BEST PRACTICES IN GOVERNMENT

Components of an Effective Contract Monitoring System

July 2003

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Russell W. Hinton, State Auditor

EXECUTIVE SUMMARY
Best Practices in Government

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Purpose of Report

The purpose of this report is to increase awareness of the importance of contract monitoring and to explain the basic tools used in monitoring. It provides agency management with an overview of the methods their agency should be using and serves as a resource for individuals who are directly responsible for ensuring that contracted services are adequately delivered. The full report provides a description of each of the components of an effective contract monitoring system and gives a brief overview of other states' and Georgia state agencies' current use of those components.

A state agency's contract monitoring system is the structure, policies, and procedures used to ensure that the objectives of a contract are accomplished and vendors meet their responsibilities. An effective contract monitoring system mitigates risk, with risk defined as the probability of an event or action having an adverse effect on a state agency. This report is also intended as a guide for state agencies to use in reviewing their current contract monitoring system to ensure their current system is operating as intended and that the system is sufficiently mitigating risk.

It should be noted that state agencies distributing grant funds have an obligation to ensure that recipients adequately perform all agreed-upon services. The components of an effective contract monitoring system may also be used to monitor services performed by grant recipients.

Overview of Service Contracts

State agencies contract out services for a variety of reasons, including:

Contracting Terms

Several terms related to contracting are often used interchangeably, despite the fact that they have slightly different definitions. The U.S. General Accounting Office (GAO) uses the following terms.

- **Privatization** – Any process aimed at shifting functions and responsibilities, in whole or in part, from the government to the private sector.
- **Outsourcing** – One method of privatization. The government entity remains fully responsible for the provision of affected services and maintains control over management decisions, while another entity operates the function or performs the service. It may include contracting out, the granting of franchises, and the use of volunteers to deliver public services.
- **Contracting Out** – One type of outsourcing. The hiring of private-sector firms or nonprofit organizations to provide goods or services for the government. Under this approach, the government remains the financier and has management and policy control over the type and quality of services to be provided. Thus the government can replace contractors that do not perform well.

Source: General Accounting Office

- Reducing costs;
- Improving service quality;
- Insufficient in-house staff;
- Insufficient expertise;
- The demand for the service may fluctuate (e.g., tax return processing), making the flexibility provided by the use of vendors preferable for the agency; and
- The General Assembly may appropriate funds to a state agency for the purpose of contracting out services to a specific vendor.

While there is no comprehensive listing of all state agency contracts, in January 2001, the Department of Audits and Accounts issued a report that inventoried three common contract types: consulting, outsourcing, and any interagency contracts that did not fall into the two prior categories. Seventy-seven of 87 agencies responding to the survey reported 5,895 eligible contracts totaling more than $1.48 billion in fiscal year 2000. The Department of Human Resources reported the largest number of contracts and the highest total value of any agency – 1,847 contracts valued at approximately $649 million. The Department of Corrections reported the largest contract at more than $85 million for prisoner health services. While numerous state entities reported few and/or small contracts, such as the Sheriffs' Retirement Fund's one contract for $9,750 or the Subsequent Injury Trust Fund's two contracts for $2,909, all entities that contract out services should have an appropriate system to monitor their contracts.

Georgia's Contracting System

The Department of Administrative Services (DOAS) and the state agencies contracting out services each play significant roles in Georgia's contracting system. Depending on the state agency, the amount of the procurement, and the service being procured, DOAS may assist the agency in soliciting bids, selecting a vendor, and negotiating the contract. If a procurement is exempt from DOAS involvement due to statutes or policy, the purchasing state agency handles all aspects of the procurement, including the solicitation of bids (if any) and the negotiation of contract provisions and contract amount. Once contract services begin, state agencies become primarily responsible for ensuring that the vendor is meeting contract obligations, paying the vendor, and performing any other necessary activities.

Overview of Contract Monitoring

Contract monitoring is a process of ensuring that a vendor adequately performs a contracted service. The level and type of monitoring conducted by state agencies is primarily at their discretion. State law does not address contract monitoring. While DOAS offers guidelines for monitoring contracts, it imposes only minimal contract monitoring requirements on agencies.

Causes and Impact of Inadequate Monitoring

Deficiencies in contract monitoring are related to violations of good management principles. Inadequate monitoring is often the result of the following:

- Poorly established criteria for evaluating vendor performance;
- Perception of oversight as a responsibility to develop a partnership rather than enforce rules, regulations, or contract provisions;
- Focus on rules and regulations rather than outcomes;

- Failure to conduct follow-up reviews to ensure that corrective action was taken; and,
- Failure to identify the risk and level of review necessary for each vendor.

Good management and supervision requires follow-up, feedback, and enough awareness of what is occurring to eliminate surprises. When conducting performance audits and program evaluations, the Department of Audits and Accounts often observes problems with contract monitoring.

Components of an Effective Contract Monitoring System

State agencies can mitigate the risks associated with contracting out services by developing an effective contract monitoring system. The components of an effective contract monitoring system are detailed below. State agencies should assess the complexity of the contracted service, the contract amount, and the risk if the work is not performed adequately when deciding what components are necessary.

Training in Contract Monitoring

Training in contract monitoring increases the likelihood that individuals will monitor contracts reliably by giving them the appropriate background knowledge related to contracts. Many of the topics that should be included in contract monitoring training are included in the list of components of an effective contract monitoring system.

Written Policies and Procedures

Written policies and procedures serve as a guide to agencies and their personnel in ensuring a consistent, high-quality contract monitoring process.

Contingency Plans

Agencies without contingency plans risk interruption of services when vendors default on their obligations and may pay additional costs for taking back services. A number of options are available for a default contingency plan: contracting with the next lowest bidder from the original solicitation; using another current vendor; delivering the service in-house; and contracting with another government entity.

Communicating Clear Expectations to Vendors

Creating a detailed Statement of Work, having performance measures in the contract, and holding a post-award meeting with the vendor contribute to the vendor's understanding of what is required under the contract. By clearly stating contract requirements and performance goals, the agency reduces the potential for poor performance. A post-award meeting allows staff that may not have been involved with the procurement process to answer questions that the vendor might have and clarify technical aspects of the contract.

Contract Administration Plan

A contract administration plan is a cursory view of planned and completed activities and can be utilized throughout the contract period as a status report. It should detail the methods that the agency will use to monitor the vendor and the individuals or offices that will be responsible for the monitoring.

Organized Contract Files
Files should be organized so that someone could reconstruct and understand the history of the contract in the absence of the contract administrator. Contract files should hold all the information necessary to know what was expected and received under the contract.

Payments Linked to Satisfactory Performance
For contracts that involve monthly or quarterly payments, agencies should require a vendor to submit programmatic reports in advance of or concurrent with its invoices. The programmatic reports should be directly related to the terms of the contract.

Regular Programmatic Reports from Vendor
The contract should require the vendor to provide specific programmatic information on a scheduled basis to determine if performance measures are being met. Programmatic reports should require information related to the performance measures (outputs and outcomes) in the contract, as well as any other deliverables.

On-Site Monitoring
Agency officials should conduct random inspections of vendor records and the delivery of services to ensure all terms of the contract are being fulfilled. On-site monitoring visits are most effective when based on a specific methodology or a checklist of review tasks. On-site monitoring visits may not be necessary for all contracts.

Use of Incentives and Consequences for Poor Performance
Performance reinforcements, such as incentives and consequences for poor performance, are helpful in obtaining optimal performance from the vendor. Financial incentives can be one of the most effective methods of inducing a vendor to perform a desired service, while consequences for poor performance written into a contract provide agencies with the ability to take disciplinary action against a vendor that fails to comply with contract terms. DOAS officials noted that agencies should establish reasonable damages based on reasonable standards. If either is unreasonable, it is likely to limit competition and lead to vendors charging higher amounts to cover the greater risk.

Access to Records/Right to Audit Clauses
Agencies have a responsibility to verify the information that the vendor reports to them and to ensure that funds are expended properly. The contract must include an agreement that the agency has access to and can audit those records.

Measuring Customer Satisfaction
Utilizing methods to measure customer satisfaction helps to improve vendor performance because the feedback can be used to notify the vendor when specified aspects of the contract are not being met. In addition, agency officials can use the information as a source of past performance information for subsequent contract awards.

Dispute Resolution Procedures
The agency should have procedures in place for the monitoring officials to notify the agency's procurement office if a dispute arises. Agency officials should provide notification of problems and a timetable for resolution to the vendor in written form. If problems are not

resolved, the agency should notify the DOAS State Purchasing Office and consider taking actions to compel the vendor to adequately comply with contract terms (i.e., financial consequences, contract cancellation).

Closeout Procedures

Formal, written closeout procedures are recommended at the completion stage of the contract so that important elements are not overlooked. The use of a checklist of closeout procedures helps to assure that all actions have been completed.

Post-Contract Review

At the end of a contract period, agencies should evaluate the vendor's performance and their own method of monitoring the vendor. Agencies should consider conducting a programmatic review and a financial audit.

Purpose of Report

The purpose of this report is to increase awareness of the importance of contract monitoring and to explain the basic tools used in monitoring. It provides agency management with an overview of the methods their agency should be using and serves as a resource for individuals who are directly responsible for ensuring that contracted services are adequately delivered. The report provides a description of each of the components of an effective contract monitoring system and gives a brief overview of other states' and Georgia state agencies' current use of those components.

A state agency's contract monitoring system is the structure, policies, and procedures used to ensure that the objectives of a contract are accomplished and vendors meet their responsibilities. An effective contract monitoring system mitigates risk, with risk defined as the probability of an event or action having an adverse effect on a state agency. This report is also intended as a guide for state agencies to use in reviewing their current contract monitoring system to ensure their current system is operating as intended and that the system is sufficiently mitigating risk.

This report does not detail all aspects of contract management, such as competitive bidding, methods for paying invoices, all standard contract clauses, and other contracting issues. Instead, this report discusses contracting issues only as they relate to contract monitoring. It is not intended to replace manuals and guides from either the Department of Administrative Services or the Office of Planning and Budget but rather to serve as a supplement to those materials.

It should be noted that state agencies distributing grant funds have an obligation to ensure that recipients adequately perform all agreed-upon services. The components of an effective contract monitoring system may also be used to monitor services performed by grant recipients.

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Source: General Accounting Office

Overview of Service Contracts

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The Department of Human Resources reported the largest number of contracts and the highest total value of any agency – 1,847 contracts valued at approximately $649 million. The Department of Corrections reported the largest contract at more than $85 million for prisoner health services. While numerous state entities reported few and/or small contracts, such as the one Sheriffs' Retirement Fund contract for $9,750 or the Subsequent Injury Trust Fund's two contracts for $2,909, all entities that contract out services should have an appropriate system to monitor their contracts.

State agencies contract out services for a variety of reasons, including:

- Reducing costs;
- Improving service quality;
- Insufficient in-house staff;
- Insufficient expertise;
- The demand for the service may fluctuate (e.g., tax return processing), making the flexibility provided by the use of vendors preferable for the agency; and
- The General Assembly may appropriate funds to a state agency for the purpose of contracting out services to a specific vendor.

Contracts between state agencies and private companies, non-profit organizations, individuals, or other government organizations may cover a wide range of services, including the paving of roads, collection of unpaid taxes, provision of mental health services, and cleaning up of abandoned hazardous waste sites. While the services contracted out by state agencies are diverse, they can generally be classified in one of two categories:

- Direct services – Activities directly related to an agency's mission or goals. Examples of direct services could include the Department of Transportation hiring a company to build a bridge or the Public Service Commission hiring a consultant to audit a telephone company.

- Indirect services or support services – Activities that may be essential to agency operations but are not directly related to an agency's mission or goals. Examples of indirect services could include the Department of Education hiring a security firm for its offices or the Department of Human Resources contracting with an office supply firm for copier maintenance.

Georgia's Contracting System

The Department of Administrative Services (DOAS) and the state agencies contracting out services each play significant roles in Georgia's contracting system. Depending on the state agency, the amount of the procurement, and the service being procured, DOAS may assist the agency in soliciting bids, selecting a vendor, and negotiating the contract. Even if DOAS involvement is necessary, the state agency participates in these activities. Once contract services begin, state agencies become primarily responsible for ensuring that the vendor is meeting contract obligations, paying the vendor, and any other necessary activities.

Georgia's decentralized contracting system is a reflection of state law and DOAS State Purchasing Office policies. O.C.G.A. Title 50, Chapter 5, Article 3 makes DOAS responsible for procuring the state's goods and services and governs the DOAS procurement process. However, exempt from DOAS oversight are contracts for personal services, professional services, many construction projects, various categories of supplies (e.g., textbooks for DOE, emergency supplies of drugs), and procurements by certain government entities, notably authorities and the legislative and judicial branches. Finally, DOAS has granted many state agencies purchasing authority of $50,000 to $100,000, even for those procurements that statutorily would be made through DOAS. If a procurement is exempt from DOAS involvement due to statutes or policy, the purchasing state agency handles all aspects of the procurement, including the solicitation of bids (if any) and the negotiation of contract provisions and contract amount.

Whether involved in a procurement or not, DOAS's responsibility for a contract decreases significantly once the contract period begins. Most duties required after the contract begins are exclusive responsibilities of the state agency. See **Exhibit 1** for an overview of DOAS and state agency responsibilities when contracting out a service.

Exhibit 1
Responsibilities When Contracting Out a Service

	DOAS State Purchasing Office	State Agency(1)
Pre-Contract Period		
If competitively bid, development of the Request for Proposal (RFP) or Request for Quote (RFQ)	X	X
If competitively bid, holding meetings to clarify questions of potential bidders	X	X
Selection of vendor	X	X
Final negotiation of contract	X	X
Contract Period (Dates of Service)		
Monitoring vendor performance through on-site visits, programmatic reports, and other methods		X
Payment of invoices		X
Contract closeout, such as ensuring all state property properly returned, all deliverables have been met, final payment made, etc.		X
Dispute resolution	X	X
Post-Contract Period		
Final evaluation of vendor, both a financial and programmatic review		X

(1) For procurements that do not require DOAS involvement (i.e., below agency's delegated purchasing authority or another exempted purchase), the purchasing state agency becomes solely responsible for all steps in the pre-contract period, contract period, and post-contract period.

In addition to the responsibilities above, DOAS has contracting responsibilities that are not directly related to individual procurements. Those responsibilities include the following:

- Formulating and issuing state purchasing rules for state agencies;
- Identifying and contracting for goods and services needed by multiple state agencies;
- Compiling a list of vendors that have registered with the state in order to receive notices for bid opportunities;
- Providing voluntary contracting training to state agency personnel; and,
- Auditing a sample of state agencies and their contracts to verify compliance with state purchasing laws and policies.

Overview of Contract Monitoring

Contract monitoring is a process of ensuring that a vendor adequately performs a contracted service. When a state agency contracts out the performance of a service to a vendor, the agency remains responsible for ensuring the work is performed satisfactorily and government funds are used appropriately. Ultimately, the state agency is responsible for the consequences of poor performance whether the agency or a vendor provided the service.

The level and type of monitoring conducted by state agencies is primarily at their discretion. State law does not address contract monitoring. And while DOAS offers guidelines for monitoring contracts, it imposes only minimal contract monitoring requirements on agencies. DOAS's *Georgia Procurement Manual* states "it is the responsibility of the agency staff to oversee, monitor, and provide technical guidance to contractors performing under a contract." The manual designates specific agency personnel responsible for reviewing contracted services, reviewing invoices, and closing out the contract. Other information on contract monitoring is presented only as guidance for agencies, as opposed to requirements. DOAS also publishes a *State of Georgia Contract Administration Guide* to "assist the various state agencies involved in purchasing in performing contract administration in a uniform manner throughout the state."

Contract monitoring is an essential aspect of all three phases of contracting – the pre-contract period, contract period, and post-contract period. While significant contract monitoring occurs when the vendor is actually performing the service (contract period), preparation during the pre-contract period is essential to effective contract monitoring. The difficulty of monitoring a contract increases without a well-written contract detailing vendor and agency responsibilities, as well as contract clauses that allow the agency to properly monitor and compel performance by the vendor. Contract monitoring also extends past the end date of the contract (post-contract period) in the form of a final evaluation of the vendor and the agency's methods for monitoring.

Phases of Contracting

Pre-Contract Period – Includes the procurement process and negotiation of contract provisions

Contract Period – Dates of service stated in the contract

Post-Contract Period – Final determination is made in regards to vendor performance

Effective contract monitoring is accomplished through the application of numerous monitoring methods that are tailored to a particular contract. Some monitoring methods may be appropriate for most contracts (i.e., performance measures, scheduled programmatic reports), while other methods are appropriate for a smaller number

of contracts (i.e., on-site visits, customer satisfaction surveys). The components used to monitor a contract are dependent on numerous factors, especially the complexity of the contracted service, the contract amount, and the risk if the work is not performed adequately. For instance, a state agency would likely not find it useful to conduct monthly on-site monitoring visits for a vendor providing auditing services for $20,000 a year. However, on-site monitoring and customer satisfaction surveys may be appropriate for a vendor operating a state park.

Within state agencies, contract monitoring is often the shared responsibility of program personnel and a contract administrator. Agencies usually rely on program personnel to provide day-to-day monitoring of vendors. Since contracts are for services provided to or on the behalf of a particular program, program personnel are often the ideal staff for determining whether the vendor is adequately providing the contracted service. The contract administrator position may be a program official or someone from the agency's contract management office or similar administrative support office. If an agency has a contract management office, it is usually involved in the development of solicitation documents and the contract (provisions of which are essential to contract monitoring). Involvement after the contract period begins may be limited to approving invoices for payment and assisting program personnel to resolve any disputes with the vendor. Agencies that do not have contract management offices generally use legal staff or financial personnel to serve a similar purpose.

It should be noted that during the 1990's two commissions and a legislative committee studied the issue of contracting out government services and addressed the importance of contract monitoring. The Governor's Commission on Effectiveness and Economy in Government, the Governor's Commission on the Privatization of Government Services, and the House Appropriations Outsourcing and RFP Study Committee all noted that to be successful, contracting out government services would require effective systems to monitor vendor performance. The House Study Committee stated that it received adequate information from state agencies concerning many aspects of contracting but acquired less information regarding agencies' contract monitoring efforts. The House Study Committee concluded that state agencies must place an increased emphasis on contract monitoring.

Causes and Impact of Inadequate Monitoring

Deficiencies in contract monitoring are related to violations of good management principles. Inadequate monitoring is often the result of the following:

- Poorly established criteria for evaluating vendor performance;
- Perception of oversight as a responsibility to develop a partnership rather than enforce rules, regulations, or contract provisions;
- Focus on rules and regulations rather than outcomes;
- Failure to conduct follow-up reviews to ensure that corrective action was taken; and,
- Failure to identify the risk and level of review necessary for each vendor.

Good management and supervision requires follow-up, feedback, and enough awareness of what is occurring to eliminate surprises.

The Governor's Commission on Effectiveness and Economy in Government noted that a lack of public sector expertise was one cause of inadequately monitoring. The report stated that "many agencies do not have employees with the expertise to write a contract which effectively describes what they expect the contractor to do (and not to do), and, more importantly, do not have the personnel and procedures in place to assure that the contractor is faithful to the agency's expectations."

Financial and programmatic consequences can result from inadequate contract monitoring. A vendor may be overpaid for work performed or paid for work never performed. Programmatic consequences can range from receiving a consultant's report that does not address an agency's needs to multi-million dollar lawsuits against the state. A well-written contract may have limited value if the agency does not adequately monitor to ensure the contract requirements are fulfilled.

When conducting performance audits and program evaluations, the Department of Audits and Accounts often observes problems with contract monitoring. The monitoring deficiencies are similar to the reasons for inadequate monitoring listed above and are generally related to violations of good management principles. Two key issues we observe are: first, once an agency contracts out for services their sense of responsibility for the service is decreased; second, program personnel who in the past have been responsible for delivering the service are now responsible for monitoring a contract for the service without adequate training. The following are some of the examples noted in previous reports:

- The former Department of Medical Assistance (DMA) contracted with a vendor for the collection of federally mandated drug rebates from manufacturers whose prescription drugs were purchased with federal and state Medicaid funds. The contract did not contain any performance measures to gauge vendor effectiveness or efficiency. The contract also did not contain any penalties and incentives that might compel the vendor to adequately perform. DMA personnel acknowledged that they were not monitoring the vendor's performance, despite the fact that they had indications of problems with the vendor's work. After the audit, the agency made numerous changes to the contracted program, resulting in a 41%, or $5.6 million, increase in quarterly collections two years later. (*DMA: Drug Rebate Program, January 1997; Followup in July 1999*)

- The Department of Corrections (DOC) contracted with a vendor for the provision of mental health services in prisons and other facilities. However, DOC had not taken the steps necessary to determine whether the contract resulted in cost savings or quality improvements or included contract provisions to ensure that the vendor met contract terms. (*DOC: Selection Process and Effect of the Mental Health Services Contract, July 1998*)

- The Department of Juvenile Justice (DJJ) contracted with two vendors for the operation of four wilderness camps, but the agency had no means of determining if program goals were being met. Prior to October 1999, none of the four contracts contained performance measures, although contracts had been annually renewed since

1991. Even after performance measures were added to the contracts, DJJ personnel did not collect performance data to see if contract terms were met. However, each year DJJ continued to renew the contracts. (*DJJ: Review of the Contract Management of the Outsourced Wilderness Camps, December 2000; Followup in February 2003*)

- The Governor's Office of Highway Safety (GOHS) did not ensure that vendors provided the level of services specified in their contracts. Vendors were not meeting their contractual obligations and were providing insufficient information to determine whether those obligations had been met. Examples include full payment to a vendor despite the vendor completing less than two-thirds of the presentations required by the contract. In another case, a contract required the establishment of a coalition to promote the use of child safety seats. The vendor was paid most of the contract amount without any evidence that the coalition was ever established. (*GOHS: Governor's Office of Highway Safety, March 2003)*

Contract Monitoring in Other States

Georgia's contracting system is similar to the systems in the six other states contacted for this report. Central purchasing offices in Alabama, Florida, North Carolina, South Carolina, Tennessee, and Virginia all reported some exception to their authority, whether it is a cost threshold or authority over particular government entities. The purchasing offices are usually involved with the agencies in the solicitation of bids and the selection of vendors.

According to personnel in other states' central purchasing offices, contract monitoring is primarily the responsibility of the agencies. The requirements related to contract monitoring imposed by the central purchasing offices vary significantly. Statutory requirements for contract monitoring range from no mention in the law to specific contract management policies. Finally, some offices offer guidelines on contract administration to their state agencies, while others do not.

Contact monitoring is a topic that other states have also been reviewing in recent years. Some examples are:

- A legislative audit in Montana found that contract monitoring varied substantially among state agencies and that its effectiveness depended greatly on the agency's monitoring experience and expertise.
- The Texas State Auditor's Office recently identified contract administration as one of five high-risk areas in state government. To improve contract administration, the Office recommended that their legislature pass a bill that included establishing a contract manager training and certification program, requiring agencies to consult with an advisory team when developing performance measures, and requiring agencies to report the results of reviews on contractor compliance.
- A program evaluation on service contract administration by the Kentucky Legislative Research Commission reported that state agencies expressed a need for training, contract administration policies and guidelines, and general assistance about contract monitoring from their central procurement agency.

- A report on privatization by the Tennessee Comptroller of the Treasury recommended that agencies develop contract monitoring systems that provide information on whether contractors are complying with the contract terms, in addition to including key elements in contracts such as performance standards, monitoring provisions, penalty clauses, and contingency plans.

Report Scope and Methodology

This project is a limited scope review intended to identify the components of an effective contract monitoring system and determine the current status of the use of those components by state agencies. The review did not determine whether state agencies were adequately monitoring particular contracts or whether a vendor was adequately performing a contracted service.

The methodology included the following:

- Review of various contract management publications. The review of contract management publications included, but is not limited to, reviews of the following publications and concepts from these publications are used throughout this report. Quotations and paraphrases are referenced (denoted by (Ref)) to a **Works Cited** page.

    - A Guide to Best Practices for Contract Administration, Office of Federal Procurement Policy
    - Public Management Occasional Papers No. 20 Contracting Out Government Services: Best Practice Guidelines and Case Studies, Organization for Economic Cooperation and Development
    - Contracting Out Government Services, Paul Seidenstat, editor
    - Effective Contract Administration: The Complete Handbook and Guide, American Management Association
    - Competitive Government Handbook, State of Arizona Governor's Office of Management and Budget
    - Contract Administration Best Practices, Kansas Legislature Division of Post-Audit
    - State Agency Service Contract Administration Program Evaluation, Kentucky Legislative Research Commission
    - Private Contracts, Public Services: Weighing the Choices, Tennessee Comptroller of the Treasury
    - Contracting for Services, National Institute of Governmental Purchasing
    - Contract Management, National Institute of Governmental Purchasing
    - Contract Administration Guide, Georgia Department of Administrative Services
    - Georgia Procurement Manual, Georgia Department of Administrative Services

- Review of the components by officials with Georgia-based chapters of the National Contract Management Association (NCMA), the National Institute of Governmental

Purchasing (NIGP), and the National Association of Purchasing Management (NAPM).

- Survey of 25 state entities regarding their contract monitoring practices.

- Review of a sample of contract files and records of the Departments of Human Resources (DHR), Corrections (DOC), Technical and Adult Education (DTAE), and Education (DOE), the Public Service Commission (PSC), and the State Board of Pardons and Paroles (SBPP).

- Interviews of contracting officials in Alabama, Florida, North Carolina, South Carolina, Tennessee, and Virginia regarding their contract monitoring policies and practices.

Components of an Effective Contract Monitoring System

State agencies can mitigate risks associated with contracting out by developing an effective monitoring system. The components of an effective contract monitoring system are detailed below. All contracts are not monitored in the same manner. Therefore, the components of an effective contract monitoring system contained in this report may not apply to all contracts. State agencies should assess the complexity of the contracted service, the contract amount, and the risk if the work is not performed adequately when deciding what components are necessary.

Components that require clauses to be included in the contract are noted with this boxed message.

Requires Contract Clause

While not all contracts are monitored using the same components, a number of the components are universal and should be a part of every agency's contract monitoring system. We identified the following components as necessary for an effective contract monitoring system:

- Training employees in contract monitoring;
- Written policies and procedures for contract monitoring;
- Contingency plans;
- Clearly communicating expectations to vendors through a detailed statement of work, performance measures, and post-award meetings;
- Contract administration plan;
- Organized contract files;
- Payments linked to satisfactory performance;
- Regular programmatic reports;
- Access to records and right to audit; and,
- Dispute resolution procedures.

Training in Contract Monitoring

Training in contract monitoring increases the likelihood that individuals will monitor contracts reliably by giving them the appropriate background knowledge related to contracts. Program officials, who likely perform much of the day-to-day monitoring of vendor performance, may lack expertise in contract monitoring. When services are contracted out, the program official's duties evolve from that of performing the function to that of managing a vendor. Program officials' expertise in the contracted service becomes only a portion of their job; it also becomes necessary for them to develop new skills in order to monitor a vendor performing that service.

In 1999, a legislative study committee noted the need for contract management training. The Outsourcing and RFP Study Committee report from the Georgia House of Representatives Appropriations Committee found that "training in contract management is crucial for reliable contractual outcomes favorable to the state's interests," and that "it is imperative that we develop contract administration professionals by training them appropriately and adequately." It also recommended that the state's contract administrators be appropriately trained in the

principles of results-based contracting and contract monitoring, in order to advance sound contracting principles and to continue to address the need for a more efficient government.

Many of the topics that should be included in contract monitoring training are included in this guide as components of an effective contract monitoring system. Other topics that should be included are the following:

- State and agency rules related to the procurement process;
- Federal and state requirements – Appropriate uses of funds, licensing requirements, etc.;
- Roles of different agency officials;
- Liability – Actions that may be required to reduce the state's liability; and,
- Standard contract clauses – DOAS State Purchasing Office has guidelines for contract clauses that should be included in contracts.

Other States' Use of Training:
Interviews with procurement agencies in six states found that two of those states offered both training and a certification for contract managers. One of the two states has a day-long training course offered twice a year that provides guidelines for setting up the administration of a particular contract in addition to documentation and reporting of performance. The other state offers a contract management course concerned with handling complaints and a one-day re-certification course on the elements of the procurement cycle, the contract structure and stages, and tools, techniques, and strategies of contract management.

Georgia's Use of Training:

- Ten of the 25 agencies (40%) surveyed reported that their staff received some form of training in contract management.

- Of the six agencies that were selected for on-site reviews, none offered sufficient formal training. When training was offered, it was either on the purchasing process with little, if any, focus on monitoring or it was delivered to only some of the individuals with contract monitoring responsibilities.

- DOAS has offered State Purchasing Basic and Intermediate courses multiple times a year, but the course focuses on the purchasing process, not contract monitoring. DOAS is now updating those courses, but current plans call for contract monitoring to remain only a small portion of any course. In fiscal year 2002, DOAS had the National Contract Management Association (NCMA) teach two classes on contract administration. The NCMA classes were attended by 59 individuals, 24 of which were DOAS State Purchasing Office employees.

- According to the *Georgia Procurement Manual*, the State Purchasing Office will coordinate with agency purchasing officers to assess agency training needs and make the training available. It also states that it will continue to periodically coordinate with professional purchasing organizations to sponsor specialized classes.

Written Policies and Procedures

Written policies and procedures serve as a guide to agencies and their personnel in ensuring a consistent, high quality contract monitoring process. Agencies may have written policies in place to cover the procurement process, but policies for contract monitoring are less common. This is despite the fact that an agency may have dozens of employees responsible for monitoring aspects of vendor performance and significant portions of its services contracted out.

The American Management Association and the National Institute of Governmental Purchasing recommend that many of the following subjects be included in policy and procedure manuals:

- Roles and responsibilities of the agency personnel – Define who is responsible for contracting activities and who has the authority to take particular actions;
- Contract correspondence – Guidance on documenting interaction with the vendor;
- Reports detailing contract monitoring efforts – Types of reports and the information that should be included;
- Conflicts of interest – Define a conflict of interest and steps that should be taken to avoid them;
- Documentation of contract administration decisions;
- Subcontract administration – Define role of the agency when work is subcontracted by a vendor;
- Standard contract terms and conditions of contracts;
- Monitoring of contract performance – Guidance on assessing risk of poor performance and the methods that should be used to monitor performance;
- Contract completion activities – Assuring that all state property is returned including security items, that there are no outstanding claims, and that the vendor has met all the deliverables of the contract;
- Dispute resolution – Guidance on how disputes between the agency and vendor will be resolved, including what offices or officials should be involved and what documentation should be used; and,
- Professional development of contract personnel.

Other States' Use of Written Policies and Procedures:

Three of the six states that were surveyed have formal contract monitoring guidelines issued by their central procurement offices (similar to DOAS State Purchasing Office). These policies range from a simple four-page document outlining statutory requirements for contract management to detailed steps and practices that the agencies are expected to follow.

Georgia's Use of Written Policies and Procedures:

- Of the 25 Georgia state agencies that were surveyed, nine (36%) reported that they had formal procedures and policies for contract monitoring.

- Only one of the six agencies (17%) selected for on-site reviews was found to have written policies on contract monitoring, while a second agency had policies that covered only the financial aspects of contract monitoring.

- The *Georgia Procurement Manual* contains information on contract administration, including aspects related to monitoring. The manual should be used as a starting point for agencies developing their own policies.

Contingency Plans

Contingency planning is a necessary component of the overall planning process that is often overlooked by agencies. It addresses how the agency would respond in the event of an interruption of service delivery. Contingency planning allows the program or service to be quickly resumed. While contingency plans are always necessary, the level of risk and contract amount will determine the formality and detail necessary in the plan. Detailed, written plans may not be necessary for small, low risk contracts, as long as the agency has analyzed and determined its course of action in case of vendor default. Agencies without contingency plans risk interruption of services and may pay additional costs for taking them back.

A number of options are available for a default contingency plan: contracting with the next lowest bidder from the original solicitation; using another current vendor; in-house delivery of the service; and contracting with another government entity. The contracting environment and agency's resources largely dictate what options may be used if a contract is terminated. An ideal contingency plan would include multiple options that provide maximum results based on the circumstances. This would allow an agency to implement the option that best suits its needs at the time of the default (Reference 1).

- Contracting with Next Lowest Bidder of Original Solicitation – Agencies with limited resources may contract with the next lowest bidder of the original solicitation. This option can only be used if the next lowest vendor is qualified to provide the service. Agencies could negotiate a backup contract with the next lowest bidder at the time the original contract is awarded. This option allows agencies to avoid going through the resource-consuming procurement process a second time.

- Use Existing Vendors – Agencies may choose to have other contracted vendors perform the additional work. This option also allows an agency to avoid having to re-bid a contract on short notice.

- State Agency Provide Services – Agencies may opt to take over service delivery after a contract has been terminated. This would require an agency to have sufficient resources to provide the service.

- Contracting with Another Government Entity – Agencies may sign an interagency agreement with another governmental entity to provide the service until they can re-bid the service.

Other States' Use of Contingency Plans:
Only one of six states surveyed reported the use of contingency plans for service contracts. Program staff said that the plan is especially useful if the contract entails a high amount of

risk. Another state is planning to implement contingency plans for service contracts, while a third reported using contingency plans for contracts that required agencies to have emergency back-up vendors during their Y2K upgrade.

Georgia's Use of Contingency Plans:

- The contract management survey of 25 state agencies found that 15 agencies (60%) reported using contingency plans.

- Site visits to six agencies found either written or clearly stated contingency plans for two (10%) of the 20 contracts. One of those plans had actually been implemented in 1991 when a vendor providing a similar service defaulted on its contract.

- Program managers frequently indicated that, in the event of default by the current vendor, the agency would have to find another vendor to perform the service.

- The *Georgia Procurement Manual* does not address contingency plans.

Communicating Clear Expectations to Vendors

Effective contract performance is largely dependent on the vendor's ability to understand the requirements established by the agency. Creating a detailed Statement of Work (a.k.a. Scope of Services), having performance measures in the contract, and holding a post-award meeting with the vendor all contribute to the vendor's understanding of what is required and essential under the contract. By clearly stating contract requirements and performance goals, the agency reduces the potential for poor performance. A post-award meeting allows staff that may not have been involved with the procurement process to answer any questions that the vendor might have and to clarify the more technical aspects of the contract.

Problems that can result from a vendor not recognizing an agency's expectations include unsatisfactory performance, delays in delivery, disputes over agency and vendor obligations, and higher costs for the service (Ref 2).

Detailed Statement of Work

The Statement of Work (SOW) is the agency's primary means of communicating its expectations to the vendor or potential vendor. It is part of the solicitation document (RFP or RFQ) and/or the contract.

Requires Contract Clause

As part of the solicitation document, the SOW must maintain a balance between protecting the agency's interests and encouraging the vendor's creativity during creation of the proposal and performance of the contract (Ref 3). The SOW should state the purpose or objective of the contract, contract requirements, the performance measures and goals, the agency's methods for monitoring the vendor's performance, and any deliverables that will be required from the vendor (Ref 4). The wording in the SOW must be clear, concise, free from ambiguity, easy to understand, and logical.

Once a part of the contract, this section should contain a list of all responsibilities of the vendor, activities the vendor is expected to engage in, a list of products to be produced, and a timetable for completion of all activities. This will be a combination of the SOW from the solicitation document and the proposal submitted by the vendor awarded the contract. If the contract was not competitively bid, the agency and vendor will negotiate the SOW.

Performance Measures and Goals

Performance measures are established by agencies to evaluate the quality and quantity of service provided by the vendor. The measures are used to ensure the successful operation and delivery of a service. Performance measures and goals in contracts result in improved quality control, more cost awareness, and a reduced probability of contract abuse by the vendor (Ref 5). Performance measures and goals should be included in the solicitation document or in the contract if there is no solicitation document.

Requires Contract Clause

According to the National Institute of Governmental Purchasing, in most cases performance measures should judge both outputs and outcomes. Outputs usually measure a process and are units of the service (e.g., tons of solid waste processed, number of persons served, etc.). Outcome measures should assess some aspect of the effect, result, or quality of the service (e.g., improvements in student test scores). A perfectly executed process is a waste of time and money if it fails to achieve the outcome desired. Contracts for services must be focused on desired outcomes that produce results that can be measured (Ref 6).

A contract should specifically address what performance data is to be collected by the vendor, how, when and to whom the data is to be submitted, and what actions the agency may take in response to evaluation of the data.

Meet with Vendors to Clarify Work

A post-award or kickoff meeting between agency and vendor personnel can prove to be of considerable value in making certain that the vendor understands the agency's expectations. In some instances, the vendor personnel performing and agency personnel monitoring the work during the contract period are not significantly involved in the procurement process. The meeting allows those that will be dealing with one another on a frequent basis to become acquainted and review the expectations of the two parties.

According to the DOAS' Contract Administration Guide, although both vendor and agency personnel should be aware of the contract requirements at the time of the award, "the post-award meeting ensures that those involved directly in the contract administration process understand all requirements of contract performance." Specific items to be covered in the meeting include the scope of the contract, contract terms and conditions, technical and reporting requirements, administration procedures, rights and obligations of parties, performance standards and monitoring procedures, potential problem areas, invoicing requirements and payment procedures, and limits of authority for agency personnel. The meeting should not be used as an avenue to change the terms of the contract (Ref 7).

While not every contract requires a full-scale formal post-award meeting, each should receive some form of discussion after the award to ensure that the parties agree on the performance requirements and the administrative procedures applicable under the terms of the contract. Agency personnel should decide whether a post-award meeting is necessary. For less-complex, low-dollar value contracts, many times a telephone call to the vendor will be sufficient. Factors that can be utilized to determine the need for a meeting are the type of contract, contract value and complexity, length of contract, period of performance, and the delivery requirements, procurement history of the services required and the expertise of the vendor, urgency of delivery schedule, agency's prior experience with the vendor, and any special or unusual payment requirements.

Other States' Use of Communicating Clear Expectations to Vendors:
Central procurement offices in the six states contacted have few requirements related to clearly communicating agency expectations. None has a standard contract clause on performance measures, though all six reported that they are used in contracts, depending on the service and type of contract. For two of the states, the contracting agencies are expected to meet with the vendor to clarify the contract work. In three other states, this is only an occasional practice and is at the agency's discretion.

Georgia's Use of Communicating Clear Expectations to Vendors:

- In the survey of 25 agencies, most indicated that they take steps to clearly communicate their expectations to vendors. In the survey, 21 (84%) responded that they used quantitative performance measures in their contracts and 22 (88%) responded that they used qualitative performance measures. In addition, 22 of 25 (88%) reported having post-award meetings between contract monitoring staff and vendors to clarify the work that would be performed under the contract.

- During a review of contracts at six agencies, program managers frequently indicated that they relied on their relationship with the vendor as a means of communicating the agency's expectations.

- In the review of 20 contracts, the audit team found inadequate evidence of clearly communicated expectations. Site visits to six agencies found that five of 20 contracts (25%) had detailed Statements of Work, and seven contracts (35%) had somewhat detailed Statements of Work that did not fully explain all contracted services or lacked performance measures.

- Ten of the 20 contracts (50%) did not have any performance measures. Of those containing performance measures, seven were determined to be either too vague or inadequate to assess the vendor's performance.

- Only one of the contracts (5%) reviewed during the site visits had a documented post-award meeting between the agency and vendor. Program managers stated that such a meeting was held for nine of the contracts (45%) but could not provide any documentation of those meetings.

- The *Georgia Procurement Manual* does suggest the use of performance measures and post-award meetings, but it does not require either.

Contract Administration Plan

The development of a contract administration plan is essential to ensuring that a contract is properly monitored. According to DOAS' Contract Administration Guide, it should make sure that all agency personnel have a common understanding of both the vendor and agency's respective obligations. It is a cursory view of planned and completed activities, and can be utilized throughout the term of the contract as a status report. Among the items that can be included are identification of deliverables, milestones, due dates, list of all contract modifications issued, summary of all invoices submitted and paid, and renewal dates. It should also detail the methods that the agency will use to monitor the vendor and the individuals or offices that will be responsible for the monitoring (Ref 8).

The plan can be simple or complex, but its content should be dependent on the complexity of the contracted service, the value of the contract, and the risk to the agency of poor performance. The agency should consider these factors when determining the methods that it will use to monitor vendor performance (quarterly on-site visits, monthly programmatic reports, penalties for unacceptable performance, etc.).

The plan should also consider that intense monitoring during the implementation phase of a new contract will likely benefit both the agency and vendor. The intense monitoring will give the vendor a clear understanding of the agency's expectations and will "set the tone" for the relationship between the two entities.

The lack of a contract administration plan can result in gaps in the monitoring process. For example, in a visit to one state agency, the audit team found that for multiple contracts, no one was checking vendor performance against the performance measures in the contracts. The vendor did not report the information. Two agency offices shared contract-monitoring responsibilities, but both stated that the other was responsible for checking the performance measures. As a result, three similar contracts totaling nearly $4.6 million a year had been renewed without a clear idea of whether the contract goals were being fulfilled. A plan detailing each office's role in the monitoring process could have prevented the oversight.

Other States' Use of Contract Administration Plans:

Results differ among the states in regard to the use of contract administration plans. One state requires agencies to submit plans to the central procurement office; however, the office files but does not review the plans. One state advocates their use and requires agencies to submit names of contract administrators and outline their authority. One state has agencies use a general contract administration plan. Three states said that they do not use contract administration plans.

Georgia's Use of Contract Administration Plans:

- Fourteen of the 25 state agencies (56%) in the survey reported using contract administration plans for at least some of their contracts.

- The on-site reviews conducted at six of the state agencies found that two of the 20 contracts (10%) had written contract administration plans.

- The *Georgia Procurement Manual* discusses contract administration plans, but it does not require that each contract have a plan.

Organized Contract Files

Maintenance of well-organized contract files is fundamental to contract monitoring. DOAS's *State of Georgia Contract Administration Guide* and the American Management Association both address the importance of properly maintained contract files. The contract administrator function is responsible for internal release of basic contract information and retention of complete contract files for reference by personnel throughout the organization. It is imperative to have quick access to the master contract files, especially when disputes with the vendor or other major contract issues arise.

Contract files should be organized in a manner that allows someone to reconstruct the contract and understand its history in the absence of the contract administrator (Ref 9). Contract files should hold all the information necessary to know what was expected and what was received under the contract. At a minimum, files should contain the following:

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

Other States' Use of Organized Contract Files:

Five of the six state procurement offices stated that maintaining the contract file was the responsibility of the contracting state agency. One of those five states added that there was a statutory requirement to this effect. The sixth procurement office stated that maintaining the contract file was the responsibility of the entity that directed the procurement process (either the state procurement office or the state agency contracting for the service).

Georgia's Use of Organized Contract Files:

- Nineteen of 25 state agencies (76%) stated in the contract management survey that they maintain a central contract file.

- In the site visits to the six agencies, only six of 20 contracts (30%) had a central file where all the documentation on the contract was either under control of one person or in a single office. Contract files were frequently divided between programmatic and financial staff at the agencies.

- The *Georgia Procurement Manual* requires that agencies maintain files containing all documents related to the contract, including performance reports.

Payments Linked to Satisfactory Performance

Payments should not be made to a vendor unless the agency has some assurance that the vendor is making satisfactory progress in fulfilling the contract. An agency should hold the vendor responsible for meeting all contract requirements for quality, quantity, and timeliness.

For contracts that involve monthly or quarterly payments, agencies should require a vendor to submit programmatic reports in advance of or concurrent with its invoices. The programmatic reports should be directly related to the terms of the contract. This arrangement permits the agency to delay payment of the invoice if all required reporting is not submitted in a timely and complete manner. Agency personnel have a responsibility to protect the interests of the state, and under the appropriate circumstances, it may be necessary to withhold payments from vendors. Additionally, in cases of cost-reimbursement contracts, the agency should require that the vendor submit adequate documentation to support invoiced amounts. Appropriate personnel, who may include both the program manager and contract administrator, should review the invoice and supporting documentation prior to payment.

Requires Contract Clause

Linking payments to satisfactory performance requires a correlation between the two. For example, the Departments of Juvenile Justice and Corrections have contracts with vendors to house adjudicated individuals. These contracts typically base payment on a daily contract amount per individual, which ensures that 80% of contract capacity used by the state results in 80% of contract amount paid to the vendor. (The example does not consider possible reduction in payment related to poor quality.) However, a contract for a vendor to provide consulting services to an agency may not have a dollar amount for each conversation or meeting with agency staff or for each document produced. In this case, the agency would have to determine whether an invoice reasonably reflects the work done during the time period covered by the invoice. If approximately one-fourth of the work has been done, the invoice should be questioned if it is significantly higher than one-fourth of the contracted amount.

Other State's Use of Payments Linked to Satisfactory Performance:
Five of the six states said that it was the responsibility of the agencies to verify performance before approving payment. One state said that approval by the contract administrator was required for payment.

Georgia's Use of Payments Linked to Satisfactory Performance:

- Twenty-two of 25 surveyed agencies (88%) responded that payments to vendors were contingent on the achievement of certain levels of service.

- Site visits to six state agencies found that there was a direct correlation between payment and performance for only four of 20 contracts (20%). The signature of the program manager was a requirement for payment for 13 of the contracts (65%).

- The *Georgia Procurement Manual* requires that program managers and contract specialists review invoices before payment is made.

Regular Programmatic Reports from Vendor

Regular programmatic reports from the vendors are an effective method for the state agency to determine whether the vendor is adequately providing the contracted services. Reviewing monthly or quarterly reports allows state agencies to identify and act promptly in cases of actual or potential default. Agencies that fail to continuously monitor vendors' performance may allow problems to persist and may send signals to vendors that poor performance is permissible.

Requires Contract Clause

The contract should require the vendor to provide specific programmatic information on a scheduled basis to determine if the performance measures are being met. The structure and contents of the report should be outlined in the contract, preferably with a programmatic report template as an appendix to the contract. At a minimum, programmatic reports should require information related to the performance measures (outputs and outcomes) in the contract and any deliverables required by the contract. The reported performance should be compared against the performance criteria established in the RFP or RFQ, vendor proposal, and contract.

In addition to stating what data is to be collected, the contract must also address the method of submitting the report, the person the report should be submitted to, the frequency of reporting, and what actions the agency may take in response to evaluation of the data (Ref 11). Agencies should require programmatic reports to be submitted at the same frequency as invoices submitted by the vendor. This allows the agency to review the vendor's performance before making a payment.

While programmatic reports are often essential, they do have a drawback in that the vendor, who has a financial interest in stating that the contract terms are being met, completes them. For this reason, state agencies often need to take additional steps to ensure the accuracy and reasonableness of reports. Periodic on-site monitoring visits or contact with individuals or organizations served by the vendor can assist the agency in determining whether the programmatic reports are reasonable. Additionally, the agency can require that supporting documentation be submitted with the report. For example, if the vendor is to provide a class to 50 individuals, the vendor can be required to submit a class roster as an attachment to the report.

Georgia's Use of Regular Programmatic Reports from Vendor:

- Twenty-one of the 25 state agencies (84%) surveyed reported that they use performance reports as a contract management tool.

- On-site reviews at the six state agencies selected for site visits found that 10 of the contracts (50%) received scheduled performance reports sufficient enough to assess the vendor's performance. Performance reports for another eight of the contracts (40%) were either available only when requested by the program manager or were determined to be insufficient to assess the vendor's performance.

- Performance reports exhibited a range of types and service information. Narratives typically provided an overview of services and generally contained little quantitative information. Activity reports were more detailed and frequently allowed for the measurement of the service outputs. Vendors usually submitted reports on a scheduled basis – monthly, quarterly, semi-annually, or annually.

- While the *Georgia Procurement Manual* does require that agencies monitor vendor performance and suggests periodic reports, it does not require the reports.

On-Site Monitoring

One method of monitoring performance is through visits to the vendor's facility. According to DOAS, on-site monitoring visits can be used to verify actual performance against scheduled or reported performance and ensure that the vendor is dedicating sufficient resources and appropriate personnel to the contract. The visits also reinforce, for the vendor, the importance of the contract to the state agency, provide opportunities to enhance communication with the vendor, and to follow up on any previously noted discrepancies (Ref 12). Agency officials should conduct random inspections of vendor records and the delivery of services to ensure all terms of the contract are being fulfilled.

Requires Contract Clause

On-site monitoring visits are most effective when based on a specific methodology or a checklist of review tasks. Although simple face-to-face contact with the vendors may be helpful, a structured review provides more useful information to assess whether the vendor is fulfilling the contract terms. A written report detailing findings of the on-site review should be produced.

On-site monitoring visits may not be necessary for all contracts. Given their time-consuming nature, site visits are typically recommended for large, complex contracts. The state agency must consider the type of work being performed under the contract. An on-site monitoring visit would probably be unnecessary for a consultant contracted to assist with an agency's strategic planning, but it would be very helpful to monitor performance of a childcare facility under contract to provide after-school programs.

Other States' Use of On-Site Monitoring:
An on-site monitoring clause is only standard in one of the six states. In that state, monitoring is done as inspections of the vendor's facilities before a contract and during its implementation to ensure that the facilities are adequate for the performance of the contract.

For two other states, the inclusion of a contract provision for on-site monitoring is at the discretion of the agencies.

Georgia's Use of On-Site Monitoring:

- In the survey of 25 state agencies, 20 (80%) reported using on-site monitoring to monitor at least some of their contracts.

- The reviews of 20 contracts at six agencies found that a clause allowing on-site monitoring was included in the contract and on-site monitoring was performed for five of the contracts (25%). Six additional contracts (30%) either did not have a clause related to on-site monitoring or the site visits were insufficient due to the lack of useful information generated by them. It should be noted that on-site monitoring might not have been necessary or appropriate for all 20 reviewed contracts. The audit team did not assess whether or not the agency should have conducted on-site monitoring in each case.

- Some of the on-site monitoring visits conducted by state agencies did not have documentation indicating a structured review. These visits appeared to be general in nature with limited useful information to assess whether the vendor is fulfilling the contract terms.

- The *Georgia Procurement Manual* discusses on-site monitoring but does not require that it be conducted.

Use of Incentives and Consequences for Poor Performance

Performance reinforcements, such as incentives and consequences for poor performance, are helpful in obtaining optimal performance from the vendor. Financial incentives can be one of the most effective methods of inducing a vendor to perform a desired service, while consequences for poor performance written into a contract provide agencies with the ability to take disciplinary action against a vendor that fails to comply with contract terms.

Requires Contract Clause

There are two types of incentives that agencies can provide to vendors – a bonus to the vendor for superior performance or allowing the vendor to keep a percentage of revenue collected.

- Bonus for Superior Performance – The superior performance may be in the form of high quality work, the completion of a project ahead of schedule, or saving the agency money. When incentives are offered, the agency must define the level of service, the project timetable to be met, or the cost savings that must be realized for the vendor to receive an incentive. Agencies should ensure that any incentive is tied to the most important requirements of the contract, instead of those requirements that minimally impact program results.

- Vendor Keeping a Percentage of Revenue – This type of incentive can be used when the vendor is operating a revenue-generating operation, such as a cafeteria or museum, or is serving as a collection agent for the state. In these cases, the vendor is allowed to

keep a percentage of all revenue generated by the operation, with the remainder remitted to the state agency.

There are several types of consequences for poor performance that can be included in contracts.

- Liquidation Damages – The most common financial consequence imposed by agencies on vendors is liquidation damages. When a vendor's performance is unacceptable, the agency is essentially overpaying for the service and is entitled to financial compensation for the loss. Liquidation damages quantify an agency's loss and deduct that loss from future payments to the vendor. The deduction is usually based on a formula stated in the contract (Ref 13). DOAS officials noted that agencies should establish reasonable damages, based on reasonable standards. If either is unreasonable, it is likely to limit competition and lead to vendors charging higher amounts to cover the greater risk.

- Partial Takeover of Operations – A more severe consequence is a partial takeover of operations. This allows the state to take over operations found to be in noncompliance and charge the new operating cost against the amount paid to the vendor (Ref 14).

- Termination of Contract – Agencies may terminate a contract with a vendor who fails to comply with contract terms. This is used as a last resort, when a vendor has been repeatedly warned about noncompliance with the contract (Ref 15).

The threat of financial consequences is often sufficient to persuade a vendor to improve performance or comply with contract terms. However, agencies should be willing to impose these consequences if a problem is not corrected after sufficient notification (Ref 16).

Other States' Use of Incentives and Consequences for Poor Performance:
All six state procurement agencies reported using either incentives or consequences for poor performance in at least some of their contracts. One state agency reported using both incentives and consequences for poor performance in their contracts, depending on the importance of the service. One state frequently uses liquidated damages for poor vendor performance in their contracts, while another uses only cost-savings-related incentives. For three of the states, neither incentives nor consequences are standard in contracts.

Georgia's Use of Incentives and Consequences for Poor Performance:

- Agencies reported on the survey that incentives are rarely used in contracts. Only four of the 25 agencies (16%) said that they use incentives in their contracts. Sixteen of the 25 agencies (64%) reported using financial consequences for poor performance in their contracts.

- The on-site reviews at six agencies found that none of the 20 contracts contained incentive clauses. However, 15 contracts (75%) contained a clause about liquidated damages, a partial takeover of services by the agency in the event that the vendor is not performing adequately, termination for poor performance, or stipulated the right to withhold a percentage of payment to the vendor.

- The *Georgia Procurement Manual* does not require agencies to include clauses related to penalties or incentives. It does state that agencies may withhold funds for contract noncompliance.

Access to Records/Right to Audit Clauses

The right to audit the vendor's books is a standard contract clause and a fundamental concept of contract administration. When government services are contracted out, the vendor represents the state in providing the service. Agencies have a responsibility to verify the information that the vendor reports to them and to ensure that funds are expended properly. This is especially important when there is a high degree of risk involved due to the type of contract or service, a high degree of liability exists for the state, or the potential for severe consequences in the event of poor vendor performance. Because the records are the property of the vendor, the contract must include an agreement that the agency has access to and can audit those records. The ability of agencies to audit vendor records should also extend to the records of any subcontractors.

Requires Contract Clause

Other States' Use of Access to Records/Right to Audit:

Access to vendor records and the right of the state to audit the contractor is present either through existing law or as a standard contract clause in five of the six states surveyed by the audit team. The clause is used only for some contracts in the remaining state.

Georgia's Use of Access to Records/Right to Audit:

- The survey of 25 state agencies found that 23 of the agencies (92%) reported that access to vendor records and the ability to audit those records was a contract management tool. This was the most frequent practice used, according to the surveyed agencies.

- Contract file reviews found that 17 of 20 contracts (85%) contained clauses related to the right of access of vendor records and the ability to audit those vendors. The three remaining contracts (15%) either addressed access to confidential information or stated that the vendor's records would become the agency's property at the end of the contract.

- The *Georgia Procurement Manual* does not require an access to records/right to audit clause but does reference it.

Measuring Customer Satisfaction

All government services have a customer in the form of government agencies, private organizations, or a portion of or all of the general public. When a state agency contracts out a service, it does not abdicate its responsibility for the customer's satisfaction. There are numerous methods of measuring customer satisfaction, including the use of surveys, forums, and complaint/compliment forms.

A common way of measuring customer satisfaction is through the use of surveys. Survey feedback can be used by the agency to notify the vendor when contract terms are not being met. In addition, agency officials can use the past performance information when making subsequent contract awards (Ref 17).

The method of performing customer satisfaction surveys can vary. The survey can be in the form of a questionnaire distributed by the agency or the vendor. However, the agency should compile results itself and ensure that any vendor involvement does not influence the survey results. The survey may be conducted during the contract period or at the end of the period.

A second common method of measuring customer satisfaction is the use of forums. The contracting agency can arrange for meetings with customers, who are allowed to discuss any positive or negative experiences with the vendor.

Finally, agencies may allow customers to express their opinions through complaint or compliment forms or phone lines. These may include paper forms, an online form on a website, or a phone number.

Other States' Methods of Measuring Customer Satisfaction:
In our survey of six other states' procurement offices, the audit team asked about the use of customer satisfaction surveys. Only one state reported the routine use of customer satisfaction surveys. These surveys are used to help evaluate contract performance. Another state reported that they survey the agencies about the central procurement office and its usefulness to the agencies.

Georgia's Methods of Measuring Customer Satisfaction:

- Twelve of the 25 (48%) surveyed agencies reported that they use customer satisfaction surveys to monitor at least some of their contracts.

- During the review at six agencies, the audit team found that five of 20 contracts (25%) were utilizing customer satisfaction surveys to evaluate contractor performance. Program managers for four of the remaining contracts were either skeptical that a survey would produce reliable results or relied on testimonial information from participants to assess vendor performance. It should be noted that measuring customer satisfaction may not be have been necessary or appropriate for all 20 reviewed contracts. The audit team did not assess whether or not the agency should have measured customer satisfaction in each case.

- The *Georgia Procurement Manual* does not address customer satisfaction.

Dispute Resolution Procedures

State agencies and vendors may disagree over terms of the contract or the performance of the vendor. Clear contract language should limit the number of disputes, but most contracts have at least minor disagreements between parties. The goal of a resolution process is to resolve all

problems as soon as possible, especially before they escalate to contract termination or litigation.

Disputes vary significantly in level of severity, with many being minor and worked out between the agency officials performing the day-to-day monitoring of the vendor and the vendor personnel actually performing the contracted service. However, if the dispute cannot be settled quickly, the agency should have procedures in place for the monitoring officials to notify the agency's procurement office. Agency officials should provide notification of problems and a timetable for resolution to the vendor in written form. If problems are not resolved, the agency should notify the DOAS State Purchasing Office and consider taking actions to compel the vendor to adequately comply with contract terms (i.e., financial penalty, contract cancellation). Agency procedures and a contract clause should detail at what level of non-compliance the vendor will receive a letter threatening termination of the contract (Cure Notice).

Requires Contract Clause

The dispute resolution clause should detail a procedure for the vendor to appeal any action (financial penalty, poor performance report, contract termination) with a higher purchasing official within the agency or a DOAS State Purchasing Office official (contract should explicitly state title of official) within a certain period of time. Appeals should be settled by negotiation or arbitration, with the dual goal of protecting the interests of the state and avoiding a claim made in the courts.

Other States' Use of Dispute Resolution Procedures:
Three of the states use their central procurement office or a variation of one as the arbitrating entity for dispute resolution. One of the remaining three states provides vendor ombudsmen to assist vendors with problems with untimely payments by agencies.

Georgia's Use of Dispute Resolution Procedures:

- The survey of 25 state agencies found that 16 (64%) had written procedures for dispute resolution between the agency and vendor.

- The on-site reviews found that five of 20 contracts (25%) had dispute resolution clauses.

- Program managers indicated during the review that they resolve most minor disputes with the vendors. As disputes become more difficult to resolve, program managers typically refer to their supervisors.

- The *Georgia Procurement Manual* does not require that the contract contain dispute resolution procedures. However, it does require that the agency take steps to communicate with the vendor and document deficiencies when disputes arise between the parties.

Closeout Procedures

Formal, written closeout procedures are recommended at the completion stage of the contract so that important elements are not overlooked. Contract closeout begins when the contract has been completed, all services have been performed and all products delivered. Depending on the type of contract, the process can be simple or complex (Ref 18).

The use of a checklist of closeout procedures helps to assure that all actions have been completed. It should be included in the contract file when closing contracts. Several contract closeout steps are related to monitoring the performance of the vendor, while others are more administrative in nature. A contract closeout checklist should include verification that:

- All invoices have been paid;
- All property has been returned;
- All deliverables have been accepted;
- There are no pending lawsuits;
- All required reports have been received;
- Contract audit has been completed, if necessary;
- There are no outstanding classified materials;
- There are no outstanding changes or amendments;
- All security badges and keys have been returned; and,
- All disallowed costs have been settled.

Georgia's Use of Closeout Procedures:

- The survey of the 25 Georgia state agencies found that 15 (60%) reported having some type of contract closeout procedures.

- On-site reviews at six agencies found that three of the agencies (50%) had formal closeout procedures for their contracts. These procedures were primarily concerned with ensuring that the final invoice has been submitted for the contract. One agency also has a closeout policy that the program manager should prepare an evaluation of the contractor's performance for each contract in excess of $250,000. None of the agencies had closeout procedures related to the return of either state property or security items.

- The *Georgia Procurement Manual* requires that program managers and contract specialists take certain steps when closing out a contract.

Post-Contract Review

At the end of a contract period, agencies should evaluate the vendor's performance and their own method of monitoring the vendor. These evaluations should provide the feedback necessary to determine whether a vendor should be awarded contracts in the future and whether the agency should improve its contract monitoring system. Even though these reviews are generally conducted after a contract has ended, contracts subject to renewal must be reviewed prior to the renewal decision being made (late in the contract period).

In their evaluation of a vendor, agencies should consider conducting a programmatic review and a financial audit. All contracts should be subject to a final evaluation of whether the vendor has performed the services sufficiently to fulfill the contract terms. Appropriate monitoring of the contract throughout the contract period should make this a simple task, and the final product will distinguish vendors with negative performances. A financial audit of the vendor is more time-consuming; therefore, the agency should determine whether it poses enough risk to warrant a financial audit.

Agencies should also review their own methods for monitoring the contract to determine whether they were sufficient. This review should cover all aspects of contract monitoring, such as:

- Did the contract and meetings with the agency give the vendor a clear understanding of the agency's expectations under the contract?
- Did the agency's policies and procedures sufficiently address all issues that arose during the contract?
- Was the contingency plan used and did it work adequately?
- Did the contract administration plan allow the agency to properly and quickly assess the performance of the vendor?
- Did agency personnel have the skills necessary to properly monitor the contract?
- Did the agency receive vendor reports that allowed it to determine if contract goals were being met?
- If incentives and penalties were included in the contract, were they useful in compelling vendor compliance?
- If dispute resolution was necessary, were the agency's procedures adequate?

Other States' Use of Post-Contract Review:
Post-contract financial audits vary among the six states. Two states routinely conduct post-contract audits while two others conduct them on only certain types of contracts. One state conducts post-contract compliance audits and one state does not conduct any post-contract audits.

Georgia's Use of Post-Contract Review:

- The survey of the 25 state agencies found that only 10 (40%) conducted any post-contract evaluations on the fiscal year 2002 contracts.

- On-site reviews at six agencies found that only two of the 20 contracts (10%) had a formal post-contract evaluation. It should be noted that post-contract review might not be necessary or appropriate for all 20 reviewed contracts. The audit team did not assess whether or not the agency should have performed post-contract review in each case.

- The *Georgia Procurement Manual* requires that a Contract Assessment Form be completed at the end of each contract period. The form must be completed and submitted to the State Purchasing Office before extension or renewal of the contract.

Appendix A
Overview of Components of an Effective Contract Monitoring System

Agencies should assess the complexity of the contracted service, the contract amount, and the risk if the work is not performed adequately when deciding what components are necessary.

Training in Contract Monitoring

Training in contract monitoring increases the likelihood that individuals will monitor contracts reliably by giving them the appropriate background knowledge related to contracts. Many of the topics that should be included in contract monitoring training are included in this guide as components of an effective contract monitoring system.

Written Policies and Procedures

Written policies and procedures serve as a guide to agencies and their personnel in ensuring a consistent, high quality contract monitoring process.

Contingency Plans

A number of options are available for a contingency plan: contracting with the next lowest bidder from the original solicitation; using another current vendor; in-house delivery of the service; and contracting with another government entity. An ideal contingency plan would include multiple options that provide maximum results based on the circumstances.

Communicating Clear Expectations to Vendors

Creating a detailed Statement of Work (a.k.a. Scope of Services), having performance measures in the contract, and holding a post-award meeting with the vendor all contribute to the vendor's understanding of what is required and essential under the contract. By clearly stating contract requirements and performance goals, the agency reduces the potential for poor performance. A post-award meeting allows staff that may not have been involved with the procurement process to answer any questions that the vendor might have and to clarify the more technical aspects of the contract.

Contract Administration Plan

A contract administration plan is a cursory view of planned and completed activities, and can be utilized throughout the term of the contract as a status report. It should detail the methods that the agency will use to monitor the vendor and the individuals or offices that will be responsible for the monitoring.

Organized Contract Files

Contract files should be organized so that someone could reconstruct and understand the history of the contract in the absence of the contract administrator. Contract files should hold all the information necessary to know what was expected and what was received under the contract.

Payments Linked to Satisfactory Performance

For contracts that involve monthly or quarterly payments, agencies should require a vendor to submit programmatic reports in advance of or concurrent with its invoices. The programmatic reports should be directly related to the terms of the contract.

Regular Programmatic Reports from Vendor

The contract should require the vendor to provide specific programmatic information on a scheduled basis to determine if the performance measures are being met. Programmatic reports should require information related to the performance measures (outputs and outcomes) in the contract.

On-Site Monitoring

Agency officials should conduct random inspections of vendor records and the delivery of services to ensure all terms of the contract are being fulfilled. On-site monitoring visits are most effective when based on a specific methodology or a checklist of review tasks. The officials should record the results of the visit.

Use of Incentives and Consequences for Poor Performance

Performance reinforcements, such as incentives and consequences for poor performance, are helpful in obtaining optimal performance from the vendor. Financial incentives can be one of the most effective methods of inducing a vendor to perform a desired service, while consequences for poor performance written into a contract provide agencies with the ability to take action against a vendor that fails to comply with contract terms.

Access to Records/Right to Audit Clauses

Agencies have a responsibility to verify the information that the vendor reports to them and to ensure that funds are expended properly. The contract must include an agreement that the agency has access to and can audit those records.

Measuring Customer Satisfaction

Customer satisfaction surveys help to improve vendor performance because the feedback can be used to notify the vendor when specified aspects of the contract are not being met. In addition, agency officials can use the information as a source of past performance information for subsequent contract awards.

Dispute Resolution Procedures

The agency should have procedures in place for the monitoring officials to notify the agency's procurement office. Agency officials should provide notification of problems and a timetable for resolution to the vendor in written form. If problems are not resolved, the agency should notify the DOAS State Purchasing Office and consider taking actions to compel the vendor to adequately comply with contract terms (i.e., financial penalty, contract cancellation).

Closeout Procedures

Formal, written closeout procedures are recommended at the completion stage of the contract so that important elements are not overlooked. The use of a checklist of closeout procedures helps to assure that all actions have been completed.

Post-Contract Review

At the end of a contract period, agencies should evaluate the vendor's performance and their own method of monitoring the vendor. Agencies should consider conducting a programmatic review and a financial audit.

Appendix B
Response from Department of Administrative Services

Trust • Excellence • Service

Department of Administrative Services

Sonny Perdue
Governor

June 10, 2003

Dana R. Russell
Commissioner

Paul E. Bernard, Director
Performance Audits Operations
Department of Audits
253 Washington St., SW, Suite 314
Atlanta, GA 30334

Dear Paul,

Thank you for the opportunity to review your report on the **Components of an Effective Contract Monitoring System**. I think that contract monitoring receives too little emphasis as state agencies outsource services. The report is generally excellent but I do have the following comments:

1. In the discussion of DOAS's role in contract monitoring (Overview of Contract Monitoring, page 4), the report states that DOAS "… imposes only minimal contract monitoring requirements on agencies". It should be noted that DOAS has no authority to impose any requirements. We can impose procurement requirements but not contract administration requirements. I would also appreciate the recognition that DOAS is not funded to provide routine contract administration services for agency contracts.
2. Under "Contract Administration Plan" (page 17), I think that the report should stress the importance of intense contact monitoring activities during the implementation phase of a new contract. The beginning stage of the contract is when the contractor gains a clear understanding of the agency's expectations. These expectations will color the relationship from that point on. Also, the contractor may have an erroneous understanding of various contract requirements. Close attention during the implementation stage will correct these misunderstandings early.
3. Under "Use of Incentives and Consequences for Poor Performance" (page 22), I think that a discussion of the impact of performance measures and liquidated damages on contract cost would be helpful. Agencies should be careful to establish realistic performance standards and reasonable damages. Too stringent standards and too harsh damages will limit competition and cause the vendors to charge higher prices to cover their risk.

I hope that these comments are helpful.

Sincerely,

Dana R. Russell
Commissioner

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Appendix C
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