

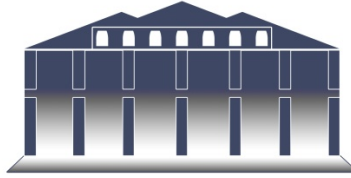
**Enhanced Oversight of Service Contracts Can Help
Ensure Cost-Effective Performance**



**Final Report to the Joint Legislative
Program Evaluation Oversight Committee**

Report Number 2016-01

January 11, 2016



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John W. Turcotte
Director

January 11, 2016

Senator Fletcher L. Hartsell, Jr., Co-Chair, Joint Legislative Program Evaluation Oversight Committee
Representative Craig Horn, Co-Chair, Joint Legislative Program Evaluation Oversight Committee

North Carolina General Assembly
Legislative Building
16 West Jones Street
Raleigh, NC 27601

Honorable Co-Chairs:

The 2015–17 Program Evaluation Division work plan directed the division to examine agency service contracts under the jurisdiction of the Department of Administration's Division of Purchase and Contract (P&C).

I am pleased to report that the Department of Administration cooperated with us fully and was at all times courteous to our evaluators during the evaluation.

Sincerely,

A handwritten signature in black ink, appearing to read "J. W. Turcotte".

John W. Turcotte
Director



PROGRAM EVALUATION DIVISION

NORTH CAROLINA GENERAL ASSEMBLY

January 2016

Report No. 2016-01

Enhanced Oversight of Service Contracts Can Help Ensure Cost-Effective Performance

Summary

The Joint Legislative Program Evaluation Oversight Committee's 2015–17 Work Plan directed the Program Evaluation Division to examine agency service contracts under the jurisdiction of the Department of Administration's Division of Purchase and Contract (P&C). State agencies are responsible for performing each of the three phases of contract procurement: sourcing evaluation, contract formation, and contract management.

State agencies are not ensuring procurement of contracted services achieves best value. PED examined 133 contracts for high-value services with total award value of \$1.24 billion. PED found \$511 million of this value stemmed from non-competitive practices such as waiving competition (sole sourcing); splitting awards among multiple vendors; extending contracts beyond the original period; and requesting and paying service providers to perform tasks not in the original Statement of Work.

State agencies are not documenting the basis for their decisions to contract with private providers. A determination to use the private sector to provide a service should be documented in a business case, which can be used to make an informed sourcing decision and allow for an effective evaluation of the performance of the private provider.

Agency procurements for high-value contracted services do not consistently include necessary attributes. PED identified three essential attributes of an effective service contract: performance measures, payment authorization, and service provider transition planning. Omitting or poorly conceptualizing any of these requirements increases the risk of controversy, undelivered services, disruptive transitions, litigation, and cost overruns.

State agencies and state-level monitoring are not consistently ensuring compliance with terms and conditions of high-value service contracts. Agencies could not provide PED with the amount paid to private providers for nine high-value contracts with \$63.6 million in award value. In addition, the contract duration period for nearly half of high-value contracts exceeded the maximum length authorized by P&C. P&C contract reviews have not contributed to the achievement of best value.

To address these findings, the General Assembly should amend state law to:

- require state agencies to submit business cases for high-value services to P&C for review and approval in accordance with established criteria; and
- direct P&C to implement a system to monitor state agency-administered contracted services.

Purpose and Scope

The Joint Legislative Program Evaluation Oversight Committee's 2015–17 Work Plan directed the Program Evaluation Division to examine agency service contracts under the jurisdiction of the Department of Administration's Division of Purchase and Contract (P&C).

As detailed in Appendix A, the Program Evaluation Division conducted a detailed analysis of 133 recently awarded contracts for high-value services under the jurisdiction of P&C and administered by state agencies. As specified in the North Carolina Procurement Manual, service contracts are contracts awarded for the procurement of accomplishing some task or activity. These tasks or activities can range from auditing to trash and recycling services, provided that the service is not primarily for review, analysis, or advice in formulating or implementing improvements in programs or services.

The Program Evaluation Division identified the 133 high-value service contracts through analysis of procurement information maintained in P&C's Interactive Purchasing System (IPS) and contract-specific information provided directly by state agencies. The methodology used to identify these contracts was designed to produce the most complete listing of high-value service procurements from readily available sources.¹

Four central research questions guided the study:

1. How much was spent by state agencies to provide contracted services?
2. What are best practices for the procurement of contracted services?
3. Have current contracts for these services produced the intended objectives?
4. How can the effectiveness of the procurement process for contracted services be improved?

The Program Evaluation Division collected data from several sources, including:

- review of laws and policies guiding the acquisition and management of contracted services;
- contract award data from the Department of Administration's Interactive Purchasing System with an award date during the period July 1, 2010 through June 30, 2015;
- interviews and queries of Department of Administration program managers; and
- administrative queries completed by each state agency.

¹ The methodology to identify high-value services contracts also included the requirement that at least one contract for each state agency be included in the evaluation.

Background

State agencies rely on a workforce of government and private providers to deliver goods and services to the citizens of North Carolina. Determining whether to provide these goods and services with state employees or through a contract with a private provider is an important economic and strategic decision critical to the State's effective and efficient use of taxpayer dollars. Such decisions attract controversy if poorly conceived or insufficiently documented.

Utilization of the private sector to provide services is primarily undertaken to improve cost-effectiveness. As with nearly all large multi-sector organizations, North Carolina contracts with the private sector to provide goods and services. Developing and adhering to an effective process to procure these goods and services can help ensure state funds are being used to achieve best value. An effective procurement process can also serve to

- incentivize private service providers to improve performance and reduce costs, and
- allow state agencies to focus on achieving their core missions rather than spending time on commercial or related tasks.

Shifting performance of tasks to a private entity, however, does not mean that a state agency has shed complete responsibility and accountability for the service.

A contract with a private provider, if well-conceived and competently administered, allows the agency to focus labor resources on precisely defined tasks and provides ways for increased accountability that are not generally possible through direct service by state employees, such as:

- including time-specific points within a multi-year contract for continuation or termination of the contract contingent upon performance;
- requiring a service provider to obtain a performance bond from a surety to protect the State against contract default and ensure resources are available for making transitions in the event of default;
- withholding retainage or a portion of the total award to protect against contract default or marginal performance; and
- allowing monetary incentives such as bonuses contingent upon superior performance as defined by the contract.²

Competitive rebidding of a contract on a regular basis also enables state agencies to incentivize a current private provider to maintain or improve performance and pricing or risk losing the contract to a competitor.

As shown in Exhibit 1, the Program Evaluation Division estimates that in Fiscal Year 2014–15 approximately \$3.7 billion was expended by state agencies to procure goods and services from the private sector.³ Based on

² Retainage is a common contracting practice whereby the contracting entity retains a percentage of the total contract award amount that will be released at the end of the contract only upon satisfactory completion of all contract requirements. Retainage may also be termed "liquidated damages" or "ascertained damages."

³ Other expenditures included transfers to other government entities, aid and public assistance, and debt payments.

an analysis of expenditures as identified in the North Carolina Accounting System, the Program Evaluation Division determined that approximately \$2.5 billion of the \$3.7 billion was spent on contracts with private entities to purchase and maintain fixed assets such as roads, bridges, and buildings. In addition, approximately \$300 million was expended to provide state agencies with information technology-related goods and services.⁴

As shown in Exhibit 1, approximately \$900 million was spent by state agencies to procure contracted services in Fiscal Year 2014–15.

Contracted services are characterized as services for which state agencies have the responsibility for achievement of the intended outcomes while a private entity is contracted to be the service provider. These contracts are used to provide services ranging from standard services such building and grounds maintenance to complex agency-specific services such as audits of Medicaid expenditures. Unless statutorily exempted, the Department of Administration's Division of Purchase and Contract (P&C) has jurisdictional authority over the procurement of contracted services by state agencies.⁵

As with the procurement of all goods and services, the objective of the procurement process for contracted services is to obtain best value from the service provider. As specified in North Carolina law, a best value procurement process is intended to result in the selection of a service provider that will provide the best trade-off between price and performance, where quality is considered an integral performance factor.⁶

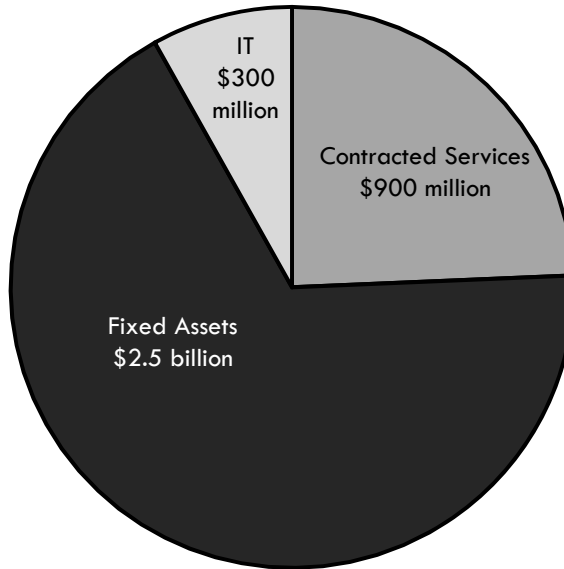
⁴ In FY 2014–15, approximately \$13.7 billion (per Fiscal Research Division estimates) in public assistance funds was paid to Medicaid providers under contract. These Medicaid vendor contracts were beyond the scope of this PED report because such contracts are exempt from P&C approval and subject to a large body of state and federal laws and regulations. Provider contracts are currently fixed "fee for service" statewide contracts with physicians, clinics, pharmacies, and hospitals that are not separately negotiated. Providers must serve any Medicaid-eligible patient because they are legally entitled to and sought those services.

⁵The Department of State Treasurer represents an example of a state agency with a statutory exemption from P&C jurisdiction authority over the procurement of contracted services. As specified in G.S. §147-68 (e), the State Treasurer, in carrying out the responsibilities of this section, shall be independent of any fiscal control exercised by the Director of the Budget or the Department of Administration.

⁶ As specified in G.S. 143-135.9(a)(1).

Exhibit 1

In Fiscal Year 2014–15, State Agencies Spent an Estimated \$3.7 Billion to Procure Goods and Services from the Private Sector



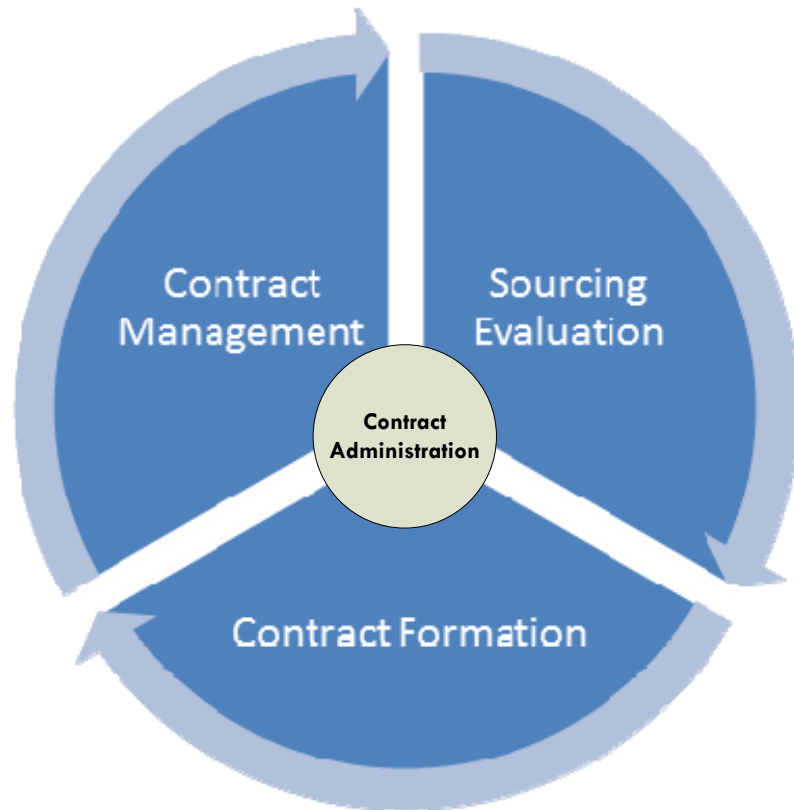
Source: Program Evaluation Division based on review of FY 2014–15 NCAS expenditures.

While P&C is responsible for ensuring achievement of best value through contracts for services, state agencies are responsible for performing the activities associated with each phase of the procurement process. As shown in Exhibit 2, the procurement process for contracted services can be categorized into three phases;

- sourcing evaluation,
- contract formation, and
- contract management.

Exhibit 2

The Three Phases of the Procurement Process for Contracted Services



Source: Program Evaluation Division based on review of applicable policies and procedures of North Carolina and other states, and of professional publications.

Sourcing evaluation. The sourcing evaluation phase encompasses activities performed from identification of the need to consider a service delivery alternative through authorization to solicit bids from prospective providers.

The objective of the sourcing evaluation phase of the procurement process for services is to identify the method of delivery that will provide the best value to the State. An effective sourcing evaluation phase is critical to the success of the entire procurement process because the information obtained during this phase is also essential for subsequent contract formation and contract management phases to effectively contribute to the intended outcome.

The first step in the sourcing phase of the procurement process is to identify which services should be considered for delivery by a private provider. The activities associated with the sourcing evaluation phase for a contracted service are typically conducted by the state agency with responsibility for the associated outcome.⁷ At a minimum, these activities should include:

- identification of available service delivery options, including delivery in-house, provision by other governmental units, contracts with non-profits, and contracts with for-profits;

⁷ Agencies may also be directed through legislative action or require a specific appropriation.

- development of complete and reliable cost, benefit, and performance data including the costs associated with the contract formation and management phases of the procurement process; and
- analysis of the market for the service to include consideration of any limitations on the use of a competitive bidding process to select a provider and incentives to ensure achievement of intended outcomes.

In addition to having staff with extensive knowledge of the service operation itself, state agencies should ensure that a team of people is available to perform each of these activities. Participation in this phase of the procurement process by a wide range of professionals helps ensure that any potential issues and problems will surface early and can be dealt with before the service is solicited from the private sector.

Contract formation. The contract formation phase is a series of pre-award procurement activities between an agency and a private service provider that results in a contract. An effective contract formation phase is also critical to achievement of best value because determinations of service specifications and performance targets serve as the primary tools to ensure achievement of intended outcomes.

The purpose of the contract formation phase is to identify and select the service provider that can most cost-effectively perform the service. State agencies are also responsible for completing the contract formation phase of the service procurement process. P&C policy requires the procurement process for contracted services ensure the private provider is selected through fair and open competition and equal access to information.

The contract formation phase of the procurement process begins with the development and issuance of a solicitation for services typically known as a Request for Proposals (RFP).⁸ The solicitation for services includes a strategically important Statement of Work, which defines the activities and tasks comprising the service and any associated performance requirements. In addition, a solicitation for services includes a standardized proposal framework for prospective providers to use as well as the basis upon which proposals will be assessed.

The contract formation phase of the procurement process also includes the receipt and evaluation of proposals. A proposal describes how the prospective provider will ensure the service is effectively performed. State agencies are responsible for evaluating these proposals and identifying the prospective service provider that can most cost-effectively perform the service. The agency must then negotiate final terms of the contract, resolve disagreements, and evaluate whether counter-proposals by the vendor are

⁸ Other forms of solicitations include:

- Request for Information (RFI): used when an agency is exploring if there is sufficient vendor interest and potential competition for performing a service. Submissions by vendors are not binding and do not commit the vendor or agency to any terms.
- Request for Qualifications (RFQ): a non-committal announcement used when an agency seeks to know the relative capabilities of potential vendors. Submissions by vendors are not binding and do not commit the vendor or agency to any terms.
- Request for Bids (RFB): used when an agency knows that vendors are capable of producing a specified product or providing a service and where relative vendor price proposals (bids) and ability to deliver are of primary consideration.

acceptable. Private service providers are often able to employ aggressive and skilled negotiators, and so it is imperative that the agency be able to match that level of skill. When negotiations are complete, the contract is executed and commences. In situations involving larger procurements, the agency may have to contend after award with protests by unsuccessful bidders.

Contract management. The contract management phase encompasses all interactions between the government and the private service provider from the time the contract is awarded until the work has been completed and accepted or the contract terminated, payment has been made, and disputes have been resolved. Once again, the terms of the contract including the Statement of Work and the vendor's proposal, usually incorporated within the contract, are strategically important.

The objective of the contract management phase of the procurement process for contracted services is to ensure the private entity provides the service as specified in the contract. In addition, state agencies are responsible for maintaining all associated documentation relating to these duties and responsibilities in a designated contract file.

The Office of the State Auditor has identified concerns with the procurement process for contracted services in several recently published audits. For example, a performance audit issued in November 2010 identified numerous deficiencies in the processes used by both state agencies and P&C to monitor service contracts.⁹ Specifically, this audit reported that the processes used by state agencies to monitor service contracts do not consistently ensure that the State receives the services for which it has paid. Furthermore, in February 2015, the Auditor reported that the State Board of Elections paid a vendor nearly \$1 million to replace the State's Campaign Finance System and received nothing in return.¹⁰

In summary, this report examines the procurement process for contracted services under state agency jurisdiction. State agencies rely on private entities to perform many of the services provided to North Carolina's citizens. Consequently, the effectiveness of the process to procure these services has a direct impact on a government entity's ability to function successfully and deliver necessary services to the public. Effective execution of each phase of the procurement process is required to achieve best value from contracted services while protecting the public interest.

Findings

Finding 1. Full competition was not utilized in the awarding of \$511 million (41%) of the \$1.24 billion awarded to private providers for high-value services.

To help ensure achievement of best value, North Carolina law requires high-value services be procured through a competitive bidding process, unless specifically waived by the Department of Administration's Division of

⁹ Office of the State Auditor, Performance Audit: Department of Administration, Division of Purchase and Contract, Service Contract Monitoring Practices, November 2010.

¹⁰ Office of the State Auditor, Information Systems Audit, Statewide Information Technology Project Benefits and Governance, February 2015.

Purchase and Contracts (P&C).¹¹ In addition, P&C policy specifies an open market solicitation be included in the competitive bidding procedure for the procurement of services. An open market solicitation is defined as the fair and open solicitation of offers for the purchase of the service. P&C policy also specifies that competition to provide the service be reasonable and adequate for the amount of the expenditure.

The decision to contract with a private service provider should include consideration of whether there is sufficient competition within the private marketplace. Sufficient competition is important because it helps ensure that the procurement process is able to achieve best value. If there are an insufficient number of service providers with the necessary expertise to effectively perform the service, a private provider may engage in monopolistic behavior by raising prices and reducing quality over time.

Utilization of a competitive bidding process helps ensure achievement of best value from a contracted service. A competitive bidding process incentivizes prospective service providers to submit a proposal that will provide the most cost-effective service delivery. State agencies are then able to evaluate each proposal and select the service provider that can provide the best value.

North Carolina law authorizes P&C to waive this requirement for a variety of reasons, such as when a competitive procurement process cannot be conducted due to an insufficient number of prospective service providers or because the projected increase in value from a competitive bidding process does not justify the associated cost.¹² Currently, state agencies are required to submit their request for a waiver from competitive bidding requirements in conjunction with their request for a P&C contract award, a step performed at the conclusion of the contract formation phase of the procurement process.

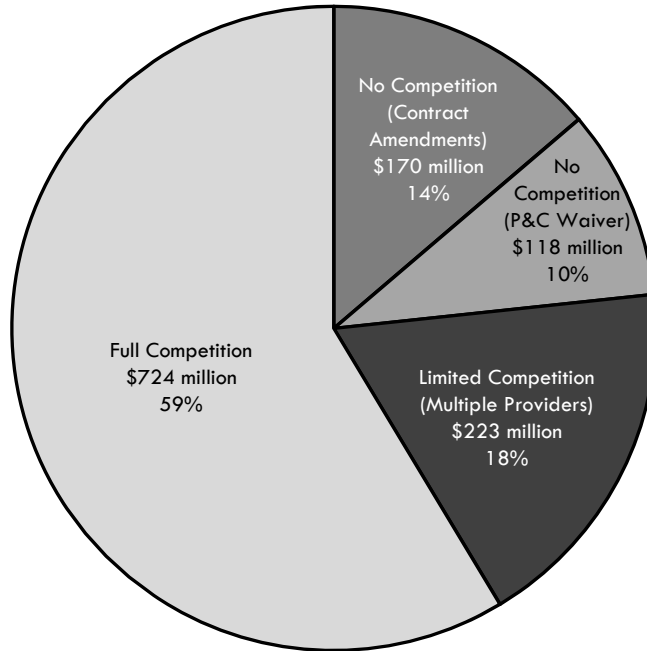
P&C waived competition for 14 high-value service contracts valued at \$118 million. As shown in Exhibit 3, the Program Evaluation Division review of the procurement process associated with 133 contract awards for high-value services identified 14 awards, with a total estimated value of \$118 million, for which P&C waived the requirement to procure contracted services through a competitive bidding process. These services ranged from analysis of petroleum contaminated soil and groundwater for the Department of Environmental Quality to marketing and advertising services for the Department of Transportation.

¹¹ As specified in G.S. 143-49(3).

¹² As specified in 01 NC Admin Code 05B.1401 (1999).

Exhibit 3

Full Competition was Not Used in \$511 Million (41%) of the \$1.24 Billion Awarded to Private Providers for High-Value Services



Note: Three contract awards identified in Appendix A—line items #28, #36, and #37—had a Waiver of Competition and multiple awards. For these contract awards, the associated value was only included in the total reported under No Competition (P&C Waiver).

Source: Program Evaluation Division based on information provided by P&C.

The decision to waive the requirement to utilize a competitive bidding process to procure a contracted service should be made during the sourcing evaluation phase of the procurement process. The ability to effectively use a competitive bidding process to achieve best value is a critical factor in the determination to contract with a private service provider. A competitive bidding process provides prospective providers with an incentive to offer the most cost-effective service delivery alternative or risk not being selected to provide the service.

When the requirement to utilize a competitive bidding process is waived, the incentive to maximize cost-effectiveness is reduced along with the ability to ensure best value. Consequently, the ability to utilize a competitive bidding process to procure a service should be considered in the determination of whether to contract with a private service provider.

In addition to impacting the effectiveness of a competitive bidding process in achieving best value, the unavailability of a sufficient number of private-sector service providers can increase the risk associated with inadequate performance. The scarcity of potential service providers poses additional risks because state agencies often depend upon the capacity of these providers to effectively provide the service. Consequently, should a private service provider default or enter bankruptcy, essential services that may be required to protect the public health or safety may be disrupted.

More than one provider was selected for 23 high-value service contracts valued at \$233 million.¹³ Many contracts for services involve awards split among multiple providers. A multiple-award contract is a contract awarded to several private providers from a single solicitation. Delivery of supplies or performance of services is then made via an individual delivery/task order placed with one of the service providers in accordance with the procedures established in the contract. As specified in North Carolina law, the intent of multiple-award contracts is to allow the state to leverage its buying power and at the same time achieve efficiencies in the procurement process and obtain best value for taxpayers.¹⁴

Contracts may be awarded to multiple service providers for a variety of reasons including circumstances in which more than one provider is needed to satisfy the service requirements.¹⁵ As specified in North Carolina law, best value should be based on a determination of which proposal offers the best trade-off between price and performance.¹⁶ The selection of more than one service provider limits the effectiveness of the competitive bidding process at obtaining best value when the proposals submitted by each selected prospective provider include different price and performance characteristics.

As also shown in Exhibit 3, the Program Evaluation Division review of the procurement process for the 133 contracts for high-value services identified 23 contracts with an estimated value of \$223 million that had awards issued to more than one service provider. The number of service providers associated with these 23 contract awards ranged from two to 29.

State agencies are currently responsible for determining whether service contracts should be awarded to more than one provider, yet P&C has not provided sufficient guidance to ensure state agency determinations are consistently using a standard methodology. Currently, the only direction from P&C is that state agencies only use more than one provider when needed to meet the requirements of the service, and that extreme care shall be exercised to protect the character and principles of competition. Consequently, state agencies may be unnecessarily limiting competition in the procurement process for some high-value services.

To ensure achievement of best value for high-value contracted services, the determination to limit the effectiveness of a competitive bidding process by utilizing more than one provider should be

- performed during the sourcing phase of the procurement process,
- considered as a condition of issuing a solicitation to potential service providers, and
- approved by P&C.

¹³ Three contracts awards identified in Appendix A—line items #28, #36, and #37—had a Waiver of Competition and multiple awards. For these contract awards, the associated value was only included in the total reported under No Competition (P&C Waiver).

¹⁴ As specified in N.C. Gen. Stat. §143-52.3.

¹⁵ As specified in the North Carolina Procurement Manual, multiple awards may be made by reason of insufficient funds, legislative mandate, or where it is advantageous to award separately by items or where more than one supplier is needed to provide the contemplated requirements as to quantity, quality, delivery, service(s) or geographical areas.

¹⁶ As specified in N.C. Gen. Stat. §143.135.9.

P&C review and approval of any agency determination that limits the ability of a competitive bidding process to achieve best value would help ensure that the associated analysis is uniformly and consistently conducted.

State agencies did not use a competitive bidding process in awarding 113 amendments totaling nearly \$170 million to 33 contracts for high-value services. An amendment documents a change to the terms and conditions identified in the initial contract award. For example, an amendment may document an increase in the amount of authorized expenditures and/or an extension in the period of time in which a service provider is authorized to expend funds.

In response to a request from the Program Evaluation Division, P&C conducted a review of its files to identify the number and value of associated amendments approved for the 133 high-value contract awards. P&C identified 33 contracts with between one and 11 amendments to the original contract. In total, these 33 identified contract awards had 113 amendments, with total authorized expenditures of \$170 million.

There are often valid reasons for contracts to be amended. For example, demand for a service may exceed the levels identified in the original contract, requiring additional resources to ensure continued achievement of the specified performance objectives. Contracts may also need to be amended when associated statutory requirements are modified.

However, extensive use of contract amendments may also indicate poor planning in the development of the Statement of Work in the solicitation document for the initial contract or a change in the service requirements that should have been achieved through a competitive bidding process.

The contract formation phase of the procurement process includes the development of a solicitation for services to prospective providers. The solicitation for services includes a Statement of Work. The Statement of Work sets the requirements to ensure the service provider achieves best value. A Statement of Work also forms the basic framework for the contract with the selected provider. Consequently, the Statement of Work directly impacts an agency's ability to effectively procure a service and achieve best value.

Dangers of Poorly Prepared Statements of Work. Prospective service providers may recognize weaknesses in a Statement of Work such as an agency failing to include tasks that must be completed or underestimating the hours required for a specified task. Consequently, prospective providers may submit a proposal anticipating that, after award, the agency will realize the additional work necessary and request the private provider agree to a contract amendment or modification. At this point, the agency has a weaker negotiating position. Contract amendments must then be negotiated with the service provider, who may press for compensation above that which would have been charged had the task or appropriate hours required been specified in the Statement of Work and subject to competition.

For example, the Department of Administration executed a contract with Accenture to provide services for the transformation of the State's procurement functions. The initial contract had an estimated value of \$1.7 million and was authorized by P&C for award on November 10, 2010. As of June 30, 2015, the Department of Administration has executed seven amendments and increased the value by \$49.4 million to \$51.4 million. All of these seven modifications and the associated increases in the contract value were established without the benefit of a competitive bidding process.

In summary, utilization of a competitive bidding process in the procurement of high-value services helps to ensure achievement of best value. Consequently, consideration of the ability to conduct a full competitive bidding process should be included in the determination to use a private service provider.

Finding 2. State agencies are not documenting the results of their determinations to use contracted services.

The Program Evaluation Division requested state agencies provide documentation supporting the results of the sourcing evaluation phase associated with high-value service contract awards. In response, the Department of Information Technology was the only state agency that provided a business case documenting the results for any of the 133 identified contract awards.

Without documentation supporting the results of the decision to contract with a private service provider, state agencies cannot demonstrate that the determination included consideration of all of the necessary factors. Consequently, state agencies may not be consistently achieving best value through the use of contracted services.

The private sector is not always the appropriate resource for the delivery of services. For example, inherently governmental services such as law enforcement, policy making, and public safety should not be performed by a private entity. These services are essential to the well-being and quality of life of citizens and therefore should never be subjected to the risk of inadequate performance. Federal policy defines an inherently governmental function as a function that is so intimately related to the public interest as to mandate performance by government employees. For example, federal policy considers any function that significantly affects the life, liberty, or property of private persons or exercises ultimate control over the acquisition or sale of property to be inherently governmental.

Utilization of contracts with a private provider should be considered for services that provide a commercial function. These functions include gathering information for or providing advice, opinions, recommendations, or ideas to state agencies. They also include functions that are primarily ministerial and internal in nature, such as building security, mail operations, operation of cafeterias, housekeeping, facilities operations and

maintenance, warehouse operations, motor vehicle fleet management and operations, or other routine electrical or mechanical services.¹⁷

The final decision to utilize the private sector to provide a service should be based on the results of the sourcing evaluation phase of the procurement process and should be documented in a business case. A business case should provide all of the information necessary to support the decision as to whether the private sector or government employees should provide a service. A business case also provides instructive guidance for how the service is to be procured, implemented, and managed. In addition, a business case should define the expectations of the contract in terms of the key benefits and potential risks to the State.

At a minimum, the results of the sourcing evaluation phase should identify:

- cost savings associated with transitioning service delivery;
- impact on the State's associated goals and objectives;
- risks of inadequate performance; and
- cost to effectively procure the service.

Further explanation of each of these components is provided below.

Cost savings. To analyze the potential cost savings associated with transitioning performance of a service to a private service provider, a comparison of the cost of production between the current and alternative providers should be conducted. In order to determine the current cost to provide the service, it is critical that all associated tasks are clearly defined.

Without accurate information on the current cost of production as well as costs associated with transition to an alternative method of delivery, it is not possible to determine whether proposals from alternative sources would result in cost savings and more efficient service delivery. Hence, the decision to issue a solicitation may not be warranted.

Impact on goals and objectives. Another important consideration in the decision to transition to another method of delivery is the anticipated impact on the State's associated goals and objectives. Knowing the impact on associated goals and objectives is important for ensuring cost comparisons between current and alternative sources of service delivery are valid and for helping to ensure that any change in the method of service delivery will not result in a decrease in the level of service.

Identification of the current level of service quality is essential to deciding whether to transition to another method of service delivery. In addition to helping determine the effectiveness of the current method of delivery, performance information can be compared with that of other entities and used to determine whether utilization of a private service provider can be expected to improve performance.

Risks of inadequate performance. The decision to contract with a private service provider should include consideration of the risks of inadequate

¹⁷The detailed list of examples of commercial activities found as an attachment to Office of Management and Budget (OMB) Circular No. A-76 is an authoritative, nonexclusive list of functions that are not inherently governmental functions. These functions therefore may be contracted.

performance throughout the contract period. Generally, the risk of non-performance increases with the operational complexity of the service and with its contribution to the State's strategic goals and objectives. Consequently, state agencies may need to develop more extensive performance measurement and validation systems to ensure solicitations can be used to identify the most appropriate suppliers and resulting contracts can be effectively managed.

Cost to effectively procure the service. Determination of the resources required to effectively procure a contracted service should be included in the decision of whether to seek a private provider. These resource requirements should include identification of the cost to effectively perform each phase of the procurement process and should be included in the determination of the total cost to utilize a private service provider.

This determination of the cost to effectively procure a contracted service should involve weighing the risks associated with inadequate performance against the level of state agency resources allocated to each phase of the procurement process. An inadequate allocation of appropriate staffing may result in an unacceptably high risk that the provider will not deliver the best level of service at the lowest possible price. However, overly restrictive oversight can interfere with a private provider's ability to perform the service and unnecessarily and inadvertently increase the total cost of the service.

Whenever possible, for high-value service procurements the same staff should be assigned throughout the entire procurement process. In addition to program staff with operational knowledge of the service, staff assignments should ensure the availability of all other required competencies, including budgeting, legal, human resource, and purchasing.

For the procurement of high-value services, assigned purchasing staff should have expertise in the use of government-vendor partnerships. As defined by state law, a government-vendor partnership is a mutually beneficial contractual relationship between state government and a private provider, wherein the two share risk and reward, and wherein value is added to the procurement of needed goods or services.¹⁸ State law specifically encourages the use of government-vendor partnerships when procuring high-value services.¹⁹

In contrast to the procurement process for contracted services in North Carolina, the federal government requires that a business case be developed for high-value services as a condition of issuing a solicitation to the private sector.²⁰ To assist federal agencies in the development of required business cases, the Federal Office of Management and Budget has developed a business case template. The template identifies the specific information that must be present in each business case, including the benefits expected as a result of the proposed acquisition and the costs to the servicing agency for awarding and administering the proposed contract.

¹⁸ As specified in G.S. §143-135.9(a)(2).

¹⁹ As specified in G.S. §143-135.9(c).

²⁰As specified in Federal OMB memorandum for Chief Acquisition Officers/Senior Procurement Executives, dated September 29, 2011.

To use a state-level example, Florida law also requires that a business case be developed as a condition of contracting with a private service provider.²¹ The law specifies information that must be included in each business case:

- a detailed description of the service;
- a description and analysis of the state agency's current performance based on existing performance metrics if the state agency is currently performing the service;
- the goals desired to be achieved from the service;
- a description of the specific performance standards that must, at a minimum, be met to ensure adequate performance; and
- a description of the current market for the service.

Avoiding Controversial Contracts

Recent contracting controversies in North Carolina have attracted attention from auditors, elected officials, and the media.

- **Relative Cost Effectiveness.** Most contracting controversies hinge on whether private providers or state employees could or are providing services more effectively. This scenario was illustrated recently by disputes regarding a Department of Public Instruction contract for the towing of vehicles seized from drivers arrested for DWI and a Department of Public Safety contract for maintenance of three correctional facilities. These controversies could have been minimized if the state agencies had performed a thorough sourcing evaluation, which included current cost and performance information. This baseline cost and performance information could then have been used to evaluate the relative effectiveness of the contracted service provider rather than having to rely on anecdotal evidence and be subject to challenge by unsatisfied parties.
- **Private Sector Complaints about Agency Failures to Consider Contracting Opportunities.** Private providers interested in contracting with state agencies for commercial services such as operation of cafeterias, facility security, and building maintenance have complained about resistance from agencies. Without enactment and active enforcement of laws and policies associated with the determination to use a private service provider, state agencies may overlook or resist potentially cost-effective opportunities. Concerns about state employees losing jobs and loss of control often work against an objective determination. State agencies may also lack sufficient expertise to effectively procure high-value services. Finally, without established statewide policies and procedures to identify services that may be more cost-effectively provided by the private sector, state agencies may fear criticism for initiating a procurement process that is unprecedented, potentially flawed, or not guided by established policies.

In summary, while state agencies may be conducting informal sourcing evaluations, the lack of documentation supporting the decision to contract

²¹As specified in Florida Gen. Stat. §287.0574.

with a private service provider increases the risk that the State will not obtain best value and limits the ability of P&C to monitor state agency procurement processes and ensure cost-effective performance.

Finding 3. Solicitations for high-value services do not consistently include all of the necessary requirements to ensure effective performance.

Essential Attributes of Solicitations. As described below, the Program Evaluation Division identified three essential attributes of an effective solicitation for service.

1. Performance measures and targets.
2. Payment authorization.
3. Transition planning.

To evaluate whether state agencies are effectively performing the contract formation phase of the procurement process, the Program Evaluation Division evaluated the solicitation documents associated with the 133 high-value service contracts analyzed in this report. As described in Exhibit 4, the Program Evaluation Division used specific criteria to rate the adequacy with which each solicitation met the three specification requirements.

Exhibit 4: The Program Evaluation Division Used Three Factors to Evaluate 133 Solicitations for High-Value Services

Performance Measures and Targets

Criteria: Contract Statement of Work (SOW) clearly identifies the service requirements and measures used to determine achievement of desired outcomes.

- **Weak/Not included:** Contract SOW does not include any service performance standards.
Example: Solicitation issued by Department of Transportation to collect traffic site data.
- **Adequate/Partial:** Contract SOW specifies minimum acceptable level of performance for service but does not include measures to identify superior performance.
- **Strong/Full:** Contract SOW includes performance measures and associated targets needed to evaluate contribution to achievement of desired outcomes.
Example: Contract executed by Department of Agriculture and Consumer Services to provide aircraft flight services to assist with fire suppression activities.

Payment Authorization Process

Criteria: Contract SOW identifies payment authorization process, including information necessary to determine achievement of service requirements and desired outcomes.

- **Weak/Not included:** No requirement in SOW to provide documentation supporting achievement of the service requirement as a condition of payment approval.
Example: Solicitation issued by Department of Environmental Quality to perform laboratory analysis of petroleum-contaminated soil and groundwater from leaking petroleum underground storage tanks.
- **Adequate/Partial:** Payment authorization process identified in SOW includes requirement to submit documentation supporting achievement of intended outcomes.
- **Strong/Full:** In addition to requiring documentation supporting achievement of intended outcomes, contract SOW includes requirement to allow for verification of associated performance information.
Example: Solicitation issued by Department of Administration for the administration, management, and operation of State Veterans Homes.

Transition Planning

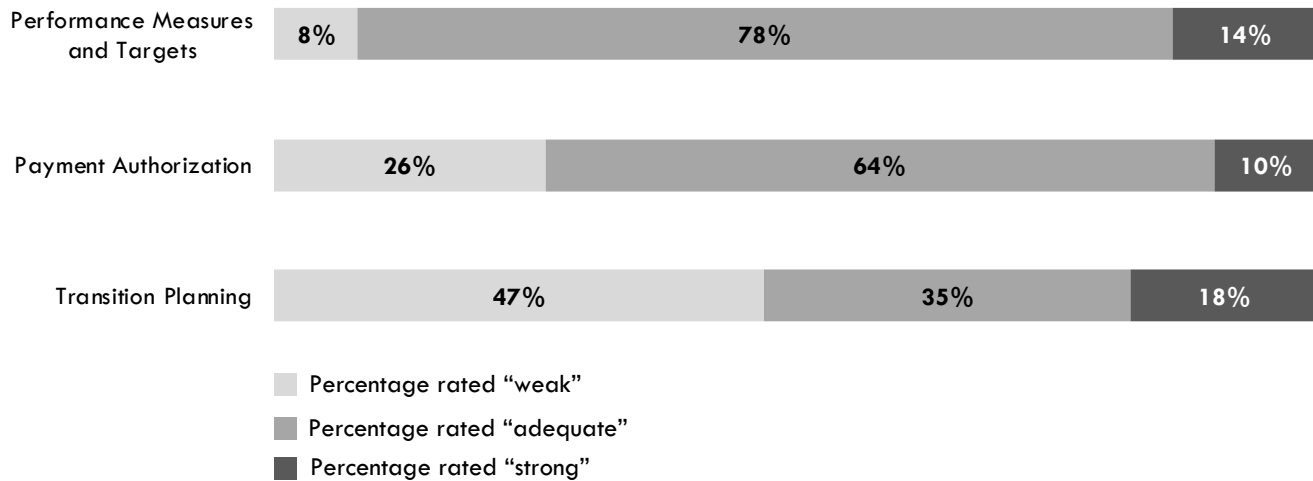
Criteria: Contract SOW identifies requirements to ensure effective service continuity.

- **Weak/Not included:** Contract SOW does not explicitly reference any requirement to address risk associated with potential service disruptions or the ability to effectively employ competitive bidding in the procurement process for a subsequent contract.
Example: Solicitation issued by Department of Information Technology for heating, air conditioning, and ventilation (HVAC) maintenance services.
- **Adequate/Partial:** Contract SOW includes requirement to address risk factors associated with either the implementation of the contract or the follow-on procurement process, but not both.
- **Strong/Full:** Contract SOW includes requirements to address risks associated with both the contract implementation and the follow-on procurement process.
Example: Solicitation issued by the Department of Health and Human Services for the operation of North Carolina's Problem Gambling Hotline.

Source: Program Evaluation Division based on review of research conducted by subject matter experts.

As shown in Exhibit 5, the Program Evaluation Division review of solicitations for high-value services determined state agencies are not consistently including all of the specification requirements necessary to ensure achievement of best value.

Exhibit 5: Solicitations for High-Value Services Do Not Consistently Include All of the Requirements Necessary to Ensure Performance Objectives are Achieved



Note: Consideration of the Transition Planning factor was not included in the evaluation for 58 of the 133 contract awards, which were associated with non-recurring services, i.e. mitigation credits. These contracts are associated with services that end upon contract expiration. Consequently, a transition plan to ensure service continuity and effective competition in the follow-on procurement process would not be an essential component of an effective Statement of Work. In addition, consideration of the Performance Measures and Targets and Payment Authorization factors was not included in the evaluation for 1 of the 133 contract awards. As identified in Appendix A, Line item #101, the state agency reported that the associated solicitation was unavailable.

Source: Program Evaluation Division analysis of solicitations for high-value services.

Specifically, for each of the three essential attributes, the Program Evaluation Division’s review found:

1. Performance measures and targets. Identification of service performance measures and targets in the solicitation helps ensure sufficient information will be available to determine whether the contracted service is cost-effectively achieving the desired outcome. In addition, the inclusion of measures to determine superior performance enable prospective providers to incorporate innovative business processes to more cost-effectively deliver the service. Without established performance measures and targets, private providers may be limited to delivering the service as explicitly described in the Statement of Work.

As illustrated in Exhibit 5, the Program Evaluation Division rated 78% of the solicitations for high-value services as having adequate performance measure specifications. The Statements of Work in these solicitations included a description of the minimum acceptable level of performance for the service. These performance specifications were not determined to be strong because the Statements of Work did not identify measures to evaluate contributions towards the achievement of desired outcomes.

The Program Evaluation Division rated 8% of the solicitations for high-value contracts as having weak/inadequate performance measures and targets. For example, a solicitation issued by the Department of Transportation for prospective service providers to collect traffic site data, valued at \$1.3 million, provides an example of inadequately specified performance measures and targets. In addition to not identifying any measures to evaluate performance, this solicitation does not adequately describe the process to provide the service. Instead, it only includes some task-specific requirements.²²

Conversely, the Program Evaluation Division also rated some solicitations as having strong performance measures. In addition to including clearly specified performance standards, these solicitations also included performance targets to demonstrate achievement of intended outcomes. For example, the solicitation for a contract executed by the Department of Agriculture and Consumer Services to provide aircraft flight services to assist with fire suppression activities not only included specific minimum personnel and equipment standards but also included aircraft availability standards to help ensure effective performance.²³

2. Payment authorization. Payment authorization requirements help to ensure achievement of specified performance standards. Requirements to document achievement of established levels of service as a condition of payment authorization help state agencies effectively manage the contract and ensure the cost-effective achievement of intended outcomes.

As shown in Exhibit 5, 26% of solicitations for high-value services did not adequately specify requirements associated with payments to service providers. These solicitations did not include any payment authorization requirements. Consequently, state agencies cannot withhold any request for payment from the service provider for these contracts because of poor performance.

For example, a solicitation issued by the Department of Environmental Quality for a private provider to perform laboratory analysis of petroleum-contaminated soil and groundwater from leaking petroleum underground storage tanks did not include adequate payment authorization requirements.²⁴ Consequently, the resulting contract did not include adequate terms and condition to enable the Department of Environmental Quality to ensure adequate performance as a condition of authorizing a payment, as identified in the associated invoice.

The Program Evaluation Division identified 18% of the solicitations for high-value services as having strong payment authorization specifications. In addition to including the requirement to submit documentation supporting achievement of intended outcomes, these

²²As specified in DOT RFP#54-Ch-11-11032549 Traffic Data Collection. The associated contract award was approved on December 14, 2011. The contract award had an estimated value of \$3,900,000, which included \$1,300,000 for an initial one-year period and two one-year extension periods with each valued at \$1,300,000. Appendix A, line item #123 provides more information on this contract award.

²³Additional information regarding this contract award is provided in Appendix A, line item #8.

²⁴This solicitation specifies that payment for services will be made upon receipt and approval of correct invoices from the Awarded Offerors reflecting the contract costs incurred in the performance of work under the contract. However, there is no requirement for the provider to submit documentation supporting achievement of the service requirement as a condition of payment approval.

solicitations also included requirements to verify achievement of the associated performance information.

For example, a solicitation issued by the Department of Administration for the administration, management, and operation of State Veterans Homes included a requirement for external audits of the associated records.²⁵ Another solicitation with strong payment authorization criteria was issued by the Department of Secretary of State. This solicitation for janitorial services included inspection requirements to verify accomplishment of specified performance standards.²⁶

Performance monitoring and verification requirements provide assurances that payments to service providers are contingent upon achievement of intended outcomes. Performance monitoring involves the collection and analysis of information to determine whether the service is being performed as intended. Monitoring should ensure contactors comply with contract terms, performance expectations are achieved, and any problems are identified and resolved. These terms and conditions should also include requirements that allow for verification of performance information. To ensure these requirements do not unnecessarily increase costs, the amount of oversight should be limited to a level sufficient to ensure achievement of the desired outcomes.

Solicitations for high-value services can be further strengthened by including performance incentives in the payment authorization specifications. To help ensure the risks and rewards associated with achievement of best value are shared, state law encourages the inclusion of performance metrics and incentives in the development of contracts for high-value services.²⁷ These incentives may be positive, negative, or a combination of both. Performance incentives should be applied selectively to motivate the service provider to meet or exceed established performance standards and to promote more efficient operations.

Performance incentives should be based on achievement of intended outcomes as defined by the associated performance measures and targets. For example, the payment authorization process may offer a financial incentive for providers to deliver the most cost-effective service by incorporating achievement of associated performance objectives as a basis for determining payment amounts. Conversely, loss in value associated with not achieving intended outcomes can be reflected in a reduction in the payments for the services performed.

A solicitation issued by the Department of Health and Human Services to provide tobacco-use cessation services is an example of a solicitation with financial incentives to promote improved performance. This solicitation specifies that 10% of each month's invoices may be withheld if the provider fails to meet or exceed the performance standards.²⁸

²⁵Additional information regarding this contract award is provided in Appendix A, line item #1.

²⁶Additional information regarding this contract award is provided in Appendix A, line item #122.

²⁷As specified in N.C. Gen. Stat. §135-9.

²⁸Additional information regarding this contract award is provided in Appendix A, line item #58.

3. Transition planning. Transition plans help ensure effective service delivery is uninterrupted and that the procurement process to obtain services upon contract termination can effectively utilize competitive bidding to ensure achievement of best value. An effective transition plan for high-value contracted services may include requirements for providers to have key performance information available upon request or ensure specified assets can be efficiently transferred to another provider. Identification of these requirements in a solicitation document helps ensure consideration of the associated resource requirements is included in the proposals submitted by prospective providers.

Nearly half of the solicitations reviewed by the Program Evaluation Division were rated as weak on this attribute because they did not include any specifications to help ensure the effective implementation of service contracts.²⁹ For example, a solicitation issued by the Department of Information Technology for heating, air conditioning and ventilation (HVAC) maintenance services was rated as weak because it did not explicitly reference any requirements to effectively transition among providers.³⁰ Consequently, the ability to effectively employ competitive bidding could be limited because prospective providers may not have sufficient access to key performance information such as the maintenance history of the associated equipment.

Conversely, a solicitation issued by the Department of Health and Human Services for the operation of North Carolina's Problem Gambling Hotline provides an example of a strong transition plan. This solicitation for services with an estimated value of \$2.4 million includes the requirement that the selected provider develop and implement an outgoing transition plan at the end of the contract.³¹

Most of the information required for an effective Statement of Work should be available from the results of the sourcing evaluation phase of the procurement process. As discussed in Finding 2, an effective sourcing evaluation should include a Statement of Work that includes a description of the tasks necessary to perform the service as well as the current cost and level of performance of the service.

In addition to providing a description of the requirements in the solicitation for services, a Statement of Work also forms the basic framework for the contract authorizing the selected provider to perform the associated work. Consequently, the Statement of Work directly impacts an agency's ability to ensure achievement of associated outcomes. The Statement of Work can also impact the quality of services because it often serves as a basis for evaluating proposals received from potential service providers.

An effective Statement of Work is a necessary component of a service contract that will ensure achievement of best value. A contract documents

²⁹ Consideration of the Transition Planning factor was not included in the evaluation for contract awards associated with non-recurring services, i.e. mitigation credits. These contracts are associated with services that end upon contract expiration. Consequently, a transition plan to ensure service continuity and effective competition in the follow-on procurement process is not an essential component of an effective Statement of Work.

³⁰Additional information regarding this contract award is provided in Appendix A, line item #75.

³¹Additional information regarding this contract award is provided in Appendix A, line item #61.

the terms of an agreement, and creates a legal, binding, and enforceable obligation. Contract law does not allow parties to add terms not part of the original contract without the consent of both parties. Therefore, it is important that the contract also contains the necessary provisions for the State to ensure the service meets acceptable quality standards and will be able to be performed without interruption.

In summary, achievement of best value from a contracted service is directly linked to the adequacy of the requirements identified in the solicitation for that service. The Program Evaluation Division found the solicitations for services issued by state agencies do not consistently include necessary information to ensure achievement of best value.

Finding 4. State agencies do not consistently ensure compliance with the terms and conditions of high-value service contracts.

Effective contract management helps ensure achievement of best value. The objective of this phase of the procurement process for contracted services is to obtain services of requisite quality, on time and within budget. The contract management phase of the procurement process involves those activities performed by state agencies after a contract has been awarded. It includes all of the communication between state agencies and the service provider from the time of award to contract termination to include completion of all financial transactions and resolution of any disputes. Failing to effectively perform contract management means state agencies do not have adequate assurance the service provider is cost-effectively satisfying all associated service requirements.

Each state agency is responsible for effectively managing contracts for services. In addition to ensuring achievement of best value, state agencies are required to ensure compliance with all terms and conditions of the contract and are responsible for maintaining all associated documentation relating to these duties and responsibilities in a designated contract file.

The methods used to monitor performance should be clearly stated in the associated contract. Effective contract management often requires the service provider to produce reports and be subject to on-site inspections, which increase costs and may be subject to legal challenge if not explicitly identified in the contract. The level of contract monitoring should be adequate to ensure compliance without unnecessarily interfering with the private provider's ability to perform the service or unnecessarily increasing costs.

State agencies reported that the amount of money paid to private providers was not readily available for nine high-value service contracts with a total estimated value of \$63.6 million. PED requested state agencies provide expenditure data for high-value service contracts under their jurisdiction. In response, four state agencies reported being unable to provide the amount of associated expenditures for at least one of their identified contract awards. As shown in Exhibit 6, these nine contract awards had a total estimated value of \$63.6 million.

Exhibit 6: Four State Agencies Reported That Expenditures for Nine High-Value Contracts Were Not Readily Available

Appendix A Line Number	Department	Control No. Description	Total Award Amount
51	Health and Human Services	Medical Transcription Services: To provide transcription of consultative examination reports. Disability Determination Services under the Division of Vocational Rehabilitation Services is responsible for developing medical evidence and rendering a determination related to disability benefits.	\$ 7,200,000
101	Public Safety	Eckerd Youth Alternatives Contract: To provide short-term residential service as a rehabilitative experience delivered in an average of 90 days to 48 adjudicated male youth ages 13 to 17 at two residential sites, as referred by the Division of Juvenile Justice.	6,679,530
104	Public Safety	Statewide Residential Services: To deliver short-term/staff-secure residential services as a Dispositional Alternative as defined in N.C. G.S. 7B-2506 for Level I and Level II adjudicated youth. Residential services include Wilderness Programs, Multi-Purpose Group Homes, and Residential Treatment Facilities.	15,000,000
105	Public Safety	Community-Based Services as a Dispositional Alternative: To provide community-based effective intermediate sanctions and re-entry services as a Dispositional Alternative as defined in N.C. G.S. 7B-2506 for high-risk Level I and Level II adjudicated youth. These evidence-based alternatives can include: cognitive behavioral therapy, day treatment/structured day, family therapy, substance abuse counseling/education, wrap-around services, aftercare, and vocational/alternative education.	20,000,000
106	Public Safety	Statewide Residential Services: To deliver short-term/staff-secure residential services as a Dispositional Alternative as defined in N.C. G.S. 7B-2506 for up to sixteen (16) Level I adjudicated female youth. Identified risks of youth admitted into the program include substance abuse, early onset of sexual activity, school failure, family discord, negative peers, gang involvement, inadequate social skills, and/or are pregnant. Residential services include Wilderness Programs, Multi-Purpose Group Homes, and Residential Treatment Facilities.	6,000,000
107	Public Safety	Statewide Residential Services (Male): To deliver short-term/ staff-secure residential services as a Dispositional Alternative as defined in N.C. G.S. 7B-2506 for Level II adjudicated males.	4,500,000
109	Public Safety	Community Based Treatment Services and Transitional Housing: To provide a program(s) that supports an evidence-based curriculum to include high-risk and high-need adult offenders (18 years or older) currently under probation and/or post-release/parole supervision. The program service types include Transitional Housing and a Community Intervention Center. The intent is to reduce recidivism and the rate of probation and post-release supervision revocations.	4,064,612
119	Revenue	Statewide Towing Services: To load, transport, and provide temporary storage of vehicles and personal property required under the Unauthorized Substances Tax.	182,965
126	Treasurer	Audit Services: To conduct financial statement audits of the North Carolina Supplemental Retirement Plans. The audits will be conducted in accordance with generally accepted auditing standards.	No appropriated funds
Total			\$ 63,627,107

Source: Program Evaluation Division based on information provided by each state agency.

The Department of Health and Human Services (DHHS) reported that accurate expenditure totals for all of its associated contractual agreements could not be provided without extensive research. DHHS reported that this expenditure information was not readily available because of its decentralized structure with regards to procurement of contracted services as well as its lack of contract management information and reporting. The department's current procurement process for contracted services delegates most of the associated activities to the DHHS division responsible for achieving the intended outcome. DHHS does not require divisions to submit the necessary information to monitor the procurement process for these contracted services and ensure achievement of best value in accordance with applicable laws and procedures.

State agency procurement staff is not required to demonstrate all requisite competencies necessary to effectively manage service contracts. In response to legislation enacted in 2010, P&C developed Contract Specialist positions that state agencies could employ in the procurement process for contracted services. Position descriptions for these newly created roles specified a preference for competencies necessary to effectively perform activities that directly contribute to an effective procurement process and offered a higher salary range than the Procurement Specialist positions.^{32,33}

In addition, P&C provides extensive procurement process training to state agency employees. For example, in 2014 P&C offered 22 training courses to 569 state agency employees. Ten of these 22 courses were provided by the National Institute for Governmental Purchasing via a service contract.

However, state agencies may not have realized all of the potential benefits from these efforts. As of October 15, 2015, only three state agencies had authorized a total of six contract management positions to assist in their procurement processes.³⁴ In addition, the P&C training program did not include funding or incentives for agency procurement staff to obtain certifications demonstrating competency in the procurement process.

In summary, state agency management of contracted services does not consistently contribute to effective performance. As a result, state agencies may not be uniformly complying with the applicable terms and conditions of service contracts or consistently achieving best value from service providers.

³² As specified in the North Carolina Salary Plan, as last revised October 1, 2014, the salary range for the Contract Specialist Positions ranged from \$44,347 to \$90,780, while the salary range for the Procurement Specialist positions ranged from \$31,736 to \$77,406.

³³ The position descriptions for the Contract Management Specialist I, II, and III positions include a preference for professional certifications from the NCMA (National Contract Management Association), for a CPCM (Certified Professional Contracts Manager) or from ISM (Institute for Supply Management) for a CPSM (Certified Professional in Supply Management), or for individuals that have an active CPM (Certified Purchasing Manager) certification.

³⁴ The three state agencies with authorized Contract Management positions are: State Treasurer (3), Department of Health and Human Services (2), and the Department of Revenue (1).

Finding 5. State-level monitoring of contracted services is not ensuring compliance with applicable state regulations.

The Department of Administration's Division of Purchase and Contract (P&C) is responsible for cost-effectively ensuring state agency procurement processes result in achievement of best value. To ensure achievement of this objective, P&C develops rules and regulations that establish minimum requirements for state agency procurement processes for contracted services. For example, P&C requires that state agencies obtain P&C approval for proposed high-value contract awards and any resulting amendments as a condition of contract execution.

State agencies are not consistently complying with this requirement.

Specifically, in response to a request by the Program Evaluation Division, P&C identified at least four contract awards that included amendments for which P&C had no record of having received submission for authorization. Non-compliance with this requirement to review proposed contract amendments limits the ability of P&C to ensure contracted services achieve best value.

P&C also reported that the former Department of Juvenile Justice & Delinquency Prevention (DJJDP) did not submit a proposed contract award valued at \$16.7 million to P&C for review and approval. In July 2007, the DJJDP issued a contract to Eckerd Youth Alternative for a therapeutic camping program. The program serves children who have behavioral problems and cannot function in a normal community, school, or family setting. The contract period was July 1, 2007 through June 30, 2008, with two one-year renewal options and a total award value of \$47.5 million. In addition, DJJDP issued three subsequent amendments to this contract, which were also not submitted to P&C for review and approval.

P&C became aware of this contract in June 2010 when the Department of Juvenile Justice and Delinquency Prevention requested P&C approve a fifth contract amendment to add an additional \$6.7 million to the contract value and extend the contract period to December 31, 2010. In response, P&C notified DJJDP it would not approve the requested amendment because it did not have any information on how the original contract was awarded.

In 2012, the responsibility for ensuring all required documentation is maintained was transferred to DPS when the General Assembly created the Department of Public Safety by merging the Department of Juvenile Justice and Delinquency Prevention with two other agencies.³⁵ The Department of Public Safety (DPS) also reported that it does not have any of the required documentation for this contracted service, as specified by P&C. Specifically, DPS reported that it could not provide the associated solicitation document, contract, or any amendments. P&C policy requires state agencies retain such records to ensure that the procurement process for contract services was performed in accordance with the specific terms and conditions, and in compliance with applicable state laws and regulations.

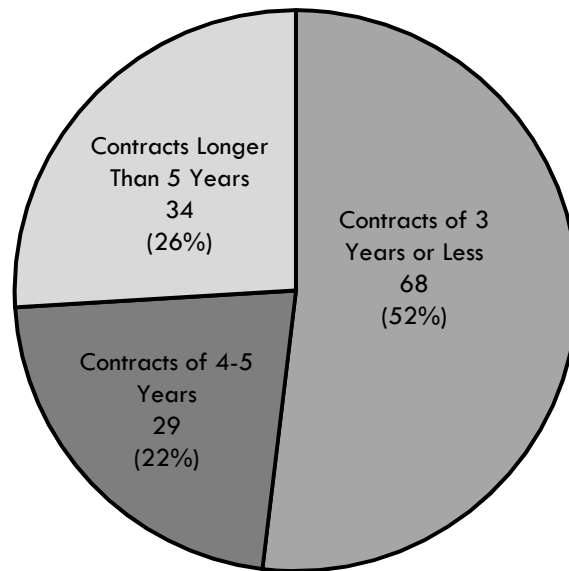
³⁵ The two other agencies that were merged to create the Department of Public Safety were the North Carolina Department of Correction and the Department of Crime Control & Public Safety.

The contract period for nearly half of the analyzed awards for high-value services exceeded the P&C-specified maximum length. P&C policy specifies that the period or length of contract awards be limited to three years, including all extensions and renewals. However, as with the requirement for P&C contract approval, this requirement is not always met.

As shown in Exhibit 7, 63 of the 133 awards for high-value services had a contract period of more than three years. In addition, the contract length for 34 of these 63 contracts exceeded 5 years. Longer contract periods increase the State’s risk of not achieving best value due to a lack of flexibility in considering alternatives to current sourcing, performance targets, and business process modifications.

Exhibit 7

Nearly Half of the Contracts for High-Value Services Exceeded the P&C-Specified Maximum Length



Note: As identified in Appendix A, 2 of the 133 contract awards identified in Appendix A were not included. For the contract award identified in line item #2, the applicable state agency reported that the contract period was not specified. For the contract award identified in line item #101, the applicable state agency reported that this data was unavailable.

Source: Program Evaluation Division based on information provided by each state agency.

P&C reviews of state agency service contracts have not contributed to achievement of best value In 2013, the General Assembly enacted legislation to strengthen P&C oversight of contracted services.³⁶ This legislation expanded P&C’s role in the procurement process for contracted services with an estimated value exceeding \$1 million. Specifically, it included the requirement that P&C review all proposed contracts with estimated value exceeding \$1 million to ensure that the contracts are:

- in the proper legal form,
- contain all clauses required by law,
- are legally enforceable, and

³⁶As specified in SB 2013-234.

- include the necessary performance requirements to ensure accomplishment of their intended purpose.³⁷

An analysis of high-value contracts awarded in Fiscal Year 2014–15 determined P&C reviews helped to ensure compliance with applicable legal standards but did not contribute to achievement of best value. In response to a request by the Program Evaluation Division, P&C provided the results of its statutorily-required review of 25 high-value awards for contracted services conducted during Fiscal Year 2014–15. These reviews identified deficiencies in only four of the 25 awards. In addition, none of the identified deficiencies were associated with specified performance requirements that help ensure achievement of best value.

Ineffective oversight in these reviews increases the risk that state agency procurement processes will not result in the achievement of best value from contracted services. Without clear performance requirements and measures, state agencies may not have sufficient authority to hold private service providers accountable for achieving intended outcomes.

In addition, inadequately defined performance requirements can limit the effectiveness of the competitive bidding process. Without clearly defined performance measures, state agencies may not be able to incentivize private providers to provide the most cost-effective method of service delivery.

Furthermore, the effectiveness of these statutorily required reviews is inherently limited because the review is performed upon completion of the contract formation phase of the procurement process. As a result, any identified deficiencies that would require modifications to performance requirements may result in additional time and cost to the associated procurement process and adversely affect a state agency's ability to ensure service continuity.

P&C compliance reviews of each state agency's procurement process for contracted services are not effectively contributing to achievement of best value. In conjunction with its responsibility to monitor state agency procurement processes, P&C performs periodic compliance reviews.³⁸

Compliance reviews of state agency procurement processes are primarily focused on verifying compliance with applicable laws, rules, and regulations. These reviews do not include an evaluation of the effectiveness of state agency procurement processes in achieving best value. For example, P&C does not require an evaluation of the Statement of Work for selected high-value service contracts to ensure all essential attributes are included.

By contrast, the Texas Sunset Commission utilizes a contracting model to assist with evaluations of agency procurement processes that includes standards for each phase of the procurement process. This contracting model establishes standards for both the sourcing evaluation and contract formation phases of the procurement process, including requirements regarding the Statement of Work.

³⁷As specified in G.S. §143.50.1(b).

³⁸As authorized in 01 NC Admin Code 05B.1605.

There is no state-level system to monitor state agency-managed service contracts. A statewide service contract management system helps ensure state agencies comply with applicable laws and regulations and contracted services achieve intended objectives.

An effective state-level contract management system provides a single source of information for all contracted services. At a minimum, a state-level contract monitoring system should include specific contract information such as the contract begin and end dates, authorized spending limits, and associated payments to the service provider. In addition, an effective contract management system should include the capacity to provide a searchable database of key documentation such as the solicitation for services and resulting contract, as well as assessment of agency procurement process performance.

State agencies can use the available information to ensure compliance with the terms and conditions of high-value service contracts. State agencies may also use the information to identify best practices in other contracts for similar services, which they may then incorporate into their procurement process.

P&C can utilize this information to ensure compliance with applicable laws and regulations as well as achievement of best value. Finally, the Office of the Governor and the General Assembly can use the information available through a state-level contract monitoring system to make more informed decisions regarding applicable policy and programs.

In summary, P&C is not effectively monitoring state agency procurement processes for contracted services. P&C is limited in its ability to effectively monitor these contracts because of a lack of information for each of the contracts for services issued by state agencies. As a result, there is a lack of sufficient assurance that these processes are complying with applicable laws and regulations and achieving best value.

Recommendations

Recommendation 1. As a condition of soliciting the private sector for high-value services, the General Assembly should require state agencies to submit a business case to OSBM and P&C for review and approval.

As discussed in Finding 2, state agencies are not documenting the results of their determinations to use contracted services. The lack of documentation supporting the decision to contract with a private entity to provide these services increases the risk that the State will not obtain best value. While state agencies may be conducting an informal sourcing evaluation, the lack of documentation identifying the factors considered and the associated analysis performed to arrive at this decision limits the ability of P&C to monitor state agency procurement processes and ensure cost-effective performance.

To ensure achievement of best value from contracted services, the General Assembly should amend N.C. Gen. Stat. § 143 to require P&C, in consultation with the Office of State Budget and Management, to develop

and promulgate a business case template(s) for contracted services to include:

- unit and total cost of performing the service for the most recently completed fiscal year;
- detailed description of current process to perform service;
- description of metrics to evaluate performance;
- current and expected performance for each identified metric;
- contract formation and management resource requirements to ensure best value obtained;
- availability of private sector service providers;
- justification for waiver of competitive bidding requirements, if applicable;
- justification for use of multiple providers to perform service, if applicable;
- information security requirements, as applicable;
- identification of roles, organizational placement, responsibilities, and qualifications of key project team members, to include demonstrated competency incorporating government-vendor partnerships into the procurement process;
- funding requirements and associated funding source for proposed contract period; and
- a service delivery transition process, both incoming and outgoing.³⁹

In addition, the General Assembly should amend N.C. Gen. Stat. § 143 to require state agencies to document the results of the determination to contract with a private service provider as specified in the proposed business case template. This requirement should be applicable for any proposed procurement of a contracted service, to include rebids of currently contracted services with an estimated value exceeding \$1 million. The estimated value should be based on the estimated realized revenue to the service provider during the contract period, including extension periods authorized in the original contract.

The General Assembly should also amend state law to include a requirement for the Division of Purchase and Contract (P&C) to review and approve the business case documenting the decision to contract with a private service provider. In addition, for contracted services with an estimated value exceeding \$5 million, including applicable extension periods, state agencies should also be required to include documentation demonstrating OSBM review and approval of the business case as a condition of P&C review and approval.

For contracted services up to a maximum estimated value of \$5 million, the General Assembly should authorize P&C to delegate business case approval authority to the applicable state agency director, including applicable extension periods. This delegated authority should be subject to the ability of the state agency to demonstrate it has the requisite

³⁹ As specified in NC. Gen. Stat. §143-135.9(a)(2), a government-vendor partnership is a mutually beneficial contractual relationship between state government and a service provider, wherein the two share risk and reward, and wherein value is added to the procurement of needed goods or services.

competencies to effectively perform the sourcing evaluation phase of the procurement process for contracted services. At a minimum, the decision by P&C to delegate business case approval authority should include consideration of the following factors:

- demonstrated competency of state agency procurement staff, to include skills necessary to effectively utilize government-vendor partnerships to achieve best value, and
- results of recent P&C compliance reviews of state agency procurement processes.

In addition, the General Assembly should amend state law to require the State Purchasing Officer and the applicable state agency to consult with the Joint Legislative Commission on Governmental Operations prior to P&C review and approval of a business case with an estimated value of greater than \$1 million, including applicable extension periods. If no action is taken by the Joint Legislative Commission on Governmental Operations within 15 days of notification of the associated business case value analysis, P&C may authorize the state agency to proceed with the procurement process as identified in the applicable business case.

To help ensure all of the services provided by state agencies achieve best value, the General Assembly should also direct OSBM to produce a report that includes a plan and resource requirements for determining whether commercial services can be more effectively performed by a private provider. This report should be submitted to the Joint Legislative Commission on Governmental Operations and the Fiscal Research Division by December 1, 2016.

Recommendation 2. The General Assembly should direct the Department of Administration to implement a contract management system for state agency-administered contracted services.

As described throughout this report, the Program Evaluation Division found that the process to procure contracted services does not ensure achievement of best value. Specifically, as discussed in Finding 3, achievement of best value from a contracted service is directly linked to the adequacy of the requirements identified in the solicitation for a service. State agencies are not consistently including necessary information to ensure best value is obtained. As described in Findings 4 and 5, the Program Evaluation Division also determined state management and monitoring of contracted services does not consistently contribute to effective performance. As a result, state agencies may not be uniformly complying with the applicable terms and conditions of service contracts or consistently achieving best value from service providers.

To ensure P&C and state agencies can effectively monitor and manage contracts to ensure compliance with applicable requirements and achievement of best value, the General Assembly should require P&C to implement a contract management system and require state agencies to effectively manage the procurement process for all of their contracts for services.

State agencies should be required to utilize the contract management system for all contract awards issued after its installation. For contract awards issued prior to installation of the contract management system, state agencies should be authorized to use the existing legacy system to monitor contract expenditures but be required to provide P&C with the amount spent under each applicable contract for services during the preceding fiscal year, as well as any other information required to produce the annual report on state agency-administered contracts for services.

At a minimum, the contract management system should include the capacity to ensure

- payments are made in accordance with the applicable contract terms and conditions,
- key documents for all state agency-managed contracted services can be stored and retrieved from a searchable database, and
- customizable management reports can be generated by state agencies and other state entities with oversight responsibilities.

In addition, the General Assembly should amend state law to require P&C to provide the Joint Legislative Commission on Governmental Operations and the Fiscal Research Division with an annual report on state agency-administered contracts for services to include:

- description, value, and procurement method of service contracts awarded during the previous year, which provides annual and total payments issued under each applicable contract;
- description, submission and approval date, and estimated value of business cases submitted to P&C; and
- results of P&C reviews of state agency procurement processes.

Appendixes

Appendix A: Summary of 133 High-Value Service Contracts

Agency Response

A draft of this report was submitted to the Department of Administration's Division of Purchase and Contract and the Office of State Budget and Management to review. Their responses are provided following the appendices.

Program Evaluation Division Contact and Acknowledgments

For more information on this report, please contact the lead evaluator, Chuck Hefren, at chuck.hefren@ncleg.net.

Staff members who made key contributions to this report include Jim Horne, CPA and Larry Yates. John W. Turcotte is the director of the Program Evaluation Division.

Appendix A: Summary of 133 High-Value Service Contracts

Line Item	Department	Description	Date awarded	Total award amount	Number of awards	Contract period (years)	Competition waived?	Total number of contract amendments (per P&C)	Total award amount associated with contract amendments (per P&C)	Total award amount plus amendment amount
1	Administration	Management and Operation of the NC State Veterans Home	10/22/2009	No appropriated funds	3	5.0	NO	0	-	No appropriated funds
2	Administration	E-Procurement Transformation Initiative Support Services	11/10/2010	\$1,980,600	1	Not specified	NO	7	\$49,379,600	\$51,360,200
3	Administration	NC Flex Flexible Spending Account	08/16/2011	5,250,000	1	5.0	NO	0	-	5,250,000
4	Administration	Full Service Elevator Maintenance and Repair	04/29/2013	1,926,372	1	5.0	NO	0	-	1,926,372
5	Administration	Manage and Operate State Veterans Homes	10/09/2014	No appropriated funds	1	10.0	NO	1	-	No appropriated funds
6	Administration	NCFLEX Cancer and Specified Diseases Insurance Plan	06/23/2015	39,708,471	1	7.5	NO	0	-	39,708,471
7	Agriculture	Waste Disposal Services	12/16/2010	1,517,056	1	5.0	NO	0	-	1,517,056
8	Agriculture	Boss Aircraft Operators for Fire Season	04/01/2012	690,000	1	3.0	NO	0	-	690,000
9	Agriculture	Parking Services	08/15/2013	3,616,351	1	3.0	NO	0	-	3,616,351
10	Commerce	Energy Efficiency for Existing Single Family & Multi-Family Housing	09/09/2010	3,600,000	1	0.4	NO	0	-	3,600,000
11	Commerce	Student Energy Internship and Fellowship Program	07/15/2010	6,451,026	29	1.8	NO	2	818,713	7,269,739
12	Commerce	Tourism Full-Service Marketing Agency	05/02/2011	33,704,250	1	5.0	NO	3	725,000	34,429,250
13	Commerce	Full Service Marketing for ABC Commission	03/20/2014	1,250,000	1	1.8	NO	2	5,300,000	6,550,000

Line Item	Department	Description	Date awarded	Total award amount	Number of awards	Contract period (years)	Competition waived?	Total number of contract amendments (per P&C)	Total award amount associated with contract amendments (per P&C)	Total award amount plus amendment amount
14	Commerce	State of North Carolina Brand Implementation	05/16/2014	\$7,500,000	1	3.1	NO	0	-	\$7,500,000
15	Commerce	Trial Assistant and Transcription Services	03/03/2015	1,860,000	1	3.0	NO	0	-	1,860,000
16	Cultural and Natural Resources	Staffing of the State Library's Virtual Reference	09/26/2012	299,265	1	1.1	NO	0	-	299,265
17	Environmental Quality	Stream and Wetland Mitigation (Yadkin River)	07/01/2010	3,164,400	2	7.0	NO	0	-	3,164,400
18	Environmental Quality	Stream and Wetland Mitigation (Cape Fear River)	07/01/2010	4,101,408	1	7.0	NO	0	-	4,101,408
19	Environmental Quality	Stream and Wetland Mitigation (Catawba River)	07/01/2010	2,032,341	1	7.0	NO	0	-	2,032,341
20	Environmental Quality	Stream and Wetland Mitigation (Tar-Pamlico River)	07/01/2010	1,046,500	1	7.0	NO	0	-	1,046,500
21	Environmental Quality	Stream and Wetland Mitigation (Little Tennessee River)	06/13/2011	1,197,000	1	6.9	NO	0	-	1,197,000
22	Environmental Quality	Stream and Wetland Mitigation (Neuse River)	06/13/2011	10,255,328	1	10.0	NO	0	-	10,255,328
23	Environmental Quality	Stream and Wetland Mitigation (Yadkin River)	06/13/2011	5,350,706	4	7.0	NO	0	-	5,350,706
24	Environmental Quality	Stream and Wetland Mitigation (White Oak River)	06/13/2011	1,195,745	1	9.9	NO	0	-	1,195,745
25	Environmental Quality	Stream and Wetland Mitigation (Cape Fear River)	06/27/2011	1,862,378	1	7.0	NO	0	-	1,862,378
26	Environmental Quality	Stream and Riparian Wetland Mitigation (Pamlico River)	06/27/2011	1,102,400	1	10.0	NO	0	-	1,102,400

Line Item	Department	Description	Date awarded	Total award amount	Number of awards	Contract period (years)	Competition waived?	Total number of contract amendments (per P&C)	Total award amount associated with contract amendments (per P&C)	Total award amount plus amendment amount
27	Environmental Quality	Stream and Wetland Mitigation (Cape Fear River)	06/27/2011	\$2,982,600	3	7.0	NO	0	-	\$2,982,600
28	Environmental Quality	Assessment & Remediation of Leaking Underground Storage Tanks	10/25/2011	7,566,730	6	2.1	YES	0	-	7,566,730
29	Environmental Quality	Stream and Wetland Mitigation (Chowan River)	05/24/2012	1,567,544	1	9.9	NO	0	-	1,567,544
30	Environmental Quality	Stream and Wetland Mitigation (Cape Fear River)	05/24/2012	5,252,082	1	9.9	NO	0	-	5,252,082
31	Environmental Quality	Stream and Wetland Mitigation (Yadkin River)	05/24/2012	6,538,218	3	10.0	NO	1	\$821,424	7,359,642
32	Environmental Quality	Stream and Wetland Mitigation (Yadkin River)	06/15/2012	7,165,937	3	10.3	NO	0	-	7,165,937
33	Environmental Quality	Stream and Wetland Mitigation (Cape Fear River)	10/16/2012	6,296,716	4	9.9	NO	0	-	6,296,716
34	Environmental Quality	Stream and Wetland Mitigation (Little Tennessee River)	10/16/2012	1,143,894	1	9.9	NO	0	-	1,143,894
35	Environmental Quality	Stream and Wetland Mitigation (Yadkin River)	11/07/2012	1,298,464	1	10.0	YES	0	-	1,298,464
36	Environmental Quality	Stream and Wetland Mitigation (Cape Fear River)	10/30/2012	4,226,252	3	10.0	YES	0	-	4,226,252
37	Environmental Quality	Lab Analysis of Petroleum Contaminated Soil & Groundwater	11/01/2012	2,190,317	2	1.0	YES	0	-	2,190,317
38	Environmental Quality	Stream and Wetland Mitigation (Catawba River)	02/22/2013	1,321,600	1	10.0	NO	0	-	1,321,600

Line Item	Department	Description	Date awarded	Total award amount	Number of awards	Contract period (years)	Competition waived?	Total number of contract amendments (per P&C)	Total award amount associated with contract amendments (per P&C)	Total award amount plus amendment amount
39	Environmental Quality	Stream and Wetland Mitigation (Neuse River)	06/06/2013	\$1,696,000	3	1.0	NO	0	-	\$1,696,000
40	Environmental Quality	Stream and Wetland Mitigation (Cape Fear River)	08/13/2013	1,540,000	1	10.0	NO	0	-	1,540,000
41	Environmental Quality	Lab Analysis of Petroleum Contaminated Soil & Groundwater	10/17/2013	2,044,161	2	0.6	NO	0	-	2,044,161
42	Environmental Quality	Stream and Wetland Mitigation (Catawba River)	01/28/2014	1,999,515	1	10.1	NO	0	-	1,999,515
43	Environmental Quality	Stream and Wetland Mitigation (Catawba River)	01/28/2014	1,867,100	1	10.0	NO	0	-	1,867,100
44	Environmental Quality	Stream and Wetland Mitigation (Cape Fear River)	02/18/2014	13,970,284	6	10.0	NO	0	-	13,970,284
45	Environmental Quality	Stream and Wetland Mitigation (New River)	06/06/2014	1,724,500	1	10.0	NO	0	-	1,724,500
46	Environmental Quality	Design Build of the Big Harris Mitigation Site Project	12/04/2014	6,221,648	1	9.0	YES	0	-	6,221,648
47	Environmental Quality	Stream and Wetland Mitigation (Neuse River)	12/30/2014	1,123,272	5	0.5	NO	0	-	1,123,272
48	Environmental Quality	Stream and Wetland Mitigation (Broad River)	03/30/2015	1,939,420	2	10.0	NO	0	-	1,939,420
49	Environmental Quality	Stream and Wetland Mitigation (Yadkin River)	06/25/2015	1,806,000	1	10.0	NO	0	-	1,806,000
50	Health and Human Services	Documentary Videos (Physical Activity and Nutrition)	09/09/2010	1,150,000	1	1.2	NO	0	-	1,150,000
51	Health and Human Services	Medical Transcription Services	10/07/2010	7,200,000	1	1.0	NO	0	-	7,200,000

Line Item	Department	Description	Date awarded	Total award amount	Number of awards	Contract period (years)	Competition waived?	Total number of contract amendments (per P&C)	Total award amount associated with contract amendments (per P&C)	Total award amount plus amendment amount
52	Health and Human Services	Analytical & Clinical Services (Medicaid Pharmacy Program)	11/08/2010	\$7,878,630	1	2.0	NO	11	\$4,338,558	\$12,217,188
53	Health and Human Services	NC AID State Pharmaceutical Assistance Program	12/23/2010	16,950,000	1	3.3	NO	4	2,450,000	19,400,000
54	Health and Human Services	AIDS Drug Assistance Program (ADAP)	02/18/2011	15,530,000	1	3.8	NO	4	4,330,000	19,860,000
55	Health and Human Services	Actuarial and Analytical Services	05/26/2011	11,162,040	1	3.0	NO	2	9,424,380	20,586,420
56	Health and Human Services	Genetic Testing for Paternity	07/21/2011	4,392,000	1	0.7	NO	0	-	4,392,000
57	Health and Human Services	Cafeteria Food Services	11/16/2011	2,759,858	1	4.1	NO	0	-	2,759,858
58	Health and Human Services	Tobacco-use Cessation Services	11/16/2011	11,759,362	1	3.4	NO	9	7,972,778	19,732,140
59	Health and Human Services	Medical Transcription Services	11/30/2011	4,800,000	1	2.0	NO	0	-	4,800,000
60	Health and Human Services	Implementation of the Resource Allocation (HSRI)	04/27/2012	2,999,999	1	3.0	NO	0	-	2,999,999
61	Health and Human Services	Carolina Problem Gambling Helpline	04/01/2014	3,374,028	1	5.0	NO	2	100,000	3,474,028
62	Health and Human Services	Personal Care Services Administrative & Support Services	01/29/2013	85,219,447	1	4.9	NO	0	-	85,219,447
63	Health and Human Services	Minimum Data Set Validations	08/24/2012	6,302,717	1	3.1	NO	1	1,050,453	7,353,170
64	Health and Human Services	Medicaid Recovery Audit Reviews	09/10/2012	12,724,900	1	3.0	NO	4	685,349	13,410,249

Line Item	Department	Description	Date awarded	Total award amount	Number of awards	Contract period (years)	Competition waived?	Total number of contract amendments (per P&C)	Total award amount associated with contract amendments (per P&C)	Total award amount plus amendment amount
65	Health and Human Services	Tenant-Based Rental Assistance (TBRA) Program	02/12/2013	\$17,535,824	1	3.0	NO	0	-	\$17,535,824
66	Health and Human Services	Pharmacy Benefit Manager Services	01/10/2014	5,800,000	1	2.1	NO	2	\$1,900,000	7,700,000
67	Health and Human Services	Actuarial and Analytical Services	06/24/2014	12,118,600	1	3.0	NO	1	2,872,420	14,991,020
68	Health and Human Services	Medical Transcription Services	08/21/2014	4,800,000	1	1.0	NO	0	-	4,800,000
69	Health and Human Services	Medicaid Audit Services	08/20/2014	21,165,000	1	5.0	NO	0	-	21,165,000
70	Health and Human Services	Third-Party Liability Services	11/24/2014	47,114,255	1	3.0	NO	0	-	47,114,255
71	Health and Human Services	Pharmacy Services (Walter B Jones ADATC)	12/31/2014	3,900,000	1	4.0	NO	0	-	3,900,000
72	Health and Human Services	Analytical and Clinical Services (Medicaid Pharmacy Program)	02/27/2015	5,598,000	1	3.0	NO	0	-	5,598,000
73	Health and Human Services	Tobacco-use Cessation Services	05/07/2015	16,550,000	1	1.0	NO	0	-	16,550,000
74	Health and Human Services	High-Tech Imaging (EQR Services not High-Tech Services)	05/15/2015	13,434,870	1	3.0	NO	0	-	13,434,870
75	Information Technology	HVAC Maintenance Services	02/05/2013	951,000	1	3.0	NO	0	-	951,000
76	Information Technology	Electrical Equipment Maintenance	01/06/2015	602,118	1	3.0	NO	0	-	602,118
77	Justice	DNA Collection Kits and Sampling	11/10/2010	11,300,000	1	5.0	NO	0	-	11,300,000
78	Justice	Expedited Analysis for Toxicology Forensic Casework	08/25/2014	3,000,000	1	1.8	NO	0	-	3,000,000

Line Item	Department	Description	Date awarded	Total award amount	Number of awards	Contract period (years)	Competition waived?	Total number of contract amendments (per P&C)	Total award amount associated with contract amendments (per P&C)	Total award amount plus amendment amount
79	OSBM	NCGEAR	04/02/2014	\$3,150,000	1	1.2	NO	2	\$946,000	\$4,096,000
80	Ports Authority	Financial Advisory Services	04/02/2014	243,600	1	3.0	NO	0	-	243,600
81	Ports Authority	Security Guard Services	11/28/2012	2,132,857	1	3.0	NO	0	-	2,132,857
82	Ports Authority	Janitorial and Cleaning Service	12/03/2013	195,450	1	1.6	NO	0	-	195,450
83	Public Instruction	Educational Value-Added Assessment System	08/16/2010	5,995,000	1	2.6	YES	3	4,045,000	10,040,000
84	Public Instruction	Reading Diagnostic Assessment	08/31/2010	14,344,121	1	2.0	NO	0	-	14,344,121
85	Public Instruction	Automated Scoring of Mathematics Items Study	12/13/2010	1,667,680	1	1.7	YES	File unavailable at P&C	File unavailable at P&C	1,667,680
86	Public Instruction	Excess Property Insurance	03/08/2011	31,758,986	1	8.1	YES	4	10,489,329	42,248,315
87	Public Instruction	Race to the Top - NC New Schools Projects	05/20/2011	9,350,639	1	3.3	YES	0	-	9,350,639
88	Public Instruction	Educational Services	06/28/2011	3,089,025	1	2.2	NO	1	184,000	3,273,025
89	Public Instruction	Liability Insurance	08/31/2011	6,090,000	1	2.0	NO	0	-	6,090,000
90	Public Instruction	Reading Diagnostic Initiative	11/06/2012	7,195,918	1	0.8	YES	0	-	7,195,918
91	Public Instruction	Reading Diagnostic Initiative	11/08/2013	17,709,658	1	1.8	NO	0	-	17,709,658
92	Public Instruction	Advanced Placement Partnership	03/26/2014	2,600,000	1	1.2	NO	0	-	2,600,000
93	Public Instruction	Educational Value-Added Assessment System	08/18/2014	7,482,948	1	1.9	NO	3	1,892,928	9,375,876
94	Public Instruction	NC Worker's Compensation Insurance	09/26/2014	19,642,496	6	6.0	NO	1	4,962,500	24,604,996
95	Public Instruction	Professional Liability Services	12/04/2014	5,000,000	1	1.0	YES	0	-	5,000,000

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96	Public Instruction	Administration of Act Plan	12/15/2014	7,831,160	1	0.7	NO	0	-	\$7,831,160
97	Public Instruction	NC Workers Compensation Insurance	06/02/2015	\$90,794,800	8	7.0	NO	0	-	90,794,800
98	Public Instruction	Advanced Placement Partnership	06/24/2015	4,500,000	1	1.0	YES	0	-	4,500,000
99	Public Safety	Armed Security Guard Services	09/20/2010	4,564,749	1	3.0	NO	2	\$307,286	4,872,035
100	Public Safety	Nephrology/Dialysis Services	01/13/2011	10,249,403	1	5.0	NO	0	-	10,249,403
101	Public Safety	Eckerd Youth Alternatives Contract	07/01/2010	6,679,530	1	Data not readily available	NO	P&C did not approve award	P&C did not approve award	6,679,530
102	Public Safety	Extradition Services	01/07/2011	4,372,057	1	3.2	NO	File unavailable at P&C	File unavailable at P&C	4,372,057
103	Public Safety	Security Contract	04/27/2011	2,576,078	1	3.0	NO	0	-	2,576,078
104	Public Safety	Statewide Residential Services	05/23/2011	15,000,000	1	3.0	NO	10	21,794,807	36,794,807
105	Public Safety	Community-Based Services as a Dispositional Alternative	07/06/2011	20,000,000	2	4.0	NO	7	1,875,000	21,875,000
106	Public Safety	Statewide Residential Services	09/20/2011	6,000,000	1	7.9	NO	9	6,000,000	12,000,000
107	Public Safety	Statewide Residential Services (Male)	09/23/2011	4,500,000	1	3.0	NO	7	6,230,000	10,730,000
108	Public Safety	Prison Facility Maintenance Services	11/01/2011	17,484,932	1	4.0	NO	2	2,678,589	20,163,520
109	Public Safety	Community-Based Treatment Services and Transitional Housing	02/29/2012	4,064,612	10	1.5	NO	0	-	4,064,612
110	Public Safety	Offender Monitoring	06/04/2012	11,738,740	1	3.0	NO	0	-	11,738,740

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111	Public Safety	Trash and Recycling Services	06/12/2013	17,550,315	8	5.0	NO	0	-	\$17,550,315
112	Public Safety	Transitional Housing	07/02/2013	5,256,000	2	3.0	NO	0	-	5,256,000
113	Public Safety	Community Intervention Centers	11/14/2013	\$6,878,027	6	3.0	NO	0	-	6,878,027
114	Public Safety	Transitional Housing	03/11/2014	1,533,000	1	3.0	NO	0	-	1,533,000
115	Public Safety	Extradition Transportation Services	05/28/2014	2,208,714	1	3.0	NO	0	-	2,208,714
116	Public Safety	Confinement in Response to Violation (CRV) Treatment Services	11/10/2014	1,077,482	1	1.0	YES	0	-	1,077,482
117	Public Safety	Offender Monitoring	05/08/2015	49,483,196	1	5.0	NO	0	-	49,483,196
118	Public Safety	Dillon Crisis Beds and Assessment Center	04/24/2015	8,399,920	1	5.0	NO	0	-	8,399,920
119	Revenue	Statewide Towing Services	06/28/2011	182,965	10	3.8	NO	0	-	182,965
120	Revenue	Processing and Mailing Services	12/20/2013	2,164,501	1	3.0	NO	1	-	2,164,501
121	Revenue	E-500 Sales and Use Books	08/01/2014	2,013,050	1	5.0	NO	0	-	2,013,050
122	Secretary of State	Janitorial Services	07/30/2014	109,440	1	3.0	NO	0	-	109,440
123	Transportation	Traffic Data Collection	12/14/2011	5,200,000	1	3.3	NO	2	\$668,000	5,868,000
124	Transportation	Guard and Security Service	08/13/2013	2,549,704	1	3.0	NO	0	-	2,549,704
125	Transportation	Marketing, Advertising, Public Relations	02/09/2015	30,000,000	1	3.0	YES	0	-	30,000,000
126	Treasurer	Audit Services	02/16/2011	No appropriated funds	1	3.0	NO	0	-	No appropriated funds
127	Treasurer	Other Party Liability Services	05/10/2011	No appropriated funds	1	5.0	NO	1	950,000	950,000

Line Item	Department	Description	Date awarded	Total award amount	Number of awards	Contract period (years)	Competition waived?	Total number of contract amendments (per P&C)	Total award amount associated with contract amendments (per P&C)	Total award amount plus amendment amount
128	Treasurer	Unclaimed Property Examination Services	11/30/2011	No appropriated funds	6	3.0	NO	1	\$14,715,000	\$14,715,000
129	Treasurer	Process for Printing and Mailing Services	01/02/2013	No appropriated funds	1	3.0	NO	1	40,000	40,000
130	Treasurer	Unclaimed Property Audit and Training Services	09/19/2013	No appropriated funds	5	3.0	NO	0	-	No appropriated funds
131	Wildlife Resources	Fulfillment & Repair Services	03/08/2013	\$162,000	1	3.0	NO	0	-	162,000
132	Wildlife Resources	Magazine Circulation Management and Promotion	09/26/2014	261,000	1	3.0	NO	0	-	261,000
133	Wildlife Resources	Recommendation for Award Chronic Wasting Disease (CWD) Testing	04/24/2015	162,702	1	4.8	NO	0	-	162,702
Total				\$1,065,412,954					\$169,947,113	\$1,235,360,067



North Carolina Department of Administration

Pat McCrory, Governor
Bill Daughtride, Jr., Secretary

Division of Purchase & Contract
Kathryn Johnston, Deputy Secretary

December 16, 2015

John Turcotte
Director, Program Evaluation Division
North Carolina General Assembly
212 Legislative Office Building
300 N. Salisbury St.
Raleigh, NC 27603

Re: Formal Response to Draft of PED Report – *Enhanced Oversight of Service Contracts Can Help Ensure Cost-Effective Performance*

Dear Mr. Turcotte:

Thank you for the opportunity to respond to the report identified above. In general the Department of Administration agrees with the five findings and the two recommendations. As to several of the findings, the Department has recently implemented, or is in the process of implementing changes, to mitigate the issues raised.

As part of Procurement Transformation and the restructuring of the Division of Purchase and Contract (P&C), that took place in late 2013 and early 2014, an increased level of scrutiny has been given to contract oversight in the areas of sourcing, contract management and compliance. The number of contracts reviewed as part of this study that were awarded after January 2014 are still in the initial term and the number of multiple award and amended contracts has decreased significantly.

Background

North Carolina's procurement function is considered to be a hybrid of a centralized and a distributed organization. North Carolina gives centralized administrative authority over operation of the procurement system to the Division of Purchase and Contract, which provides direction and oversight to ensure purchasing decisions are made in compliance with State law and administrative rules. Except for those purchases in which the State

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will benefit from leveraging its total purchasing volume into a single contract, the substantive decisions regarding each agency's purchasing needs are distributed to the individual agency.

The principle behind this hybrid system is that subject-matter expertise about the details of the need for purchasing goods and services lies with agency end-users and that it is more efficient for these end-users to work with purchasing personnel assigned to and familiar with the functions of that agency in order to develop specifications, requirements and scope-of-work descriptions for needed goods and services. On the other hand, development of and compliance with established procedures and rules is better handled by an independent and neutral entity with authority to ensure that mandated processes are not neglected in the name of short-term efficiency or expediency.

As the procurement of goods and services has become more complex, the State has developed three methods by which bids for goods and services may be evaluated. The simplest of these is "lowest bid meeting specifications," which is almost exclusively used for goods purchases. The second evaluation methodology is "the bid most advantageous to the State" taking into account a number of enumerated factors identified in the solicitation document (e.g., price, quality, reputation of vendors, speed of performance, etc.). Although this method was informally termed a best method evaluation, only in 2010 was P&C expressly authorized to conduct "best value" evaluations as that term is defined in G.S. 143-135.9(a).

The difference between the second and third methods is that the second method pre-assigns the weight of each factor (often a numerical value) based on that factor's relative importance within a theoretical "ideal offer" and identifies those weights in the solicitation document. The third method, however, does not attempt to give any factor a specific weight, but rather evaluates the specific strengths and weaknesses of each offer compared to the others, making trade-offs among the price and performance factors to arrive at the best overall offer.

Finding 1: *Full competition was not utilized in the awarding of \$511 million (41%) of the \$1.24 billion awarded to private providers for high-value services.*

The Department agrees with this Finding. As noted in the finding, the reasons for not seeking competition are varied. Some are legitimate, and others are the result of poor advance planning or of an agency's belief that it already knows the best vendor to provide the service. Although P&C's ability to provide meaningful input into the terms of service solicitations is hindered by the existing Administrative Code rule that allows agencies to issue service solicitations without the approval of P&C, the Department is currently reviewing Administrative Code changes that will require agencies to submit all solicitation documents for services costing more than the agency's delegation for approval by P&C prior to issue.

Although nothing in either State purchasing law or the Administrative Code authorizes an agency to issue a non-competitive solicitation prior to receiving approval of a waiver of competition from P&C, this is not an infrequent occurrence. Although it admonishes the agency on such occasions, it will work with the agency to obtain a proper justification for a waiver rather than creating delay and more effort by forcing the agency to issue its

solicitation again. Requiring agencies to obtain pre-approval of service solicitations should eliminate this problem.

Finding 2: *State agencies are not documenting the results of their determinations to use contracted services.*

The Department agrees with this Finding. Requiring agencies to develop a business case for high-value service procurements will greatly improve both the quality of solicitation documents and will force agencies to conduct significantly more advance planning than currently occurs in too many cases. It is projected, however, that agencies will need substantial additional resources in order to train or hire employees with the necessary skillset to prepare an adequate business case.

Finding 3: *Solicitations for high-value services do not consistently include all of the necessary requirements to ensure effective performance.*

The Department agrees with this Finding. The Report identifies three essential attributes of effective solicitations: performance measures and targets, payment authorization (acceptance criteria), and vendor transition planning. During the past year P&C has increased its emphasis on these three attributes in its training sessions and in its standard solicitation templates. Training classes now discuss the need for active contract management and the need for specific performance criteria and standards for State acceptance (often the measure of when payment is due) of vendor performance or work.

Revised solicitation templates for services that were issued in July 2015 include a section on contract management requirements, as well as a representation by the prospective vendor that if any task or work the vendor agrees to perform also requires the completion of a preliminary task or sub-task not expressly set out, then the vendor agrees it will perform the preliminary task or sub-task as part of the contract. The service template also includes a section requiring the vendor to cooperate to perform the work at the end of the contract necessary to allow the State to transition smoothly to another vendor.

Finding 4: *State agencies do not consistently ensure compliance with the terms and conditions of high-value service contracts.*

The Department agrees with this Finding. Although P&C offers training on the techniques of effective contract management, and, as noted above, includes sections for contract management requirements in its services solicitation template, agencies have been less than aggressive in implementing a more active contract management function. It is the Department's perception that one significant factor for this resistance is a lack of available resources.

Finding 5: *State-level monitoring of contracted services is not ensuring compliance with applicable state regulations.*

The Department agrees with this Finding. To the extent that this lack of compliance results from an agency failing to provide the proposed contract for P&C's approval, P&C cannot monitor a contract of which it is unaware. Implementation of a mandatory contract management system will greatly reduce this problem.

Service contracts are prohibited from lasting more than three years, including renewals and extensions, without approval of the State Purchasing Officer. The SPO requires a justification for any contract term or a renewal that results in a contract continuing for more than three years. In some cases those extra lengths are approved and in some the additional period is rejected. Appendix A in the report does not indicate those contracts in which a lengthy term was requested or the number of lengthy contracts approved by the SPO.

As a result of the State's traditional division of procurement duties between P&C and individual agencies, with subject-matter expertise residing in the agencies, P&C lacks the capability to ensure that State agency procurement processes result in achievement of either best value or of a contract in the best interest of the State. P&C reviews contracts for compliance with procurement procedures that are designed, in general, to produce advantageous contracts. It can provide minimally-acceptable template language and training in the techniques to adapt those templates. It does not, however, have the subject-matter expertise to determine—for each individual service contract across all agencies—what specific performance requirements are required to ensure that the contract is successful in accomplishing the agencies purpose in soliciting contract offers.

Recommendation 1: *The General Assembly should require state agencies to conduct an evaluation of available sourcing options for high-value services as a condition of issuing a solicitation to prospective private-sector providers.*

The Department agrees with this Recommendation. Although mandating that agencies conduct such an evaluation and document a business case for each high-value procurement will require additional resources, the process of doing so will provide the agencies with the information necessary to develop more effective solicitations. Agencies will be much more aware of how more clearly to describe what they want, as well as being better able to identify the minimum criteria for success.

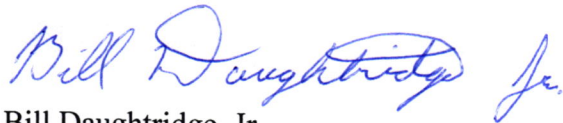
The Department is skeptical, however, about the benefit of requiring it to evaluate the efficacy of an agency's business case. Not only does it lack the expertise to do so, but it will add a layer of review that is likely to significantly increase the length of the procurement process. On the other hand, P&C is capable and is not opposed to performing a procedural review of a business case to ensure it contains the required template elements and is not obviously inadequate.

Recommendation 2: *The General Assembly should direct the Department of Administration to procure and implement a contract management system for state agency-administered contracted services.*

The Department agrees with this Recommendation. The Department has developed and, pending approval from the Department of Information Technology, expects to issue in January 2016 an RFP for a contract management system capable of providing the functionality in the Report. Under the projected schedule, this system will be implemented and rolled out for a pilot project (limited in scope to P&C and IT Purchasing) by the end of the current fiscal year.

We are committed to continuing improvements in the State's procurement process and look forward to implementing your recommendations.

Sincerely,

A handwritten signature in blue ink that reads "Bill Daughtride, Jr." with a stylized flourish at the end.

Bill Daughtride, Jr.



**STATE OF NORTH CAROLINA
OFFICE OF STATE BUDGET AND MANAGEMENT**

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GOVERNOR

LEE HARRISS ROBERTS
STATE BUDGET DIRECTOR

December 16, 2015

John Turcotte
Director, Program Evaluation Division
North Carolina General Assembly
212 Legislative Office Building
300 N. Salisbury St.
Raleigh, NC 27603

Dear Mr. Turcotte:

Thank you for the opportunity to review and comment on the Program Evaluation Division's report, "Enhanced Oversight of Service Contracts Can Help Ensure Cost-Effective Performance." OSBM generally agrees with the findings cited in this report, and similar issues were noted during the information gathering phase of NC GEAR. As you are aware, our office also recently recommended the State adopt a standard methodology for comparing public and private costs when making decisions on whether to contract for services. Your recommendations would help move the State in this direction through the establishment of a standard business case template and approval process for agencies seeking to contract for services. We also agree with the recommendation for development of a plan to address the broader question of whether there are other services being performed in-house that could be more effectively performed by a private provider.

While we support the goal of these recommendations, OSBM would require additional resources to effectively develop and implement the new requirements and processes. Based on our initial assessment of the volume of contracts that would be subject to review, the OSBM responsibilities can be addressed with the addition of one FTE. OSBM performs somewhat similar oversight and review functions for IT projects and administrative rules. We anticipate that, as with these areas, not all agencies will be equally equipped with the expertise necessary to conduct this analysis in-house. For those agencies that do not have the internal resources, they may rely on OSBM or supplemental contract staff (if they have funds available) to help meet these requirements. To prevent this new process from becoming a deterrent for agencies to pursue outsourcing opportunities that may be in the best interest of the state, it is important to ensure adequate support for agencies to develop the necessary skillsets.

These reforms offer the potential to identify significant efficiencies and savings for the State. We look forward to working with you to strengthen the State's procurement process in these areas.

Sincerely,

A handwritten signature in black ink, appearing to read "Lee Harriss Roberts".

Lee Harriss Roberts