

**National State Auditors Association**

**JOINT AUDIT**

**STATE CONTRACTING  
FOR  
PROFESSIONAL AND TECHNICAL  
SERVICES**

**September 1996**

# National State Auditors Association

September 25, 1996

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Baton Rouge, LA 70804  
(504) 339-3839

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National State Auditors Association  
P.O. Box 94397  
Baton Rouge, Louisiana 70804

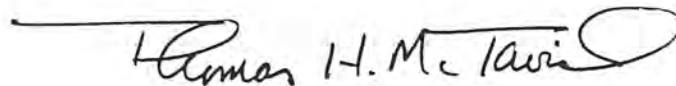
Dear Mr. Kyle:

This is the report on the results of the National State Auditors Association's Joint Audit of State Contracting for Professional and Technical Services.

Nine state audit organizations participated in this joint audit project: Office of State Auditor, Colorado; Office of Auditor of Accounts, Delaware; Office of the Auditor, Hawaii; Legislative Division of Post Audit, Kansas; Auditor of Public Accounts, Kentucky; Office of the Auditor General, Michigan; Office of the Auditor, Ohio; Division of State Audit, Tennessee; and Office of the State Auditor, Utah. Each audit organization conducted a performance audit of State Contracting for Professional and Technical Services within its state. Michigan coordinated the planning and information sharing during the audit and prepared the joint report based on the nine audit reports issued by the individual states.

The National State Auditors Association sponsors joint projects to improve audit efforts through the sharing of information and expertise. The projects also give states access to a larger audience for those issues that may need to be addressed from a federal or national perspective. We hope that this joint audit report on State Contracting for Professional and Technical Services will further these goals.

Sincerely,



Thomas H. McTavish, C.P.A.  
Project Coordinator

## FOREWORD

The National State Auditors Association (NSAA) sponsors joint projects to improve audit efforts through the sharing of information and expertise. The projects also give states access to a larger audience for those issues that may need to be addressed from a federal or national perspective.

This report on State Contracting for Professional and Technical Services is the seventh joint audit report issued by member states of NSAA. The project was coordinated by the Michigan Office of the Auditor General. Nine states participated in this joint audit project, with 8 states preparing formal audit reports and 1 state preparing a letter report.

The audit report title and coordinating state agency for the previous six joint projects were:

Hazardous Waste - Pennsylvania Office of the Auditor General/Michigan Office of the Auditor General

Medicaid Surveillance and Utilization Review - Florida Office of the Auditor General

Insurance Regulation - New York Office of the State Comptroller

Foster Care Program - Division of State Audit, Tennessee Office of the Comptroller of the Treasury

Medicaid Prescription Drug Program - Maryland Office of Legislative Audits

Child Support Enforcement Program - Michigan Office of the Auditor General

The eighth joint project, on Prison Industries, is currently in progress and is being coordinated by the Oregon Division of Audits.

## EXECUTIVE SUMMARY

State contracting for professional and technical services is the topic for NSAA's seventh joint audit project. Nine state audit organizations participated in this coordinated performance audit to primarily evaluate the effectiveness of state contracting for professional and technical services in their states: Colorado, Delaware, Hawaii, Kansas, Kentucky, Michigan, Ohio, Tennessee, and Utah. Eight of the 9 participating states issued individual audit reports. The state of Ohio issued a letter which provided an overview of its internal control structure, scope of project, and methodology.

The basic audit objectives of the joint audit were:

1. To assess the adequacy of the internal control structure over contractual services.
2. To assess contractual services evaluation efforts.
3. To assess compliance with state reporting requirements pertaining to contractual services.

This report cites weaknesses identified in contracting for professional and technical services in some states as well as proposed or implemented solutions. This information is provided to help the reader understand the types of problems existing in contracting for professional and technical services and the possible solutions that are being tried. The report is not intended to be a criticism of a particular state's contracting for professional and technical services efforts or to suggest that these are the only states seeking solutions.

**NSAA JOINT AUDIT  
STATE CONTRACTING  
FOR  
PROFESSIONAL AND TECHNICAL SERVICES**

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**TABLE OF CONTENTS**

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|   | <u>Page</u> |
|---|-------------|
| TRANSMITTAL LETTER  | i           |
| FOREWORD  | iii         |
| EXECUTIVE SUMMARY   | iv          |
| INTRODUCTION  | 1           |
| Purpose of NSAA Joint Audit                                     | 1           |
| Project Objectives, Scope, and Methodology                      | 1           |
| AUDIT OBJECTIVES, CONCLUSIONS, FINDINGS, AND<br>RECOMMENDATIONS |             |
| Internal Control Structure                                      | 3           |
| The Make-or-Buy Decision  | 3           |
| Contract Specifications, Terms, and Conditions                  | 4           |
| Contract Evaluation and Award                                   | 6           |
| Contract Documentation  | 7           |
| Contract Management   | 9           |
| Evaluation Efforts  | 12          |
| Reporting Requirements  | 13          |



## INTRODUCTION

### PURPOSE OF NSAA JOINT AUDIT

The National State Auditors Association (NSAA) chose state contracting for professional and technical services as the topic for its seventh joint audit project as the result of a survey of states completed in July 1994 regarding their interest in potential NSAA joint audits. The topics were selected based on NSAA criteria that audit issues should be considered topical, auditable, common to many states, and of significant importance beyond state boundaries.

Nine state audit organizations participated in this coordinated audit to primarily evaluate the effectiveness of state contracting for professional and technical services in their states: Colorado, Delaware, Hawaii, Kansas, Kentucky, Michigan, Ohio, Tennessee, and Utah. The audit organizations in the participating states conducted individual performance audits of their respective state's program. Eight of the 9 states issued individual audit reports. The state of Ohio issued a letter which provided an overview of its internal control structure, scope of project, and methodology. The Michigan Office of the Auditor General coordinated the planning of the joint audit and information sharing among participating states and prepared the joint audit report based on the individual states' audit reports and letter.

### PROJECT OBJECTIVES, SCOPE, AND METHODOLOGY

The basic audit objectives, scope, and methodology for the joint audit were developed in a cooperative effort by most of the participating states.

The participating states concluded that they could determine their individual audit periods, but that the periods chosen would include their last two completed fiscal years (1993 and 1994) to provide comparative information for the joint audit.

In addition, the participating states concluded that the joint audit scope would encompass only professional and technical service contracts within the state's executive branches. The audit would specifically exclude procurement of commodities, state authorities, and colleges and universities. Individual states were not precluded from addressing a broader

scope of contractual services or the legislative and judicial branches. The basic audit objectives of the audit were:

1. To assess the adequacy of the internal control structure over contractual services.
2. To assess contractual services evaluation efforts.
3. To assess compliance with state reporting requirements pertaining to contractual services.

For each of the nine states, the audit objectives of the individual performance audits consisted of or included the preceding basic audit objectives.

# **AUDIT OBJECTIVES, CONCLUSIONS, FINDINGS, AND RECOMMENDATIONS**

## **INTERNAL CONTROL STRUCTURE**

**Audit Objective:** To assess the adequacy of the internal control structure over contractual services.

**Conclusion:** The nine state audits indicated that the adequacy of the internal control structure over contractual services varied significantly among the individual states. Most state audit reports contained recommendations for improvement.

The contractual services process can be summarized into five components (steps): the make-or-buy decision; contract specifications, terms, and conditions; contract evaluation and award; contract documentation; and contract management. We categorized specific audit findings of the various states under each of these five components in the internal control structure over contractual services.

### **THE MAKE-OR-BUY DECISION**

The first step in any contractual services process is to identify the need to contract for a service. This decision could be influenced by the inability to provide the service internally at a competitive price, the inability to meet a specified deadline, and/or the lack of the necessary skills and expertise internally to complete a given task. A thorough understanding of the task at hand, the current work force, and alternatives available via contracting, including cost information, is considered vital in evaluating the need to contract for services.

### **FINDINGS**

The Colorado audit report noted that state managers do not always have the information to calculate costs associated with contracting for services. These cost comparisons are important when determining if the agency should provide services with contractors where the option to contract exists. Of the 50 contracts reviewed, agency management was able to provide formal or informal cost comparisons for 7 (14%) contracts. Further, 2 of the 7 agency-prepared cost comparisons contained incorrect information or comparisons. (Colorado Recommendation 8)



The Hawaii audit report recommended the development of an internal control structure which requires that a thorough evaluation of the need for and availability of resources to pay for a contractual services agreement be documented before contracts are entered into. The definition of an internal control structure implies that management plans for the proper use of resources. This would include assessing the need for a particular project as well as determining the wherewithal to pay for it. (Hawaii Recommendation C2-2)

The Tennessee audit report noted that some contracts entered into resulted in an employer-employee relationship. In Tennessee, as in many other states, it is state policy that employees be hired through the merit system in place within each individual state and that any contract creating an employer-employee relationship is prohibited. For example, a \$16 million three-year contract for systems analysts, designers, and programmers created an employer-employee relationship because the department, as opposed to the contractor, assigned the task and supervised the work. (Tennessee Recommendation 3)

### **RECOMMENDATIONS**

State agencies should provide agency contract managers training in preparing cost comparisons for contract management decisions, including the information needed and its sources.

State agencies should develop an internal control structure which requires that a thorough evaluation of the need for and availability of resources to pay for a contractual services agreement be documented before contracts are entered into.

Guidance in rules or a contracting manual should be provided to ensure that state agencies obtain the best services for the least costs without abdicating their responsibility for monitoring and understanding the work.

### **CONTRACT SPECIFICATIONS, TERMS, AND CONDITIONS**

After the decision has been made to pursue a contractual services agreement, adequate planning is necessary to ensure that all proposals are clearly written to address the desired contractual requirements and to be in compliance with any state laws, policies, and procedures.

### **FINDINGS**

The Colorado audit report identified the need to improve contract development training by helping state agencies identify and develop performance measures to include in

personal services contracts. Performance measures provide two benefits for managing contracts. First, they provide clarity for the contractors on the criteria against which their work will be measured. The contractors know in advance the standards to be met. Second, performance measures enable agency staff to objectively evaluate the services provided by contractors. When performance measures are used, they can be negotiated up front and audited after the fact for performance and quality. (Colorado Recommendation 4)

The Colorado and Kansas audit reports identified the need to improve state contract management by providing state agencies with information about accountability clauses (also referred to as enforcement clauses), including guidelines and training to enable contract managers to identify when specific accountability clauses would be appropriate and enforceable, as well as information needed to be maintained by the agency to enforce them. These specific accountability clauses would enable state agencies to recover damages for poor performance or to withhold payment until successful completion of part or all of a contract. For example, a contract required the vendor to prepare a certain report. To ensure that the report was submitted on time and was of good quality, the contract could have tied the last payment to the acceptance of that report. These accountability clauses hold contractors liable by providing legal recourse to the state for contractor nonperformance. Without them, state agencies may be unable to recover damages resulting from a contractor's poor performance and the state's interest may not be fully protected. (Colorado Recommendation 5 and Kansas Recommendation Q2-3)

The Delaware, Hawaii, Tennessee, and Utah audit reports identified contracts which did not contain specific contract provisions, including contract identification numbers, time frames for completion, maximum contract amounts, and standard terms and conditions. The Tennessee audit report recommended that all contractual service agreements include some type of monitoring provisions, such as progress reports, activity data, site visits, inspections, or outcomes. Without adequate provisions, the state agencies may be vulnerable to unnecessary legal liabilities. (Delaware Recommendations 3 and 4, Hawaii Recommendation C2-2, Tennessee Recommendation 4, and Utah Recommendations R10-4 and R11-3)

The Kansas audit report recommended that the contractual services agreement language for large, complex, troublesome type, and sole-source vendor contracts be reviewed on a routine basis. This review will ensure that state agency contracts contain the language needed to maximize their chances of receiving the quality and level of services expected. (Kansas Recommendation Q2-3)



## **RECOMMENDATIONS**

State agencies should improve contract development training by helping to identify and develop performance measures to include in personal services contracts.

State agencies should improve contract management by providing information about accountability clauses (also referred to as enforcement clauses), including guidelines and training to enable contract managers to identify when specific accountability clauses would be appropriate and enforceable, as well as information needed to be maintained by the agency to enforce them.

State agencies should include specific contract provisions in all contractual service agreements, including contract identification numbers, time frames for completion, maximum contract amounts, standard terms and conditions, and some type of monitoring provisions, such as progress reports, activity data, site visits, inspections, or outcomes.

State agencies should review the wording of large, complex, troublesome type, and sole-source vendor contracts to maximize the chances of receiving the quality and level of services expected.

## **CONTRACT EVALUATION AND AWARD**

Before deciding on a qualified vendor for a contractual services agreement, the applicant's proposals and qualifications must be thoroughly reviewed and analyzed. Contract specifications and requirements aid in the review process, but there are other factors that are equally important in the evaluation of potential contractors.

## **FINDINGS**

The Hawaii and Kansas audit reports identified the need to award contractual service agreements on the basis of a competitive process to ensure that the best price and product are received. Maintaining competition in the selection of a contractor is widely recognized as an effective method of protecting resources from waste, fraud, and inefficient use. In addition, noncompetitive awards can give the appearance of favoritism. Kansas reviewed a sample of 32 professional services contracts from five state agencies and noted 4 instances in which state agencies did not seek competitive bids when other vendors existed who could have bid on the services. (Hawaii Recommendation C2-1 and C4 and Kansas Recommendation Q2-8)

The Delaware audit report recommended that consideration be given to initiate a statewide control point for the review and approval of contracts entered into by state

agencies. A statewide system with review and approval features would increase the controls over contracts and services entered into by the states and also increase the effectiveness of services received. (Delaware Recommendation 1)

### **RECOMMENDATIONS**

State agencies should award contractual service agreements on the basis of a competitive process to ensure that the best price and product are received.

Consideration should be given to initiate a statewide control point for the review and approval of contracts entered into by state agencies.

### **CONTRACT DOCUMENTATION**

At this point in the process, a number of factors should have been analyzed and evaluated in arriving at a decision as to which qualified contractor would be awarded the contractual services agreement. It is important to maintain documentation to support the decisions made as well as ensure the propriety of the decision-making process should it come under scrutiny by state agencies or other contractors. One of the most important pieces of documentation is the contractual services agreement.

### **FINDINGS**

The Delaware, Hawaii, Kansas, Michigan, Tennessee, and Utah audit reports all recommended that policies and procedures be developed and enforced to ensure that contractors are prohibited from providing services until a fully executed, legally binding contract is in place. These policies and procedures should apply to all contract amendments as well. To be considered fully executed, a contract or contract amendment should be properly signed by all of the parties to the contract. Further, all necessary approvals and authorizations should be obtained prior to the beginning of contracted services.

Properly executed contracts are essential to ensure that the type and scope of services to be provided have been agreed upon, the services are those for which the state legislature appropriated funding, and the roles and responsibilities of the state agency and contractor are clearly delineated to avoid confusion or misunderstandings. Providing services without contractually defined roles and responsibilities puts both the state agency and the contractors in jeopardy should any legal problems arise. (Delaware Recommendations 5 and 6, Hawaii Recommendations C3-4 and C4, Kansas Recommendation Q2-1, Michigan Recommendation 2, Tennessee Recommendations 1 and 2, and Utah Recommendations 10-1, 10-2, and 12-1)

The Colorado audit report recommended that state agencies develop cost-effective methods to track contracts, such as a manual contract log or a computerized tracking system, to assist agency staff in contract management. (Colorado Recommendation 7)

The Hawaii audit report recommended that controls and procedures should be established over the filing of contracts. During its review, Hawaii noted that contracts could not be readily located in filing cabinets. For example, one state agency took three days to locate one of the contracts to be examined. The absence of administrative controls over contract files results in operational inefficiencies, promotes confusion and frustration, and impedes effective contract administration. (Hawaii Recommendation C3-1)

The Utah audit report recommended that state agencies document support for all sole-source contract determinations, as well as retain adequate documentation regarding the bidding process followed for each contract, including submitted bids and advertisement. In 3 of 22 contracts sampled during Utah's review, state agencies did not maintain documentation to support the awarding of sole-source contracts. Further, in 3 of the 22 contracts sampled during Utah's review, the request for proposal and the proposal of the firm awarded the contract were retained, but the bids of the competing firms and documentation of the advertisement were not retained. To ensure the integrity of the contractual services bid process, these documents should be maintained. (Utah Recommendation R11-2)

## **RECOMMENDATIONS**

State agencies should develop and enforce policies and procedures to ensure that contractors are prohibited from providing services until a fully executed, legally binding contract is in place. These policies and procedures should apply to all contract amendments as well.

State agencies should develop cost-effective methods to track contracts, such as a manual contract log or a computerized tracking system, to assist agency staff in contract management.

State agencies should establish controls and procedures over the filing of contracts.

State agencies should maintain documentation to support all sole-source contract determinations, as well as retain adequate documentation regarding the bidding process followed for each contract, including submitted bids and advertisement.



## **CONTRACT MANAGEMENT**

After the decision-making process has been completed, adequately documented, and the contract awarded, the contracting process is still not complete. It is imperative that some level of contract management be applied to each contractual service agreement. The degree of contract management necessary will vary depending on the specific circumstances of each contractual services agreement. There are many factors that impact the degree of contract management applied to an agreement, such as the size of the contract, sensitivity of the tasks contracted for, and past history in dealing with a particular contractor. Ultimately, the level of contract management necessary will be based on the judgment of a contract manager within the state agency. The overriding responsibility of any contract manager is to ensure that the assets of the state agency are properly safeguarded and that the contract is completed in compliance with the contractual service agreement and at a minimal risk to the state agency.

## **FINDINGS**

A number of states made recommendations relating to the development and enforcement of formalized policies and procedures for use by contract managers. The Colorado audit report recommended the formation of a task force to improve contract management and define the role of state agencies regarding contract oversight responsibilities. The Colorado audit report also recommended that guidelines be developed for use by state agencies in developing procedures and training for contract managers. In 2 of the 14 contracts reviewed, Colorado identified that poor contract management resulted in the need for additional state resources to correct problems. Both contracts resulted in the expenditure of additional staff time to correct problems noted, and one of the contracts also incurred additional legal fees as a result of the contractor's performance. Had these two contracts been properly monitored, the monitoring might have prevented or limited the need for additional state resources to correct the problems caused by the contractors' performance. (Colorado Recommendations 1 and 2)

The Kansas audit report recommended continued development of a written policies and procedures manual. The manual should formalize current informal policies and procedures, as well as contain current laws and regulations applicable to contracting and information about established "best practices" for all phases of the contracting process. Such "best practices" are not procedures as such, but they give guidelines and pointers for all state agencies to follow that help them get the best results from the purchasing process.

The Tennessee audit report recommended that contracting rules and policies be revised to ensure that requirements are clearly explained and unnecessary requirements are deleted. The Kansas audit report also recommended that greater guidance be provided to state agencies on monitoring activities and contract management, including new policies and procedures on contract management issues. The Kansas audit report further recommended that legal counsel be consulted to develop written guidance that specifies when state agencies should award grants and when they should award purchase contracts to ensure consistent guidance regarding awards of grants and purchase contracts. (Tennessee Recommendation 9 and Kansas Recommendations Q2-1, Q2-4, and Q2-7)

The Michigan audit report recommended that a control structure be established to ensure that state agencies are complying with contractual personal service policies and procedures. The Michigan report also recommended the development of a cooperative plan for enforcing rules and regulations related to contractual personal services. The report noted instances when state agencies appeared to attempt to circumvent established policies and procedures in an attempt to contract for personal services. In one instance, a request for contractual personal services had been turned down by the appropriate state authority, yet the state agency attempted to contract for the same services via an improper process. (Michigan Recommendations 3 and 1)

Two state audit reports identified the importance of adequate training of individuals involved in contract establishment and management. The Hawaii audit report recommended that the program specialist be properly qualified and trained to establish and enforce a policy to ensure complete and organized contract files, monitor and evaluate policies and procedures, and formulate a manual to guide staff in the performance of their contract administration duties. The Hawaii audit report also recommended that staff be properly trained in the performance of their contract monitoring and evaluation duties. The Kansas audit report recommended that training continue to be provided to state agencies on all aspects of the contracting process, including the establishment of appropriate monitoring activities. (Hawaii Recommendations C3-2 and C3-3 and Kansas Recommendation Q2-2)

In addition, the Kansas audit report recommended that an assessment be made to focus direct assistance to state agencies based on an assessment of risk. Similarly, the Colorado audit report recommended assistance be provided to state agencies to help develop and apply contract risk criteria. These criteria should include public impact, dollar value, public safety, and contract requirements. On the basis of this risk assessment,

agency management can determine which contracts present more risks and require more intensive monitoring. (Kansas Recommendation 2-5 and Colorado Recommendation 3)

The Colorado and Hawaii audit reports recommended that state agency staff accountability in contract monitoring be improved by the development of individual performance objectives for contract managers and the evaluation of the effectiveness of state agency contract managers based on their contract management skills. Evaluation of contract managers would help identify deficiencies early and allow for a more expedient corrective action and identify positive characteristics possessed by individual contract managers to be shared with all contract managers. (Colorado Recommendation 6 and Hawaii Recommendation C2-3)

The Hawaii, Michigan, Tennessee, and Utah audit reports all identified the need to establish clear payment approval policies and procedures. This would help ensure that the appropriate approvals and signatures were obtained and that documentation to support the appropriate provision of services was received prior to payment being made to the contractor. Further, contractual personal service expenditures should be monitored to ensure that payments to contractors do not exceed approved amounts and that there is follow-up on any contracts with unapproved expenditures. (Hawaii Recommendation C3-1, Michigan Recommendation 4, Tennessee Recommendation 5, and Utah Recommendations R10-3 and R11-2)

## **RECOMMENDATIONS**

State agencies should develop and enforce formalized policies and procedures for use by contract managers.

State agencies should continue to develop written policies and procedures manuals which contain current policies and procedures, laws and regulations, and information about established “best practices” for all phases of the contracting process.

States should establish a control structure to ensure that state agencies are complying with contractual personal service policies and procedures. In addition, states should develop a cooperative plan for enforcing rules and regulations related to contractual personal services.

State agencies should provide adequate training to individuals involved in contract establishment and management. In addition, states should properly train agency staff in the performance of their contract monitoring and evaluation duties.

State agencies should focus their monitoring efforts on the basis of an assessment of risk relating to each individual contractual service agreement.

State agencies should improve the accountability of contract managers by developing individual performance objectives and evaluating the effectiveness of contract managers based on their contract management skills.

State agencies should establish clear payment approval policies and procedures.

## EVALUATION EFFORTS

**Audit Objective:** To assess contractual services evaluation efforts.

**Conclusion:** The nine state audits indicated that contractual services evaluation efforts varied within the individual states. Four of the state audits noted a lack of contractor monitoring during the provision of services and a lack of formal evaluations of contractors at the completion of the provision of services.

### **FINDING**

The primary recommendation relating to contractual service evaluation efforts focused on the need for the evaluation of contractors and the services they provide both during and at the completion of the provision of services. The Colorado audit report recommended that contract development training be improved by addressing information necessary to evaluate contractor compliance with performance measures. The Delaware audit report recommended evaluating contracted work on an annual basis, at a minimum, and documenting these evaluations and maintaining them in a central location for future reference. The Tennessee audit report recommended formal evaluations at the end of the contract period. (Colorado Recommendation 4, Delaware Recommendation 2, and Tennessee Recommendation 7)

The Michigan audit report recommended that state agencies monitor the progress of contractors and evaluate their performance after the completion of the project. The report noted that only 66% of the contracts reviewed that required periodic monitoring had progress reports on file. Also, only 26% of the completed contracts reviewed that required final evaluations had evaluation reports on file. Periodic progress reports and final evaluation of contractor performance are necessary to ensure that work is performed in accordance with the terms and conditions of the contract. Final evaluation reports



would also be useful in the development of contract requisitions and the evaluation of future contract proposals. (Michigan Recommendation 5)

### **RECOMMENDATION**

State agencies should monitor contractors during the provision of services and formally evaluate contractors at the completion of the provision of services.

## **REPORTING REQUIREMENTS**

**Audit Objective:** To assess compliance with state reporting requirements pertaining to contractual services.

**Conclusion:** Based on the assessments of the nine state audits completed, state agencies were generally in compliance with reporting requirements pertaining to contractual services.

### **FINDINGS**

The primary recommendation relating to compliance with state reporting requirements was the timely submission of the required contractual service reports. The Delaware audit report recommended that all state agencies be informed of their statutory reporting requirement and to maintain a record of the reports submitted. In addition, the Delaware audit report recommended that follow-up be completed to inform state agencies that have not met their reporting requirements. The Michigan audit report recommended that the state improve the accuracy of its Annual Report for Contractual Services by improving reporting instructions and performing limited reviews of reported data for accuracy. The Utah audit report recommended that state agencies submit reports on the anniversary date of the delegations, as required. (Delaware Recommendation 7, Michigan Recommendation 6, and Utah Recommendation R11-1d)

### **RECOMMENDATION**

State agencies should submit required contractual service reports on a timely basis.