and Administration Cabinet should establish policies and procedures that reflect the intent of the statutes relating to memoranda of agreement.

Conclusion. The MARS system does not meet the data needs of the Government Contract Review Committee. Contract data are provided to the Committee in a text document that cannot be converted to a database that can be easily searched and analyzed. Also, the Proof of Necessity form required by statute for the Committee's review has not been incorporated in MARS. Doing so would allow Committee staff to compile and analyze the information in a systematic way.

Recommendation 2.6

Government Contract Review Committee staff should work with the Finance and Administration Cabinet to have their Procurement Desktop inbox extracted to a database to facilitate summary analysis. Information from the Proof of Necessity form should also be retrievable in database format.

Chapter 3 – Contracting for Services and State Employment

Conclusion. Many agency managers justify the use of service contracts on the basis of state hiring and salary caps and the lack of flexibility they face in hiring and removing employees because of merit system rules.

Recommendation 3.1

The Personnel Cabinet should work with the Finance and Administration Cabinet to determine any adjustments that should be made to the state personnel system to better meet the needs of agency managers and reduce the pressure for them to obtain services through contracting. Recommendations on this issue should be submitted to the Government Contract Review Committee and the Interim Joint Committee on State Government prior to the 2004 General Assembly.

Conclusion. Responses from a survey of state contractors revealed that about half of them had learned of contracting opportunities only by being contacted by state agencies or by having similar contracts in the past. At the least, this creates a perception of favoritism in contracting that is contrary to the provisions for equal opportunity and treatment afforded state employees through the merit system.

Recommendation 3.2

Agencies should be required to more widely publicize the availability of service contracts. The current system depends too heavily on direct contact between agency personnel and known contractors. Contractors and potential contractors for services should be as protected from favoritism as state employees are under the merit system.

Conclusion. The federal government has outlined criteria for determining who is a common-law employee, but so far has not imposed those criteria on state governments for the purposes of deciding who is eligible for state benefits. It is unknown how many contractors might meet the definition of common-law employee based on federal or state criteria. Interviews with agency managers revealed that many were unaware of either the criteria for determining who is a common-law employee or the financial liability they could incur through such a determination.

Recommendation 3.3

The Finance and Administration Cabinet, in association with the Personnel Cabinet and staff of the Kentucky Employees Retirement System, should develop and impose contracting guidelines that prohibit agency managers from structuring service contracts in a manner that allows the contractor to meet the criteria of a common-law employee, except in cases where a documented reason exists for doing so.

Recommendation 3.4

The Finance and Administration Cabinet should educate agency managers about the potential financial liability they could face if they do structure service contracts in a manner that allows the contractor to meet the criteria of a common-law employee.

Recommendation 3.5

The Kentucky Retirement Systems Board has full authority to determine the criteria for deciding who is an employee for the purposes of membership in state retirement systems. The General Assembly may want to consider whether to give the Board additional guidance in making that determination. In particular, the General Assembly may want to clarify the conditions under which a contractor could be considered an employee for the purposes of receiving benefits.

Conclusion. Except for benefits governed by federal rules, such as Social Security, agencies are inconsistent in the types and levels of employee benefits that are included in service contracts. Agency personnel do not always understand regulations that may impinge on their ability to freely negotiate benefit arrangements. Considerations of equity would suggest that contractors doing similar work should be afforded similar compensation options. Finally, care should be taken to maintain a distinct line between the terms of regular employment and contract work.

Recommendation 3.6

Officials of the Finance and Administration Cabinet should work with the Personnel Cabinet to standardize the set of non-federal benefits that agencies would be allowed to incorporate into service contracts. At a minimum, standard policies should be developed to address the conditions under which service contracts may include benefits normally associated with regular employment. These include health insurance, workers' compensation coverage, and retirement contributions. Additionally, standard guidelines should be developed to govern travel reimbursement for service contractors. Agency managers should be trained in the regulations that govern each type of benefit so that they are only used in an appropriate manner in contract negotiations.

Conclusion. Many service contracts are issued without a thorough analysis and documentation of the need for the contract. When completing the Proof of Necessity form required by the Government Contract Review Committee, many agency officials submit boilerplate language that does not adequately demonstrate the need for the obtaining the services through a contract or present an adequate analysis of the costs and benefits of contracting.

Recommendation 3.7

Unless special circumstances make it impractical, agency managers should be required to more thoroughly document the need for a service contract and provide evidence of an adequate comparison of its costs relative to those of using a regular state employee to provide the same service. This information should replace the boilerplate justifications that are too often included in the Proof of Necessity form supplied to the Government Contract Review Committee.

Chapter 4 – Contract Administration and Monitoring

Conclusion. Competition is one of the most useful tools in designing a system that promotes fairness in the award of contracts, as well as efficient prices and quality service. Despite this, there is a heavy reliance on sole source contracting in some cabinets. There is a concern that the large number of sole source awards limits the benefits available to the state from the competitive award of contracts.

Recommendation 4.1

The Secretary of the Finance and Administration Cabinet should closely examine any request for a sole source exemption. Only those cases specifically permitted by statute, or those most rigorously documented, should be permitted to circumvent the benefits of the competitive award of contracts. Additionally, summary information should be retained and reported semi-annually to the Government Contract Review Committee documenting the number of sole source

contracts awarded by each cabinet, the recipients of sole source contracts, the not-to-exceed amounts of the contracts, and the services acquired through the contract.

Recommendation 4.2

Sole source contracts that are renewed year after year are a particular concern. These contracts have the potential of continuing for years without the benefit of a competitive procurement process. The Finance and Administration Cabinet should develop policies specifying a four-year limit on the renewal of sole source contracts. After the fourth year, a sole source contract should be offered as a competitive award.

Conclusion. The Commonwealth and contractors would be well served if alternative means of contract notification were used more effectively. Increased use of the Internet seems most promising. Those with contracts through the cabinets with the best websites were less dependent on being notified directly of contract availability. Rather than having each cabinet design and maintain its own website for potential contractors, it would be more efficient to have a centralized site that would provide information on all state service contracts. The Finance and Administration Cabinet would seem to be the obvious agency to implement such a centralized system. A centralized website would greatly benefit contractors by allowing them to gather information on potential contracts without having to go to every agency that might have a relevant contract available. Until a centralized website is online, state agencies should make more effective use of alternative means of communication such as e-mail lists, advertising in periodicals, and working through professional associations.

Recommendation 4.3

The Finance and Administration Cabinet should implement a centralized website that would provide information to potential contractors on all available service contracts to be issued by any state agency. The site should be easily searchable and, whenever feasible, provide online access to any documentation and forms that contract applicants would need. The availability of the central website should be widely advertised to potential contractors and to the general public.

Conclusion. Better advertising of the availability of contracts should increase the actual and perceived fairness and effectiveness of the contracting system. It would also help if contractors and other members of the public had ready access to information on contracts as they are awarded. Contractors volunteered several complaints that could be addressed with a more transparent contracting process. Timely and accurate information on contract awards should not only make procedures more fair and responsive to contractors but would also allow legislators, the media, and interested members of the public to serve as more effective watchdogs of the contracting system.

Recommendation 4.4

In addition to information on available contracts, the centralized contract website implemented by the Finance and Administration Cabinet should provide details on the status of contracts during the award process and provide summary information on contracts that have been awarded. The information on awarded contracts should at least include the name and location of the recipient of the contract, the awarding agency, the amount and duration of the contract, and a brief description of the work to be done. If it is a sole source contract, this should be indicated. If

not, finalists for the contract should be listed. If the contract is a renewal of a contract for the same or similar work, the amount of time that the same person or firm has had the contract should be noted.

Conclusion. Given the number and diversity of service contracts, the system could also be improved if there were a central office that could help contractors and those interested in getting contracts to deal with complaints that could not be resolved through the contracting agency, to maintain records of contractors' complaints, and to provide access to summaries of complaints to contractors.

Recommendation 4.5

An independent ombudsman's office should be created. The ombudsman would handle complaints from contractors that could not be resolved with the contracting agencies. The ombudsman also would maintain records of contractors' complaints and provide summaries of those records to interested contractors and any other interested parties.

Conclusion. The quality of contract monitoring is inconsistent. Even within agencies, contracts are not monitored with a uniform approach. While all contracts cannot be monitored in the same way, it is crucial that all contracts receive some monitoring. This is important not only for the efficient and effective provision of services, but also for the perception of fairness and uniformity that is critical to the state's system of awarding contracts.

Recommendation 4.6

The Finance and Administration Cabinet should develop policies and procedures and provide training for all agencies on the necessity of adequate contract monitoring. The training should incorporate industry acknowledged "best practices," as well as guidelines agencies should consider when determining the methods that will provide the best assurance that contracts will be carried out efficiently and effectively.

Conclusion. The perspectives of those awarded contracts may differ markedly from those of agency officials charged with contract monitoring and administration. To improve the effectiveness and efficiency of the state's contract administration system, the insight of those who have been awarded contracts should be solicited. Such information should be used to balance agency perceptions and promote a system beneficial to all parties involved.

Recommendation 4.7

The Finance and Administration Cabinet should undertake periodic surveys of individuals and firms that have been awarded contracts with state agencies. These surveys should be structured so that the results of the survey will help Finance and the individual agencies develop a more effective, efficient, and fair contract award and monitoring system.

Conclusion. Without the benefits of a competitive award, sole source contracts should be monitored more closely than contracts awarded through a competitive process. Agencies, however, usually appear to be monitoring sole source contracts with less rigor than other contracts.

Recommendation 4.8

The Government Contract Review Committee should consider requiring additional information on any contract presented for its approval based on a sole source award. Without the benefits of a competitive award process, sole source contracts should typically be monitored more closely than competitively awarded contracts. The Committee should require a detailed explanation of the monitoring process agencies would follow on sole source contracts to be included with the proof of necessity form. Monitoring practices should include those methods the agency will follow to ensure that the services they receive reflect the needs of the agency, are of acceptable quality, and are provided at an efficient price.

Conclusion. The MARS system allows agencies to report about vendor performance; however, the capability does not seem to be used extensively. This valuable tool should be used more effectively.

Recommendation 4.9

The Finance and Administration Cabinet should promulgate administrative regulations requiring state agencies to provide assessments of the performance of contractors providing services.

Conclusion.

As part of its oversight function, it is essential that the Government Contract Review Committee have access to information about contracts on which payments are being made. The use of pre-qualified master agreements may make it difficult for the Committee to determine which contractors are being awarded work, and in what amount.

Recommendation 4.10

The Government Contract Review Committee may wish to consider requiring quarterly or semi-annual reporting on the use of pre-qualified master agreements. Such reporting could detail the number of projects and the estimated cost of work awarded under each master agreement, as well as the amounts actually expended.

CHAPTER 1

DESCRIPTION OF CONTRACTS AND THE CONTRACTING PROCESS

**Study approved to
examine service
contracts.**

In September 2000 the Program Review and Investigations Committee approved a study to examine executive agencies' use of contracts to obtain services. The overall goal of the study was to evaluate whether the use of service contracts is an efficient and accountable method of delivering government services and to assess the impact of extensive use of service contracts on regular executive agency employment. The Program Review and Investigations Committee approved the following objectives for this study at its October 2000 meeting:

- Describe the volume and nature of service contract use by Executive Branch agencies;
- Examine the process for awarding service contracts by Executive Branch agencies;
- Determine the role of service contracts in the overall use of labor in performing agency tasks;
- Determine whether past recommendations by the Program Review and Investigations Committee concerning the administration of service contracts have been implemented; and
- Evaluate how the use and monitoring of service contracts by executive agencies compares with "best practices" identified in the relevant literature and by other states.

**Staff examined
documentation from a
random sample of
contracts, surveyed
contractors, and
reviewed regulations,
statutes and contracting
literature.**

Staff conducted a review of contract documentation and interviewed agency managers to determine the contract award and monitoring process used for a random sample of 353 contracts. This was done to assess whether the Executive Branch is following best practice guidelines in the awarding and monitoring of contracts for services. The random sample was selected from a population of 4,359 service contracts issued in the five quarters from the first quarter of Fiscal Year 2000 through the first quarter of Fiscal Year 2001.

Also, to assess contractor opinions about the Commonwealth's contracting system, a mail survey was sent to all contractors represented in the population of contracts. Fifty-two percent of the 2,199 contractors who received a copy completed the survey.

In addition to the detailed examination of a random sample of contracts, staff also performed a general review of contract

descriptions in MARS, the newly implemented statewide accounting system, for the entire population of 4,359 relevant contracts. Here, the objective was to identify contracts that raised additional questions that were deemed worthy of further review. Staff contacted agency personnel for additional clarifying information regarding these contracts.

Analysis of the data collected in the efforts noted above was coupled with reviews of statutes, administrative regulations, published agency procedures, and best practices literature to complete the assessment of Executive Branch contracting for services.

Organization of the Report

The topics addressed in the remaining chapters are as follows.

- **Chapter 1** presents a summary of the service contracting process and information on the number and characteristics of service contracts.
- **Chapter 2** describes the contracting system used in the Executive Branch and presents information about the dollar amount of contracts for services.
- **Chapter 3** discusses the relationship between contracting for services and the regular system for state employment. Particular attention is given to the issues of rehiring retired state employees on contract and the varied coverage of employee benefits, such as retirement contributions, for contractors.
- **Chapter 4** uses information from the random sample of contracts and the mail survey of contractors to assess the award and monitoring process used in service contracting.
- **Chapter 5** provides information on the extent to which the Finance and Administration Cabinet has implemented recommendations from the 1999 Program Review and Investigations Committee report on contract administration.
- **Appendices A, B, C, and D** present details of the research methods and analysis.

Gray boxes are used throughout the text to provide examples related to issues raised in the text.

Service Contracting Process

There are several types of contracts used to procure services. The most prevalent are personal service contracts, which are used to obtain professional services requiring skill or judgement for a specified period of time and at an agreed upon price. Other contracts, such as price contracts, are used to procure non-professional services, such as janitorial and security guard services. Still others, such as architectural/engineering master agreements, are used to pre-qualify contractors to perform services on an as-needed basis.

Memoranda of agreement (MOAs) are another prominent type of contract used to procure services. This type of contract is to be used solely for agreements with other governmental and quasi-governmental entities. Because MOAs do not involve the use of private sector services, they were not included in the review.

State law permits the purchase of services by means of a contract if state personnel are not available or if it is not feasible for state personnel to perform the needed service. State agencies are not required to obtain competing bids from potential vendors in every situation.

The Secretary of the Finance and Administration Cabinet is the state's chief procurement officer.

The Kentucky Model Procurement Code (KRS 45A) stipulates that the Finance and Administration Cabinet is to serve as the central procurement and contracting agency for the Executive Branch. The Secretary of the Finance and Administration Cabinet is the state's chief purchasing officer. As such, the Secretary has the responsibility for all procurement by the Commonwealth. The Secretary has the authority to adopt regulations, decide matters of policy, and review the implementation of regulations and policy determinations with regard to all aspects of purchasing.

Personal service contracts must be reviewed by both the Finance and Administration Cabinet and the Government Contract Review Committee. Pursuant to KRS 45A, no work shall begin on a personal service contract until it is filed with the Committee, except in the event of a governmental emergency. Should the Committee disapprove a contract, payment may be made only for work done up to the time of the Committee's disapproval. The Committee's decision can be overridden by the Secretary of the Finance and Administration Cabinet.

The Government Contract Review Committee reviews memoranda of agreement and personal service contracts.

The Government Contract Review Committee is specifically charged with the responsibility of reviewing memoranda of agreement for \$50,000 or more, and personal service contracts for \$10,000 or more. Personal service contracts and memoranda of agreement below these threshold amounts are filed with the committee for informational purposes, although the Committee may elect to review the lower dollar amount agreements as well. The Committee reviews:

- The stated need for the contract service;
- Whether the service could or should be performed by state personnel;
- The not-to-exceed amount of the contract;
- The duration of the contract or agreement; and
- The appropriateness of any exchange of resources or responsibilities.

Legislators have raised concerns about the growth of service contracting and whether service contracting is being used to circumvent salary and hiring caps. Additional concerns have been expressed about the use of retainer fees and a lack of uniformity in payments and expenses associated with service contracts.

A precise measure of state expenditures for contract expenditures over time is unattainable.

Description of Contracts

Ideally, one could measure the dollars expended on service contracts across multiple years and compare this to wages and salaries to measure any change in the use of contracts relative to employment. As will be discussed later in this report, such a precise measure is unattainable.

In the absence of a total amount for service contract expenditures, an approximation of the relative magnitude of expenditures can be derived based on select personnel expenditure categories in the state's financial system. The financial system includes a professional contracts expenditure category within personnel expenditures; janitorial and security guard services are also categorized separately within personnel. These expenditure categories do not include travel, which may be broken out separately on a contract, nor do they include capital project expenditures. They do, however, provide a good indicator of change in expenditures on service contracts relative to personnel costs.

Table 1.1 identifies \$336.6 million Fiscal Year 2000 expenditure amounts for each of the personnel expenditure categories that were selected as being predominately for contractual services.

Table 1.1
Contractual Executive Branch Personnel Expenditures
Fiscal Year 2000

Accounting Object Code	Expenditure	Percent of Total
E141 Legal Services (1099 Reportable)	7,761,695	2.3%
E142 Auditing Serv-Incl Fin Discl Rev Aud (1099 Reportable)	2,704,832	0.8%
E143 Architect & Engineering Serv (1099 Reportable)	72,265,287	21.5%
E144 Medical & Dental Service (1099 Reportable)	7,178,869	2.1%
E145 Prof Computer Services Outside Contr (1099 Reportable)	38,352,503	11.4%
E146 Consulting Services (1099 Reportable)	32,460,255	9.6%
E147 Advertising Services (1099 Reportable)	4,108,483	1.2%
E148 Artistic Services (1099 Reportable)	433,835	0.1%
E149 Appraisal Services (1099 Reportable)	63,478	0.0%
E150 Miscellaneous Services (1099 Reportable)	116,358,114	34.6%
E151 Expert Witnesses (1099 Reportable)	1,251,668	0.4%
E152 Court Reporters (1099 Reportable)	477,750	0.1%
E153 Key punch Services (1099 Reportable)	363,077	0.1%
E155 Court Designated Worker Serv (1099 Reportable)	1,071	0.0%
E156 KDOE Contractual Agreement Salaries-Non 1099 Reportable	14,266,807	4.2%
E157 KDOE Contractual Agreement Fringes-Non 1099 Reportable	282,460	0.1%
E158 Veterinarians Services (1099 Reportable)	223,502	0.1%
E159 Actuarial Services (1099 Reportable)	1,617,131	0.5%
E170 Professional Services W-2 Reportable	8,772,664	2.6%
E191 Temporary Manpower Services	9,271,924	2.8%
Total Professional Contracts (expenditure class 140)	<u>318,215,405</u>	94.5%
Other identified contractual service accounting object codes		
E154 Personal Services Expend Reimbursement/Distr	(656,226)	-0.2%
E162 Security Guard Services (1099 Reportable)	4,687,427	1.4%
E163 Janitorial Services-Non Employees (1099 Reportable)	13,621,470	4.0%
E166 Lab Tests & Analysis Fees (1099 Reportable)	756,461	0.2%
Total Estimated Service Contract Expenditures	<u>\$336,624,537</u>	100.0%

Note: These expenditure categories are a component of personnel expenditures. They do include some small expenditures that are not under contract, and they exclude other service contract expenditures that do not fall within personnel expenditures such as capital construction projects and travel expenditures in cases where travel is paid separately.

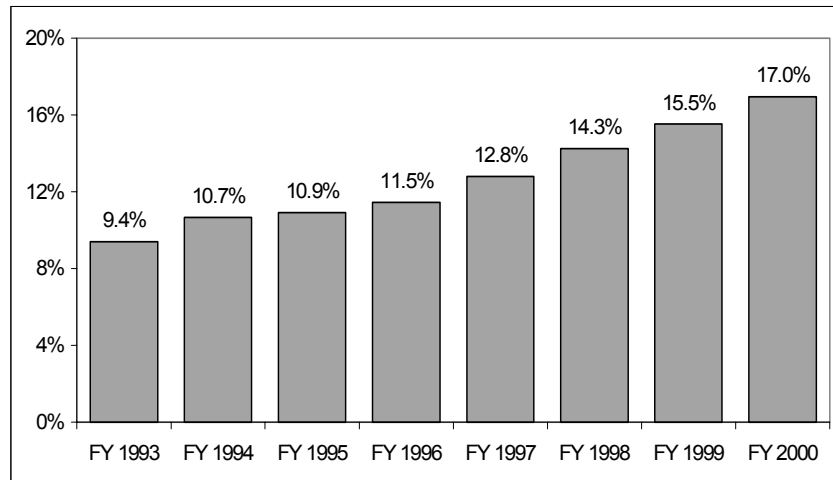
Source: Management Reporting Database General Ledger table.

Expenditures on contract services as a percent of personnel costs have increased significantly.

Figure 1.A indicates a trend toward devoting more resources to purchasing services from the private sector, relative to hiring employees to provide those services. The figure shows the portion of personnel expenditures that are contractual, based on the expenditure categories detailed in Table 1.1, from FY 1993 through FY 2000.¹

¹ The FY 2000 dollar estimate presented in Chapter 2 is slightly higher (3.7%) than the FY 2000 amount presented here, because it was derived using different data. That data is believed to be more complete; however, it was not available

Figure 1.A
Contractual Executive Branch Personnel Expenditures
as a Percentage of Personnel Costs
Fiscal Year 1993 through Fiscal Year 2000



Source: FY 1993 through FY 1999 from extracts provided annually by Finance to LRC Budget Review. FY 2000 from Management Reporting Database general ledger table. Total personnel costs exclude operating transfers.

Using object codes provides an estimate of expenditures for a given fiscal year, but it does not provide details specific to individual contracts. Information such as contract type, duration, and detailed description is maintained in a separate system, Procurement Desktop, a component of the MARS system in use since the beginning of July 1999. Much of the analysis presented in this study was based on an extract of the contract data in Procurement Desktop.

An extract from Procurement Desktop provided by Finance formed a substantial basis of the analysis for this study.

The Office of Technical Services in the Finance Cabinet provided an electronic extract from the MARS system of all contracts entered into the Procurement Desktop system from implementation, July 1, 1999, through December 5, 2000. This extract contained 41,679 contracts. Of these, 38,333 represented Executive Branch contracts that had a status of active (27,441), expired (10,715), pending (94), or cancelled (83).

The extract included thirty-six different contract “sub-types” selected by the user from a list at the time of creation of the contract. These sub-types determine the required approvals that are necessary for the given document. The thirty-six different sub-types can be grouped into twelve broad categories. The accompanying brief descriptions are based primarily on the May

for prior years. The approach described above gave the best available measure of change over time.

30th Administrative Update disseminated by the Finance and Administration Cabinet.

Table 1.2
Executive Branch Contracts Included in Procurement Desktop Extract

Type of Contract	Number of Contracts	Percent of Total
Personal Service Contracts (professional services)	3,115	8%
Price Master Agreements (non-professional services)	1,262	3%
Construction Contracts (construction projects including small construction)	805	2%
Architectural/Engineering Master Agreements (pre-qualified services)	768	2%
Special Authority Contracts and Master Agreements (Division of Material and Procurement Services approval required)	685	2%
Department of Transportation (DOT) Contracts (special authority, small purchase, small construction not routed through Finance)	3,186	8%
Standard Contracts (general contracts such as small purchase sealed bids)	13,899	36%
Memorandums of Agreement and Internal Master Agreements (with governmental or quasi-governmental entities)	11,664	30%
Property Rental Contracts (leasing space from an external vendor)	1,473	4%
Revenue Generating Master Agreements (concession stands etc.)	13	0%
Provider Agreements (for providers of direct Medicaid health care to individuals)	36	0%
Catalog Master Agreements (electronic catalogs predominately for purchase of goods)	1,427	4%
	38,333	100%

A standard commodity code in conjunction with contract types was used to delineate contracts for services.

The focus of this study on contracting for services required reviewing contracts for services, as opposed to goods. The contract categories contained in MARS do not allow for such delineation. Therefore, contracts for services were identified using a commodity code provided for each line of the contracts in the extract. Procurement Desktop uses The National Institute of Government Purchasing Commodity Code standard for classifying items being purchased.

Memoranda of Agreement (MOA) were excluded from the population but reviewed separately for appropriate use.

This approach yielded 21,885 Executive Branch contracts for services. Several contract types were then excluded based on their definitions. Most notably, Memoranda of Agreement (MOA) were excluded from the population because they are supposed to be used in agreements with other governmental entities rather than with private sector firms or individuals. The use of MOAs was reviewed separately to make sure they were used as intended, but they were

not included in the analysis of contracts with private sector firms and individuals.

Other types of contracts were also excluded from the analysis when it was determined that the service aspect of the contract was incidental, or involved services such as newspaper advertising that did not fit within the area of interest. This reduced the population to 6,186 contracts. From this population a further restriction was made when the sample was drawn by limiting the population to those contracts issued during the five quarters from the first quarter FY 2000 through the first quarter FY 2001. This provided the 4,359 contracts from which the sample was drawn.

In order to present summary statistics on the entire population, however, it was not desirable to restrict the population to only the five quarters mentioned above. For summary purposes the population of 6,186 contracts was reduced to 5,102 after removing renewed contracts to avoid double counting. The following table provides the number of contracts by type of contract at each stage of the selection process. The gray column denotes the population for which a summary follows.

Table 1.3
Determining The Contracts of Interest
Procurement Desktop Contracts through December 5, 2000

Type of Contract	All Executive Branch Contracts							
	Number Pct.		For Services					
			Exclude Select Types				Remove Renewed	
	Number	Pct.	Number	Pct.	Number	Pct.		
Personal Service	3,115	8%	2,960	14%	2,955	48%	2,358	46%
Price	1,262	3%	910	4%	910	15%	771	15%
Construction	805	2%	748	3%	748	12%	747	15%
Architectural/Engineering	768	2%	768	4%	768	12%	455	9%
Special Authority	685	2%	381	2%	381	6%	376	7%
DOT	3,186	8%	1,655	8%	153	2%	153	3%
Standard	13,899	36%	3,365	15%				
Memorandum of Agreement/Internal	11,664	30%	10,792	49%				
Property Rental	1,473	4%	2	0%				
Revenue Generating	13	0%	9	0%				
Provider Agreements	36	0%	24	0%				
Catalog Master Agreements	1,427	4%	271	1%	271	4%	242	5%
	38,333	100%	21,885	100%	6,186	100%	5,102	100%

Note: The 4,359 service contracts from which the random sample was drawn was a subset of the 6,186 contracts noted above. Prior to removal of renewal contracts, the population sampled was restricted to contracts initiated during the five quarters from first quarter FY 2000 through first quarter FY 2001.

The seven types of contracts included in the selected population differ in their use and in their approval requirements. For instance only two of the seven types, personal service contracts and architectural engineering master agreements, are routinely routed through the Government Contract Review Committee.

Table 1.4 provides general characteristics for each of the seven types of contracts selected for inclusion as service contracts. Among the notable information presented is that personal service contracts are for professional services, and they comprise nearly half of the selected population. The other types of contracts are for non-professional services, with the exception of architectural/engineering master agreements, which are for pre-qualified work on an as needed basis. One-third of personal service contracts are with individuals as opposed to companies. The Finance and Transportation cabinets are generally the heavier users of service contracts.

Summary Information by Type of Contract						
Type of Contract	Number	Percent of Total	Most Frequent Users (cabinet)	Duration	Percent With Individuals	Primary Types of Services
Personal Service Contract	2,358	46%	Transportation (29%), Finance (13%), Education (10%)	59% of contracts one year or less, master agreements usually one to two years	33%	Architectural / Engineering (32%), medical (10%), human services (9%), legal (9%), financial (7%)
Price	771	15%	Families & Children (28%), Transportation (18%), and Finance (10%)	One-third one year or less, one-third between one and two years, most of the remaining were not over five years	2%	Janitorial, pest control, laundry & cleaning (49%)
Construction	747	15%	Finance (79%)	More than half were one year or less	1%	Construction
Architectural/Engineering	455	9%	Finance (96%) remainder in Transportation	One year	0%	Prequalified engineering and construction
Special Authority	376	7%	General Government (24%), Natural Resources (18%), and Workforce Development (11%)	Both contracts and master agreements were predominantly one year or less	11%	Physical plant maintenance (28%), computer related (25%), janitorial, pest control, laundry & cleaning (21%), printing and communication (8%)
DOT	153	3%	Transportation	Evenly split between one year or less and between one and two years	3%	Physical plant maintenance (82%), construction (10%)
Catalog Master Agreements	242	5%	Finance (31%), Transportation (14%), Health Services (12%)	62% more than two years but less than five years	1%	Computer related (29%), security, fire, safety, and lab testing (20%)

Most contracts follow a similar set of steps.

Contracting Process

Most contracts follow a similar set of steps:

1. Needs analysis;
2. Development of statement of work and selection of contract type;
3. Request for proposals or solicitation of bids;
4. Contract award;
5. Contract monitoring; and
6. Assessment of performance against contract requirements.

First, a need is identified that the agency does not feel it can meet through its available resources. Once the need is identified, an analysis should be undertaken to make sure all aspects of the need are understood. From this analysis, a statement of work is developed to describe the effort required to meet the need. The statement of work must encompass all aspects of the work to be completed and serves as the basis from which vendors will develop their bids and against which agencies can judge the quality of the work performed.

After a statement of work is developed, a decision must be made about how the contract will be issued. Contracts can be issued through several different award processes: competitive or noncompetitive negotiations, small purchase procedures, or sealed bidding. Best practices guides usually encourage the use of competitive awards, such as competitive negotiation or sealed bidding because as vendors compete against each other on price and quality of service, purchasers are more likely to receive lower costs and higher quality services.

The decision to pursue a non-competitive acquisition may be appropriate in certain situations, depending on the type of contract and the type of service being acquired. A project with unique characteristics or exceptional conditions surrounding the need to begin a project quickly may justify a non-competitive award.

Once a vendor is selected and contract terms are agreed upon, a contract is awarded and the vendor begins work. During the period of time in which the contractor is working, the performance of the contractor should be monitored by the state agency to ensure that the terms of the contract are met. Once the contract has been completed, the performance of the contractor should be judged against the contractually defined requirements to determine if the completion of the contract has satisfied the previously identified need, or if more work is required. If more work is required, the

entire cycle may need to be repeated with the same or a different contractor until the identified need is met.

Personal service contracts are usually awarded through the RFP process.

Personal Service Contracts

Most Executive Branch personal service contracts are awarded through a competitive negotiation, also referred to as a request for proposal (RFP) process. The RFP describes the services required, lists the type of information and data which must be provided by the potential contractors, and states the relative importance of particular qualifications the agency will be considering when it makes its decision. Factors that an agency might consider could include experience of the contractor, technical details of the proposal, and cost. If the estimated amount of the personal service contract is \$25,000 or more per fiscal year, the agency is required to give adequate public notice, which may include advertising in newspapers, professional journals, or agency web pages. The notice must contain a brief description of the services requested, the estimated amount of work involved, and who to contact to obtain a copy of the RFP. Sole source contracts and those with an emergency start date require prior approval of the Secretary of the Finance and Administration Cabinet.

The agency then reviews the proposals received in response to the RFP and determines the best proposal received, based upon the evaluation factors set forth. After determining the best proposal, the agency may negotiate a fair and reasonable compensation with the selected contractor. If compensation cannot be agreed upon, negotiations may be conducted with other offerors in the order of their qualification ranking.

The Government Contract Review Committee reviews the award of personal service contracts.

Once an agency has identified a contractor and negotiated terms, the contract is reviewed by the Finance and Administration Cabinet. If the award equals \$10,000 or more it must also be submitted for approval by the Government Contract Review Committee. The Government Contract Review Committee is a statutory committee of the General Assembly created to review personal service contracts and memoranda of agreement. Each personal service contract must be filed with the committee prior to the effective date of the contract. Work on a personal service contract should not begin until notification of the contract has been filed with the Committee, unless a governmental emergency is declared, as defined under KRS 45A.690.

Two of the primary review functions assigned the Committee are to examine the need for any proposed contract service and to examine whether that service could or should be performed by

state personnel (KRS 45A.705 (4) a and b). In order to adequately review each personal service contract or memorandum of agreement, the committee requires that agencies submit contract information in a specified format, called a proof of necessity form (PON), with each contract submitted.

**Need for services must
be documented.**

The PON requires agencies to document both the need for any proposed services and that existing state employees cannot perform the service. The PON should also document the total projected cost and duration of the contract. The Committee may also require submission of any other information it deems appropriate.

The following figure provides an example of a typical proof of necessity form.

Figure 1.B
Example of Proof of Necessity Form (PON)

Legislative Research Commission		Contract Number: _____
Agency	Division, Branch, etc.	
TYPE OF CONTRACT: <input checked="" type="checkbox"/> New <input type="checkbox"/> Renewal (Renegotiation) or <input type="checkbox"/> Extension for Time Only		
NOTE: All questions must be answered fully. If space provided is insufficient, additional pages should be attached referencing the specifically numbered item. Questions regarding this form should be directed to the Bureau/Staff Office Contract Officer.		
1. Name & Address of Contractor: <u>Somebody</u> <u>Some Place</u> <u>Somewhere, KY 40000</u>	2. Effective Period of Contract: Starting Date: <u>7/1/99</u> Ending Date: <u>6/30/00</u>	
3. Explain, with specificity, the work to be performed. (Include: Description of project, types(s) of service to be delivered; reports or products to be prepared; reason for duration of contact, etc.): <u>Assist the Secretary's Office in reviewing and understanding issues that have a programmatic impact, and to advise the Secretary as to project implementation impacts that relate and overlap other state agencies.</u>		
4. a. Does an identified or anticipated reason now exist which would indicate a need to renew the contract for the succeeding fiscal year? <u>NO</u> If yes, explain: _____		
b. Will the contract provide for cancellation by the Department up on a maximum of 30 days or less written notice to the contractor? <u>Yes</u>		
5. FINANCIAL AND CONTRACT COST DATA:		
a. Total Projected Cost of Contract: \$ <u>45,000.00</u>		
Source of Funds: Federal: \$ _____ State: \$ <u>45,000.00</u> Local/Other \$ _____		
b. If contract is supported by federal funds, indicate: Grant/project title; grant I.D. number; and CFDA number: _____		
c. If contract is supported by state funds, indicate source(s) and amount(s) (e.g., General Fund, Trust and Agency, Other): _____		
d. Was the contract cost included in the original Budget Request? YES <input checked="" type="checkbox"/> NO If no, explain: <u>Not anticipated at the time budget.</u>		
e. Describe, in <u>detail</u> , how the projected cost of the contract was derived (attach proposed budget when applicable): <u>Negotiations with contractor.</u>		
f. Basis for Payment: • Hourly: \$ <u>50.00</u> per hour • Per Diem: \$ _____ per day • Fee for Service: \$ _____ per service • Other - Explain: _____		
g. Method of Payment: • Straight Disbursement <input type="checkbox"/> • Inter-Account <input type="checkbox"/>		
h. Frequency of Payment: • Monthly <input checked="" type="checkbox"/> • Quarterly <input type="checkbox"/> • Upon Completion <input type="checkbox"/>		
• Other <input type="checkbox"/> - Explain: _____		

Figure 1.B (continued)
Example of Proof of Necessity Form (PON)

i. Social Security Number (if individual) or IRS I.D. Number (if firm or corporate entity) of proposed contractor: 999-99-9999

NOTE: If professional employment contract with firm or corporate entity, attach a complete list of names and social security numbers of all officers, as well as all employees performing work directly related to the contractor. If individual, attach name and social security number.

j. If an individual, will the terms of contract require that the contractor be considered an "employee" of this Department for FICA purposes? Yes

6. JUSTIFICATION FOR CONTRACTING WITH AN OUTSIDE PROVIDER TO PERFORM THE SERVICE.
The following questions should be addressed at a minimum:
What in-house method(s) were considered and why were potential in-house method(s) rejected? Is the part of such nature that it should be done independently of the agency to avoid a conflict of interest; it requires unique or special expertise/qualifications, and/or legal or other special circumstances require use of an outside provider? If services are needed on a continuing basis, describe efforts made to secure services through regular state employment channels? Will agency personnel provide staff support services to the contractor?

Extent of contractor's expertise not available on staff. Mr. Somebody's prior experience as former Commissioner of this agency and Director of that office make him uniquely qualified to examine and understand these issues.

7. Name and address of other provider(s) considered to perform the service:

None – See above

8. Basis for selection of the proposed contractor (explain process used in making decision, i.e., solicitation of proposals, bids, references, and evaluation criteria applied):

None – See above

9. PLANNED SUPERVISION AND MONITORING OF THE CONTRACTOR'S PERFORMANCE:

a. Name and Title of Responsible Person: Secretary
Office and Location: Capitol Annex, Frankfort, KY
Telephone Number: (502) 555-5555

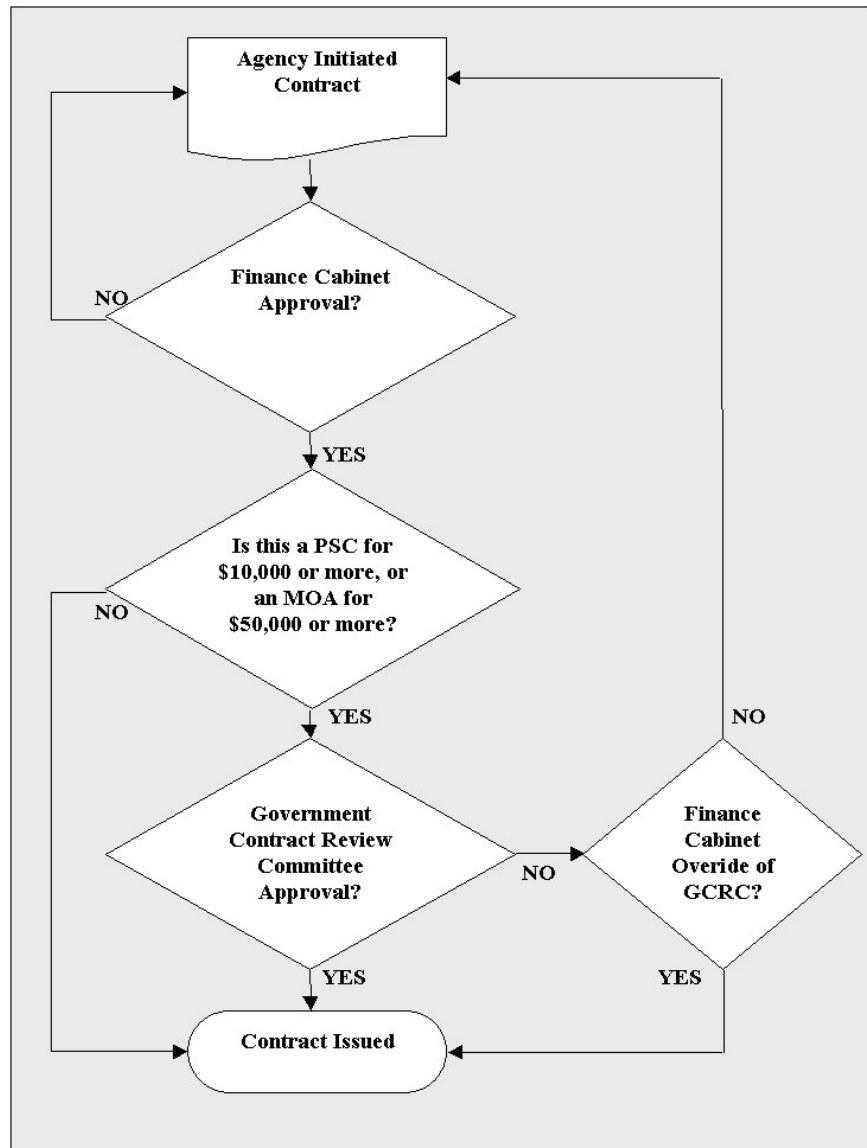
b. Describe the monitoring activities, both programmatic and fiscal, which will be performed including the manner in which monitoring needs will be addressed in the contract to facilitate this activity:

Submission of hours and days worked, services provided.

The Secretary of Finance and Administration may override the Government Contract Review Committee's disapproval of a contract.

If the Committee disapproves the personal service contract, no further payments may be made. Payments may be made, however, for the work done from the time the contract was filed up to the time of the disapproval. Disapproval of the Committee may be overridden by the Secretary of the Finance and Administration Cabinet, who serves as the state's chief purchasing officer. Should the Committee's disapproval be overridden, the agency may proceed with the contract. Figure 1.C summarizes the typical contract award oversight process.

Figure 1.C
The Contract Award Process



Source: Program Review staff.

Other types of contracts follow different processes.

Other Types of Contracts

Other types of contracts for services follow different award processes. Contracts for non-professional services could fall within one of the following four categories, as detailed in KRS 45A.075.

1. Small purchase procedures;
2. Competitive sealed bidding;
3. Competitive negotiation; and
4. Noncompetitive negotiation.

1. Small purchase procedures

Small purchase procedures determine the number of price quotes an agency must solicit for purchases of commodities, services, and construction that fall below an agency-specific amount. The standard agency limit is \$1,000 for commodities and services and \$10,000 for construction projects. Certain agencies have been granted higher thresholds. For example, the Finance and Administration Cabinet, the Governor's Office for Technology, and the Transportation Cabinet all have \$20,000 thresholds for the purchase of commodities and services. In instances where the threshold is higher than the standard agency limit, a higher number of quotes is required. For example, the Finance and Administration Cabinet may:

- Use a single quote for services estimated to cost up to \$5,000;
- At least three quotes for services estimated to cost between \$5,000 and \$10,000; and
- At least five quotes for services estimated to cost between \$10,000 and \$20,000.

These dollar thresholds are generally higher for construction projects.

Agencies are prohibited from splitting purchases in order to subvert the intent of this requirement. Agencies also are prohibited from using these procedures to obtain printing services.

2. Competitive sealed bidding

Formal sealed bidding is required except when the purchase is made in accordance with the small purchase procedures, in accordance with the competitive negotiation statute using a request for proposal, or through a sole source contract. Unless otherwise permitted by law, only the Division of Purchases within the Finance and Administration Cabinet may issue a formal Invitation for Bid.

The Division of Purchases is supposed to use its source list and other types of information to foster the highest level of competition among vendors interested in doing business with the Commonwealth. Invitations to bid are to be sent to at least ten vendors. In addition, the Division may advertise bid openings in a major newspaper of general circulation in the state. Bid openings can be held no sooner than seven days after the invitations to bid are mailed.

All bids are to be opened at a preset time in the presence of any interested parties. Bids are tabulated and the award is to be based on the determination of "best value." Best value incorporates the

total price for the item or service, adjusted by an evaluation of measurable criteria. Adjustments could be based upon factors such as delivery schedule or the warranty associated with a product or service.

Best Value Example

An agency evaluation committee, or designated individual, will evaluate the information provided by the vendors in response to the established measurable criteria contained in the solicitation.

<u>Measurable Criteria</u>	<u>Points</u>
Number of Personnel	30 points
Experience	30 points
Qualifications	40 points

Using the price adjustment approach, the vendor's total offered price is divided by a composite score to determine the evaluated best offer. The composite score is determined by dividing the total evaluated score by the total possible points. In the above example, if a vendor received a raw score of 80, the composite score would be calculated as .80 ($80/100=.80$). Thus, if a vendor offered \$20,000 and received a composite score of .80, then that vendor would have an evaluated "best value" offer of \$25,000 ($\$20,000/.80=\$25,000$)

3. Competitive negotiation

Competitive negotiation may be used to award a contract when it is determined that competitive sealed bidding is not practicable. The complex nature or technical details of a proposed project may prohibit development of bid specifications. For example, a contract with a legal firm to defend an agency in a court case would not allow the specifics necessary for firms to bid specific amounts. Law firms could, however, detail their experiences in similar cases and present their technical qualifications. Once the most capable firm is identified, a mutually acceptable rate could be negotiated. Other contracts, as specifically determined by the Secretary of the Finance and Administration Cabinet, may be issued through the competitive negotiation process also. This is the same process used for most personal service contracts.

Competitive negotiation follows the request for proposal process described earlier. Agencies issue the RFP and review responses based upon criteria set forth in the RFP document. After

determining the best response, the agency may enter negotiations with that respondent. If they fail to reach a mutually acceptable price, they may withdraw and begin negotiations with the next most favorable respondent.

4. Noncompetitive negotiation

A contract may be made by noncompetitive negotiation only for sole source purchases or when competition is not feasible. Sole source is a situation in which there is only one known, capable supplier of a commodity or service, occasioned by the unique nature of the requirement, the supplier, or market conditions. Examples of instances where competitive bids may not be required include public utility services, services where rates are fixed by law or ordinance, visiting speakers, professors, expert witnesses, and performing artists. Personal service contracts may be issued as a sole source contract, as noted earlier, if they are approved in writing by the Secretary of the Finance and Administration Cabinet.

CHAPTER 2

THE CONTRACTING SYSTEM

Fiscal Year 2000 was a period of major transition to a new accounting system (MARS).

Fiscal Year 2000 was a period of major transition to a new state accounting system—the Management Administrative Reporting System (MARS). As part of the Governor’s EMPOWER Kentucky initiative, MARS was deployed in July 1999 to streamline and reduce the cost of the Commonwealth’s administrative processes. MARS was intended to integrate the financial management, procurement, budgeting, and reporting functions of state government. As of the end of June 2000, MARS acquisition costs totaled \$32.9 million. This figure does not include the cost of the extensive training required to instruct state employees in the use of MARS.

MARS provides a centralized database of contracts; but implementation problems limit its usefulness.

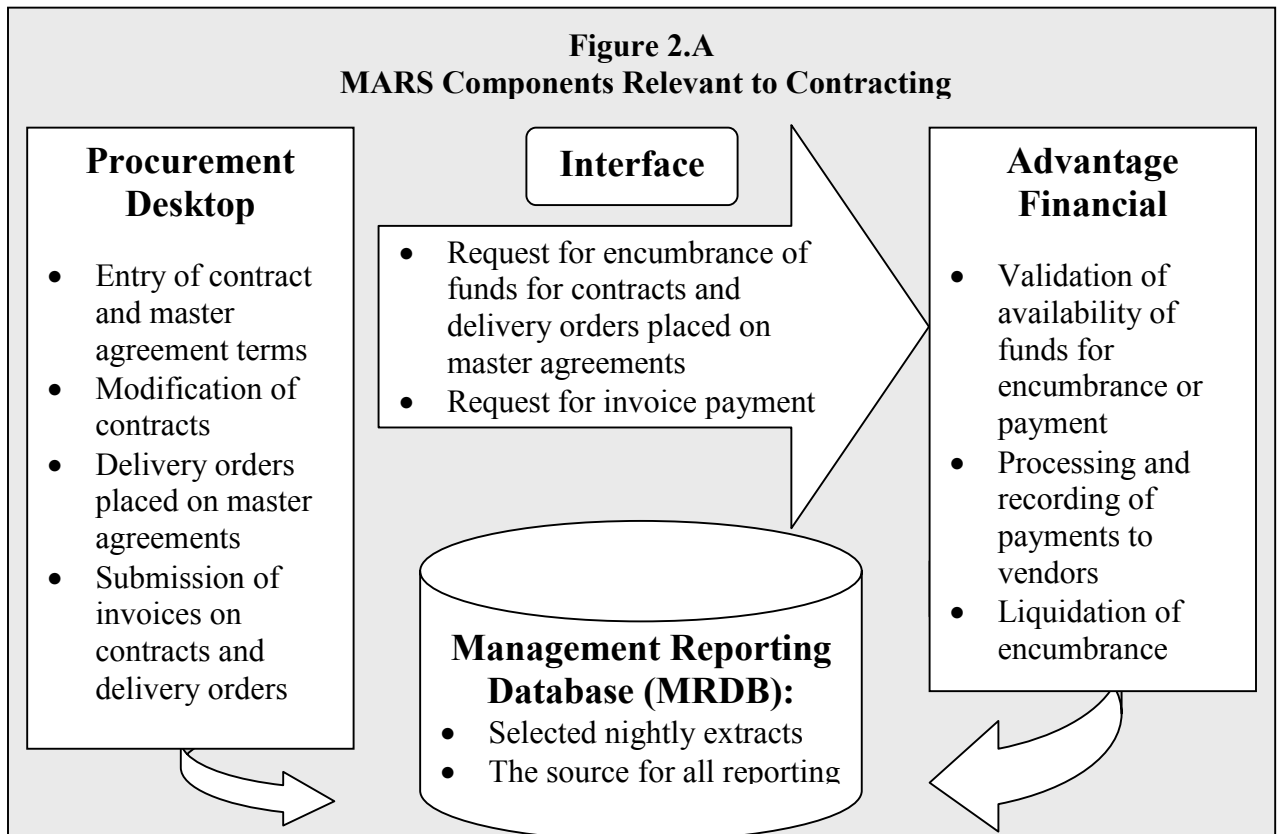
The transition to MARS during the time period of this study had a major impact on the analysis of the state’s contracting practices. The new system provided a central repository of all contracts which could be extracted and summarized. Difficulties with the implementation of MARS, however, particularly the interface between the contracting and financial components, negatively affected staff’s ability to get complete payment information for contracts. A system audit was not within the scope of this study, but significant issues, such as the following, merit discussion.

- Agencies can pay contract vendors using methods that do not tie the paid amount back to the contract. This means there is no reliable way to ensure that contracts do not have payments greater than the not-to-exceed amount approved by the Finance Cabinet and the Government Contract Review Committee.
- Because of this limitation, it was impossible to calculate a total amount paid on all service contracts. Payments that were traceable to contracts totaled nearly \$350 million in FY 2000, for an average of \$125,000 per contract with traceable expenditures. Over three-fourths of the traceable contract amount was issued by the Finance and Administration, Transportation, and Health Services cabinets.
- Two years after initial implementation, the new practices and terminology related to MARS have not been formally added to either the statutes, administrative regulations, or Finance’s policies and procedures. This has led to confusion about how to correctly enter contract information into the system.

- Because of early MARS implementation problems, many agencies had difficulty entering contract data as taught in initial training classes. Also, procurement reporting has not been fully implemented. In response, agencies adopted their own procedures and developed stand-alone systems, such as spreadsheets (or even paper and pencil) to track contract expenditures. Continued use of these inconsistent procedures and dual systems frustrates agency personnel, undermines the accuracy and usefulness of the data contained in MARS, and limits the efficiency gains that were the system's goal.
- Some agreements that should have been classified as personal service contracts with private entities (PSCs) were misclassified as memoranda of agreement with public entities (MOAs). This is a critical error because the Government Contract Review Committee has a lower reporting threshold for PSCs (\$10,000 or more) than for MOAs (\$50,000 or more). There was no evidence that contracts were misclassified to deliberately circumvent the lower reporting threshold for PSCs.
- The MARS system does not currently meet the data needs of the Government Contract Review Committee. Contract data is provided to the Committee as a text document that cannot be converted to a database which can be easily searched and analyzed. Also, the proof of necessity form required by statute for the Committee's review has not been incorporated in MARS in a manner that would allow Committee staff to compile and analyze the information in a systematic way.

MARS

Figure 2.A provides a simplified view of the components of MARS that are relevant to contracting, followed by an explanation of key terminology.



MARS Terminology

Procurement Desktop: The software component of MARS that provides for entering contracts, ordering services, and requesting invoices.

Advantage Financial: The software component of MARS that handles financial accounting processes, including tracking fund availability and processing and recording payments.

Interface: For these purposes, the interface is a process that transfers relevant information between Procurement Desktop and Advantage Financial.

Encumbrance: An entry in the financial system that reserves funds for a particular use. It is used as a means to ensure that an agency does not obligate more funds than it has available.

Liquidation of Encumbrance: An automated entry that reduces an encumbered amount when the actual expenditure occurs.

Contract/Award: A contract/award is used to record the terms and conditions of an agreement with a vendor and to reserve (encumber) funds for the value of the agreement. This type of document is established to purchase a specific quantity or amount at a specific price for delivery at a specific time(s).

Master Agreement: The master agreement records the terms of the agreement but does not reserve (encumber) funds. This type of document is intended to replace various price contracts. A master agreement must be used to establish price agreements with vendors for supplying specific items at specified unit prices at any time during an agreed time period, typically one year, with renewal options. A master agreement is used for placing multiple orders or for making multiple payments for an ongoing need. This document is not to be used for one-time purchases.

Delivery Order: A specific order against a master agreement. It behaves like a contract/award in that it will reserve (encumber) funds in the financial system.

Management Reporting Database (MRDB): A data warehouse that is updated nightly from the “live” financial system. MRDB is the source for agency financial reports.

Procurement Desktop, Advantage Financial, and the Management Reporting Database (MRDB) are the three MARS components relevant to contracting.

Procurement Desktop, Advantage Financial, and the Management Reporting Database (MRDB) are the three MARS components relevant to state contracting (Figure 2.A). Procurement Desktop is the software component that is to be used for entering contracts, ordering services, and requesting invoices. Information related to encumbering funds and paying invoices passes through an interface to Advantage Financial, which validates, processes, and records payments. Finally, select information from both components is extracted nightly and stored in the Management Reporting Database, which is the source for agency reports. The relative size of the arrows in Figure 2.A illustrates that the bulk of MRDB tables are built from Advantage Financial information.

Database tables that comprise MRDB are works-in-process. Throughout FY 2000, the focus was on building financial expenditure data to meet agencies' basic financial reporting needs and to ultimately provide the basis of the Kentucky Comprehensive Annual Financial Report. As the extract tables grew in size, the performance of the system lagged, and resources were committed to improve performance through hardware upgrades and extensive database indexing.

MRDB has been limited in its ability to provide procurement data for reporting purposes.

Procurement Desktop data has been slowly incorporated into MRDB because of the focus on Advantage Financial data to meet basic financial reporting needs. In addition, the internal database structure of Procurement Desktop has made nightly extracts into MRDB difficult to manage. The details of this problem were beyond the scope of work performed for this report; however, it has limited the amount of reportable procurement data within MRDB.

Some Payments Are Not Traceable to Contracts

Stand-alone invoices that do not tie back to specific contracts have been used.

In an attempt to provide the basic information regarding how much Executive Branch agencies spend on service contracts, staff obtained an extract of all payments that could be traced to specific contracts. The extract was obtained from the Office of Technical Services in the Finance and Administration Cabinet and covered the period from July 1, 1999, through December 31, 2000.

It was determined that it is not possible to calculate total expenditures on the contracts because agencies can pay vendors using methods that do not link the paid amount to a particular contract.

Agencies have been directed to use stand-alone invoices to pay on contracts in certain circumstances.

MRDB expenditure tables extracted from Advantage Financial can be used to report contract-specific expenditures only on invoices that have a reference number that ties back to the contract number or delivery order number (for master agreements). However, at times the system requires the use of stand-alone invoices that do not reference the contract in the Advantage Financial tables. In addition, vendor payment vouchers, which are payments made directly from Advantage Financial, cannot be linked to specific contracts. (More detailed discussion of the nature of untraceable contract payments can be found in the Appendix A.)

There is no reliable way to ensure that total contract payments stay within the not-to-exceed amount.

The inability to link all payments to a contractor to a specific contract is a serious matter, because it means there is no reliable way to ensure that the total payments made on the contract stay within the approved not-to-exceed amount. The not-to-exceed amount is the universal figure of review during the various stages of contract approval. As its name implies, it is the maximum figure that has been approved for expenditure on the contract. Once approved, contract-specific expenditures are not scrutinized at a central administrative point such as Finance or the Government Contract Review Committee. Given the lack of continued centralized, contract-specific oversight, it is imperative that the system has controls in place to ensure that contract expenditures remain within the not-to-exceed amount.

Conclusion

Given the issues regarding payments that cannot be traced to contracts, staff could not definitively calculate the amount of payments made on contracts for services. This undermines the enforceability of the “not to exceed” amount that is approved by Finance and the Government Contract Review Committee.

Recommendation 2.1

A system modification should be made to eliminate or minimize the use of contract payments that do not tie back to specific contracts. While stand-alone invoices are a necessary part of the payment system, they should not be necessary to make contract payments.

Expenditures on Service Contracts

The use of stand-alone invoices precludes the ability to definitively calculate the total amount spent on service contracts.

The following tables summarize FY 2000 payments that are traceable in the reporting system by type (Table 2.1) and by cabinet (Table 2.2).

As shown in Table 2.1, personal service, construction, price, and catalog master agreement contracts have the most traceable expenditures. Architectural/engineering contracts issued by Transportation are broken out separately because their average traceable amount (for nine contracts) is significantly higher than those issued by Finance (for eighty-seven contracts). The average values for the top five contract types are skewed somewhat higher due to each category having a few contracts with very high traceable expenditure amounts.

As indicated in Table 2.2, the Finance and Transportation cabinets have significantly more traceable expenditures on contracts than the other cabinets, representing forty and twenty-five percent of total traceable expenditure, respectively.

Table 2.1
Traceable* FY 2000 Expenditures on Contracts for Services
by Award Type

<u>Type of Award</u>	<u>Expenditures</u>	<u>Percent</u>	<u>Average per Contract</u>
Personal Service	\$ 152,208,018	44%	\$100,867
Construction	\$ 100,309,164	29%	\$229,016
Price	\$ 51,137,015	15%	\$134,571
Catalog Master Agreement	\$ 36,065,248	10%	\$238,843
Architectural/Engineering (Transportation)	\$ 5,447,559	2%	\$605,284
Special Authority	\$ 2,230,297	1%	\$ 18,901
Architectural/Engineering (Finance)	\$ 1,322,073	0%	\$ 15,373
DOT	\$ 233,439	0%	\$ 2,683
TOTAL	\$ 348,952,813	100%	\$125,613

Average per contract is for contracts with traceable expenditures. Average values are skewed higher due to a few contracts with very large expenditures.

** Not all expenditures on awards can be traced to the award; refer to text for details.*

Table 2.2
Traceable* FY 2000 Expenditures on Contracts for Services
by Cabinet

<u>Cabinet</u>	<u>Expenditures</u>	<u>Percent</u>	<u>Average per Contract</u>
Finance and Administration	\$ 138,815,183	40%	\$184,350
Transportation	\$ 86,320,721	25%	\$121,067
Health Services	\$ 41,387,264	12%	\$222,512
Families and Children	\$ 30,205,801	9%	\$103,800
Education, Arts, and Humanities	\$ 16,144,267	5%	\$104,833
Corrections	\$ 8,212,780	2%	\$119,026
Natural Resources	\$ 5,358,414	2%	\$ 75,471
General Government	\$ 4,997,625	1%	\$ 28,558
Tourism Development	\$ 4,710,519	1%	\$ 44,862
Public Protection and Regulation	\$ 3,828,139	1%	\$ 42,535
Statewide Buying Entity **	\$ 2,499,433	1%	\$357,062
Justice	\$ 2,415,300	1%	\$ 33,086
Economic Development	\$ 1,817,859	1%	\$121,191
Personnel	\$ 1,023,633	0%	\$113,737
Revenue	\$ 525,233	0%	\$ 30,896
Labor	\$ 398,165	0%	\$ 17,312
Workforce Development	\$ 292,477	0%	\$ 10,832
Postsecondary Education	\$ -	0%	\$ -
TOTAL	\$ 348,952,813	100%	\$125,613

Average per contract is for contracts with traceable expenditures. Average values are skewed higher due to a few contracts with very large expenditures.

** Not all expenditures on awards can be traced to the award; refer to text for details.*

*** Statewide buying entity represents contracts that are not specific to a single cabinet.*

Absence of Statutes and Administrative Regulations Related to MARS

Failure to standardize terms and practices has led to confusion and mistakes.

The new practices and terminology related to MARS have not been formally added to either KRS or KAR citations, and the processes described in the various regulations do not always agree. Required changes have also not been incorporated into Finance and Administration's policies and procedures. As a result, many agencies have experienced confusion, leading to errors in the classification of contracts.

Currently, there are twenty-seven different sub-types of contracts to select from in the MARS system. In the first two years of Procurement Desktop, there have been thirty-six different sub types, with new ones added and old ones deleted over time. Definitions for these different sub-types have been published informally in the Finance and Administration Cabinet's administrative services updates. The first list was issued in May 2000 at the request of the Mars Users Group. A subsequent revision was issued in October 2000.

These definitions have not been added to the Cabinet's policies and procedures manual, nor have they been promulgated into administrative regulation or enacted into statute. In fact, none of the definitions or procedural changes that occurred when MARS was deployed in July 1999 have been incorporated into statute or administrative regulation.

The definition of what constitutes a professional service is not always clear.

One particular area of confusion relates to which services are classified as professional, and therefore should be classified as personal service contracts subject to review by the Government Contract Review Committee. Some services such as medical and legal are clearly professional; others such as janitorial can clearly be categorized as non-professional. A number of services cannot be categorized as clearly.

For example, many people would consider information technology services such as computer programming as professional. Finance and Administration generally classifies skills that do not require a certificate or degree as non-professional. Thus, contracts for information technology services are often issued as price contracts or catalog master agreements that are not subject to review by the Government Contract Review Committee.

Conclusion

The absence of precise, clear, and consistent definitions and procedures has left agency personnel confused about the correct way to submit contract information.

Recommendation 2.2

The Finance and Administration Cabinet should recommend statutory language that legally implements the main features of the MARS system. The Cabinet should then promulgate administrative regulations that are consistent with the adopted statutes and implement those with a more detailed set of procedure directives.

Recommendation 2.3

The criteria used to designate a service as professional should be determined by the Finance and Administration Cabinet, in cooperation with the Government Contract Review Committee. These criteria should then be used to develop a formalized list of professional services that is distributed to agency contracting personnel.

Inconsistent Procedures and Systems Are Common

Implementation problems have led to the use of inconsistent procedures.

Because of early MARS implementation problems, many agencies had difficulty entering contract data correctly. Faced with a system that did not initially perform as intended, agency personnel found work-around solutions that would allow them to get what they needed from the system, even if the procedures used were incorrect. This was one of the reasons they began to use stand-alone invoices to pay contractors.

Agencies rely on non-standard in-house contract tracking systems.

MARS does not have the ability to generate accurate procurement reports, so agencies have been maintaining their own in-house contract tracking systems. These systems are used as a means to track payments to guard against over-payments and can range from a simple paper and pencil log book to a sophisticated computer program. (See gray box for an example.) When Program Review staff requested contract payment history information from the agencies, staff observed almost exclusive use of in-house systems, as opposed to MARS, to track how much had been paid on a given contract.

In-house tracking systems undermine the efficiency potential of MARS

A major problem with these in-house tracking systems is that they are not uniform or centralized. They cannot be used by either the Finance and Administration Cabinet or the Government Contract Review Committee to directly obtain information on a specific contract or evaluate the status of the system as a whole. They also undermine the efficiency gains that were the goal of MARS.

Problems with encumbrances and potential overpayments provide additional incentive to maintain in-house tracking systems.

Problems with encumbrances and overpayments have weakened agencies' trust in the system, providing further incentive to maintain their own in-house systems:

- One agency said it had contracts where encumbrances were exceeded by \$100,000, but had since corrected the error. Agency staff said that controls in PD do not work. If an overpayment was attempted in the first payment, it would be rejected; but overpayments made in subsequent payments are not rejected. This causes additional work for the agency and, if not detected, can result in overpayment of the contract's not-to-exceed amount.
- When paying a vendor's invoice in Procurement Desktop, agency staff can check a field denoted "final payment." At that point, the remaining encumbrance is liquidated. If the field was checked in error and the payment is not the final payment, future payments must then be made through a stand-alone invoice. The Finance Cabinet sets the policy for making "final payments" on a contract through PD. Encumbrances that are liquidated in error result in additional work for several employees.

Conclusion

Because of early MARS implementation problems, many agencies had difficulty entering contract data correctly. Correct means of paying on contracts as covered in initial training classes were not fully functional. Also, procurement reporting has not been fully implemented. In response, agencies have adopted their own procedures and developed stand-alone systems, such as spreadsheets (or even paper and pencil) to track contract expenditures. Continued use of these inconsistent procedures and dual systems causes much frustration for agency personnel, undermines the accuracy and usefulness of the data contained in MARS, and limits the efficiency gains that were the system's goal.

Recommendation 2.4

Once procurement reporting capabilities are in place, and the need for stand-alone invoices on contracts has been removed, the Finance and Administration Cabinet should develop clear and consistent policies and procedures and train staff in their use.

Memoranda of Agreement

425 memoranda of agreement that appeared to be with private entities were selected for review.

This study was limited to a review of service contracts with private entities. KRS 45A.690 requires agreements between the Commonwealth and governmental, or quasi-governmental, entities to be classified as memoranda of agreement (MOAs). The distinction between MOAs and private service contracts is important because the Government Contract Review Committee reviews MOAs with amounts of \$50,000 or more, while the threshold for personal service contracts is only \$10,000. Because of this difference, MOAs were evaluated to determine if agencies were incorrectly classifying contracts with private entities as MOAs to avoid the Committee's review process.

A review of MARS vendor descriptions for all MOAs yielded 425 that appeared questionable based on the name of the vendor and description of the agreement. Agency staff were interviewed regarding these agreements. Staff called the Cabinet for Finance and Administration for clarifications of some classification categories. Appropriate statutes, regulations, and policies were used to assist in the review and interview process.

Over half the reviewed MOAs were incorrectly classified.

Of the MOAs reviewed, 231—over half—were classified incorrectly. Thirty-three should have been classified as personal service contracts. The remaining 198 were for services that should have been classified as fixed price, architectural/engineering contracts, delivery orders, and contracts for small purchases and services.

There is no evidence of deliberate misclassification to circumvent the Government Contract Review Committee's threshold amounts.

There was no evidence that agencies are deliberately using the incorrect contract classification to avoid review of the contracts by the Government Contract Review Committee. Only eight of the 33 personal service contracts noted above were for amounts over \$10,000 but under \$50,000, the difference between thresholds for review. For example, three contracts with the Kentucky Coal Association were processed as MOAs. Because the association is a nonprofit 501(c)6 with members of private industries, these contracts should have been processed as personal service contracts.

Two of the remaining five contracts between \$10,000 and \$50,000 initially went through the Committee's review. A modification for one of the contracts was to add additional services that increased the dollar amount and was processed as an MOA. The other contract modification was to change a project code without a monetary increase and was classified as an MOA. The other three contracts appear to have been simply classified in error. The agency had other contracts to the same vendors classified correctly.

Agency staff gave numerous reasons why contracts were incorrectly classified. Many said that they are still confused about the appropriate classification of some contracts. Summaries of comments of agency personnel are contained in the gray box below. These comments are instructive not only in regard to proper classification of MOAs, but as a reflection of the overall confusion regarding MARS discussed above.

Investigation of MOAs confirms the conclusion offered above that there remains considerable confusion about Procurement Desktop and how contracts should be entered in MARS. Specific examples of this confusion are offered in the gray box.

- Some said the requirements for the way they determined sub-types for contracts has changed many times since the initial implementation of MARS and Procurement Desktop; thus, they stay confused.
- Some agency personnel claimed that they still do not know how some contracts should be sub-typed. (Staff from many agencies spent time researching, calling the Finance Cabinet, and getting back with Program Review staff.)
- Others said they know how the contract should be classified; but accidentally entered the wrong sub-type.
- Some realized that contracts were coded incorrectly and that they would be more careful next time.

Definitions in the statutes and policies and procedures regarding MOAs are often vague or in conflict. An example is KRS 45A.690, which says that the definition of memorandum of agreement does not apply to agreements between state agencies and rural concentrated employment programs. However, BO-111-44-00 says a memorandum of agreement may be used when the agreement or

contract is between a state agency and rural concentrated employment programs.

Another example, pointed out by agency staff, is the definition of an MOU in 200 KAR 5:025 that is not addressed elsewhere. The administrative regulation identifies an MOU as a contract or agreement used whenever there is a joint project or undertaking by any state agency and another entity or entities, either government or private, but this category is not addressed in Finance's policies and procedures.

Conclusion

Without additional clarification, there will be continuing errors and misclassifications of contracts because of the different interpretations of statutes, administrative regulations, and policies and procedures. Such errors could lead to exclusion of some contracts that should be reviewed by the Government Contract Review Committee.

Recommendation 2.5

The General Assembly should consider revising the definitions for KRS 45A.690 to 45A.725 relating to memoranda of agreement to clarify any misunderstanding of what constitutes appropriate use of the contract type. The Finance and Administration Cabinet should establish policies and procedures that reflect the intent of the statutes relating to memoranda of agreement.

System Does Not Meet Information Needs of Government Contract Review Committee

The Government Contract Review Committee receives information in a form that does not facilitate analysis.

Prior to MARS, Government Contract Review Committee staff had access to a database of the MOAs and personal service contracts subject to Committee review. This database allowed Committee staff to quickly call up specific contracts and to report summary information. With Procurement Desktop, contracts subject to review are routed to a Government Contract Review Committee staff "in-box" that stores documents until they are approved by the Committee.

Government Contract Review Committee staff have worked with Finance information systems staff to extract the contents of their "in-box" into Microsoft Word documents that are in the standard format with which the Committee is familiar. The contents of these documents are then cleaned or edited by staff prior to printing for

inclusion in Committee members' folders. The approach of extracting directly to Microsoft Word documents, as opposed to a database, limits the ability of staff to do on-going review and summary analyses of the contracts that come through the Committee.

PON forms have not been well integrated into MARS.

As noted in Chapter 1, a proof of necessity (PON) form is required on all personal service contracts and memoranda of agreement. The PON is meant as a tool to aid the Committee in evaluating the necessity of a contract. KRS 45A.695 specifies information that must be contained in the PON.

For the first two years of MARS, the incorporation of PON forms in Procurement Desktop was limited to attached documents as opposed to integrated data fields. The use of attached documents was a much simpler approach but it fell short of fulfilling the potential for the new system to provide data for compilation and summary analysis.

A new release of Procurement Desktop (mid-August 2001) incorporates PON information within the software. The storage of PON information in data fields should improve the ability to compile information in the future. However, subsequent to the system change, PONs now print with incomplete content and poor formatting. Committee staff continue to work with Finance on this issue.

Conclusion

The MARS system does not currently meet the data needs of the Government Contract Review Committee. Contract data is provided to the Committee as a text document that cannot be converted to a database that can be easily searched and analyzed. Also, the proof of necessity form required by statute for the Committee's review has not been incorporated in MARS in a manner that would allow Committee staff to compile and analyze the information in a systematic way.

Recommendation 2.6

Government Contract Review Committee staff should work with the Finance and Administration Cabinet to have their Procurement Desktop inbox extracted to a database to facilitate summary analysis. Information from the Proof of Necessity form should also be retrievable in database format.

CHAPTER 3

CONTRACTING FOR SERVICES AND STATE EMPLOYMENT

Agency managers cite limits imposed in the state personnel system as a major reason for issuing service contracts.

It is impossible to fully understand contracting for services in the Executive Branch without also considering the state personnel system. Each is affected by the other. The most frequent reason given by agency managers for obtaining services from private vendors is that caps on salary and the hiring of personnel limit the use of regular state employees to provide those services. Voicing a different perspective, the Executive Director of the Kentucky Association of State Employees stated that the steady increase in the share of state financial resources devoted to private service contracting, from 9.4 percent of personnel costs in 1993 to 17 percent in 2000, threatens the long-term job security of regular employees and demoralizes them.

This chapter discusses the relationship between contracting and the personnel system.

This chapter presents information on the relationship between contracting for services and the state personnel system. The major conclusions regarding this issue are as follows.

- Increasing reliance on private service contractors is unlikely to abate without significant changes to the merit system and revisions to state hiring and salary caps, although these limits do not appear to be as severe as agency managers indicate.
- At the average FY 2000 state employee compensation of \$40,582 (salary + benefits), an additional 8,600 regular state employees could have been hired with the \$349 million spent on service contracts. This represents approximately twenty percent of actual Executive Branch positions as of June 2000.
- Evidence presented in Chapter 4 indicates that service contracts are often issued without adequate documentation of the need for the external contract and that half of service contractors learn of contracting opportunities directly from state agencies. This raises a legitimate question of whether the procedures for service contracting can be used to circumvent the merit system and the protections against influence it was intended to embody.
- The absence of consistent guidelines for agencies in structuring service contracts blurs the line between who is a contractor and who is an employee. This has led to inconsistencies in the types

of benefits, such as travel and retirement contributions, that are paid to various contractors.

- The absence of consistent guidelines has also created a potential liability for some agencies that have treated contractors as common-law employees, raising a legitimate question of whether they are eligible for employee benefits such as workers' compensation coverage and membership in the Kentucky Employees Retirement System.
- Although there are many anecdotes about a large number of state retirees returning to work, either as regular employees or as contractors, such individuals apparently comprise a tiny share of the state workforce. Those who could be identified in the system totaled less than one percent of state employees. While data limitations precluded identification of all retirees working on contract, it is unlikely that state retirees account for a significant share of regular or contract employment.

State Personnel System and Contracting for Services

There are three aspects of the state personnel system that may cause state agencies to seek service contracts: the merit system, the statutory hiring limitation, and the constitutional cap on state salaries. Each of these is discussed below in the context of contracting for services.

Merit System

The general purpose of KRS 18A .005 to 18A.200 is to establish a system of personnel administration for Kentucky, based on merit principles and objective criteria in the recruitment, examination, appointment, promotion, transfer, lay-off, removal, discipline, and welfare of classified employees and others employed by the state. The General Assembly enacted this legislation "...in order to improve the morale and motivation of state employees and to gain the maximum utilization of human resources in order to provide better service to the citizens of this Commonwealth."¹

**KRS Chapter 18A
establishes a state merit
system.**

**The merit system is to
ensure that the methods
used for selecting the
workforce will result in
competent workers that
serve the best interest of
the Commonwealth.**

The merit system is meant to ensure that the process used for selecting and maintaining the state workforce will result not only in an able labor pool, but will also create an opportunity for individuals to work for the Commonwealth if they are qualified. Once hired, employees of the merit system are protected against

¹ KRS 18A.010(1).

arbitrary action, favoritism, coercion for political purposes, and whistleblowing reprisal. Similar pay for similar work is also an attribute of the merit system and is achieved in the Commonwealth by the pay grade system.²

The Personnel Cabinet is the administrative body responsible for carrying out the provisions of KRS Chapter 18A. The Personnel Board, created in KRS 18A.045, is charged to promulgate administration regulations, make investigations, hear appeals, promote understanding of the merit principles in government service, present budget requests, and represent the public interest in the improvement of personnel administration in the state service.³ This board oversees the grievance and disciplinary concerns of the personnel system and is the guardian of the merit principles established by the General Assembly.

The nature of the merit system limits flexibility in hiring and in firing.

The traditional protections afforded in the merit system, however, tend to create an inflexible system when an agency needs to fill a position quickly or when a manager wishes to replace a worker whose performance is inadequate. Thus, it may take a long time to hire someone and to get that individual into the system, or replace a worker who cannot or will not produce a quality work product in a timely manner.

There is concern that a lack of advertising of service contract opportunities may undermine merit system principles.

While agency managers may feel constrained by the merit system, the director of a Kentucky state employee association stated that a major area of concern for employees regarding extensive contracting for services was that, over the long term, the integrity of the merit system would be undercut. He stated that the merit system was created so that “people were hired based upon what they knew, not who they knew.”⁴ Given that around half of recent state service contractors reported learning of contracting opportunities from being contacted directly by agency personnel rather than through a process of open advertising, this concern may be legitimate. (See Chapter 4 for a full discussion of the survey of contractors.)

State Hiring Limitation

The total number of Executive Branch employees is limited.

A frequent reason given by agency managers for contracting for services is that they do not have adequate staff to complete needed tasks. The General Assembly statutorily limited the total number of

² KRS 18A.030; 18A.110; 18A.165; 18A.155; 101 KAR 2:034; and 101 KAR 3:045.

³ KRS 18A.075.

⁴ Telephone conversation with the Executive Director of the Kentucky Association of State Employees. August 23, 2001.

permanent full-time employees in the agencies of the Executive Branch to 33,000.⁵ However, for many years the General Assembly has included language in the budget bill that authorized the Executive Branch to establish a different cap. The budget bill language takes precedence over the statutory cap.

Table 3.1 shows the positions budgeted for FY 2000 – 2002. Although actual total positions in July 2000 were virtually equal to budgeted total positions, just over ten percent of those were vacant. While this is a snapshot, so that the vacancy rate may be lower at other times, there seems to be flexibility for agencies who have a critical need to obtain additional positions. The Governor’s Office of Policy and Management (GOPM) allocates the total positions among agencies and agencies can request additional positions from GOPM.

Table 3.1
Budgeted Positions FY 2000 - 2002
and Actual Postions as of July 2000

Cabinet	Budgeted Positions	Actual Employment July 2000		
		Filled	Vacant	Total
30 Revenue	1,176	1,087	58	1,145
31 General Government	4,737	4,014	571	4,585
32 Justice	7,596	6,716	653	7,369
33 Education, Arts, and Humanities	1,459	1,276	163	1,439
34 Natural Resources	1,850	1,614	121	1,735
35 Transportation	6,765	6,263	1,083	7,346
36 Economic Development	176	155	21	176
37 Public Protection and Regulation	1,983	1,399	142	1,541
39 Finance and Administration	838	918	178	1,096
43 Tourism	3,968	3,792	281	4,073
44 Labor	576	479	93	572
46 Workforce Development	2,687	2,417	208	2,625
47 Personnel	222	189	34	223
48 Families and Children	6,214	5,868	744	6,612
49 Health Services	4,069	3,311	618	3,929
	44,316	39,498	4,968	44,466

Source: Budgeted positions from the 2000-2002 Executive Budget in Brief, actual employment from the Master Position List database.

Documentation of a lack of available employees is often missing in contract justifications.

When the duties and responsibilities of agencies expand through the enactment of state or federally mandated programs, the personnel needs of the agencies also expand. To meet deadlines, to

⁵ KRS 18A.010(2). Note: This limitation does not apply to employees of the General Assembly, the Legislative Research Commission, the Kentucky Higher Education Assistance Authority, the Kentucky Higher Education Student Loan Corporation, or the Court of Justice.

ensure quality, and to have an adequate number of individuals to do required work, agencies, through the processes established in KRS Chapter 45A, may meet their needs by contracting with persons outside of the state personnel system. However, before they contract with private entities for services, agency managers should document that regular state employees are not available to perform the service. This recommendation is based on both the best practices literature and on requirements imposed by the Government Contract Review Committee. As will be discussed more fully in Chapter 4, thorough documentation of the absence of available state employees is often lacking in contract justifications, including the Proof of Necessity form required by the Committee.

The number of people working for the Commonwealth on contract is not available.

In comparing regular state employment with contracting for services, one basic question is how many full-time equivalent employees are working for the Commonwealth under contract. Unfortunately, the number of people performing work for the Commonwealth under contract is not available from the procurement system. The selected population of service contracts included 839 contracts that were clearly with individuals. The remaining contracts appeared to be with companies that could have numerous people performing work under the contract. Any given contract may represent work that varies from a very short duration, such as one week, to work that extends for the entire year or beyond. Therefore, two different contracts with individuals may represent two very different numbers of hours worked.

Given these limitations, it is not possible to state definitively how many people work for the Commonwealth under contract. A different type of assessment was developed using the service contract expenditure figures outlined in Chapter 2.

At the average state employee compensation, 8,600 additional employees could be hired with the \$349 million spent on service contracts.

In Fiscal Year 2000, \$349 million in expenditures could be traced to service contracts. In that same year the average state employee total compensation (salary + benefits) was \$40,582. If the dollars spent on service contracts (\$349 million) were spent on employee salaries instead, then the Commonwealth could have hired approximately 8,600 additional employees, at the average state salary. This is equivalent to nearly twenty percent of the budgeted positions in FY 2000.

There are two additional points to be made. First, the common justification given for contracting by agency managers—that they cannot obtain adequate staff—is less compelling given the significant number of vacancies that GOPM can reallocate if they are requested to do so. Second, when the Executive Branch

develops a recommendation to the General Assembly for the total number of positions, and allocates those positions among agencies, it is in effect making a policy decision about the proportion of work for state government that will be conducted by regular employees and the proportion that will be conducted by service contractors.

State Salary Cap

The constitutional salary cap in state government sometimes prevents agency managers from hiring highly skilled and technical experts.

The expertise needed in many areas of state government may not be available through the state workforce. The Commonwealth does not compete for employees in a vacuum. Rather, it must compete for employees in a state labor market that has recently exhibited the lowest unemployment rate in decades. For some occupations, such as technical, medical, legal, engineering, architectural, and financial occupations, the Commonwealth must compete in a tight national labor market where competitive salaries may exceed the state salary cap. The constitutional salary cap may limit the ability of agency managers to hire individuals in these occupations as regular employees.⁶ According to the Personnel Cabinet, the current salary cap is \$121,018 (salary plus taxable benefits). Agency managers say the salary cap, coupled with the state pay grade schedule, reduces their ability to hire highly trained individuals to perform certain specialized tasks. They give this as a reason to meet their needs through contracts with service providers outside the personnel system.

The state pay grade is not substantially lower than the statewide average salary for several occupations that occur frequently in service contracts.

While it is true that the salary schedule may limit the ability of agency managers to hire a technical employee in a specific instance, it is unlikely that this explanation is true for the majority of service contracts. The left side of Table 3.2 displays the median annual salary for selected technical occupations paid by all employers in Kentucky. The right side shows the midpoint of the Commonwealth's pay grade for similar state employee classifications. Although they are generally lower, the midpoint pay grades for state employee classifications for these particular occupations are often not substantially below those found in Kentucky as a whole. Note that this comparison does not include a comparison of benefits, which could change the relative differences.

⁶ Kentucky Constitution, Section 246. The limitation on salaries of public officers does not apply to salaries of subordinate employees. *Pardue v. Miller*, 306 Ky. 110, 206 S.W.2d 75 (1947) and *Board of Education v. De Weese*, 343 S.W.2d 598 (Ky. Ct. App. 1960).

Table 3.2

**Comparison of Kentucky Median Annual Salaries for Selected Occupations
 and Commonwealth Pay Grade Classifications for Similar Occupations**

1999 State Occupational Employment and Wage Estimates for Kentucky			Commonwealth of Kentucky Numerical Index and Pay Grades of Classifications			
Occupation	Number Employed in Kentucky	Median Annual Salary	Title Code	Class Title	Pay Grade	Annual Midpoint Wage
Pharmacists	4,180	67,163	4032	Pharmacist II	17	53,580
Registered Nurses	34,600	38,230	4321	Registered Nurse	13	36,775
Civil Engineers	1,820	51,418	7037	Engineer II	16	48,711
Architects	420	47,590	7073	Project Architect	16	48,711
Computer Systems Analysts	2,930	51,230	7367	Systems Analyst III	15	44,283
Network Systems and Data Communications Analysts	830	40,893	7387	Network Analyst II	14	40,256
Actuaries	40	70,138	3535	Actuary	18	58,939
Substance Abuse and Behavioral Disorder Counselors	150	23,026	6211	Alcohol and Drug Rehabilitation Counselor	10	27,495
Medical & Public Health Social Workers	1,050	26,086	6220	Social Service Worker I	13	36,775
Lawyers	3,840	68,786	9825	Staff Attorney II	17	53,580
Paralegals & Legal Assistants	1,420	27,622	9857	Paralegal II	10	27,495
Claims Adjusters, Examiners, & Investigators	650	47,736	3552	Insurance Fraud Investigator III	14	40,256
Accountants & Auditors	6,650	36,108	9157	Auditor II	13	36,775

Source: 1999 State Occupational Employment Wage Estimates for Kentucky from the U.S. Bureau of Labor Statistics. Kentucky state government employment classifications and pay grades were obtained from the Personnel Cabinet web site on August 28, 2001.

Conclusion

Many agency managers justify the use of service contracts on the basis of state hiring and salary caps and the lack of flexibility they face in hiring and terminating employees because of merit system rules. However, evidence from the state labor market indicates that the Commonwealth's salary schedule is not substantially below the state average salary for several occupations that often appear in Executive Branch contracts. The Governor's Office of Policy and Management also has some flexibility in allocating total budgeted positions among agencies.

Recommendation 3.1

The Personnel Cabinet should work with the Finance and Administration Cabinet to determine the adjustments to be made to the state personnel system so that it better meets the needs of agency managers and reduces the pressure for them to obtain services through contracting. Recommendations on this issue should be submitted to the Government Contract Review Committee and the Interim Joint Committee on State Government prior to the 2004 General Assembly.

Conclusion

Responses from a survey of state contractors revealed that about half of them had learned of contracting opportunities only through direct contact with state agencies, rather than through some form of public advertising. This raises a concern that increasing use of contractors, as opposed to regular employees, to complete the work of state government could weaken certain protections offered by the merit system.

Recommendation 3.2

Agencies should be required to publicize the availability of service contracts more widely. The current system depends too heavily on direct contact between agency personnel and known contractors. Contractors and potential contractors for services should be as protected from favoritism as state employees are under the merit system.

Reemployment of Retired State Employees

State retirees can return to work for the Commonwealth in several ways.

One recurring topic of interest has been the extent to which Commonwealth retirees are returning to work. A retiree can return to work for the state as a regular employee, as an individual service contract vendor, or as the employee of a company providing services to state government. Program Review staff provided Kentucky Retirement Systems (KRS) officials with a list of all active state employees as of December 15, 2000, along with all vendors in the Procurement Desktop extract.

As of December 2000 there were 300 regular employees and 91 contract vendors who are state retirees.

KRS, in turn, matched the provided information with its listing of current retirees, and returned those matches to us. Three hundred active state employees were identified as re-employed Kentucky Employees Retirement System retirees. A memo describing this group of employees was prepared by Program Review and

Investigations Committee staff for the January 2001 meeting of the Government Contract Review Committee.

Most employees who had previously retired from a salaried position earned less than their previous high five-year average salary.

Forty-seven percent of the 300 retirees rehired as regular employees had retired in 1999 or 2000. Forty-eight percent of the rehired KRS retirees worked full-time, and thirty-eight percent worked less than one hundred hours per month. The group was about evenly split between hourly and salary pay types. There were seventy salaried rehires who had retired in 1999 or 2000. Seventy-six percent of these employees had salaries that were lower than their high five-year average salary at the time of retirement.

Alcoholic Beverage Control		
Type of Work: Technology liaison		
Contract Nos.,	C-00218563	\$40,000
Amounts:		
Review Issues: Reemployed Retiree		
<p>One person has worked on segments of Alcoholic Beverage Control computerization project, first as an employee, then as a contractor and then back again as an employee. ABC undertook the project in conjunction with the Governor's Office of Technology to link its licensing, legal and enforcement divisions electronically. The employee was a trainer for ABC before her retirement at the end of July 2000 after over thirty years of service, according to an agency spokesperson and contract documents. She was assigned to the project for over two years before her retirement and was "instrumental in articulating ABC's existing program and collecting and developing information for the new system" contract documents indicate.</p> <p>A month after retirement, she began contracting with ABC, serving as a liaison between the agency and GOT in helping set up the system. Among her duties was to advise the ABC board on the form and function of software, participate in communications between the agencies, advise and consult with software developers regarding the conversion to continuous licensing, be involved in testing, and communicate with ABC staff and technical staff.</p> <p>According to the ABC spokesperson, the employee-turned-contractor did not occupy an office at the agency during the time she was a contractor; but worked out of her home part of the time and came to the agency and GOT part of the time. Her contract ended on August 31, 2001, and she rejoined the state under a different job title than before, although she continued doing the same work.</p> <p>The ABC spokesperson said the employee/contractor is highly competent and has a wealth of knowledge about the agency's licensing operations. According to the spokesperson, it made good business sense to have the retiree under contract to assist in the complicated project. Even though her contract ended in August 2001, the contractor rejoined the ABC in June 2001. The spokesperson said they realized that the project they were undertaking was going to last longer than first believed.</p>		

Ninety-one state retirees currently hold service contracts.

In addition to the three hundred regular employees, there were ninety-one retired individuals who were providing services under contract. The following table provides a breakdown of these retirees by the cabinet with which they contracted.

Table 3.3
Number of KRS Retirees with Individual Contracts
By Cabinet

Cabinet	Number	Percent
Families and Children	33	36%
Transportation	15	16%
Health Services	12	13%
General Government	5	5%
Education, Arts, and Humanities	5	5%
Natural Resources	5	5%
Public Protection and Regulation	4	4%
Revenue	3	3%
Justice	3	3%
Finance and Administration	3	3%
Corrections	1	1%
Tourism	1	1%
Workforce Development	1	1%
Total	<u>91</u>	<u>100%</u>

The number of retirees working as employees of companies providing services to the Commonwealth is indeterminable.

It should be noted that this means of selecting retirees working under contract cannot identify individual proprietors who use a taxpayer ID as a vendor number. Also, this method cannot identify those who return to work as an employee of a company that provides services to the Commonwealth.

Conclusion

Without a central system that identifies all individuals performing contractual work for the state, it is not possible to completely enumerate the number of retirees who have returned as contract workers. Nevertheless, available evidence indicates that retirees of the Commonwealth comprise a very small percentage of the state's regular or contract workforce.

Contractors As Common-Law Employees

Agencies treat some contractors like common-law employees, but are often unaware of the possible consequences of doing so.

Agencies treat some independent contractors much like state employees. Often, the employing agency provides office space, furniture, materials, and staff assistance. They pay Social Security (FICA), workers' compensation, life insurance, health insurance, travel, dues and other fees, and in some cases, even make contributions to retirement systems. Interviews with agency managers revealed that many were unaware of either the criteria for determining who is a common-law employee or the financial liability they could incur through such a determination.

An issue of concern that has come to light during this study is the knowledge that some contractors may be considered employees when certain statutory and court established guidelines are followed. Such contractors are called “common-law” employees.

A common-law employee is one that meets certain IRS criteria regarding who controls the work situation — the contractor or the agency.

Some service contracts are renewed year after year. This recurring contract pattern, coupled with other factors, may require that a contractor be considered a common-law employee for specific purposes. There are instances where contractors work in a state office environment with state employees, use state office equipment and supplies, benefit from staff support services, have professional dues and training paid on their behalf, are compensated for travel, and receive state payroll checks. Despite the fact that these individuals have signed service contracts, in some respects they are considered “employees.”

Since Social Security is deducted and we are told what to do, are we not employees? If yes, why aren't we allowed to be in the retirement plan? I know the IRS auditors think we should be allowed to participate.
Comment received in survey of contractors.

Contractors who meet the criteria for common-law employee may put agencies at financial risk for mandatory benefit coverage.

It is unknown how many contractors might meet the criteria of a common-law employee. Still, a major concern is that if contractors are judged to meet the criteria, then the contracting agencies may be at financial risk for contributions for benefits such as retirement contributions and workers' compensation coverage. Interviews with agency managers regarding these contracts indicated that few were aware of this risk.

Federal Criteria

The federal government developed the criteria to determine who is a common-law employee.

The United States Supreme Court adopted a common-law test for determining who qualifies as an “employee” in *Community for Creative Non-Violence V. Reid*, 490 U.S. 730, 740 (1989). The Court stated:

In determining whether a hired party is an employee under the general common-law of agency, we consider the hiring party's right to control the manner and means by which the product is accomplished. Among the other factors relevant to this inquiry are the skill required; the source of the instrumentalities and tools; the location of the work; the duration of the relationship between the parties; whether the hiring party has the right to assign additional projects to the hired party; the extent of the hired party's discretion over when and how long to work; the method of payment;

the hired party's role in hiring and paying assistants; whether the work is part of the regular business of the hiring party; whether the hiring party is in business; the provision of employee benefits; and the tax treatment of the hired party.

The factors cited in *Reid* have been used by the federal government and by some agencies in the Commonwealth to determine "employee" status based on common-law principles.

The Internal Revenue Service (IRS) looks to common-law principles in the determination of common-law employee status.⁷ The IRS applies twenty traditional common-law factors to determine if an individual is an "employee" for the purpose of federal tax and FICA withholding. According to standards set by the IRS, an independent contractor may be deemed a common-law employee based on behavioral control, financial control, and the relationship of the parties.⁸

According to IRS standards, an independent contractor may be deemed a common-law employee based on behavioral control, financial control, and the relationship of the parties.

- **Behavioral Control** determines whether the governmental agency has the right to direct and control how the contractor does the task.
 - ◊ Does the agency direct when, where, and how to work; and
 - ◊ Does the agency supply the contractor office space and expect the contractor to be at the work site like other state employees?
- **Financial Control** shows whether the governmental agency has a right to control the business aspects of the contractor's job. This includes:
 - ◊ The extent to which the contractor has unreimbursed expenses;
 - ◊ The extent of the contractor's investment;
 - ◊ The extent to which the contractor makes services available to the relevant market;
 - ◊ How the agency pays the worker; and
 - ◊ The extent to which the contractor can realize a profit or loss.
- **Type of Relationship** includes:
 - ◊ The description of services in the contract showing intent of the parties;

⁷ Rev. Rul. 87-41, 1987-1C.B.296.

⁸ Internal Revenue Service's Publication 15-A, Employer's Supplemental Tax Guide. (This provides the guidelines used in determining a common-law employee.)

- ◇ Whether the agency provides the contractor with benefits such as insurance, vacation pay, sick pay, and pension plans;
- ◇ The permanency of the relationship; and
- ◇ Whether the services performed by the contractor are a key aspect of the regular business of the company.

The U. S. Supreme Court has recently handed down decisions that recognize state immunity from suits in federal court on certain employment matters.

It is important to note that the federal government will enforce only the federal criteria in regard to federal programs, such as FICA. Several cases have been heard by the United States Supreme Court that speak to the right of regular and common-law employees to sue a state for employee benefits. Issues addressed to date have included

- Overtime benefits under the Fair Labor Standards Act;⁹
- Money damages under Title I of the Americans with Disabilities Act of 1990;¹⁰
- Money damages for discrimination on the basis of age under the Age Discrimination in Employment Act of 1967;¹¹ and
- An effort to compel a state to perform its duty under the Indian Commerce Clause.¹²

In each of these cases, the U.S. Supreme Court found that the states were sovereign and immune, and could not be sued without giving consent. This is in spite of the fact that the suits were filed pursuant to federal laws that expressly created a private cause of action against a state if the state violated the federal statute. The Court's decisions were based on the principle of state sovereignty as set forth in the United States Constitution. The Court has made it clear that, without the consent of a state, state immunity will not be overridden in federal courts even on claims based on alleged violation of federal law. Thus, the Court has left these matters to the state, to be decided in state courts.

Kentucky Retirement System Criteria

The Board is given full authority to administer the Kentucky Retirement Systems.

Through KRS Chapters 61, 16, and 78, the General Assembly has clearly delegated to the Kentucky Retirement Systems Board the authority to conduct the business of the Kentucky Retirement Systems.¹³ Currently, that authority includes the ability to

⁹ *Alden v. Main*, 527 U.S. 706 (1998).

¹⁰ *Board of Trustees of the University of Alabama v. Garrett*, 2000 WL 33179681 (U.S. Ala., 2001).

¹¹ *Kimel v. Florida Board of Regents*, WL 14165 (U.S. Fla., 2000).

¹² *Seminole Tribe of Florida, v. Florida*, 517 U.S. 44 (1996).

¹³ KRS Chapters 61, 78, and 16 control conditions of participation with the retirement systems. KRS 61.510 defines KERS and its authority. KRS 61.510

determine who is a state employee for the purposes of participating in the Kentucky Retirement Systems.

KRS 61.645(e) states in part that “The board shall have the authority to...conform with federal statutes and regulations and to meet the qualification requirements under 26 U.S.C. sec. 401(a).” This section of the United States Code (U.S.C.) sets forth the criteria necessary to establish a qualified pension plan. The federal statute is silent on who is to determine eligibility but requires fairness for all employees covered.

The Kentucky Retirement System Board uses the federal criteria to decide if a contractor is an “employee” for retirement purposes.

The Board has essentially adopted the federal criteria outlined above to determine whether an individual, including a contractor, is an “employee” for the purposes of membership in the Kentucky Retirement Systems. The Board also looks for guidance on this issue to *Ratliff v Redmon* Ky. 396 S.W. 2d 320 (1965), a workers’ compensation case that distinguished an “employee” from an “independent contractor.”

The Kentucky court determined in *Ratliff* that the individual was an “employee” for workers’ compensation purposes. The court cites Larson’s Workmen’s Compensation Law, page 624 as its authority. Larson’s echoes the common-law factors found in *Reid*, the IRS rules, and the Social Security guidelines. However, *Ratliff* also states that one of the factors to be considered is, “Whether or not the parties believe that they are creating the relationship of master and servant¹⁴....What the parties believe with respect to the relationship created is important in determining that relationship.”¹⁵

The KRS Board does not actively review all contracts to determine employee status.

The Kentucky Retirement Systems Board does not review all contracts or actively seek contractors for inclusion in the Kentucky Retirement Systems. However, if a contract is presented to the Board, or if a contract is brought to the Board’s attention, a determination will be made using the federal criteria. The use of these criteria in light of the non-delegable fiduciary responsibility of the Board¹⁶ is entirely proper, as is the Board’s reliance on the court’s test in *Ratliff*.¹⁷

(5) gives the Board the authority to determine who is an employee within KRS 61.515 to 61.705. KRS 78.70 gives the Kentucky Retirement Systems authority to carry out provisions of KRS 78.510 to 78.852 for the County Employees Retirement System. KRS 16.505 to 16.652 is authority for the State Police Retirement System. KRS 16.505(2) defines the board of trustees as the Kentucky Retirement Systems.

¹⁴ *Ratliff v Redmon*, p. 325.

¹⁵ *Ibid.* p. 326.

¹⁶ KRS 61.645, 61.650.

¹⁷ *Ibid.*

If contractors negotiate a higher salary to compensate for lack of benefits, it would be unfair to later allow them to claim those benefits.

The Secretary of the Personnel Cabinet has argued that it would be unfair to regular state employees to allow service contractors to receive a total compensation package that substitutes salary for benefits, then later allow them to claim eligibility for the foregone benefits too. Individuals who negotiate contracts to offer services would generally be expected to evaluate their own interests in negotiating contract terms. They are likely to seek a total compensation amount similar to individuals with comparable skills and credentials in regular employment situations. While regular employees may receive a share of their total compensation package in the form of health and retirement benefits, it is expected that contractors who are denied those forms of compensation would seek a higher payment to keep total compensation in line with alternate employment arrangements.

The Secretary's concern raises the following question. If a contractor enters into a signed agreement with the Commonwealth, receives a higher rate of pay, and foregoes employment benefits, should this factor be a consideration when a determination is being made for purposes of retirement, workers' compensation, unemployment, and for life and health insurance benefits and contributions?

Conclusion

The federal government has outlined criteria for determining who is a common-law employee, but does not impose those criteria on state governments for the purposes of deciding who is eligible for state benefits. It is unknown how many contractors might meet the definition of common-law employee under the federal criteria.

Acting entirely within the authority granted to it by the General Assembly, the Kentucky Retirement Systems Board has substantially adopted the federal criteria in determining who is eligible for membership in the state retirement systems. If it finds that a contractor is a common-law employee, the Board can compel the contracting agency to make contributions on behalf of that employee.

Interviews with agency managers revealed that many were unaware of either the criteria for determining who is a common-law employee or the financial liability they could incur through such a determination.

Recommendation 3.3

The Finance and Administration Cabinet, in association with the Personnel Cabinet and staff of the Kentucky Employees Retirement System, should develop and impose contracting guidelines that prohibit agency managers from structuring service contracts in a manner that allows the contractor to meet the criteria of a common-law employee, except in cases where a documented reason exists for doing so.

Recommendation 3.4

The Finance and Administration Cabinet should educate agency managers about the potential financial liability they could face if they do structure service contracts in a manner that allows the contractor to meet the criteria of a common-law employee.

Recommendation 3.5

The Kentucky Retirement Systems Board has full authority to determine the criteria for deciding who is an employee for the purposes of membership in state retirement systems. The General Assembly may want to consider whether to give the Board additional guidance in making that determination. In particular, the General Assembly may want to clarify the conditions under which a contractor could be considered an employee for the purposes of receiving benefits.

Benefits Provided to Service Contractors

Traditional employee benefits are provided to some service contractors.

A review of the contract information contained in MARS, coupled with details obtained from agency interviews, indicated that a few contractors receive some benefits normally associated with traditional employment arrangements. For example, the contracts of four individuals stipulate that they can be members of the state employee health insurance group, with employer contributions paid by the state board with whom they contract. One of these four individuals also receives a contribution for life insurance. The Workers Compensation Branch, Employee Benefits Division, in the Personnel Cabinet, has determined that some contractors are entitled to workers' compensation benefits because they have working situations similar to those of regular employees. The two benefits most often provided to service contractors are Social Security contributions (FICA) and travel.

FICA

The Kentucky Division of Social Security within the Finance and Administration Cabinet uses required federal criteria in determining whether an independent contractor fits the definition of a common-law employee for the purposes of federal withholdings for FICA. The Kentucky Division of Social Security reported that FICA was withheld for 274 contractors in FY 2000 and 433 in FY 2001.

Agencies pay travel for many contractors.

Travel

Unlike FICA, where federal rules determine who is eligible for the benefit, policies for reimbursing service contractors for travel are inconsistent across state agencies. There were 696 contracts that included travel benefits during the five fiscal quarters in the scope of this study. Additionally, all architectural and engineering contracts stipulate reimbursement for travel expenses. There were 728 prequalified architectural and engineering contracts for the period of our study. There were no data available on the exact number of those contractors who have been reimbursed for travel.

Nineteen percent of all service contracts included travel.

The Education and Finance and Administration cabinets, along with the boards and commissions in the General Government category, issued the largest share of total service contracts with travel included (Table 3.4). Cabinets with the highest percentage of their own service contracts that included travel were Education, Economic Development, and Natural Resources. Nineteen percent of all Executive Branch service contracts included travel.

Table 3.4
Service Contracts with Travel

	Cabinet	Percentage of Each Cabinet's Contracts That Include Travel	Cabinet's Share Of Executive Branch Contracts With Travel
30	Revenue	7%	0%
31	General Government	21%	13%
32	Justice	17%	3%
33	Education, Arts, and Humanities	56%	29%
34	Natural Resources	34%	8%
35	Transportation	1%	0%
36	Economic Development	36%	1%
37	Public Protection and Regulation	31%	7%
39	Finance and Administration	27%	22%
42	Corrections	15%	3%
43	Tourism	2%	0%
44	Labor	8%	0%
46	Workforce Development	13%	1%
47	Personnel	20%	1%
48	Families and Children	8%	4%
49	Health Services	10%	5%
	Total	—	100%

Source: Staff analysis of data extracted from Procurement Desktop.
 Note: Excludes architectural and engineering contracts.

Agencies' travel reimbursement policies for contractors are inconsistent.

Each agency determines its own travel reimbursement policy. Even within the agency, the policy may vary from contract to contract. For example, the Department of Education's "Non-State Employee Travel Reimbursement Policy" primarily subjects non-state employees to the same rules as regular employees for reimbursement of travel. However, there are three categories of non-state employees who are exempted from that policy and are reimbursed for actual and necessary expenses. One exempted category is anyone on a personal service contract that stipulates a different arrangement in the terms of the contract.

Agency officials from the Department of Education say their policies vary by terms that are negotiated in contracts. Most personal service contracts are worded to reimburse contractors for travel based on state travel regulations. However, a few contracts do allow the contractor to be reimbursed for "actual and necessary expenses." Officials stated that contractors actually prefer to be reimbursed based on state travel regulations because it is more difficult to keep up with the receipts than be paid based on a mileage rate. Some Department of Education contracts include reimbursement for rental cars and airfare.

The Department of Insurance has different travel policies for different categories of contractors. Some are paid based on the Internal Revenue's 32.5 cents mileage rate, while others are paid based on current and past state government mileage rates. (Those rates were 30 cents and 27 cents a mile at the time staff spoke to agency personnel. The state rate is currently 32 cents per mile).

Some contracts allow the contractor the option of being paid an hourly contract rate for the time they spend traveling or being reimbursed for travel based on mileage. For example, if the contractor were making more than \$20.80 ($\0.32×65) an hour, it would be more advantageous to choose the hourly rate versus 32 cents per mile, assuming the contractor averages 65 miles an hour.

Contributions to Retirement System

Eighteen service contractors receive retirement contributions on their behalf.

According to data obtained from the Uniform Personnel and Payroll System and from the Kentucky Employees Retirement System (KERS), state agencies make contributions to retirement systems for eighteen service contractors. Fifteen contractors either currently receive, or have received, contributions made on their behalf to KERS, two received contributions paid to the Teachers' Insurance and Annuity Association (TIAA), and one contractor receives contributions paid for a private retirement fund.

As discussed earlier in this chapter, the issue of who is and is not eligible for membership in KERS could have significant financial ramifications for state agencies. To help clarify some of the related issues, the instances where retirement contributions are currently made are summarized.

Case 1.

Compensation for executive position covered by statute.

One contractor deemed an employee by KERS is the President and CEO of the Kentucky State Fair Board. He receives a salary that exceeds the salary cap, plus \$37,200 of additional benefits that include retirement contributions. KRS 247.130 allows the Board to fix the compensation and the terms of employment or contract for the president. It further states that the president is not subject to the provisions of KRS Chapter 18A. Therefore, the contract is within the guidelines set by statute.

Case 2.

KET's policy is to pay retirement contributions for contractors that fit common-law employee criteria.

Kentucky Education Television (KET) makes retirement contributions for seven individuals who are on contract. One has been determined to meet the criteria of employee status per KERS; the others are under review for status. According to KET officials,

retirement contributions are made based on IRS guidelines and a KERS determination of common-law employee status.

Case 3.

Sole source contractor is receiving retirement contributions and other employee benefits.

A contractor who audits medical billings for the Department of Corrections receives retirement and other employee benefits. This is not an executive position and there are no statutory provisions that permit or authorize such benefits for this position. According to agency officials the contract was initially issued with an RFP. However, since the original RFP, the Department of Corrections has executed a sole source contract with the contractor for nearly six years. Retirement contributions were included in the original contract, and those benefits have been included in subsequent years. Current procurement staff were not at the agency when the contract was initially established. Therefore, they were unsure why retirement benefits were initially included.

Case 4.

A review of invoices identifies retirement contributions not mentioned in the contract.

During a review of invoices on one of the contracts, it was noted that the Revenue Cabinet was making retirement contributions on behalf of a contractor. There were no express references to retirement contributions for the contractor in the contract or in the proof of necessity form. Without the invoices, the retirement contributions being made were not traceable to the contract.

The original contract was reviewed by KERS, and the contractor was determined to be an “independent contractor,” so not eligible for membership in the retirement system. Although KERS made this determination, the agency continued to contribute on behalf of the contractor. After notification to KERS, it is refunding all contributions to employee and employer.

Case 5.

Executive director receives contributions for private retirement account.

The executive director of the Board of Medical Licensure is also on contract and receives retirement benefits. Prior to an Executive Branch Ethics Commission Advisory Opinion 98-08, issued in April 1999, all of the administrative services for the Kentucky Medical Association (KMA) were provided through service contracts. The opinion concluded that the Board should no longer contract with the KMA for administrative services on an expense reimbursement basis because of an “appearance of conflict of interest.” Therefore, all administrative and secretarial personnel were transferred into the state personnel system with retirement contributions made to KERS. The exception was the executive

director. It was determined that, in order to provide the executive director with comparable salary and benefits, he would be hired as a sole source contractor. Under the terms of this contract, an amount is paid to fund contributions to a private retirement account.

Case 6

**Postsecondary
Education contributes
retirement benefits to
TIAA and to Kentucky
Teachers' Retirement
System.**

The Council on Postsecondary Education contributed retirement benefits to TIAA on behalf of two contractors during the time period in the scope of this study. In addition to retirement and other benefits, the contractors received salaries that exceeded the state salary cap. Both contracts specifically stated that, “for the purpose of these benefits, the contractor is considered to be a state employee.”

Conclusion

Except for those governed by federal rules, such as FICA, agencies are inconsistent in the types and levels of employee benefits that are included in service contracts. Agency personnel do not always understand regulations that may impinge on their ability to freely negotiate benefit arrangements. Considerations of equity would suggest that contractors doing similar work should be afforded similar compensation options. Finally, care should be taken to maintain a distinct line between the terms of regular employment and contract work.

Recommendation 3.6

Officials of the Finance and Administration Cabinet should work with the Personnel Cabinet to standardize the set of non-federal benefits that agencies would be allowed to incorporate into service contracts. At a minimum, standard policies should be developed to address the conditions under which service contracts may include benefits normally associated with regular employment. These include health insurance, workers' compensation coverage, and retirement contributions. Additionally, standard guidelines should be developed to govern travel reimbursement for service contractors. Agency managers should be trained in the regulations that govern each type of benefit so that they are only used in an appropriate manner in contract negotiations.

Best Practices in the Decision to Contract for Services

It is important to determine whether it is cost effective to obtain a service through a contract.

The decision to contract for a service or to have the service performed within the state personnel network is driven by two questions: Is this service really needed? If needed, what is the most cost-effective and feasible method of acquiring the service?

Personnel in other state agencies should also be considered before a contract is issued

Purchasing industry associations, as well as some state agencies, have recognized that before a contract is issued an agency should go through a formal process to validate that the service is necessary and to assure that all aspects of the needed service are understood before a contract is negotiated. Only if the agency assures itself that the need is real and that the ability to satisfy that need does not exist within state government should the agency issue a contract for an outside provider. However, Program Review staff found very little evidence to indicate that other state agencies and state universities had been consulted before a contract was issued to an outside vendor.

State agencies are required to determine if capabilities exist within state government before issuing a contract. Finance Cabinet policy BO-111-43-00 requires state agencies to determine whether another state agency or state university can reasonably provide needed services before beginning the contracting process for personal service contracts. The Cabinet for Health Services (CHS) has included similar language in a new manual designed to help standardize operating procedures for personal service contracts and memoranda of agreement within the Cabinet. The CHS Procurement Work Group stated that:

Foremost, a documented need for services has to be established. Agency staff should be able to determine if these services can be performed within the Department/ Office. If not, the agency must be able to provide a rationale for the use of another state agency to perform these services. If neither of the first two options is feasible, contracting with an outside vendor may need to be considered.¹⁸

Assessing agency needs is the first step.

A needs assessment should be done to determine if the service should be performed by state personnel or by an outside contractor. A cost-benefit analysis should be done to assess whether it would

¹⁸ Cabinet of Health Services Procurement Work Group, "Personal Service & Memorandum of Agreement Contracting Manual for the Cabinet of Health Services," December 2000, p. 15.

be less expensive to contract for the needed service rather than to have a state employee provide the service. A combination of the most cost-effective method of providing the service at the highest quality, consistent with the need, should guide this assessment. Decisions should be based on an unbiased view of all the facts.¹⁹

Agency service contracts often lack adequate documentation of need for the service.

Evidence presented in the next chapter, and the examples shown in the gray box, indicate that many service contracts are issued without thorough analysis and documentation of the need for the contract. In completing the proof of necessity forms required by the Government Contract Review Committee, agencies tend to incorporate boilerplate language that does not adequately demonstrate the need for obtaining the service through a contract.

Requirements of the PON

The proof of necessity form requires that the following questions should be addressed:

1. What in-house method(s) were considered and why were potential in-house method(s) rejected?
2. Is the part of such nature that:
 - It should be done independently of the agency to avoid a conflict of interest;
 - it requires unique of special expertise/qualifications;
 - legal or other special circumstances require use of an outside provider?
3. If services are needed on a continuing basis, describe efforts made to secure services through regular state employment channels.

An Acceptable Response on a PON

“Services provided by the contractor are expected to be finite and it is more economical to contract vs. creating a state government position. Contractor has extensive knowledge of the customized software, 27 years of experience in a Kentucky local school district and excellent rapport with our clients.”

Unacceptable Responses on a PON

“This is the most qualified person for the project. Contractor has previous experience in developing curriculum and teaching in area previously.”

“The provider has special and unique experience in regard to this area of assessment.”

“KDE does not have the staff or the capability to provide the service.”

A cost-benefit analysis may be needed to evaluate the merits of contracting with outside vendor.

An analysis of the cost of providing a service in-house may also be useful in determining whether a new service should be provided by hiring new staff or by contracting out. “A Needs Statement is the first major work effort of the contracting out process.... As the

¹⁹ National Institute of Governmental Purchasers, *Contracting For Services, First Edition*, 2001.

name implies, the Needs Statement justifies the need for the intended services. Once that need is established, a case must be made concerning the most cost effective and efficient method of delivery.²⁰” To fully evaluate the merits of contracting with an outside vendor, a cost-benefit analysis may be needed. Additionally, agencies may wish to periodically review services currently being provided by state government personnel to determine if a private sector vendor could provide the service more efficiently. An example of an appropriate cost benefit analysis is shown in the following gray box.

Department for Public Health		
Type of Work: Vaccine distribution		
Contract Nos., Amounts:	M-00218872	Contract costs based on vaccine dosage shipments
Review Issues: Change from state-run operation to contract		
<p>For some years, the state handled vaccine shipments as part of the federal Vaccines for Children program (VFC), but recently opted to join a vaccine shipment cooperative. (Cooperative purchases are allowed under KRS 45A.300.) The program is located in the Division of Epidemiology and Health Planning, Communicable Disease Branch, Department for Public Health. Before joining the cooperative, the state handled its own vaccine shipments to public health providers and health departments. According to officials interviewed in a general review of contracts, Kentucky’s shipment costs were higher than most states and the state operation was experiencing vaccine waste and incidents of spoilage. The vaccine shipment operation logged \$179,000 in additional costs in FY 99 because of inappropriate vaccine storage and handling, according to agency personnel.</p> <p>The Centers for Disease Control commissioned a study by the Logistics Management Institute to look at states’ efficiencies. A state analysis as a part of the study found that the Kentucky cost was an average 94 cents per delivered dose. That cost, officials determined, was too high, based on the average per-dose distribution cost among all states of 68 cents. Given that information, and at the recommendation of the study group, officials decided to join the New York State National Vaccine Logistics Contract. The study recommended that the CDC work with states whose distribution costs varied significantly from the average. Kentucky was one of those with high per dose shipping costs. Since joining the cooperative, the state is realizing substantial savings because it now pays a range of 13-16 cents per dose to distribute vaccines, according to officials.</p> <p>The contract resulted in three people being transferred and one part time worker being released. A state retiree, hired through an employment agency, did come onboard to serve as coordinator for the program. The coordinator is to develop a procedures manual and conduct training, according to contract documents.</p>		

²⁰ National Institute of Governmental Purchasing, “Contracting for Services,” 2001, p. 31.

Efficiency was not frequently considered in the decision to contract for services.

When the proof of necessity forms for the sampled contracts were reviewed, however, efficiency was not a frequent consideration in the decision to contract for services.²¹ The most frequently cited reason to issue a contract for services was the need for specialized knowledge or expertise. Of the sampled contracts requiring a PON, fifty percent listed the need to acquire a contractor with special expertise that existing agency staff did not possess. This special expertise ranged from hiring lawyers with a particular expertise in certain aspects of case law, to hiring nurses and physical therapists. Another thirty-two percent of the contracts requiring a PON listed limited in-house staff as a rationale for contracting out for services.

Lack of expertise in agencies was often attributed to state salary constraints.

As Program Review staff conducted follow-up conversations with agencies about each of the contracts in the sample, they found that the lack of expertise within agencies was often attributed to state salary constraints. Agencies often reported that state salary levels were not competitive with private sector salaries in fields such as actuarial analysis, computer programming, and a variety of health care fields. Agency officials stated they were unable to hire individuals with these specialized skills through the state personnel system and were forced to make use of contracts, which are not subject to the state's salary limitations.

In some cases, contractors can provide services more cheaply than regular employees.

Another consideration is whether it would be cheaper for services to be obtained from private vendors rather than from regular employees. The preceding discussion of relative wages focused on the difficulty managers may face in attracting highly paid technical workers to state government. A different issue is raised in regard to tasks that require minimal skills and education. The Commonwealth offers its permanent employees a relatively rich set of benefits compared to those who perform low skill tasks, such as janitorial work, for small private employers (Table 3.5). Because of this difference, private firms may be able to provide low skill services, such as cleaning, mowing, and minor maintenance more cheaply than having the same tasks completed by regular state employees. In this instance, it is more efficient for the Commonwealth to contract for such services.

²¹ See Chapter 4 and Appendix B for a complete discussion of the sample contracts reviewed for the study.

Table 3.5
Participation in Selected Benefit Programs
Full-Time Blue-Collar and Service Employees
of Small Private Establishments

Benefit	Percent Participating	Average Benefit if Participating
Paid Holidays	71	7 days per year
Paid Vacations	79	10.7 days per year (with 5 years of service)
Paid Sick Leave	35	9.6 days per year (with 5 years of service)
Life Insurance	54	More than half who participate have \$15,000 or less
Medical Benefits	56	Slightly more than half of participants are required to make an employee contribution
Defined Pension	15	1.67%: (average flat percent of final salary received per year of service)
Defined Contribution Retirement Plan	28	Most participating employers match 50% of employee contributions, up to 6% of employee salary

Source: *Employee Benefits in Small Private Establishments, 1996*, U.S. Department of Labor, Bureau of Labor Statistics, Bulletin 2507, April 1999.

Conclusion

Many service contracts are issued without a thorough analysis and documentation of the need for the contract. The Proof of Necessity forms required by the Government Contract Review Committee tend to incorporate boilerplate language that does not adequately demonstrate the need for obtaining the services through a contract or present an adequate analysis of the costs and benefits of contracting. To ensure efficiency in contracting for services, managers should be required to more fully document that they have adequately compared the costs of contracting with the costs of obtaining services in-house.

Recommendation 3.7

Unless special circumstances make it impractical, agency managers should be required to thoroughly document the need for a service contract and provide evidence of an adequate comparison of its costs relative to those of using a regular state employee to provide the same service. This information should replace the boilerplate justifications that are too often included in the Proof of Necessity form supplied to the Government Contract Review Committee.

CHAPTER 4

CONTRACT ADMINISTRATION AND MONITORING GUIDELINES VERSUS PRACTICES

A random sample of contracts was examined in order to assess contract administration and monitoring.

Without effective contract administration and monitoring of contractor performance, there can be no assurance that the state is getting quality service at a reasonable cost. Contract administration and monitoring practices vary widely among cabinets. To assess the practices Executive Branch agencies followed in contracting for services, Program Review staff examined a sample of 353 contracts²². Because the contracts were selected at random, the sample should be representative of all contracts issued within the five quarters from July 1999 through September 2000, within a margin of sampling error.

Contractors were surveyed in order to get their assessment of the state's contracting system.

Since the sampled contracts consisted of information provided by state agencies, it was believed beneficial to also elicit the views of state contractors themselves. Specifically, a survey of contractors was conducted to provide further information on the characteristics of contractors, details about how contractors find out about available contracts, and obtain contractors' perceptions of the administration and monitoring of contracts. A four-page questionnaire was mailed to each person or firm that received a Kentucky service contract within the past two fiscal years. Over 1,100 contractors completed the questionnaire. A detailed description of the methods, a copy of the questionnaire, and frequency tables of the responses to all the questions are included in Appendix C.

This chapter provides evidence about the current status of the state's system of contracting for services.

The sample of contracts examined by staff and the survey of contractors provides strong evidence about the current status of the state's system of contracting for services. The first major conclusion developed from this effort is that the integrity and professionalism of contract administrators in state agencies are major factors in ensuring a contracting process that generally works well. However, serious issues remain. Therefore, most of the major conclusions that follow pertain to the system and procedures for contracting. Those conclusions are as follows.

- While competition among contractors is one of the key factors in attaining the lowest price for the highest quality of services, some agencies use a large number of sole source contracts,

²² For details on the methodology of the random sample, readers may refer to Appendix B.

without pursuing the advantages inherent in competitive procurement.

- The monitoring of contract performance, the methods used by state agencies to determine whether the state is getting what it paid for, is inconsistent. Often sole source contracts, awarded without the benefit of the competitive marketplace, are monitored more poorly than other contracts. Additionally, many contractors did not report a high level of monitoring of the work they did. About a quarter said that they were not given feedback over the course of the contract or an evaluation at the end of the contract period.
- Based on the results of the survey of service contractors, the availability of contracts could be better publicized. Half the contractors reported that their only sources of information on contracts were either being contacted directly by a state agency or from having a similar contract before. Only slightly more than half the contractors felt that contract availability was well publicized, and these were individuals who had been awarded a contract. The contractors' sources of information and their satisfaction with information received varies by type of contract and cabinet.
- Larger majorities of contractors were satisfied with other aspects of contract administration, such as fairness, timeliness of award, and appropriate compensation.

It is worth repeating that, in the survey of contractors, the questionnaire was completed only by those who received contracts. The results do not include those who did not get a state service contract in the past two fiscal years, either because they tried for contracts and failed or did not attempt to get any contracts. Those who were denied a contract or have shown no interest in contracts may have a different opinion of the state's contracting system, but a listing of those contractors without state contracts was not available.

Sole Source Contracts

Some cabinets award a large percentage of their contracts as sole source contracts.

Once it is determined that agency staff cannot perform a needed service and a decision to contract for the service has been made, a determination must be made about how the contracting process will proceed. Should a contract be competitively awarded, or issued without competition?

In some instances, there may be only a single vendor for a needed service. For example, a needed training session may be copyrighted by an individual, or equipment maintenance by the manufacturer may be required under the terms of a warranty. Agency officials in various cabinets also expressed a concern that competitive award of all contracts was time consuming and costly. In instances where a well-known vendor, or a vendor with whom the agency had experience, was available, agencies felt it would be more efficient to simply award a sole source contract to that vendor than go through the lengthy process of competitively awarding a contract.

Personal service contracts follow a competitive negotiation

Personal service contracts are generally required to follow a competitive negotiation process that makes use of a request for proposals (RFP). KRS 45A.695 describes the procedures state agencies are to follow when issuing a personal service contract. The contract is supposed to be awarded to the offeror determined to be best qualified, based on the evaluation factors set forth in the RFP, if a fair and reasonable compensation can be negotiated with that offeror. While other competitively bid contracts may be awarded based solely upon price, the RFP process allows considerations for technical merit, quality, and other factors to be included in the decision-making process. As with other types of contracts, a personal service contract may be issued by a sole source award with prior approval from the Secretary of the Finance Cabinet.

Some contracts are designated sole source by statute, others require approval.

Not all personal service contracts must follow a competitive process, however. KRS 45A.095 states that a contract may be made by noncompetitive negotiation for sole source purchases, or when competition is not feasible, or in emergency situations. The statute goes on to define sole source as, "...a situation in which there is only one known capable supplier of a commodity or service, occasioned by the unique nature of the requirement, the supplier, or market conditions." Specific examples of contracts for which competitive bids might not be required include visiting speakers, professors, expert witnesses and performing artists, as well as other personal service contracts specifically identified by statute, such as contracts between the State Fair Board and judges for events. In general, agencies desiring to issue a sole source contract must get prior approval from the Finance and Administration Cabinet's Division of Purchases.

On average, 17% of service contracts were identified as sole source, but some cabinets had higher percentages than others.

Because the MARS system cannot readily identify which contracts were awarded through a sole source process, Program Review staff relied on the random sample to estimate the percentage of state

agency contracts issued as sole source. Of the 353 contracts reviewed, seventeen percent were identified as sole source contracts by agency officials. Some cabinets appeared to use far more sole source contracts than others. Table 4.1 identifies the cabinets with the most frequent use of sole source contracts.

Table 4.1: Cabinets With Greatest Use of Sole Source Contracts

Cabinet	Percentage of Sampled Contracts Identified as Sole Source
Families and Children	42%
Health Services	37%
Public Protection and Regulation	30%
Education Arts and Humanities	29%
General Government	25%

Source: Program Review and Investigations Committee Staff

Competition among contractors is one of the keys to attaining highest quality at lowest price.

This higher-than-average use of sole source contracts is of concern because competition among contractors serves as one of the primary controls to limit price and promote quality services. According to the National Association of State Purchasing Officials, “Competition is the central principle of public procurement.... In a competitive market, the consumer, including the government purchaser, attains the highest quality goods at the lowest possible prices or cost. Where vendors must compete, they cannot elevate prices and reduce quality without suffering a loss of customers.”²³

“The greater the number of bidders usually provide the “best” provider. Bidder needs to be educated on how and where they (we) can learn of and bid for services needed.”

- Contractor’s comment from survey of contractors

Cabinets cite many reasons for sole source contracts.

When asked about the higher-than-average use of sole source contracts in the Cabinet for Families and Children, cabinet officials stated that social workers’ salaries in Ohio and Indiana were higher than the salaries for similar positions in Kentucky. Thus the cabinet had difficulty filling entry level positions in areas of the state close to the borders with those states. Families and Children officials said that a large number of their sole source contracts

²³ National Association of State Procurement Officials, “State & Local Government Purchasing Principles & Practices,” 2001, pp. 16, 22.

were issued to former employees, hired back under contract in order to meet short-term staffing shortages.

Officials with the Cabinet for Health Services were also asked about the relatively large number of sole source contracts their agency has issued. Health Services officials stated that market forces were a big factor in their reliance on sole source contracts. Health Services officials stated that a number of new programs had been initiated in the last few years. They said that they did not have personnel within the cabinet to provide these services professionally. Additionally, when they do issue an RFP, they get limited response from within the state because professionals are often not interested in competing for salary levels that officials characterized as being below the private market level. Finally, Cabinet officials stated that because these issues often involve patient care, it is important that the program provide a continuation of coverage. They stressed that patient care was a critical concern in the way they approach contracting overall.

The prevalence of sole source contracts raises questions about contract cost, accountability, and quality of work.

Questions remain about the implications of using large numbers of sole source contracts. For example, without a competitive contract award process, how does the agency know it is getting the most efficient price from contractors? Similarly, without a competitive process, how do agencies know they are receiving the highest quality service available? Competitive awards also help to preserve the accountability of the contracting process by reducing the likelihood that contracts are awarded on the basis of influence and contacts, rather than value and quality.

The frequent use of sole source contractors, with relatively poor advertising of agency needs, likely means that agency managers fail to identify many qualified contractors who might provide higher quality services at a lower price. These issues become more pressing when contracts are awarded year after year without any attempt at competitive award. The following gray box provides an example of a contract that has been renewed since 1995 as a sole source contract.

Department of Corrections		
Type of Work: Medical-related reviews		
Contract No., Amount:	M-00093442	\$171,552
Review Issues: Sole source, retirement		
<p>Since January 1995, the Department of Corrections has contracted sole source with a person to perform a variety of medical-related services for the agency. Corrections pays for the medical care of its inmates and the contractor consults with the agency in areas of medical cost containment, including “unbundling detection,” medical coding procedures, and development of a quality assurance and utilization review program. The contract, issued originally with an RFP, pays \$171,552 for a two-fiscal-year period ending in June 2002 and includes retirement payments and FICA. The FY 2000 contract totaled \$81,801.</p> <p>Could a state employee perform the same services, staff asked in a general review of contracts? According to officials, the various medical reviews the contractor performs has saved the Department in excess of \$1 million a year. The contractor produces reports of her activities, with the reports becoming more detailed in recent months.</p> <p>Officials contended that Corrections receives considerable benefit from the contractor’s experience in areas like quality assurance and utilization review, plus the contractor has almost seven years of experience in working with the agency. They claimed that it would require a number of staff people to perform the same services as the contractor. Nevertheless, Corrections plans to seek competitive bids on the contract when it next expires, a procedure that would help determine if potential competitors are available to perform the services.</p>		

Conclusion

Competition for work is one of the most useful tools in designing a system that promotes fairness in the award of contracts as well as efficient prices and quality service. With the heavy reliance on sole source contracting in some Cabinets, the only protection against undue influence in the award of contracts is the integrity and professionalism of the agency managers, which Program Review staff found to be high. The concern remains, however, that there is no systemic protection, particularly in areas where the large number of sole source awards limits the benefits available from the competitive award of contracts.

Recommendation 4.1

The Secretary of the Finance and Administration Cabinet should closely examine any request for a sole source exemption. Only those cases specifically permitted by statute, or those most rigorously documented, should be permitted to circumvent the benefits of the competitive award of contracts. Additionally, summary information should be retained and reported semi-

annually to the Government Contract Review Committee documenting the number of sole source contracts awarded by each cabinet, the recipients of sole source contracts, the not-to-exceed amounts of the contracts, and the services acquired through the contract.

Recommendation 4.2

Sole source contracts that are renewed year after year are a particular concern. These contracts have the potential of continuing for years without the benefit of a competitive procurement process. The Finance and Administration Cabinet should develop policies specifying a four-year limit on the renewal of sole source contracts. After the fourth year, a sole source contract should be offered as a competitive award.

Contractors' Views on the Award and Administration of Contracts

The survey of contractors provides another perspective on how the availability of contracts is publicized and how contracts are administered. The survey also provides some basic information on the characteristics of the people and firms who receive state service contracts.

Within the past three years, about 40% of those receiving contracts got one contract. About half had tried to get one or two.

Contractors are split almost evenly between those who have usually received contracts within the past three years as individuals (48.1%) or through an organization (51.9%). Contractors were also asked how many contracts they had tried to get and how many they had received in the past three years. Contractors are diverse in each case. As shown in Tables 4.2 and 4.3, about half (49.5%) the contractors tried to get only one or two contracts in the past three years, and forty-two percent received only one contract during this period. However, about a third tried to get four or more contracts, with 18.2% trying for ten or more. The average contractor tried to get 6.9 contracts over the past three years. Over a third of contractors received three or more contracts; the average number received was 3.2.

**Table 4.2: Number of Contracts Contractors
 Tried to Get within Past Three Years**

Number of Contracts	Contractors	% of Total
1	283	31.7%
2	158	17.7%
3	180	20.1%
4 to 9	110	12.3%
10 or more	163	18.2%
Total	894	100.0%

Categories coded from open-ended responses.

**Table 4.3: Number of Contracts Received
 by Contractors within Past Three Years**

Number of Contracts	Contractors	% of Total
1	403	42.2%
2	206	21.6%
3	173	18.1%
4 or more	172	18.0%
Total	954	100.0%

Categories coded from open-ended responses.

Total higher in Table 2 because more contractors answered this question.

Contractors who have gotten at least one contract are usually successful in getting the number of contracts that they have tried to get.

Contractors who received contracts were often successful in getting the number of contracts they tried for. Because the survey was completed by those who had received contracts, the success rate for those trying for one contract has to be 100%. The success rates are almost as high for those who tried for two (90%) or three contracts (87%). In other words, for those who received at least one contract, if they tried for two contracts, they usually received two contracts. If they tried for three, they usually received three. For those trying for four to nine contracts, they received 61% of the contracts they tried for, on average. The success rate for those trying to get ten or more contracts drops to 32 %.

The typical state contractor is not very dependent on state contracts for services as a source of income. Contractors were asked to estimate the percentage of their income from Kentucky service

contracts in 2000. The answers are summarized in the categories in Table 4.4.

Income from service contracts is not a major share of income for most contractors. However, about a fifth of contractors reported that a majority of their 2000 income was from service contracts.

Almost half (48.4%) of those who had income from state service contracts in 2000 said that such contracts provided ten percent or less of their income that year. Sixty-five percent reported that state contract income was less than a quarter of 2000 income. There are a number of contractors, however, whose income is largely dependent on state contract work. Over a fifth of contractors (21.1%) say that at least half their 2000 incomes were from Kentucky personal service contracts. Contracts provided all or nearly all the income for 8.6% of contractors.

Table 4.4: Kentucky Service Contract Income as Share of Total 2000 Income

	% of 2000 Income	Contractors	% of Contractors
1 to 10%		425	48.4%
11 to 24%		145	16.5%
25 to 49%		123	14.0%
50 to 89%		110	12.5%
90 to 100%		76	8.6%
Total		879	100.0%

Categories coded from open-ended responses.

Over 80% of contractors said that they did not subcontract any work on their most recent contract. Less than 5% contracted half or more of the contract.

Contractors typically do their own work. They were asked what percentage of the value of the most recent contract was subcontracted. A huge majority—83.4%—said that there was no subcontracting. About twelve percent report that less than half the contract's dollar value was subcontracted. Less than five percent said that over half the value was subcontracted.

How Contractors Get Information on Contracts

Contractors were asked about the different ways that they found out about Kentucky personal service contracts. Table 4.5 shows the frequencies for each method.

Table 4.5: How Contractors Get Information on Kentucky Service Contracts

Source of Information	Contractors	% of Total
Contacted by state agency	558	50.4%
Had similar contract in past	444	40.1%
Ky. government website	174	15.7%
Professional association	161	14.5%
Newspaper announcement	156	14.1%
Word of mouth	70	6.3%
E-mail distribution list	65	5.9%
Other	86	7.8%

% based on number of contractors answering the question (1108).
 Contractors could choose more than one source so total % is over 100%.

The most common ways for finding out about contracts are being contacted by a state agency or from having a similar contract in the past.

Two information sources predominate. Over half the contractors indicated they found out about contracts by being contacted by state agencies. Over forty percent of contractors said that they knew about a contract from having a similar contract in the past. Each of the other sources was utilized by less than twenty percent of contractors.

“More general advertising should be done; not just the web site. Using the web site only means that only ‘regulars’ get contracts, others do not know about the web site. Advertising in trade journals and general advertising should be done.”

- Contractor’s comment from survey of contractors

Contractors also seem to rely on sources of information differently. Those who find out about contracts by word of mouth are a special case since this is the most haphazard source of contract information.²⁴ For over two-thirds of those who hear about contracts by word of mouth, this is their only source of information. Word of mouth aside, those who get information by being contacted or from having past contracts are less likely to use alternative sources of information. Almost half (48%) of those contacted by an agency say this is their only source of information. Thirty-eight percent of those with previous contracts say they had no other sources of information about contracts. Except for word of mouth, those using all the other ways of gathering information are less likely to rely on one source of information and use more sources, on average. Taking into account how sources are utilized

²⁴ The questionnaire did not provide “Word of mouth” as a response category; it was recoded from those who listed it under “Other.”

and that contact and having a previous contract are the most common sources, almost half (49.1%) of contractors reported that being contacted by an agency or having a previous contract were their *only* sources of information about contracts to be awarded.²⁵

How potential contractors get information is largely of a function of how agencies publicize contracts.

It is important to note that the ways that potential contractors find out about contracts is also a function of how agencies provide information. For example, if little or no information on contracts is provided on an accessible website or if the information appears for a short time, then few, if any, contractors will get the information via the Internet. The same could be said for newspapers, e-mail lists, or using professional associations to publicize available contracts.

Contractors with the Finance and Transportation Cabinets report more widely available information on contract opportunities.

This point can be clarified by looking at how contractors with different agencies report getting information about contracts. Table 4.6 shows the percentages of contractors getting information by different methods for six Cabinets for which there were at least fifty contractors responding to the survey.²⁶ The Finance and Transportation Cabinets stand out in terms of the diversity of sources of information for their contractors. At least ten percent of Finance contractors use each of the methods to obtain information; at least ten percent of Transportation contractors use each of five information sources. Although twenty-three percent and thirty-three percent of Finance and Transportation contractors, respectively, report previous contracts as a source of information, these percentages are lower than for the other cabinets. Around half or more of Cabinet for Families and Children, Cabinet for Health Services, and Justice Cabinet contractors say they find out about contracts from having similar contracts already. Finance and Transportation also have more contractors getting information from their websites.

²⁵ Contact by an agency was the only source of information for twenty-four percent of contractors. The only source was having a previous contract for seventeen percent. Ten percent cited contact *and* a previous contract but did not have any other sources of information.

²⁶ Specifically, these are the responses of those who answered the question on information sources and who listed only one cabinet through which they have received contracts within the past three years (question 14).

Table 4.6: Source of Information by Cabinet

	CFC	CHS	Educ.	Finance	Justice	Trans.
Contacted by state agency	53%	41%	51%	55%	48%	60%
Newspaper announcement	13%	9%	2%	13%	18%	16%
Professional association	5%	8%	12%	15%	9%	13%
Ky govt. website	3%	15%	4%	33%	8%	21%
E-mail distribution list	1%	2%	5%	13%	2%	5%
Had similar contract in past	48%	57%	40%	23%	47%	33%
Word of mouth	13%	8%	8%	11%	8%	2%
Total contractors by Cabinet	75	93	106	110	66	110

% based on number of contractors answering the question, by Cabinet.

Large majorities of contractors had no problems in finding out about biddable contracts in time or in becoming pre-qualified for contracts.

Keeping in mind that that this is a survey of those who have received contracts, most contractors are satisfied with how some types of information on contracts are provided. About half of the contractors (53%) indicated that they had been interested in contracts requiring the submission of bids in the past three years. Of these contractors, eighty-five percent said that they had found out about such contracts early enough to prepare suitable bids; fifteen percent said that they did not find out early enough. Over ninety percent of contractors indicated that they did not have problems in becoming officially pre-qualified for agencies requiring pre-qualification for contracts.

“Would perhaps bid more contracts if we had easy access to RFPs. Is there a web site with this info?”

- Contractor’s comment from survey of contractors

Only half of contractors say that contracts are “well publicized.”

Contractors were asked two questions on how well they thought Kentucky agencies publicized contracts to be awarded. The first was the "yes/no" question "Do Kentucky state agencies do enough to reach potential personal service contractors?" Seventy-nine percent said yes, twenty-one percent said no. The second question asked if "based on all your own experience...the availability of contracts is well publicized." Table 4.7 shows how contractors responded. While only sixteen percent of all contractors disagreed or strongly disagreed that contracts were well publicized, only about half agreed or strongly agreed with that statement. Table 4.7 also shows responses to this question with contractors subdivided into those who indicated that they had received contracts only from the Finance and Transportation Cabinets and those indicating they

had only received contracts from other cabinets.²⁷ As should be expected at this point, Finance and Transportation contractors are more satisfied with how contracts are publicized. Less than ten percent disagreed with the statement that contracts were well publicized; over two-thirds agreed or strongly agreed. About eighteen percent of contractors for other cabinets disagreed or strongly disagreed; less than half agreed or strongly agreed.

Table 4.7: Responses to Statement “The availability to contracts is well publicized.”

	All Contractors		Finance & Trans. Cabinets		Other Cabinets	
Strongly agree	162	15%	44	20%	54	13%
Agree	390	37%	86	39%	132	32%
Neither agree nor disagree	337	32%	67	31%	150	37%
Disagree	131	12%	14	6%	58	14%
Strongly disagree	40	4%	7	3%	15	4%
Total	1060	100%	218	100%	409	100%

As will be discussed later, there were similar survey questions about other aspects of contracting such as the fairness and timing of awards, and amount and timeliness of compensation. As shown in Figure 4.A below, contractors were less satisfied with the publicizing of contracts than any other aspect of contracting that they were asked about.

Conclusion

State agencies can reach potential contractors by directly contacting the individuals, firms, or associations that agency officials think would be interested in and qualified for the particular tasks to be contracted. The Commonwealth and contractors would be well served if alternative means of contract notification were used more effectively, however. State government would benefit from the increased competition generated through an expanded pool of qualified contractors that are interested in state service contracts. Contractors would benefit by finding out about state contracts more easily and more often. The increased perception that all contractors would have equal opportunity to be informed of service contracts can only increase

²⁷ Those cabinets are Families and Children, Health Services, Education, Justice, Natural Resources, Public Protection, and Tourism.

confidence that the contracting system is not subject to undue political influence.

Not coincidentally, the cabinets that award more service contracts—Finance and Administration and Transportation—have the better websites for potential contractors. Those who contracted with those cabinets were less dependent on being notified directly of contract availability. One option then would be for other state agencies to make their websites more useful for potential contractors by providing better notification of future contracts. While this would be an improvement, it would not be the most efficient or effective way to proceed. Rather than having each cabinet design and maintain its own website for potential contractors, it would be more efficient to have a centralized site that would provide information on all state service contracts. The Finance and Administration Cabinet would seem to be the obvious agency to implement such a centralized system. A centralized website would also benefit contractors by allowing them to gather information on potential contracts without having to go to every agency that might have a relevant contract available. A useful example is Texas' Electronic State Business Daily.²⁸ State agencies are required to provide notification of contracts via this source and local governments in Texas have the option of providing notification of contracts on the site as well. Vendors can search for contracts of interest by keyword or industry classification codes (e.g., code 906-56=Landscape Architecture).

Until a centralized website is online and virtually all potential contractors have access to it, state agencies should also make more effective use of alternative means of communication such as e-mail lists, advertising in periodicals, and working through professional associations. In the long run, Finance and Administration officials may be able to demonstrate that a centralized website is the only means necessary to reach enough potential state contractors to establish a system that is fair, and perceived to be so. In any case, it is critical that the website's availability be widely publicized in any forum to which potential contractors would have access.

Recommendation 4.3

The Finance and Administration Cabinet should implement a centralized website that would provide information to potential contractors on all available service contracts to be issued by any state agency. The site should be easily searchable and, whenever

²⁸ <http://www.marketplace.state.tx.us/1380/sagency.cfm>. Accessed August 30, 2001.

feasible, provide online access to any documentation and forms that contract applicants would need. The availability of the central website should be widely advertised to potential contractors and to the general public.

Contractors' Views on the Administration of Contracts

The questionnaire also contained five statements about contracts with which contractors could strongly agree, agree, neither agree nor disagree, disagree, or strongly disagree:

“Contracts are awarded fairly.”

“Contracts are awarded in a timely fashion.”

“The required work and expenses are fairly compensated.”

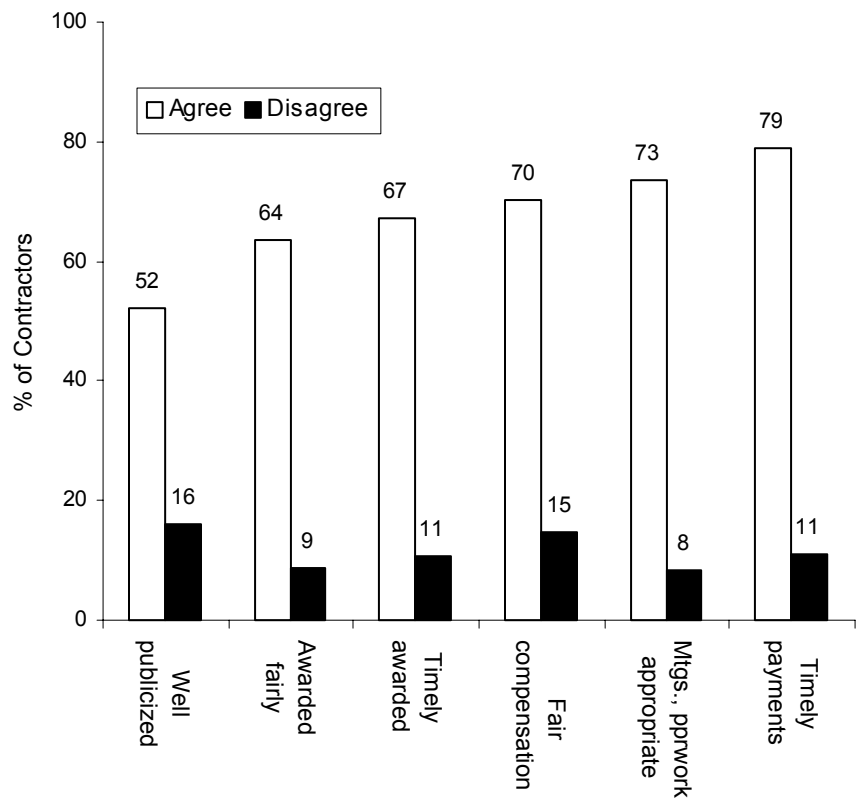
“Time devoted to required meetings and paperwork is appropriate.”

“Payments are received in a timely fashion.”

Around two-thirds or more of contractors agree with different positive statements about contract administration. Around 10 to 15 percent disagree.

Figure 4.A shows those who agreed (“agree” and “strongly agree” are combined) or who disagreed (“disagree” and “strongly disagree” are combined) with each of these statements. (The question on publicizing contracts is also shown in the figure.) As noted earlier, only about half the contractors agree that contracts are well publicized. Around two-thirds of contractors agree that contracts are awarded fairly, in a timely fashion, and are fairly compensated. Seventy-three percent agree that the required meeting time and paperwork are appropriate and seventy-nine percent said that payments were timely. Around ten percent each felt that contracts were not awarded fairly or in a timely fashion, that time for meetings and paperwork was inappropriate, and that payments were not timely. Higher percentages, around fifteen percent, felt that contracts were not well publicized and not fairly compensated.

Figure 4.A: Contractors' Evaluations of the Award & Administration of Contracts



Conclusion

Of the different aspects of contracting being evaluated by contractors, probably the most important is whether contracts are seen as being awarded fairly. Around a tenth of contractors thought contracts were not awarded fairly. Less than two-thirds of contractors agreed with the statement that contracts were awarded fairly. It is worth noting again that these are the people who have received contracts. It would be reasonable to assume that those who have tried and failed to get contracts are even less confident in the fairness of the process. It is possible that all contracts are being awarded fairly based on some reasonable definition of fairness. Even if true, the contracting system would be improved if virtually everyone perceived it as completely fair and above board. One way to increase the perception of fairness has been noted already. If available contracts are widely advertised, then contractors have less justification in claiming that they were unfairly excluded from notification.

It would also help if contractors and other members of the public had ready access to information on contracts as they are awarded. Contractors volunteered several complaints that could be addressed with a more transparent contracting process. For example, some contractors suspected that some competitors for contracts did not meet the qualifications for bidders. Others did not feel sufficiently informed of the ongoing status of projects on which they were bidding. Timely and accurate information on contract awards should not only make procedures seem more fair to contractors but would also allow legislators, the media, and interested members of the public to serve as more effective watchdogs of the contracting system.

Given the number and diversity of service contracts, the system could also be improved if there were a central office that could help contractors and those interested in getting contracts deal with complaints that could not be resolved through the contracting agency. This ombudsman's office would also maintain records of contractors' complaints and provide access to summaries of complaints to contractors. Just as consumers can get basic information on satisfaction with particular companies from the Better Business Bureau or Chamber of Commerce, contractors should be able to find out any particular problems that other contractors have had in general or with specific state agencies. The ombudsman's office could also use other means to solicit the views of contractors, such as focus groups or surveys. The position of ombudsman should be located independently of any agency that awards service contracts.

Recommendation 4.4

In addition to information on available contracts, the centralized contract website implemented by the Finance and Administration Cabinet should provide details on the status of contracts during the award process and provide summary information on contracts that have been awarded. The information on awarded contracts should at least include the name and location of the recipient of the contract, the awarding agency, the amount and duration of the contract, and a brief description of the work to be done. If it is a sole source contract, this should be indicated. If not, finalists for the contract should be listed. If the contract is a renewal of a contract for the same or similar work, the amount of time that the same person or firm has had the contract should be noted.

Recommendation 4.5

An independent ombudsman's office should be created. The ombudsman would handle complaints from contractors that could not be resolved with the contracting agencies. The ombudsman would also maintain records of contractors' complaints and provide summaries of those records to interested contractors and any other interested parties.

The Use of Contract Monitoring by Cabinets

Methods of monitoring contractor performance varied considerably.

The methods that state agencies use to monitor contract performance (how the agencies verify that the state is getting what it paid for) vary considerably from contract to contract, as well as from agency to agency. Program Review staff asked agency personnel to describe how each of the 353 contracts in the random sample were monitored. Some agencies conducted detailed assessments of contractor performance compared to pre-established benchmarks, while others reported informal assessments characterized by "if something went wrong we would know about it." A uniform system with established criteria to effectively monitor contracts across agencies was lacking.

What is contract monitoring?

The National Institute of Governmental Purchasing (NIGP) defines contract monitoring as:

...the process by which...government agencies oversee and check the contractor's performance to assure that it meets the contract's performance standards [and the]...primary tool used to guard against contracting problems once the contract is awarded...Without effective contract monitoring there is no way of knowing whether the contractor's work is faithful to the contract terms or whether citizens or agency officials are satisfied with the service or product. Without effective monitoring, fraud, waste, and abuse will surely occur.²⁹

What makes a good contract monitoring system?

The NIGP and The Reason Foundation have issued a list of ten items that they believe make up a good contract monitoring system:

1. Require the contractor to present periodic reports.

²⁹ National Institute of Governmental Purchasing, *Contract Management*, 2001, p. 74.

2. Review those reports carefully for adherence to the written contract.
3. Compare wage rates, equipment charges, rentals, and material changes with the written contract.
4. Verify that all services, materials, labor, and equipment were received, used or consumed.
5. Initiate, in writing by the procurement officer, all change orders that affect the written contract.
6. Make on-site inspections, whenever possible. Report the results of inspections by comparing results to the prescribed specifications.
7. If site inspections are not feasible (as in a contract for legal services) keep accurate records of end-user satisfaction.
8. Follow up every complaint.
9. Survey citizen or end-user satisfaction whenever possible.
10. Document all unsatisfactory performance and provide this information in writing to the contractor.³⁰

LRC's Government Contract Review Committee has also recognized the importance of effective contract monitoring, requiring agencies to provide the name of the individual responsible for monitoring the contract as well as a description of how the monitoring will be conducted on the Proof of Necessity (PON) form required for each personal service contract.

Different categories of contract monitoring identified.

Program Review staff interviewed agency officials to obtain an understanding and a description of the monitoring techniques used on each of the 353 contracts reviewed. Based upon a review of the literature concerning government purchasing, as well as the monitoring activities described by program officials, staff grouped the observed contract monitoring methods into four broad categories. These categories reflect whether the monitoring methods included an active effort to collect information on the contractor's performance, or if the monitoring followed a more passive approach. Other factors included whether the monitoring occurred throughout the contract period, allowing for feedback and corrections during the course of the contract, or whether the contractor was evaluated only at the end of the period, after the work had been performed. Additionally, staff considered whether the monitoring process included performance measures that allowed the contractor's performance to be weighed against some criteria, such as industry standards, or the performance of others in

³⁰ National Institute of Governmental Purchasing, *Contracting For Services*, 2001, p. 171.

a similar function. Table 4.8 describes these categories, listed in order of increasing effectiveness.

Table 4.8: Contract Monitoring Categories

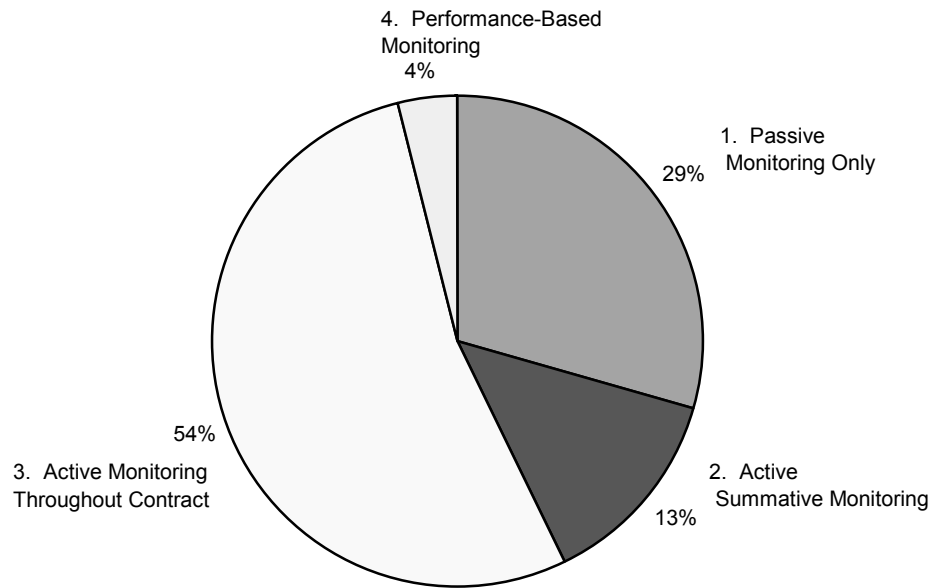
Category	Description of Monitoring Efforts
1	Characterized by passive monitoring: “If something goes wrong, we would know about it.” Also, contracts in which a subjective, but not formal assessment was done — for example, where contractors were thought to have done a good job, but where no formal evaluation effort was made.
2	Characterized by some formal monitoring of the contractor’s performance, but usually limited to summative assessments at the end of the contract. There is usually no ongoing, active monitoring with corrective feedback during the course of the contract.
3	Characterized by active, formal monitoring throughout the contract period, or at multiple phases of the contract, providing feedback to the contractor and allowing for corrections and improvements during the course of the contract.
4	Performance-Based: active monitoring using contractor assessments with outcome-based measurement of contractor’s performance, ideally linked to agency’s overall outcome measures or strategic planning outcome measures. If not linked to agency’s strategic plan, then linked to some benchmark, such as industry-level performance measures, that allow for an objective assessment of performance.

Source: Program Review and Investigations Committee staff

Surprising number of contracts show weak monitoring.

When individual contracts were assigned to these categories the majority of contracts were found to fit within category 3, active monitoring throughout the contract period. However, a surprising number of contracts were also identified as category 1, the weakest form of monitoring. Conversely, a surprisingly small number of contracts were found to be in category 4, the strongest form of contract monitoring. Figure 4.B summarizes the contract monitoring approach used for each of the contracts Program Review staff examined in the random sample.

Figure 4.B: Distribution of Contracts by Monitoring Category



Source: Program Review and Investigations Committee Staff

The specific contract monitoring methods program officials described, and the frequency they were encountered in the sampled contracts are detailed in Table 4.9.

Numerous methods of contract monitoring observed

Table 4.9 Methods of Contract Monitoring Observed in State Agencies

Methods of Monitoring	Number
1 Passive Monitoring Only	
Exception monitoring or subjective assessments only. If something goes wrong the agency gets a report or hears about it, but no formal reviews (for example, “we work with them every day, they seem to do fine,” but no documentation of any formal assessment of performance.)	84
2 Active Summative Monitoring	
Evaluated like any other state employee with performance appraisal at end of period	6
Outside firm hired to provide independent, third-party audit or review of contractor performance	6
A product or report is required and must be judged satisfactory before final payment will be made (examples include the punch list inspection for construction, or approving a draft report before final payment)	52
3 Active Monitoring Throughout Contract	
In-house programmatic staff do periodic, formal assessments of the contractors work (example would be formal assessment by in-house legal staff of performance of contracted law firm)	96
Compliance monitoring, monitoring to assure contractor is in compliance with applicable laws and regulations	8
Observation (for example, sitting in on a class to observe the instructor’s performance) or inspections, often using checklists (examples; janitorial and construction contracts)	96
Regular reports are required from the contractor and are reviewed to determine on-going performance	32
Automated tracking of activity (examples include automated systems tracking number of calls answered or call response time)	5
Customer or client surveys/feedback collected on a regular basis	7
Performance incentives and/or penalties included in the contract so that, if the contractor does not perform as required they are penalized, and if they exceed expectations, they receive a bonus.	6
4 Performance-Based Monitoring	
Performance compared to other contractors or employees doing similar work, or compared to industry-wide standards or benchmarks.	11

Source: Random sample of 353 contracts conducted by Program Review staff.
 Note: Observations will not total 353 because some contracts were monitored by more than one method. Also, not all contracts included in the sample had work performed. For those contracts that did not have any work performed to date, no monitoring could be observed.

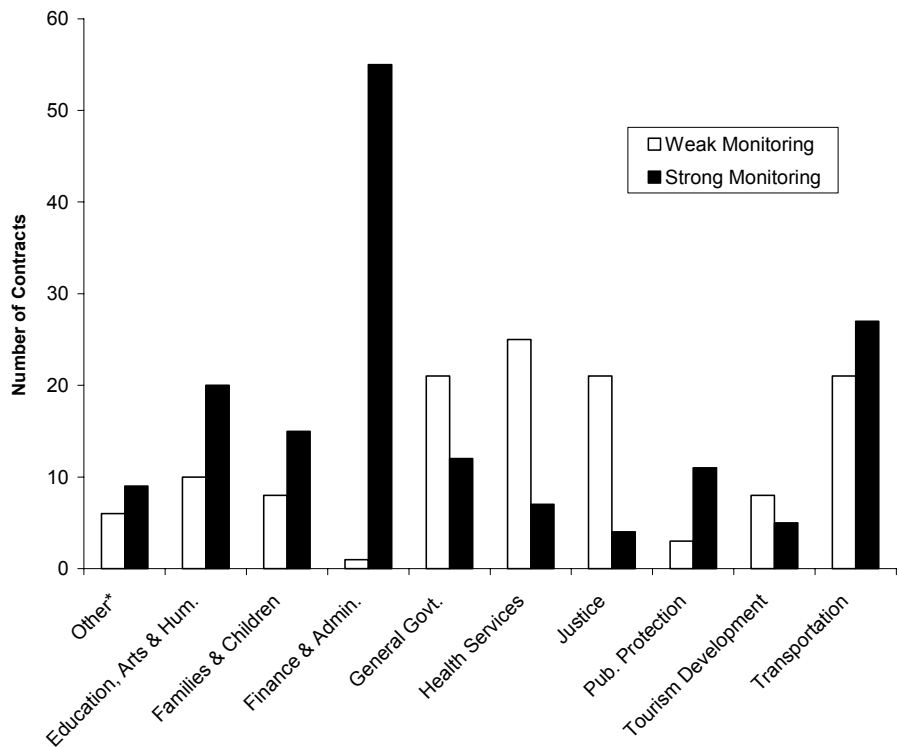
Obviously, some of these methods lend themselves to certain contract types more than others. For example, soliciting feedback from customers is generally limited to those contracts in which the contractor has direct contact with the customer. Similarly, inspections using a checklist to rate performance may be appropriate for a janitorial services contract, but not for a contract for an education curriculum consultant.

Uniform, state-wide contract monitoring system is lacking.

The review of contracts revealed that differences in monitoring methods are not only due to the types of services under contract. Staff found that some agencies seem to have a more rigorous contracting process in place than others. Additionally, contract monitoring practices within the cabinets may vary considerably from contract to contract. Figure 4.C illustrates the average monitoring score by cabinet, as determined by staff’s review of the sample contracts. Weak monitoring consists of those contracts that scored only a one or a two on the contract monitoring scale, while strong monitoring was scored as a three or a four.

Monitoring as rated by Program Review staff by agency

Figure 4.C Comparison of Contract Monitoring by Cabinet



Source: Program Review and Investigations Committee Staff

Based upon the review of contract records and follow-on discussions with agency officials, the Finance and Administration Cabinet seems to be one of the strongest cabinets for establishing procedures for contract monitoring. In large part this is attributable to the Division of Engineering, in conjunction with the Division of Contracting and Administration. These two divisions are responsible for overseeing a large number of the construction, and architectural and engineering contracts awarded by the state. The Division of Engineering has a formal process in place whereby these contracts are reviewed periodically by in-house staff familiar with the technical aspects of each contract. The in-house staff also conduct site visits and weigh the amount of work completed against billing statements and requests for payment. Finally, the division is supposed to withhold final payment on the contract until a formal inspection is conducted of the completed project and all quality issues are resolved.

Contracts with multiple methods of oversight tended to be scored highly.

Contracts with multiple methods of oversight, such as the construction contracts noted above, tended to be scored highly when staff reviewed the contract monitoring process. Yet even a Cabinet with a comparatively high number of contracts using strong monitoring techniques may have problems with some aspects of the contract administration process. For example, while the contracts administered by the Division of Engineering were rated high in the area of contract monitoring, the Auditor of Public Accounts, in the Statewide Single Audit for the year ended June 30, 1999, found that the Division of Contracting and Administration had deficiencies in its internal controls relating to the use of change orders in construction contracts. Architectural and Engineering master agreements in the Finance Cabinet may have multiple projects included under a single agreement. Program Review staff noted that it was difficult, at times, to differentiate among the payments made for different projects under the same master agreement.

Contract monitoring must include financial as well as performance monitoring.

Any contract monitoring system must include aspects of financial monitoring as well as performance monitoring. Agencies must ensure that they are paying no more than contractually required and that charges to the contract are well-founded and properly documented. Since the Auditor of Public Accounts routinely reviews the financial aspect of agency contracting, Program Review staff focused on the issue of monitoring the performance of contractors and the quality of work performed. This should in no way be interpreted to diminish the importance of the financial aspect of contract monitoring.

Another example of a cabinet with a strong contract monitoring program is the Education, Arts and Humanities Cabinet. An example from within Education is the Teachers' Retirement System, which scored well on monitoring the effectiveness of its investment management services. The retirement system uses multiple methods to evaluate the quality of the investment services it receives. These methods include requiring investment services contractors to submit quarterly reports, which are reviewed by an in-house investment committee; hiring an outside firm to do formal assessments of their investment services; and subscribing to an association that provides industry-wide benchmarks against which the Retirement System can rate the returns generated by their investment services contractors.

Another contract with the Teachers' Retirement System for actuarial service, however, was not as well monitored. Retirement system officials told staff that they have been satisfied with the performance of the current contractor, and noted that an actuarial audit of the current service was planned within the next two years. However, they could not point to recent, formal assessments of the contractor's performance. Other agencies also vary in the degree to which they provide formal monitoring of contractor performance. Without uniform, statewide contract monitoring standards, the variability of contract monitoring within the various agencies of state government will be likely to continue.

Transportation Cabinet	
Type of Work: Public relations	
Contract Number:	C-99021052 & C-00161221
Amounts:	\$56,250 & \$56,250
Review Issues: Monitoring, sole source, salary cap	
<p>When the Transportation Cabinet began developing the new Kentucky Vehicle Information System (KVIS), the agency decided it needed someone to serve as a liaison between the Cabinet and county clerks in the state. The Transportation Cabinet issued an RFP and contracted in March 1999 with a retired county clerk from Hardin County. He was the only one to respond to the advertisement. The Cabinet put the contractor under a sole source contract at the beginning of the next fiscal year.</p> <p>The vendor essentially acted in a public relations capacity, meeting with clerks and getting their input on the new system. Officials described the contractor as a “subject matter expert” and “buffer” between clerks and the Cabinet. He remained under contract until June 2001. The contractor originally was to “oversee choice of software and hardware contractors” and “assume the position” to be vacated by the state project manager on his retirement, but officials admitted the plan did not work out because the contractor did not have the technology expertise needed. The Cabinet then put a retiree under sole source contract to serve as project manager. That contract currently costs the state \$175,000 per fiscal year.</p> <p>Transportation Cabinet officials monitored the liaison to clerks on an informal basis, meeting with him weekly and receiving status reports. There were no performance evaluations of the contractor. In addition, Transportation Cabinet officials made no attempt to get the assessment of clerks concerning how the contractor was doing. But a Transportation Cabinet official said they would take the same approach again of having someone deal with clerks.</p> <p>Through a review of the invoices and payment history related to the two contracts for the liaison, it was determined the Cabinet apparently overpaid the contract by at least \$4,000. As of the writing of this report, agency officials were reviewing payment documents to determine the precise amount of overpayment.</p>	

Conclusion

The quality of contract monitoring is inconsistent. Even within agencies, contracts are not monitored with a uniform approach. While all contracts cannot be monitored in the same way, it is crucial that all contracts receive some monitoring. This is important not only for the efficient and effective provision of services, but also for the perception of fairness and uniformity that is crucial to the state's system of awarding contracts.

Recommendation 4.6

The Finance and Administration Cabinet should develop policies and procedures and provide training for all agencies on the necessity of adequate contract monitoring. The training should incorporate industry acknowledged “Best Practices,” as well as guidelines agencies should consider when determining the methods that will provide the best assurances that contracts will be carried out efficiently and effectively.

Contractors’ Views of Monitoring

Over 75 percent of contractors reported that their work was monitored. Only a fifth reported getting feedback during the contract and an evaluation at the end.

Contractors were asked how the work on their most recently completed contract was monitored. As shown in Table 4.10, half the contractors said that were given feedback over the course of the contract. An evaluation at the end of the contract as the only form of monitoring was a rare occurrence; fewer than five percent of contractors gave this answer. About a fifth of the contractors noted that they had received full monitoring: feedback during the contract and an evaluation at the end. About a quarter of contractors (23.6%) though, reported that they had been given no feedback during the contract and had not received an end-of-contract evaluation.

Table 4.10: Monitoring of Most Recently Received Contract

	Contractors	% of Total
Given feedback over course of contract	434	50%
Given evaluation at end of contract	43	5%
Given feedback & evaluation	192	22%
Not given feedback or evaluation	207	24%
Total	876	100%

The amount of monitoring reported by contractors varies by type of contract.

Figure 4.D breaks down the full-monitoring (during and at end of contract) and no-monitoring contractors by the type of contract.³¹

³¹ The chart includes each contract type for which there are at least forty contractors who answered the monitoring question. The types and the number of contractors (in parentheses) are Accounting/Auditing (44), Education (112), Real Estate (40), Social Services (56), Construction (104), Medical (91), Legal

The percentages of contractors reporting no monitoring range from fourteen percent for Accounting contracts to around thirty percent for Medical, Legal, and Architecture/Engineering contracts. The percentages reporting full monitoring range from around thirty percent for Accounting, Education, and Real Estate contracts down to less than twenty percent for Medical, Legal, and Architecture/Engineering contracts. The latter three contract types are also notable for having significantly more contractors reporting no monitoring than full monitoring.

Figure 4.D: Percentage of Contractors Reporting No or Full Monitoring of Most Recently Completed Contract by Type of Contract

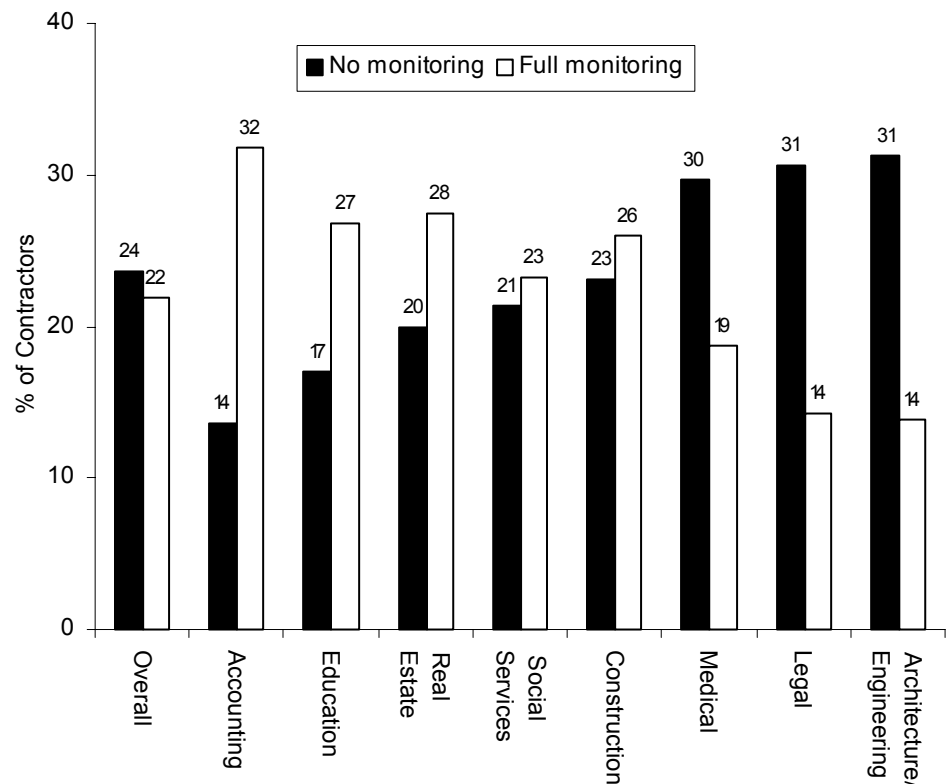


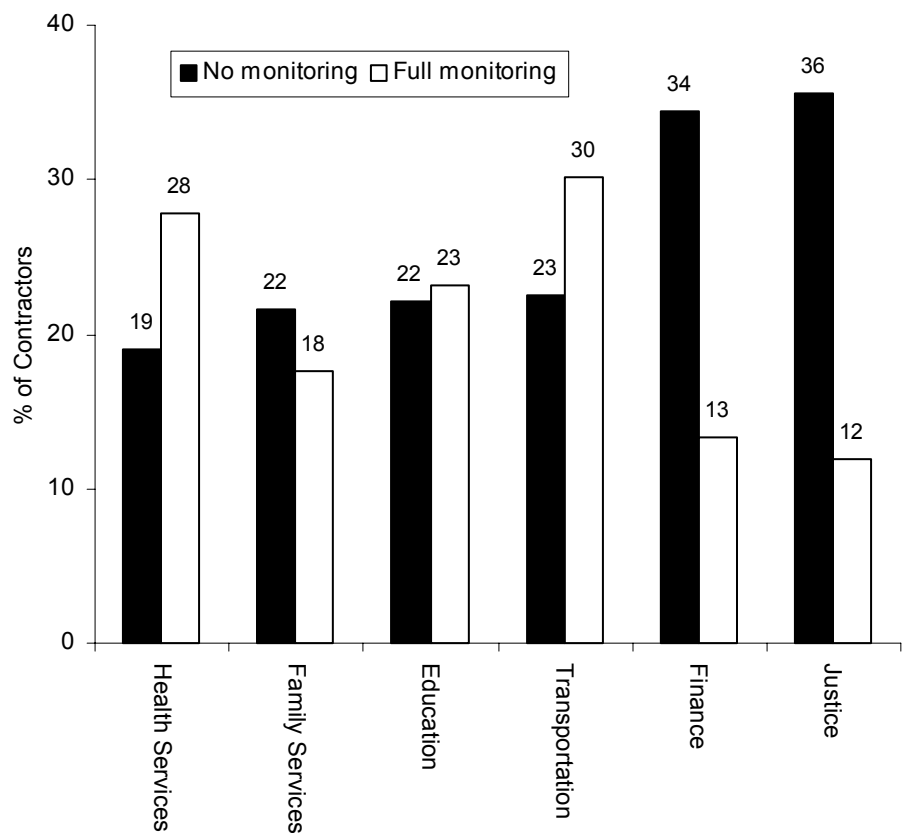
Figure 4.E shows monitoring as reported by contractors by Cabinet.³² For contracts awarded by the Health Services, Families

(49), and Architecture/Engineering (115). “Overall” includes everyone who answered the monitoring question (876 contractors).

³² The issuing Cabinet of the most recent contract is for those contractors who answered the monitoring question and identified only one Cabinet from which they had received contracts (question 14). The figure includes the Cabinets for which there are at least fifty responses. The Cabinets and number of contractors

and Children, Education, and Transportation, around a fifth of contractors said they received no feedback during the contract and no evaluation at the end. Around a third of Finance and Justice Cabinet contractors reported no monitoring. Health Services and Transportation had the highest percentages of contractors reporting full monitoring, about thirty percent. Fewer than fifteen percent of Finance and Justice contractors reported getting feedback and an end-of-contract evaluation.

Figure 4.E: Percentage of Contractors Reporting No or Full Monitoring of Most Recently Completed Contract by Cabinet



There are very obvious differences in the way monitoring was assessed by contractors and by Program Review staff. The sheer number of contractors involved in the survey limited staff's ability to simply go back and ask each contractor about the difference in the assessment of agency monitoring. However, part of the difference may simply be due to a difference in the perception of

are Health Services (79), Families and Children (51), Education (95), Transportation (93), Finance (90) and Justice (59).

the two different sides of the contract. While multiple methods of review may be conducted, these may not seem as beneficial to the contractor as they do to agency officials.

The Finance and Administration Cabinet has the greatest difference in assessments, particularly in the area of architectural and engineering services. In part, this may be a function of the volume of work flowing through that agency. Because there are so many projects going on at the same time, officials within Finance stated that a single project manager may have as many as seventy projects underway at the same time. Though the system may have numerous inspection points and points of review, a project manager with seventy projects underway may not be able to provide a great deal of individual feedback to any particular contractor.

Ultimately, additional research would be needed to determine the reasons for the disparity is the assessment of contract monitoring. Agencies may wish to consider including periodic surveys of their contract workforce in their contract monitoring system to determine if the feedback and monitoring contractors are receiving is meeting the needs of the contractor as well as the agency.

Conclusion

The opinions of those awarded contracts may differ markedly from agency officials charged with contract monitoring and administration. In order to improve the effectiveness and efficiency of the state's contract administration system, the insight of those who have been awarded contracts should be solicited. Such information should be used to balance agency perceptions and promote a system beneficial to all parties involved.

Recommendation 4.7

The Finance Cabinet should undertake periodic surveys of individuals and firms that have been awarded contracts with state agencies. These surveys should be structured so that the results of the survey will help Finance and the individual agencies develop a more effective, efficient, and fair contract award and monitoring system.

Sole Source Contracts Reveal Troubling Pattern

Contract monitoring worse for sole source contracts

Despite the large number of contracts that use some form of active contract monitoring, and the new approaches some cabinets are developing, concerns remain about the significant percentage of contracts that make use of only the most passive methods of contract monitoring. As noted above, twenty-nine percent of the contracts reviewed received only minimal monitoring by state agencies who had failed to perform the elements of a good contract monitoring system promoted by NIGP and The Reason Foundation. What is more troubling is that, when staff looked at those contracts that were not competitively bid, this feature was more pronounced.

Sole source contracts should have a more stringent level of contract monitoring.

Where the benefits of competitive procurement are lacking as, for example, in a sole source contract, it would seem reasonable to expect a more stringent level of contract monitoring. Without the benefits of competitive procurement to drive down costs and increase quality, it is more important than ever to ensure that the services specified in the contract were delivered in the most effective and efficient manner possible.

In order to assess how agencies monitored sole source contracts, Program Review staff isolated the sole source contracts and compared the distribution of monitoring methods in those contracts to the sample as a whole. The sole source contracts were reviewed in the same manner, and at the same time as all other contracts in the sample and were not separately identified until all monitoring scores had been assessed. When viewed in isolation from the complete set of contracts, a very different pattern of monitoring was evident for sole source contracts (see Table 4.11).

Table 4.11 Comparison of Monitoring Methods on all Contracts and Sole Source Contracts

Monitoring Method	Non-Sole Source Contracts	Sole Source Contracts Only
Passive Monitoring Only	25%	50%
Active Summative Monitoring	13%	17%
Active Monitoring Throughout Contract	58%	33%
Performance-Based Monitoring	5%	0%

Source: Program Review and Investigations Committee Staff

Half of sole source contracts are weakly monitored.

Fully fifty percent of the contracts identified by agency officials as sole source were only monitored through a passive process, and none of the sole source contracts were monitored through the performance-based contract monitoring process. In general, the use of the more rigorous, proactive monitoring practices was less frequent while the more passive, reactive monitoring practices was more frequent.

Several of the sole source contracts Program Review staff found to have limited monitoring were issued for very technical professional services, such as legal or medical services. Program officials in more than one agency stated that they did not believe they could adequately judge the work of such specialized professionals. The officials indicated that, unless they had a similar specialized knowledge, they did not feel qualified to assess the quality of the contractors' performance.

These services, however, are not beyond the scope of monitoring systems. For example, the quality of a physician's services may be gauged by surveying the satisfaction of patients, as well as by surveying other healthcare professionals in the same setting, such as nurses or therapists. This provides multiple perspectives on performance of the contracted duties. Legal services may be monitored by in-house legal staff who are charged with reviewing case files. Similarly, legal services are provided for specific purposes, and those within the agency working closely with the legal services contractor should be surveyed to determine their satisfaction with the services being provided to the agency. Agency officials need to be flexible in developing methods that will allow them to assess the quality of services being provided, no matter how specialized the field.

Conclusion

Without the benefits of a competitive award, sole source contracts should be monitored more closely than contracts awarded through a competitive process. Agencies, however, appear to be monitoring sole source contracts with less rigor than other contracts, on average.

Recommendation 4.8

The Government Contract Review Committee should consider requiring additional information on any contract presented for their approval based on a sole source award. Without the benefits of a

competitive award process to rely on, sole source contracts should be monitored more closely, on average, than competitively awarded contracts. The Committee should require a detailed explanation of the monitoring process agencies will follow on sole source contracts to be included with the Proof of Necessity form. Monitoring practices should include those methods the agency will follow to ensure that the services they receive reflect the needs of the agency, are of acceptable quality, and are provided at an efficient price.

There is also a lack of reporting on the results of contract monitoring activities.

Contract monitoring has not failed if it identifies serious problems. If a contractor's performance is judged to be poor, some reporting mechanism should be in place so that other state agencies can be made aware of the contractor's poor past performance. On the other hand, should a vendor do an outstanding job, their performance should be noted so other agencies will be able to identify exceptional performers and make use of them in the future.

MARS system has the reporting capability, but it is not being effectively used.

The MARS system has the capability for agencies to report about vendor performance; however, the capability does not seem to be used extensively. When Program Review staff examined the vendor tracking system within MARS, they found only 118 records of problems with vendors. These 118 records represent only 61 individual contracts—less than a quarter of one percent of all contracts in effect during the period MARS has been in operation. Only 22 of those contracts are for services, one-tenth of one percent of the total number of service contracts in the database. This valuable tool should be used more effectively.

Recommendation 4.9

The Finance and Administration Cabinet should promulgate administrative regulations requiring state agencies to provide assessments of the performance of contractors providing services. The knowledge of a contractor's past performance may be crucial in deciding who can best serve the interests of the Commonwealth in the future.

Pre-qualified Contracts

Pre-qualified contracts do not reflect which contractors actually receive work.

Another special issue staff noted when conducting the initial review of sampled contracts concerns a certain set of contracts that were not being exposed to the same level of review as other contracts. These contracts are pre-qualified Master Agreements,

approved by both the Finance and Administration Cabinet and the Government Contract Review Committee based upon the technical merits of the contractor, but not necessarily reflective of who actually receives the work to be performed.

**Finance,
Transportation, and
Natural Resources
Cabinets all use pre-
qualified contracts.**

Examples of these pre-qualified contracts include the Architectural and Engineering contracts in the Finance and Administration Cabinet, the Small Operator Assistance Program (SOAP) contracts in the Natural Resources and Environmental Protection Cabinet, and the right of way and appraisal contracts in the Transportation Cabinet. The Architectural and Engineering contracts are the most common, with 391 contracts awarded in FY 2000 to 230 different vendors.

The Transportation Cabinet also prequalifies highway construction contractors, consulting engineers and right of way acquisition firms and appraisers, but the scope of this study did not include construction contractors. Other than in the construction sector, Transportation prequalifies contractors in two main divisions, Professional Services and Right of Way. Both divisions have rigorous experience and education requirements that contractors must meet to be considered for the prequalification list. Further, appraisers in the Right of Way Division must pass a written test before receiving prequalification status. Contracts in both divisions are subject to Government Contract Review Committee review.

Most of these contractors are awarded Master Agreements in these areas based upon their technical qualifications. In the example of the Architectural and Engineering Master Agreements, each is issued with a \$100,000 not-to-exceed amount for a year. Officials within the Finance Cabinet told staff that these contracts are awarded to anyone who requests a Master Agreement as long as they have a valid architect's or engineering license and complete the appropriate paperwork.

Because these are Master Agreements, no specific funds are reserved (encumbered) when the contract is awarded. The contractor has merely been authorized to do work, if needed, up to the amount of the Master Agreement. In addition, contractors can be awarded these Master Agreements in more than one technical discipline, so a single contractor could be awarded a number of Master Agreements for \$100,000. In the Architectural and Engineering example, firms may be awarded a Master Agreement in any one of ten disciplines, ranging from landscape architecture to HVAC to aerial surveying.

When a project is identified, the agency is at liberty to select among the contractors who have been awarded a Master Agreement and to encumber the funds for the project through a Delivery Order. In the use of the SOAP Master Agreements, the selection of a contractor is made by the small operator, and agency staff have no control over which contractors receive work under the contracts. In other instances, the agency staff determine which contractors among those with Pre-Qualified Master Agreements actually receive work.

In the example of the Architectural and Engineering contracts in the Finance Cabinet, the project managers have discretion as to which firm they choose to work on any particular project. Project managers said that they look at a variety of things like the location of the project and the possible contractors nearby, specific project skills needed, confidence in the ability of the contractor to get the job done, minority participation, immediacy of need, and the wishes of the agency for whom the project is being designed. Their choice is also limited by the money left before the contractor reaches the \$100,000 limit on the particular Master Agreement, so running totals of all projects assigned to each Master Agreements must be kept accurately and up to date. The Finance Cabinet has specific equal opportunity rules that govern selection of the businesses as well.

Managers within the division of engineering told staff that one major advantage in using the Master Agreements is that it is possible to have a pool of architects and engineers to draw from if work becomes necessary. This process saves time if a project is needed quickly because the Master Agreements are open from the beginning of the fiscal year. Often a project, such as a storm-damaged roof, will arise quickly and the need to fix it will be immediate. In these situations using a Master Agreements can allow the work to be performed very quickly.

There is little accountability in the selection of which contractors actually receive work.

One difficulty with this arrangement is that there is little accountability regarding the selection of which contractors actually receive work. For FY 2000, only forty-two percent of the Architectural and Engineering contractors who had Master Agreements actually received work. While the Government Contract Review Committee reviews the award of the individual Master Agreements, they do not receive information about which contracts actually receive work. The Government Contract Review Committee may wish to consider requiring reporting on the use of these Master Agreements on a semi-annual basis to ensure that

some firms are not being favored in the distribution of work at the expense of other deserving firms.

An additional concern about this award method is that project managers within the division make their decision without any competition among the contractors. While this may make for a speedier award, it does not necessarily promote a cost effective award. Emergency declarations are already established as a method of expediting the award of contracts in urgent situations. The lack of any competitive process in the award of Architectural and Engineering work should be revised to ensure that the state is receiving the highest quality work at the most efficient price.

Two firms have received 25 percent of work on prequalified contracts in Transportation's Division of Professional Services.

In the Transportation Cabinet, the Division of Professional Services has about 150 firms prequalified in more than a dozen aspects of transportation engineering work, but only about one-third of that number have received engineering jobs since late 1997. One company alone has received fifteen contracts totaling almost \$15 million. Another company has received eleven contracts totaling just over \$11 million. Work awarded to those two companies alone accounts for over twenty-five percent of the more than \$97 million in engineering work through January of this year.

When highway work becomes available through the Six-Year Road Plan or other ways, the Division of Professional Services posts public notices asking for design proposals from prequalified engineering firms. A committee reviews the proposals and selects what it considers the best proposal. Division personnel and the potential contractor then negotiate a fee. Two alternates are also selected in case the cabinet cannot negotiate a mutually acceptable fee with the initial firm.

The Director of that Division told Program Review staff that he instructs the selection committees to not dwell on the size of a firm when making a contract decision. Also, he said some firms that do not win a contract as a prime engineering contractor may actually perform subcontract work for a prime contractor and, thus, would not show up on the list of those getting engineering work.

Another Division has pre-qualified retirees doing significant amounts of work.

The Right of Way Division prequalifies in two areas — property appraisers and right of way consultants. The Division has over eighty people or firms prequalified for appraisals. Of that number, over half have received appraisal contracts since January 1999. These contracts vary in size, depending on the scope of the job. One appraiser has received work totaling over \$235,000 since that

time. On the other hand, two appraisers have each received a single job totaling \$2,000. The Division has about six state retirees who do appraisal work, with one of those getting almost \$182,000 for thirty-two contracts during the time period. An official said the retiree mostly has reviewed other appraisers' work or has written project reports. Division officials defend the practice of using state retirees under contract because they have a high level of expertise based on their previous transportation experience.

Selection process to be revised in the future.

One problematic area regarding appraisers may be in the way the Division selects them for work. When contract work comes available, Division personnel draw up a list of potential appraisers to perform the service, then narrow that down to one and contact him or her. If the appraiser agrees, they send him or her a request for a proposal. According to a Division official, they plan to revise that procedure in the future and send RFPs to perhaps three or four appraisers for competitive bids.

In addition, the Division has ten firms prequalified to handle comprehensive right of way acquisitions (they do not do appraisals). One of the companies, which also is qualified as a consulting engineering firm, has received eight contracts worth over \$3.5 million out of the twenty-nine contracts awarded during the period totaling \$9.4 million.

SOAP contract work not awarded by state agency personnel

Finally, the Small Operator Assistance Program (SOAP) prequalification procedures work differently than do those in Finance and Transportation. Engineering firms are prequalified to perform work under SOAP, but small coal mine operators who need engineering work make their own selections. According to SOAP data, about fifty-four engineering firms are prequalified. Of that number, a total of seventeen have received mine engineering work since July 1999.

Conclusion

As part of its oversight function, it is essential that the Government Contract Review Committee have access to information about contracts which actually work for pay. The use of pre-qualified master agreements may make it difficult for the Committee to determine which contractors are being awarded work, and in what amount.

Recommendation 4.10

The Government Contract Review Committee should consider requiring quarterly or semi-annual reporting on the use of pre-

qualified master agreements. Such reporting could detail the number of projects and the estimated cost of work awarded under each Master Agreement as well as the amounts actually expended.

CHAPTER 5

RECOMMENDATIONS FROM PRIOR REPORT

**Previous Program
Review report
addressed pre-MARS
contract administration.**

In July 1999 a Program Review and Investigations Committee report was published on the pre-MARS system of contract administration. That report, called *State Agency Service Contract Administration*, raised several concerns that were similar to those raised in the current study.

The earlier study used a different approach and discussed service contracting procedures among state agencies, and procurement procedures of the Finance and Administration Cabinet. A central component of the study was a survey of ninety-one agencies and their contract administration procedures. Staff also surveyed fifteen other states about their contract administration practices. The report compared contract administration practices in Kentucky state agencies to best practices of organizations from other states, the federal government, and the private sector.

Agencies responding to the earlier survey complimented the Finance and Administration Cabinet on its help in providing information and assistance with the contracting process. On the other hand, the survey respondents noted that contract administrators tended to be part-time, received little training—other than on the job—and lacked any clear guidance or monitoring from the Finance and Administration Cabinet. Although most agencies indicated they believed they did a good job in administering contracts, few used performance standards, penalties or sanctions, performance monitoring, or post-contract evaluations. Agencies expressed to Program Review staff the need for training, contract administration policies and guidelines, contractor performance data, and general assistance.

**Recommendations from
July 1999 report and
agency response.**

The following recommendations were contained within the July 1999 Program Review report on State Agency Service Contract Administration. As part of the current review of contracting practices, the Finance Cabinet was asked to briefly address how they have responded to each of the recommendations from the previous report. The response was provided by the Commissioner of the Department for Administration on June 8, 2001. The following summarizes the 1999 recommendations and the current response to those earlier recommendations.

Finance should review agency plans for contract administration and audit select contracts.

1999 Recommendation 1:

The Finance and Administration Cabinet has statutory responsibility to issue regulations and guidelines and ensure compliance. The Cabinet should review agency plans for contract administration and physically audit their actions on a periodic basis, concentrating especially on complex contracts, high cost contracts, contracts to be renewed, and those having significant impact on health or safety.

Current Finance Cabinet Response:

“The Division of Material and Procurement Services is working with the Division of Administrative Policy and Audit to establish periodic audits of agency procurements, especially Small Purchases as defined under KRS 45A.100. In addition, the Division of Material and Procurement Services regularly reviews complex, high cost contracts at the time those contracts are scheduled for renewal or rebidding.”

The Finance Cabinet should develop a training program for agency personnel assigned responsibility for contract monitoring.

1999 Recommendation 2:

In delegating authority to the agencies for all aspects of contract administration, the Finance Cabinet is responsible for ensuring that agencies are capable of performing the duties. The Finance Cabinet should develop a training program for agency personnel assigned responsibility for contract monitoring. Such a program could be developed through the Governmental Services Center. Finance should also organize periodic workshops, utilizing staff from state agencies with contract administration expertise, or utilize other resources, such as the training provided by the National Institute of Governmental Purchasing.

Current Finance Cabinet Response:

“In anticipation of the implementation of the Management and Administrative Reporting System (MARS), the Finance and Administration Cabinet created the Customer Resource Center (CRC) in April 1999. As a part of its mission, the CRC provides MARS related training to all state agency personnel. Both the Division of Material and Procurement Services and the Division of Contracting and Administration are working with the CRC to develop contract administration training for state agency personnel. In addition, the Division of Material and Procurement Services has contracted with the National Institute of Governmental Purchasing (NIGP) to provide training this fall to all interested state agency personnel.”

Finance should require agencies to include provisions related to performance assessment, monitoring, and documentation in all service contracts.

1999 Recommendation 3:

The Finance and Administration Cabinet should require agencies to include in all service contracts provisions related to enforcement, performance assessment, monitoring and documentation. Finance should develop model guidelines based upon the various major categories of contracts, to assist the agencies and provide training to assist agency legal staff in drafting such provisions.

Current Finance Cabinet Response:

“The Finance and Administration Cabinet is currently working to revise the Policy and Procedure Manual to include guidelines related to enforcement, performance assessment, monitoring and documentation. Training is to be provided by the CRC.”

The Finance and Administration Cabinet should define the roles and responsibilities for agency contract administrators.

1999 Recommendation 4:

The Finance and Administration Cabinet should define the roles, responsibilities, and necessary expertise for agency personnel serving as full-time or part-time contract administrators. The defining should be in line with the professional standards Finance now requires agencies to follow in administering contracts.

Current Finance Cabinet Response:

“The Finance and Administration Cabinet is reviewing the roles, responsibilities and expertise for agency contract administrators in conjunction with the revision of the Policy and Procedure Manual.”

The Finance Cabinet should identify sound principles of effective purchasing in its regulations and provide necessary guidelines and policies using them.

1999 Recommendation 5:

Finance Cabinet regulations require that agencies administer contracts in accordance with sound principles of effective purchasing. This report outlines the major principles recommended by federal, state, and private organizations. The Finance Cabinet should identify these “sound principles” in its regulations and provide necessary guidelines and policies using them.

Current Finance Cabinet Response:

“As already stated, the Finance Cabinet is currently in the process of updating the Policy and Procedures Manual which will contain the major principles recommended in the LRC report of July 1999.”

The Finance Cabinet should maintain documentation of complaints and problems encountered during contracts.

1999 Recommendation 6:

The Finance Cabinet should require agencies to submit a record of complaints and problems encountered during a contract and agency satisfaction with the resolution. In addition, Finance should develop a post-contract evaluation form for the agency to rate the contractor's performance, strengths, and weaknesses. This documentation should be maintained in Finance by contractor and available to the agencies.

Current Finance Cabinet Response:

“The Procurement Desktop (PD) module within MARS provides a process for agency personnel to record complaints, problems, and agency satisfaction with vendors. In addition, there is an on-line form for agencies to rate vendor performance, strengths, and weaknesses. This data is available for all agencies to access through PD.”

Post-contract reviews for services of a recurring nature should be required, evaluating the effectiveness, cost, and savings related to the contract as well as strengths, weaknesses, and improvements for future contracts.

1999 Recommendation 7:

Finance should require agencies to perform post-contract reviews for services of a recurring nature of certain dollar threshold. These reviews should evaluate the effectiveness of the service; costs and potential cost savings related to the contract for the service; and strengths, weaknesses, and improvements for future contracts. Agencies should be required to document these reviews, maintain copies with the contract files, and submit copies to the Finance Cabinet for maintenance in Finance contract files.

Current Finance Cabinet Response:

“As stated in the previous response, PD provides agencies with a method to evaluate vendor performance for all contracts, including service contracts. These records are maintained by the agencies on-line and available to Finance for review as needed.”

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APPENDIX A

THE PROCUREMENT DESKTOP EXTRACT

VENDOR PAYMENTS

**THE PROCUREMENT DESKTOP EXTRACT
VENDOR PAYMENTS**

Appendix A contains more detailed information on topics discussed previously in this report. Definitions and frequencies are provided for the types of contracts included in the Procurement Desktop (PD) extract described in Chapter 1. Greater detail is also furnished on how vendors are paid, a topic from Chapter 2.

The Procurement Desktop Extract

There are twelve categories of contracts in the Procurement Desktop extract.

Categories of Contracts in the PD Extract

The 36 different contract sub-types can be aggregated into twelve broader categories:

Personal Service Contracts (3,115 contracts in the PD extract) are for contracting for *professional services*. KRS 45A.690 defines professional services as those that require “professional skills or professional judgement.” Contract sub-types found within this category are PSC Standard, PSC Legal (routed through the Governor’s Office), PSC Contingency Fee (for collection type services), and PSC Standard Fixed Price Master Agreements (used when an encumbrance amount is indeterminable because the agency is contracting with multiple vendors to provide the same services and it is unknown how much a given vendor will be used).

Price Master Agreements (1,262) are for goods or *non-professional services* and are generally stated in terms of agreed unit price. Sub-types in this category are Standard Fixed Price and Fluctuating Price. The Fluctuating Price contract allows for volatile market prices, where delivery orders can exceed stated unit prices. An older sub-type called RFP Master Agreement was rolled into this category.

Construction Contracts (805) are for construction projects including agency small construction.

Architectural/Engineering Master Agreements (768) are used primarily by the Finance and Administration Cabinet to pre-approve vendors for architectural and engineering services as needed. Delivery orders are issued for specific work as the need arises. The Cabinet’s authority is granted by KRS 45A.825 and KRS 45A.837 (engineering services).

Special Authority Contracts and Master Agreements (685) require prior approval by the Director of the Division of Material and Procurement Services.

Department of Transportation (DOT) Contracts (3,186) are not routed through Finance and Administration for approval and include the following sub-types: DOT Special Authority, DOT Small Purchase, DOT Small Construction, DOT Repair Parts, and DOT Emergency Purchase.

Standard Contracts (13,899) are general contracts such as small purchase, sealed bids that do not fit the other contract types listed here.

Memoranda of Agreement and Internal Master Agreements (11,664) are for agreements with governmental and quasi-governmental entities. They include memoranda of agreement (MOA), memoranda of understanding (MOU), program administration contracts, and interlocal agreements meeting the definition of a memorandum of agreement in KRS 45A.690. Document sub-types in PD are MOA Standard contracts and Master Agreements, MOA Internal Master Agreements for internal vendors such as the Auditor of Public Accounts, MOA Grant Master Agreements for sub-recipients of Federal grant funds, MOA Universities Master Agreements, and Internal Master Agreements used by Material and Procurement Services for price agreements with internal vendors such as Kentucky Correctional Industries.

Property Rental Contracts (1,473) are for leasing of space by an agency from an external vendor.

Revenue Generating Master Agreements (13) are used when the Commonwealth is receiving revenue from a vendor, such as 20 percent of sales from a concession stand.

Provider Agreements (36) are used to set up an agreement with a provider of direct Medicaid health care to individuals.

Catalog Master Agreements (1,427) are contracts with vendors that provide commodities through an electronic catalog accessible to multiple agencies. These contracts are predominantly for goods as opposed to services.

A standard Commodity Code in conjunction with contract types was used to delineate contracts for services.

Selecting Contracts for Services from the PD Extract

When a contract line is keyed into PD, a commodity code is selected from a list. In this analysis, the code was used to distinguish contracts for services from contracts for goods. Contracts with services line were selected, except services lines with descriptions that included “freight, ” “shipping, ” “handling, ”and “postage.” Catalog Master Agreements, which did not have a commodity code, were reviewed separately to discern whether particular contracts were for services or goods based on the contract description.

Vendor Payments

Agencies at first had difficulty using MARS to make payments.

At the time MARS began to be used, the interface between PD and Advantage was not fully functional. There was a period of time when agencies had difficulty using the system as designed to make payments to vendors. As a result, payments were made with Vendor Payment Vouchers and stand-alone invoices that did not reference the contract.

Agencies were directed to use stand-alone invoices to pay on contracts in certain circumstances.

Stand-alone invoice payments that do not tie back to contracts may have been more extensively used, both intentionally and unintentionally, than the other two types of untraceable payments. In some circumstances, agencies were instructed to use stand-alone invoices to pay on award documents. One such instance involves payments on catalog master agreements. The following is quoted from a July 1999 Project Update disseminated by Finance and Administration: “To create an invoice directly from a Catalog Master Agreement (for example, janitorial services where no delivery order is needed), a stand-alone invoice is required.”

Agencies were also instructed to use stand-alone invoices during the closeout period of Fiscal Year 2000 after encumbrances had been moved to FY 2001. The Comprehensive Annual Financial Statements closeout period runs for two weeks beyond the June 30 fiscal year end. All payments must be made during or prior to this period to tie the expenditure to the amount encumbered for a particular contract. A problem arises when vendors do not submit all current fiscal year invoices to the agency responsible for payments before the financial statement closeout period. In these cases, agencies must submit payment through a stand-alone invoice that will not tie to the contract.

Stand-alone invoices were unintentionally created by agencies using a common practice of copying prior invoices on contracts receiving multiple periodic payments.

Additionally, for contracts that had multiple periodic payments, stand-alone invoices were *unintentionally* created by agencies when they copied the original invoice document to create a subsequent payment. In these instances, the invoice in Procurement Desktop appeared to reference the document correctly, but the payment information sent to Advantage and recorded in MRDB did not include the information needed to link the payment to the contract. Thus, payments made using this copy function were not recorded against the contract and not-to-exceed amounts could be exceeded.

Agencies have been instructed not to use the other two vendor payment methods, Miscellaneous Quick Payments and Vendor Payment Vouchers, for payments on contracts. Agency staff said they did not pay invoices submitted for personal service contract work through Miscellaneous Quick Pay. They said they use Miscellaneous Quick Pay for small purchases or miscellaneous payments under \$1,000 — a utility bill for example. It would be expected that these methods would not be used to pay on contracts because they do not liquidate encumbrances that are created by contracts or delivery orders. However, agencies are not *precluded* from paying vendors with these means, and their use can lead to undetected duplicate payments.

APPENDIX B

THE SAMPLE OF CONTRACTS

THE SAMPLE OF CONTRACTS

Appendix B details the selection process for contracts in the sample of contracts analyzed in Chapter 4. This appendix also includes a copy of the data collection instrument used to gather information from agency officials about each of the sample contracts.

A sample of 353 contracts were selected for in-depth analysis.

The Selection of the Sample Contracts

Because it was not feasible to do in-depth analyses of all 4359 contracts, a sample of 353 contracts was chosen. Contracts in the sample were chosen randomly, so it is possible to generalize from the sample to the population with a known margin of sampling error. The margin of error will usually be plus or minus five percentage points, at most. The exact margin of error will vary by question, depending on the variation of answers and the number of contracts for which the question was answered.

The sample size of 353 was calculated based on three assumptions. First, the maximum acceptable error for a statistic from the sample was assumed to be plus or minus five percentage points. Second, the assumed proportion of responses was assumed to be 50-50. For example, this means that for a question that could be answered “yes” or “no,” it was assumed that for half the contracts the answer would be “yes.” This is a conservative assumption, and it means that the margin of error will usually be smaller when there is less variation, a 70-30 split for example. Third, a 95-percent confidence interval was chosen. This means that if we took 100 samples of 353 contracts, the answer to a question would be within the margin of error in 95 of them.

The standard formula for calculating efficient sample size for a random sample was used:

$$n' = p(1-p)/(te/1.96)^2$$

where n' is the sample size without adjusting for size of the population; p is the presumed proportion for responses (.5); te is the tolerable error (.05); and 1.96 is the standard score for a 95 percent confidence interval.

The formula to adjust the above to take the size of the population into account is:

$$n = n' - (n'(1+n')/N)$$

where N is the size of the population (4359).

Once the sample size of 353 was determined, the specific contracts to include in the sample had to be chosen. The sample size was divided based on the proportions of contracts with beginning effective dates within each quarter of the time period studied. For instance, since one third of the 4359 contracts began in the first quarter of FY2000-2001, one third of the sample is from that period too. Within each quarter, the appropriate number of contracts was chosen at random. The breakdown of contracts in the sample by quarter is as follows:

Beginning Effective Date	Number
2000-01, Quarter 1	118
2000-01, Quarter 2	26
2000-01, Quarter 3	30
2000-01, Quarter 4	33
2001-02, Quarter 1	146
Total	353

The Data Collection Instrument

The following page contains an example of the data collection instrument staff used to interview agency officials about each of the contracts. A similar instrument was developed for each contract in the survey. Staff used the instrument to guide their discussions with agency officials to ensure that the same information was collected in every instance. Additional information provided by agency officials during the course of the interviews was recorded by staff and included in the contract review.

Example of Data Collection Instrument

1	C-00005056	Contract-PSC-Standard	FY00:3	1/10/00 thru 6/30/00	Expired
30 - REVENUE -- 301073 REV-ADMINISTRATION, DIV OF			Contract Amount		\$57,500.00
CONTRACT ADMINISTRATOR: DANA MAYTON - 5025646866			Mods Included		\$0.00
CITED AUTHORITY: BO111-43-00-00 Perso					
CONTRACT DESCRIPTION: C30-RB					
VENDOR: 263564889-00 -- BAHL, ROY		LOCATED IN ATLANTA	, GA	Line Total	\$57,500.00

GOVERNMENT CONTRACTS REVIEW COMMITTEE INFORMATION

Date that this contract was filed with Gov. Contracts Review Committee? . . . _____ (A) NA

LRC Approval in Procurement Desktop: 2/15/00 11:05:18 AM

Proof of Necessity form exists? <input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> NA	Yes	No	NA	If Yes:	Yes	No
COPY				Item #3 -- Is there an explanation of work to be performed?	<input type="checkbox"/>	<input type="checkbox"/>
				Item #5 -- Does cost match contract amount?	<input type="checkbox"/>	<input type="checkbox"/>
				Item #6 -- Is justification specified?	<input type="checkbox"/>	<input type="checkbox"/>
				Item #9A -- Is agency monitoring official identified?	<input type="checkbox"/>	<input type="checkbox"/>
				Item #9B -- Are monitoring activities specified?	<input type="checkbox"/>	<input type="checkbox"/>
				Signed by Finance Secretary?	<input type="checkbox"/>	<input type="checkbox"/>

AGENCY-LEVEL INFORMATION

How was this contract awarded? **Yes** **No**

Circle One: Competitively Bid RFP Sole Source** Emergency Declaration** Other _____

** For astericked items, is there a signed Exemption Letter?

COPY IF YES

What is the nature of the legal binding agreement between the agency and vendor?

Circle One: PD Document Other Contract Other _____ Vendor Signature?

COPY **COPY**

Are there additional clauses pertinent to the performance of work on the contract?

COPY IF YES

Post Award Monitoring

Important Dates and Payments:

Work start date _____ First payment date _____ Last payment date _____ Total paid as of 12/31/00 _____

(B) (C)

Dates and payments traceable in Advantage	6/30/00	6/30/00	1 pmt(s)	\$3,008.00
---	---------	---------	----------	------------

If dates B or C are before date A, was Emergency Declaration circled above?

Was any part of work subcontracted?

Is there documentation of hours worked?

COPY IF YES

Is there documentation of other reimbursed expenses?

COPY IF YES

How many people were employed on this contract? _____ How many total hours of work? _____

Is there a record of work products delivered?

Are there specific Federal Guidelines concerning monitoring of this contract? Yes No

COPY

Is there any documentation of agency monitoring of this contract? Yes No

COPY

If Yes, is reference given to the completion of specific contract requirements? Yes No

APPENDIX C

THE SURVEY OF CONTRACTORS

THE SURVEY OF CONTRACTORS

This appendix details how the sample of contractors was conducted and provides support for the sample being representative of all contractors who have received contracts in the past two fiscal years. A copy of the questionnaire used and detailed frequency tables for contractors' answers to questions are also included.

How the Survey Was Conducted

A mailing list was compiled of the 2254 contractors located in the United States who had received at least one state service contract in Fiscal Year 1999-2000 or Fiscal Year 2000-2001. We mailed a four-page questionnaire to each of them. A week later, everyone on the mailing list received a postcard thanking them for responding if they had done so and, if they had not, again encouraging them to complete the questionnaire. Those who did not respond after the first mailing were mailed a second copy of the questionnaire. Those who still had not responded to the first or second mailings received a third and final questionnaire. The first mailing was done in late April 2001. Over three fourths of those who responded did so within a month of the initial mailing but responses trickled in through July. During the survey process, 55 incorrect contractor addresses or contact names were discovered, meaning that 2199 contractors (2254 minus 55) presumably received the questionnaire and had a chance to complete it.

Contractors returned 1137 completed questionnaires for an overall response rate of 51.7%. Not surprisingly, the response rate for contractors located in Kentucky was much higher than for out of state contractors, as shown in the following table:

Response Rates for Mail Survey of Contractors

	Received Questionnaire	Completed Questionnaire	Percent Completed
Kentucky Contractors	1748	978	55.9%
Out-of-state Contractors	451	159	35.3%
Total	2199	1137	51.7%

The Representativeness of the Sample

This is a large sample and a response rate of over 50 percent is excellent for a mail survey. However, because this is not a random sample, it is subject to response bias. It cannot be ruled out that the contractors who chose to respond to the survey are meaningfully different from those who did not. It is possible, however, to analyze available information to increase confidence that this sample is representative of all service contractors over the past two fiscal years.

First, a rough comparison can be made of the state government cabinets through which contracts have been received for contractors in the sample and all contractors. This comparison is useful because cabinets differ in the average dollar value of contracts they administer and in the average number of contracts per contractor, as well as how they administer contracts. The information from surveyed contractors is from a question asking them from which agencies they have

received contracts over the past *three years*. The source for all contractors is the information available via MARS on contracts within the past *two fiscal years*.

Besides the difference in time frame, there is another problem in making an exact comparison between the sample and population data. Surveyed contractors are naming agencies from memory. Some omitted naming any agencies, and others' answers could not be classified. In sum, the comparison between the sample and the population, as shown in the following table, will have to be an approximate one.

Contracting Agency for Survey Respondents and All Contractors

	Survey	All Contractors
Transportation Cabinet	19.5%	14.8%
Finance & Administration Cabinet	19.3%	25.0%
Education Cabinet	14.5%	11.1%
Cabinet for Health Services	13.5%	8.7%
Justice Cabinet	11.3%	7.7%
Cabinet for Families & Children	10.8%	9.4%
Natural Resources Cabinet	5.7%	6.5%
Public Protection & Regulation Cabinet	4.7%	5.0%
Tourism Development Cabinet	3.9%	5.1%
Economic Development Cabinet	0.7%	0.8%
Labor Cabinet	0.4%	1.1%
General Government	9.8%	13.2%

Based on this table, the sample of contractors seems to be a reasonable representation of all contractors. The biggest differences are that the sample has a higher percentage of contractors from Transportation and a lower percentage from Finance and Administration. However, the percentages for most cabinets are close and, more importantly, given that precise comparisons are not reasonable here, the cabinets' rankings are similar. The cabinets that have a higher percentage of contracts in the population have higher shares among surveyed contractors too. The cabinets in the population that contract less frequently do so among the sample contractors too.

Another way to address the question of potential response bias is to compare those who responded to the survey quickly and those who responded later. The logic is that if there is a response bias, those who respond later may be more similar to those who do not respond at all. For example, a worry with most surveys is that those who have more negative attitudes about the subject of the survey are more likely to respond without much prompting. In this case, that would be contractors who have complaints about the current system. So if early respondents are very different from late respondents, that could indicate response bias. To see if that is the case here, the surveyed contractors are divided into those who responded after receiving the questionnaire in the mail once (55 percent of respondents) and those who only responded after one or two more mailings (45 percent). The answers of late respondents are then used as proxies for those who did not respond to the survey at all. Based on this assumption, it is possible to project what the survey results would be if the response rate was 100 percent.

The tables below compare the actual results from the survey with the projected results. The first table shows the distribution for the type of contracts that contractors said they had received in the past three years.

**Types of Contracts Over Past Three Years,
 Survey and Projected**

	Survey	Projected
Architectural/Engineering	13.7%	13.1%
Education	12.4%	13.1%
Construction	11.6%	12.5%
Medical	11.0%	9.4%
Social Services	6.5%	6.1%
Legal	6.4%	6.3%
Real Estate	4.5%	4.7%
Accounting/Auditing	4.2%	4.3%
Surveying	3.7%	3.8%
Janitorial	3.6%	3.3%
Financial	2.2%	1.9%
Geological	1.1%	1.1%
Other	27.2%	29.4%

The differences between the results based on the answers of those who returned the survey and the projected results are small. The differences by contract type range from zero to only 1.6 percentage points.

Although the survey respondents appear to be representative in terms of the types of contracts received, their views on the contracting process could still be unrepresentative. To address this question, the actual and projected results are shown for six questions on aspects of contracting. The percentages indicate those who disagree or strongly disagree with each of the statements in the first column.

**Evaluations of Contract Administration,
 Survey and Projected Percent Disagreeing with Each Item**

	Survey	Projected
Contracts Well Publicized	16.1%	15.8%
Contracts Awarded Fairly	8.8%	8.6%
Contracts Awarded in Timely Fashion	10.6%	10.1%
Work & Expenses Fairly Compensated	14.7%	13.5%
Meetings, Paperwork Time Appropriate	8.5%	8.5%
Payments Are Timely	10.9%	10.6%

As before, the differences between the actual and projected results are miniscule. The representativeness of a sample can never be guaranteed, but all indications are that those who responded to the survey are typical contractors in terms of who they are and their views on contracting.

SURVEY ON KENTUCKY CONTRACTS FOR PERSONAL SERVICES

The following survey should take only a few minutes to complete. Your participation is voluntary and you may skip any questions that do not apply to you.

Your answers are confidential; any information that would identify you will not be associated with your answers in any report or public communication. You may choose to provide your name and contact information at the end of the questionnaire for possible follow-up communications from our staff about state contracts for personal services. If you do so, any information you provide will not be publicly associated with you by name.

You may respond as quickly as convenient, but a reply by **May 11** would be most appreciated.

For each question, please indicate the best response for you. When appropriate, please explain your answer to a question. Feel free to use a separate sheet of paper if necessary.

EACH QUESTION ON THE SURVEY APPLIES ONLY TO **CONTRACTS FOR PERSONAL SERVICES FUNDED BY KENTUCKY STATE GOVERNMENT**. Thank you.

Question 1: *How do you find out about available state contracts for personal services? Please choose all that apply.*

- Contacted by Ky. state agency
If yes, which one(s)?

- Newspaper announcement
If yes, which newspapers?

- Through a professional association
If yes, which one(s)?

- A Ky. government web site
If yes, which one(s)?

- E-mail distribution list
- From having a similar contract in the previous year
- Other (*please list*)

2: *Do Ky. state agencies do enough to reach potential personal service contractors?*

- Yes No ↓

If no, what suggestions for improvement would you make?

3: *To your knowledge, how many other contractors were considered for the most recent personal service contract that you received?*

- None
- 1
- 2
- 3 or more
- Others were considered but I do not know how many
- Don't know

4: *In the year **2000**, about what percentage of your income was from **Kentucky** state contracts for personal services?*

QUESTIONS 5 THROUGH 14 APPLY TO PERSONAL SERVICE CONTRACTS WITHIN THE PAST THREE YEARS (JULY 1, 1998 TO PRESENT).

5: *In the past three years, were you interested in any state personal service contracts requiring the submission of bids?*

- Yes (Go to question 6)
 No (Go to question 7)

6: *In the past three years, did you usually find out about state personal service contracts early enough to prepare suitable bids?*

- Yes No ↓

If no, please explain:

7: *In the past three years, did you ever have problems in becoming officially pre-qualified for Ky. agencies that require pre-qualification before bidding on personal service contracts?*

- Yes ↓ No Not
Applicable

If yes, please explain:

8: *In the past three years, what types of contracts for personal services have you received?*

- Architectural / Engineering
 Construction
 Legal
 Medical
 Financial
 Accounting / Auditing
 Education
 Geological
 Surveying
 Other (please describe)

9: *In the past three years, how many state contracts for services did you try to get?*

10: *In the past three years, how many state contracts for services did you receive?*

11: *In the past three years, how often were you paid according to the terms in your contract?*

- Always or almost always
 Usually
 Sometimes
 Rarely or never

Please explain:

12: *In the past three years, were you ever asked to do work that was not in the original contract?*

- Yes ↓ No

If yes, how was the request for additional work resolved?

- Formal contract modification
 No extra work done
 Completed the extra work within the original contract amount
 Other (please describe)

13: *In the past three years, have personal services contracts usually been awarded to you personally or to an organization for which you work?*

- Individual Organization

14: *Please list the Ky. state agencies from which you have received personal service contracts in the past three years:*

d. The required work and expenses are fairly compensated.

- Strongly agree
- Agree
- Neither agree nor disagree
- Disagree
- Strongly disagree

Comment:

e. Time devoted to required meetings and paperwork is appropriate.

- Strongly agree
- Agree
- Neither agree nor disagree
- Disagree
- Strongly disagree

Comment:

f. Payments are received in a timely fashion.

- Strongly agree
- Agree
- Neither agree nor disagree
- Disagree
- Strongly disagree

Comment

20: Do you have any further comments or suggestions about any aspects of contracts for personal services (such as notice of offerings of contracts, bidding, negotiating, awarding, monitoring, communication, or payment, etc.)? Please use extra paper if necessary.

If it is okay for staff to contact you so that you can provide more extensive comments, please check here: _____

If you choose to provide your name and contact information, please do so below:

Name: _____

Address: _____

Phone: _____

E-mail: _____

Please mail your completed questionnaire in the addressed, postage-paid envelope.

Thank you very much for your time.

Survey of Contractors for Personal Services
Responses to Questions

Question 1: How do you find out about available state contracts for personal services?

Contacted by state agency	558	50.4%
From having similar contract	444	40.1%
Ky. government website	174	15.7%
Professional association	161	14.5%
Newspaper announcement	156	14.1%
Word of mouth*	70	6.3%
E-mail distribution list	65	5.9%
Other	86	7.8%

% based on number of respondents who answered the question (1108).

Respondents could choose more than one method so % column sums to over 100%.

"Word of mouth" coded from write-in answers for "Other."

2: Do Ky. state agencies do enough to reach potential personal service contractors?

Yes	732	78.8%
No	197	21.2%
Total	929	100.0%

3: To your knowledge, how many other contractors were considered for the most recent personal service contract that you received?

			"Don't know" omitted
None	92	8.4%	14.3%
1	24	2.2%	3.7%
2	51	4.7%	7.9%
3 or more	257	23.5%	40.0%
Just know others considered	218	19.9%	34.0%
Don't know	453	41.4%	----
Total	1095	100.0%	100%

4: In the year 2000, about what % of your income was from Ky state contracts for personal services? (Coded from open responses.)

			% of Year 2000 Contractors	
0	96	9.8%	----	
1 to 10%	425	43.6%	48.4%	
11 to 24%	145	14.9%	16.5%	
25 to 49%	123	12.6%	14.0%	
50 to 89%	110	11.3%	12.5%	
90 to 100%	76	7.8%	8.6%	
Total	975	100.0%	100.0%	

requiring the submission of bids?

Yes	576	52.9%
No	513	47.1%
Total	1089	100.0%

6: In the past three years, did you usually find out about state personal service contracts early enough to prepare suitable bids? (If "yes" to question 5.)

Yes	478	84.6%
No	87	15.4%
Total	565	100.0%

7: In the past three years, did you ever have problems in becoming officially pre-qualified for Ky. agencies that require pre-qualification? ("Not applicable" answers excluded.)

Yes	43	6.8%
No	587	93.2%
Total	630	100.0%

8: In the past three years, what types of contracts for personal services have you received?

Architectural/Engineering	143	13.7%
Education	129	12.4%
Construction	121	11.6%
Medical	114	11.0%
Social Services*	68	6.5%
Legal	67	6.4%
Real Estate*	47	4.5%
Accounting/Auditing	44	4.2%
Surveying	38	3.7%
Janitorial*	37	3.6%
Financial	23	2.2%
Geological	11	1.1%
Other	283	27.2%

% based on number of respondents who answered this question (1041).

Respondents could choose more than one method so % column sums to over 100%.

"Social Services," "Real Estate," and "Janitorial" coded from write-in answers for "Other."

9: In the past three years, how many state contracts for services did you try to get? (Coded from open responses.)

1	283	31.7%
2	158	17.7%
3	180	20.1%
4 to 9	110	12.3%
10 or more	163	18.2%
Total	894	100.0%

10: In the past three years, how many state contracts for services did you receive? (Coded from open responses.)

1	403	42.2%
2	206	21.6%
3	173	18.1%
4 or more	172	18.0%

11: In the past three years, how often were you paid according to the terms in your contract?

Always or almost always	856	81.5%
Usually	146	13.9%
Sometimes	34	3.2%
Rarely or never	14	1.3%
Total	1050	100.0%

12: In the past three years, were you ever asked to do work that was not in the original contract?

Yes	345	32.3%
No	722	67.7%
Total	1067	100.0%

If yes (to question 12), how was the request for additional work resolved?

Formal contract modification	185	56.4%
No extra work done	10	3.0%
Completed w/i original contract	94	28.7%
Other	39	11.9%
Total	328	100.0%

13: In the past three years, have personal services contracts usually been awarded to you personally or to an organization for which you work?

Individual	501	48.1%
Organization	541	51.9%
Total	1042	100.0%

14: Ky. state agencies from which contracts received in past 3 years? (Coded from open responses.)

Transportation Cabinet	161	19.5%
Finance & Administration Cabinet	159	19.3%
Education Cabinet	120	14.5%
Cabinet for Health Services	111	13.5%
Justice Cabinet	93	11.3%
Cabinet for Families & Children	89	10.8%
Natural Resources Cabinet	47	5.7%
Public Protection & Regulation Cabinet	39	4.7%
Tourism Development Cabinet	32	3.9%
Postsecondary Education	24	2.9%
Military Affairs	18	2.2%
Agriculture	16	1.9%
Auditor of Public Accounts	14	1.7%
Workforce Development Cabinet	11	1.3%
Office of Attorney General	9	1.1%
Revenue Cabinet	7	0.8%
Economic Development Cabinet	6	0.7%
Labor Cabinet	3	0.4%

% based on number of respondents who listed at least one of these agencies (825).
Respondents could choose more than one agency so % column sums to over 100%.

15: Did the most recent personal service contract that you were awarded include a clear statement of work to be done under the contract?

Yes	1006	95.6%
No	46	4.4%
Total	1052	100.0%

16: For the most recent personal service contract that you completed, were you...

Given feedback over course of contract	434	49.5%
Given evaluation at end of contract	43	4.9%
Given feedback & evaluation	192	21.9%
Not given feedback or evaluation	207	23.6%
Total	876	100.0%

17: For the most recent personal service contract that you completed, what % of the contract's value was subcontracted? (Coded from open responses.)

0	831	83.4%
1 to 49%	122	12.2%
50 to 100%	44	4.4%
Total	997	100.0%

18: For the most recent personal service contract that you completed, was your work under the contract evaluated fairly?

Yes	831	95.3%
No	41	4.7%
Total	872	100.0%

19a: The availability of contracts is well publicized. (Agree/disagree based on own experience.)

Strongly agree	162	15.3%
Agree	390	36.8%
Neither agree nor disagree	337	31.8%
Disagree	131	12.4%
Strongly disagree	40	3.8%
Total	1060	100.0%

19b: Contracts are awarded fairly. (Agree/disagree based on own experience.)

Strongly agree	209	19.8%
Agree	464	43.9%
Neither agree nor disagree	291	27.5%
Disagree	58	5.5%
Strongly disagree	35	3.3%
Total	1057	100.0%

19c: Contracts are awarded in a timely fashion. (Agree/disagree based on own experience.)

Strongly agree	183	17.2%
Agree	530	49.9%
Neither agree nor disagree	237	22.3%
Disagree	92	8.7%
Strongly disagree	21	2.0%
Total	1063	100.0%

19d: Required work & expenses are fairly compensated. (Agree/disagree based on own experience.)

Strongly agree	153	14.2%
Agree	605	56.1%
Neither agree nor disagree	161	14.9%
Disagree	121	11.2%
Strongly disagree	38	3.5%
Total	1078	100.0%

19e: Time devoted to required meetings & paperwork is appropriate. (Agree/disagree based on own experience.)

Strongly agree	139	13.1%
Agree	641	60.4%
Neither agree nor disagree	192	18.1%
Disagree	65	6.1%
Strongly disagree	25	2.4%
Total	1062	100.0%

19f: Payments are received in a timely fashion. (Agree/disagree based on own experience.)

Strongly agree	242	22.8%
Agree	596	56.1%
Neither agree nor disagree	109	10.3%
Disagree	84	7.9%
Strongly disagree	32	3.0%
Total	1063	100.0%

APPENDIX D

GLOSSARY

GLOSSARY

Advantage Financial - The software component of MARS that handles financial accounting processes, including tracking fund availability and processing and recording payments.

Catalog Master Agreement - An agreement whereby a unit price is agreed to with a contractor for services or commodities. All state agencies may then take advantage of the agreement and participate under the agreement at the agreed upon terms.

Contract/Award - A contract/award is used to record the terms and conditions of an agreement with a vendor and to reserve (encumber) funds for the value of the agreement. This type of document is established to purchase a specific quantity or amount at a specific price for delivery at a specific time(s).

Delivery Order - A MARS document used to order goods and services from a master agreement that has established prices with a vendor. delivery orders encumber funds. When personal service contracts within a biennial budget period are established by master agreement, a delivery order must be processed to encumber funds for the first year. A new delivery order must be processed for the second year.

Encumbrance - An entry in the financial system that reserves funds for a particular use. It is used as a means to ensure that an agency does not obligate itself for more funds than it has available.

Fluctuating Price - Similar to price contracts, but used for services or commodities in a volatile market where price fluctuates a great deal.

Interface - For these purposes, the interface is a process that transfers relevant information between Procurement Desktop and Advantage Financial.

Liquidation of Encumbrance - An automated entry that reduces an encumbered amount when the actual expenditure occurs.

MARS - The Management Administrative Reporting System; the uniform computerized system for state government accounting, budgeting, contract management, and procurement.

Master Agreement - A MARS document used to record the terms of an agreement but that does not encumber funds. This type of

document is intended to replace various price contracts. A master agreement must be used to establish price agreements with vendors for supplying specific items at specified unit prices during a specified time period, typically one year, with renewal options. A master agreement is used for placing multiple orders or for making multiple payments for an ongoing need. This document is not to be used for one-time purchases. Under a master agreement, delivery orders are used to encumber funds.

Memorandum Of Agreement (MOA) - An agreement between a state agency and any other governmental body or political subdivision of the Commonwealth that involves an exchange of resources or responsibilities to carry out a governmental function. It includes agreements by regional cooperative organizations formed by local boards of education or other public educational institutions for the purpose of providing professional educational services to the participating organizations and agreements with Kentucky Distinguished Educators pursuant to KRS 158.782. KRS 45A.690 specifically exempts the following from the definition of a Memorandum of Agreement:

- Agreements between the Transportation Cabinet and any political subdivision of the Commonwealth for road and road-related projects;
- Agreements between the Auditor of Public Accounts and any other governmental agency or political subdivision of the Commonwealth for auditing services;
- Agreements between state agencies as required by federal or state law;
- Agreements between state agencies and state universities or colleges and agreements between state universities or colleges and employers of students in the Commonwealth work-study program sponsored by the Kentucky Higher Education Assistance Authority;
- Agreements involving child support collections and enforcement;
- Agreements with public utilities, providers of direct Medicaid health care to individuals except for any health maintenance organization or other entity primarily responsible for administration of any program or system of Medicaid managed health care services established by law or by agreement with the Cabinet for Health Services, and transit authorities;
- Nonfinancial agreements;
- Any obligation or payment for reimbursement of the cost of corrective action made pursuant to KRS 224.60-140;
- Exchanges of confidential personal information between agencies;

- Agreements between state agencies and rural concentrated employment programs;
- Any other agreement that the Government Contract Review Committee deems inappropriate for consideration.

Personal Service Contract (PSC) - An agreement as defined by KRS 45A.690 (1) whereby an individual, firm, partnership, or corporation is to perform certain services requiring professional skill or judgement for a specified period of time at a price agreed upon. The statute specifically exempts the following from the definition of a personal service contract:

- Agreements between the Department of Parks and artists for \$5,000 or less per fiscal year per artist or artists;
- Agreements with public utilities, foster parents, Medicaid providers, homemaker services, and transit authorities;
- Agreements with state universities and employers of students under a work study program sponsored by the Kentucky Higher Education Assistance Authority;
- Agreements between state agencies and rural concentrated employment programs;
- Agreements with the state fair board and judges, officials, and entertainers; or
- Any other contract deemed inappropriate for consideration by the Government Contract Review Committee.

Price Contract - Typically administered by the Finance and Administration Cabinet, price contracts provide for the purchase of goods or services in quantifiable units at a unit price for a state agency.

Procurement Desktop - The software component of MARS that provides for entering of contracts, ordering services, and requesting invoices.

Proof of Necessity form (PON) - A document required to be submitted to the Government Contract Review Committee for each personal service contract and memorandum of agreement. The document should be filed with the committee before the effective date of the contract. KRS 45A.695 also requires that the PON should document the following information:

- The need for any proposed services;
- The unavailability of state personnel or the nonfeasibility of using state personnel to perform the service;
- The total projected cost of the contract or agreement and the source of funding;
- The total projected duration of the contract;

- Payment information, in detail;
- In the case of memoranda of agreement or similar device, the reason for exchanging resources or responsibilities; and
- Such other information as the Government Contract Review Committee deems appropriate.

APPENDIX E

FINANCE AND ADMINISTRATION CABINET RESPONSE TO REPORT ON EXECUTIVE BRANCH CONTRACTING FOR SERVICES

(The Cabinet's response is not available in electronic format. For a copy of the material please contact Program Review and Investigations Committee staff.)

