



Chapter 16 - Client Service Contracts

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16.10

General Policies for Client Service Contracting

16.10.10

July 1, 2007

Authority for these policies

State agencies are to effectively and efficiently manage their client service contracts as set forth in chapter 39.29 RCW. Chapter 16 forms the uniform guidelines required by RCW 39.29.100 for the effective and efficient management of client service contracts.

16.10.15

July 26, 2009

Special definitions

Agency – Any state office or activity of the executive and judicial branches of state government, including state agencies, departments, offices, divisions, boards and commissions, and educational, correctional, and other types of institutions.

Client Services – Services provided **directly** to agency clients including, but not limited to, medical and dental services, employment and training programs, residential care, and subsidized housing. Clients are considered to be those targeted or specific **individuals** who the agency has statutory responsibility to serve, protect, or oversee.

Client Service Contract – An agreement, or any amendment thereto, with a firm or individual for the rendering of **direct** services to clients of the state agency.

Contract Management – Activities related to contracting, including the decision to contract, contractor screening and selection, contract preparation, contract monitoring, auditing and post-contract follow-up.

Contract Manager – Any state agency staff involved in the contracting process who is responsible for oversight of a contract (e.g. contract specialists, program managers, state agency executives, etc).

Contract Monitoring – Planned, ongoing or periodic activity that measures and ensures contractor compliance with the terms, conditions, and requirements of a contract.

Contractor – Any business entity, whether a sole proprietor, partnership, corporation, etc., that is providing client services to state agencies. May also be called a “service provider” or “vendor.”

16.10.20

July 26, 2009

Who is a client?
16.10.20.a

Clients are individuals, external to state government, who have social, physical, medical, economic, or educational needs. These individuals require some government assistance to meet their needs. State agencies have statutory responsibility to serve different types of needs for individuals, thus often serve different clients.

Examples of clients served by different agencies include, but are not limited to, the following:

- Clients of the Department of Social and Health Services include nursing home patients, institutionalized individuals, and children in need of therapy;
- Clients of the Employment Security Department include unemployed and displaced workers;
- Clients of the Department of Veterans Affairs include disabled veterans and widows of veterans;
- Clients of the Department of Community, Trade and Economic Development include homeless individuals and crime victims;
- Clients of the Office of Superintendent of Public Instruction include K-12 public school students and their parents; and
- Clients of institutions of higher education include their students.

This definition of clients and client service contracts applies when state agencies buy services, not when the state agency or institution of higher education is providing services to another entity, e.g., funding is coming into the state as revenue not being expended.

The contractor must provide **direct** services to agency clients for the contracts to be classified as client service contracts. Direct service means the contractor is in direct contact with the individual client as part of providing the client service.

For some state agencies where identifying clients may be difficult, it is helpful to review the agency's implementing statute. State agencies that only serve other state agencies do not have client service contracts.

16.10.20.b

The following are not considered clients under this policy:

- **Providers of services.** For example, if a state agency contracts with a firm to provide training to contractors (service providers) who provide counseling services to clients, the contract with the firm to provide the training is not a client service contract.
- **Federal, state, or local government employees.** An exception would be if an employee qualifies for food stamps or other state programs. In that sense, they are clients of an agency.
- **Firms/businesses.** When state agencies are contracting to assist private businesses in increasing their business or trade opportunities, those services are not considered to be client service contracts.

General public. Contracts for services that do not meet the needs of specific individuals under an agency's statutory responsibility, but rather provide services to, or on behalf of, the general public or community groups are not considered client service contracts.

16.10.25

June 10, 2010

Contract procurement

16.10.25.a

Agencies need flexibility in selecting contractors to effectively and efficiently meet the needs of state clients. Therefore, agencies may select client service contractors by using procurement methods most appropriate to their needs, e.g., competitive, non-competitive (direct award) or sole source methods. Federal funding rules and internal agency policies may require a competitive process for certain client service contracts.

16.10.25.b

In general, the higher the dollar amount of the potential contract, the longer its duration, and the more complex the services, the greater the need for formality and competition.

16.10.25.c

Non-competitive and sole source procurements. Non-competitive or sole source award processes for client service contracts are appropriate to use since competition is not required for these services pursuant to RCW 39.29.040 (6).

State agencies are encouraged to award three percent (3%) of all non-competitively awarded client service contracts to veteran-owned businesses certified by the Department of Veterans Affairs.

Some client service contracts are continually renewed year after year based on a non-competitive or sole source award. These contracts should be reviewed periodically to determine whether competition is warranted.

Non-competitive award means a direct award to a contractor when multiple firms are available to provide the same or similar type of service. Multiple contracts for the same or similar services may be awarded using this approach depending on client needs.

Sole source contracts are those which are of such a unique nature that the contractor is clearly the only practical source for the service. Unique services would be those that are highly specialized or one-of-a-kind. Other factors that may be considered include past performance, cost effectiveness (learning curve), and/or follow-up nature of the required services.

16.10.25.d

Competitive procurement. When competition is deemed appropriate in contracting for client services, the competitive process must be a fair and open process but may be conducted informally or formally. Informal competition may include telephone solicitation, with responses recorded on a standardized form. It may also consist of e-mail and/or facsimile transmissions describing the services needed, proposed schedule, request for qualifications and fees, and due date and time for submission of a response.

For formal competition, agencies may issue a solicitation document such as a Request for Proposals or Request for Qualifications and Quotations to a reasonable number of contractors.

An agency may publish a legal notice of the solicitation in a newspaper, post a notice on their website, use internal bidders' lists, or use other methods that garner the attention of qualified firms. An agency may also notify firms by using the on-line registration and bid notification system called Washington's Electronic Business Solution (WEBS) operated by the Department of General Administration (GA).

WEBS was developed to centralize the location of bid information on multiple types of state purchases for the convenience and benefit of both state agencies and those firms, organizations and individuals that want to participate in state contracting.

Client Service Contracts

WEBS may be accessed at: <http://www.ga.wa.gov/webs/>. For assistance using WEBS, contact GA at (360) 902-7400.

If WEBS does not have the commodity category of service needed, the agency should notify GA to add the category. Also, agencies should encourage firms with which they conduct business to register in WEBS.

WEBS includes names of certified minority and women-owned businesses, and agencies are encouraged to include them in any notification process.

Agencies may also contact the Office of Minority and Women's Business Enterprises for assistance in locating certified firms and/or to use the BizNet System for names of additional firms to contact.

Proposals submitted are evaluated based on the evaluation criteria set forth in the solicitation document.

16.10.30

July 1, 2007

Screening contractor qualifications

Contractor screening criteria and methods will vary depending on program requirements, contract risk, and the type of selection process used. Using screening criteria and methods helps ensure the selection of contractors who are qualified to meet program performance expectations.

Using appropriate screening methods will help contract managers select contractors who are able to meet the following standards:

- The contractor has the appropriate experience, licensure, staffing, technical qualifications, subcontractor relationships, and facilities.
- The contractor is able to comply with the proposed or required time of delivery or the performance schedule.
- The contractor has adequate financial capability, financial management practices and internal controls, and is in sound financial condition.
- The contractor has a satisfactory record of integrity, judgment, and performance.
- The contractor has resolved all audit findings from previous contracts.

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- The contractor is otherwise qualified and eligible to receive a contract under applicable laws and regulations.
- The contractor is not on the federal suspended/debarred list, which identifies contractors who cannot be given federally funded contracts, if the contract will be funded with federal money.

Contract managers may also want to require contractors to disclose details of any indictment or litigation against the organization, or criminal investigations.

Contract managers should maintain documentation applicable to the contract, considering the type of services, and risks associated with the contract. Examples of screening documentation could include resumes of contractor staff, proof of professional licenses or accreditation, and/or copies of background clearances, if required by the contract and/or state law.

16.10.40

July 26, 2009

Training on client service contracts

16.10.40.a

Training on client service contracts is required for all state agency staff who execute or manage client service contracts. Those employees must complete OFM client service contract training or agency-approved training prior to executing or managing client service contracts. OFM provides ongoing client service contract training for state agency personnel responsible for executing or managing these contracts. The training covers topics from contract planning and procurement through effective and efficient contract management and contract completion.

Agencies may provide their own client service contract training, if the course is approved in writing in advance by OFM. If agencies provide contract training, names of staff who have attended the client service training must be reported to OFM.

16.10.40.b

State agencies shall require agency employees responsible for executing or managing client service contracts to complete the applicable training course to the satisfaction of OFM prior to executing or managing these contracts.

(Training is also required for those who execute or manage personal service contracts, so those classes are also listed below.) Staff who execute contracts are those who sign contracts. Staff who manage contracts are those who have responsibility for the day-to-day activities of the client service contract.

These activities may include conducting the procurement, drafting and negotiating contracts, providing technical assistance to contractors, monitoring contractor activities, reviewing and approving invoices, etc.

Staff who only execute or manage client service contracts of less than \$5,000 are not required to take the training, however, the training is recommended. Staff who make payments against contracts or log or track contracts, but who do not engage in other contract management activities, are not required to take the training.

Executive Management training is available to a more limited audience of agency directors and assistant directors (or the management equivalent) who execute but do not manage contracts.

The following table provides further information about required classes:

Contract Responsibility	OFM Training Class*
Manage client service contracts	Introduction to Client Service Contracts (1/2 day) or Client Service Contract Overview (full-day)
Manage personal service contracts	Introduction to Personal Service Contracts (1/2 day) or Personal Service Contract Overview (full-day)
Execute client service contracts and personal service contracts	Contracting for Mid-Level Managers (1/2 day) or the client service or personal service classes listed above
Execute client service contracts and personal service contracts for Agency Directors or Assistant Directors (or management equivalent) only	Executive Management Contract Training (1 hour) or the client service or personal service classes listed above
Manage both client service and personal service contracts	One of each class required to manage each type of contract

* If an agency provides its own OFM approved contract training, then that training satisfies the requirements.

State agency staff may register for OFM training through the OFM website at: <http://www.ofm.wa.gov/training/default.asp>.

All internal agency procedures for requesting training must be followed prior to registration with OFM.

Client Service Contracts

Attendance at the half-day *personal* service contracts training offered by OFM will not meet the training requirement for staff who manage or execute *client* service contracts. Likewise, staff who only manage or execute *personal* service contracts would not meet the training requirement by attending the *client* service classes.

- 16.10.40.c Any request for an employee to be exempt from this training requirement must be submitted to OFM in writing. OFM must grant approval to the agency prior to the employee executing or managing contracts, with few exceptions.

The exemption is to be considered temporary. The employee granted the exemption must attend contract training as soon as feasible after receipt of the exemption from OFM. Multiple requests for exemption for an individual will not be approved. State agencies are responsible to ensure that staff attend the training as soon as possible after receiving the exemption.

16.10.50

July 1, 2007

Annual contract procedures report

- 16.10.50.a RCW 39.29.110 requires state agencies that have awarded or renewed client service and/or personal service contracts during a calendar year (January to December) to provide a report to OFM detailing the procedures the agency employed in awarding, renewing, and managing the contracts. The contract procedures report is due to OFM by **January 31** of each calendar year.
- 16.10.50.b This policy addresses client service contracts, but the report applies to both client service and personal service contracts, so both items are included below.

The following items will be required as part of submitting the Annual Contract Procedures Report:

1. **Contract procedures.** A copy of, or a website link for, the agency's procedures on client service contracts; or if an agency does not have written internal contract procedures in place, but the agency utilizes the policies in Chapter 16, those policies should be referenced.
2. **Contract totals.** The total number of and total dollar value of client service contracts awarded by the agency during the calendar year period of January – December. Contracts to be included in these totals are those in the amount of \$5,000 or more.

16.10.55

July 1, 2007

Risk-based audits

OFM conducts risk-based audits of the contracting practices associated with individual client service contracts to ensure agency compliance with the provisions of this Chapter. A risk-based audit means a review of the management and fiscal controls and contracting practices associated with client service contracts.

OFM determines the number of audits to conduct and which agencies to include based on funding provided.

OFM forwards the results of the risk-based audits conducted to the Governor, the appropriate standing committees of the Legislature, and the Joint Legislative Audit and Review Committee.

16.10.60

July 1, 2007

Audit and investigative findings

RCW 39.29.130 requires the State Auditor's Office (SAO) and the Attorney General's Office (ATG) to annually prepare an annual report of agency client service contract audit and investigative findings and enforcement actions with a status of agency resolution. The SAO and ATG submit the report to the OFM, the Governor and the Legislative policy and fiscal committees by November 30th of each year.

The audit findings referenced herein are those issued by the SAO and are not related to the risk-based audits conducted by OFM.

16.10.65

July 1, 2007

Expenditure coding for client service contracts

Subobject NB "Payments to Providers for Direct Client Services is to be used for reporting expenditures against client service contracts.

The definition for this subobject is included in Subsection 75.70.20.

16.10.70

July 1, 2007

Standards of ethics and conduct

Chapter 42.52 RCW, “Ethics in Public Service,” applies to all state employees in all branches of state government. State employees contracting on behalf of the state are to maintain strict ethical standards and take caution to avoid any real or apparent conflict of interest situations. State employees must also be aware of requirements and restrictions regarding contracting with current or former state employees. State employees should familiarize themselves with this statute prior to entering into contracts.



16.20

Client Service Contracts – Contract Award, Management, and Monitoring

16.20.05

July 1, 2007

Purpose of this policy

This policy serves as the basis for awarding, managing, and monitoring client service contracts.

16.20.10

July 1, 2007

Contract negotiations

Part of the process of awarding a client service contract under a competitive solicitation or a sole source process is to negotiate the specific contract terms. Any discussions, whether formal or informal, that are held with the apparent successful contractor to develop and finalize the contract are considered contract negotiations.

Under a competitive process, negotiations may be held with the apparent successful contractor if more favorable terms are desired than were submitted in the proposal or if the proposal is not sufficiently precise or direct.

Areas in the proposal that may be considered less than satisfactory include: time devoted to the project or phases of the project by the consultant, scheduling related to the items in the scope, pricing, billing terms, etc.

Negotiations should not substantially change the terms of the original proposal, but should eliminate any ambiguities in the contract and clarify the terms. If the terms offered by a contract are fair and equitable, award may be made without negotiations. Under a non-competitive or sole source award, price negotiations may be necessary if the contractor costs proposed seem higher than expected.

16.20.15

July 26, 2009

Formalizing client service contracts

16.20.15.a

Written contract. All client service contracts, regardless of dollar amount, require a **written** document specifying the agreement between the agency and the contractor.

Required elements in a client service contract are:

- Identification of all parties to the contract;
- Scope of services that clearly describes the responsibilities and obligations of the parties;
- Maximum compensation, when applicable;
- Period of performance; including start and end dates or a statement, for example, that the end date is two years from the start date;
- Payment mechanism that describes the basis on which the contractor will be paid for services whether an hourly/daily/weekly/or monthly rate, by deliverable, completion of a project phase or milestone, achievement of a performance target or outcome, lump sum, etc.; and
- Signatures of all responsible parties.

Numerous other terms are often included in the contract documents to provide additional legal protection to the State.

Amendments to client service contracts must also be in writing.

A sample client service contract is provided on OFM's Additional Contract Resources website at:

<http://www.ofm.wa.gov/contracts/resources/default.asp>.

16.20.15.b

Contract format. Agencies may choose a contract format appropriate to the services being acquired, provided that the required elements identified in Subsection 16.20.15.a are included. For example, an agency may wish to use a short-form contract or letter of agreement where the contract services are not complex or where the contract consideration is less than \$5,000.

- 16.20.15.c **Approval as to form.** Approval as to form by the Office of the Attorney General (ATG) verifies the legality of the contract instrument, but does not necessarily imply concurrence in or approval of the content. It is a good business practice to have the agency's contract format or template reviewed "as to form" by the ATG prior to usage. As long as the ATG-approved contract format is used, it is not necessary that each contract executed by the agency be approved "as to form" by the ATG.

In addition to approval "as to form," it is advisable to have contracts reviewed by an Assistant Attorney General for "substance and content," whenever additional legal advice is needed prior to finalizing the document. Each agency may determine which contracts they submit to the ATG for review.

- 16.20.15.d **Available funding.** Agencies shall not execute a client service contract or amendment that increases funding unless funding is available for the contract services prior to execution of the contract or amendment.

Agencies must identify the source and amount of funds to be used for the contract. If the contract is federally funded, state agency staff must ensure that the appropriate contract language regarding federal requirements is included in the contract. This would include suspension/debarment language, A-133 Single Audit language, and any other federal requirements appropriate for the fund source. Federal rules and regulations may also supersede State rules and regulations, and this should also be clear in the contract.

- 16.20.15.e **Health Insurance Portability and Accountability Act (HIPAA).** The Health Insurance Portability and Accountability Act of 1996 (HIPAA) is a federal law addressing several aspects of health insurance and the management of health care information. (Pub. L. 104-191, 110 Stat. 1936, 2054 and 110 Stat. at 2063) (HIPAA), and 45 CFR part 160 and part 164.

HIPAA contains requirements related to the confidentiality of protected health care information, electronic transmission of health care information, including billings, and the security of health care information. It also requires retention of records covered by the law for a six-year period of time.

Some client service contracts may require HIPAA language in order for the contracting agency to be in compliance with HIPAA. If the service provider is a physician or other medical care provider, they may seek insertion of HIPAA language into the contract so that they are in compliance with the federal law.

These provisions generally relate to “business associate” arrangements, where one of the contracting parties is a business associate of a covered entity under HIPAA or where both parties are covered entities sharing protected information.

The decision about whether or not HIPAA compliance language or an addendum should be part of the contract is based on whether the parties fall under the HIPAA legal definition of a covered entity or business associate. The law provides exceptions for certain types or uses of information as well.

When the issue of inserting HIPAA language into a contract is raised, the following considerations apply:

- Is either or both of the contracting parties covered entities under HIPAA?
- Does the provided service include the sharing or disclosure of HIPAA protected health care information?
- Is the type of information created, stored, or disclosed in the scope of services protected information under HIPAA?
- Is either or both of the contracting parties business associates as defined under HIPAA?

If the answer to any of these questions is “yes”, please contact your agency HIPAA compliance officer, in-house counsel, or your Assistant Attorney General to determine whether HIPAA language needs to be part of the contract.

16.20.15.f

Hold harmless and indemnification. Hold harmless and indemnification provisions in client service contracts protect state agencies from assuming responsibility for the *contractor’s* acts and omissions. These provisions do not shield state agencies from responsibility for their own acts and omissions.

Under a **hold harmless** provision, the contractor releases the state agency from any responsibility for losses to a third party arising from the acts and/or omissions of the contractor or its officers, directors, partners, employees, and agents while the contractor is performing work under the contract. For example, if a client is injured in a contractor’s facility due to the carelessness of one of the contractor’s employees, the contractor cannot seek reimbursement from the agency for the amount the contractor has to pay to the client who suffered the loss.

An **indemnification** provision requires the contractor to reimburse the agency for losses incurred by the agency because of the contractor's acts or omissions in performing under the contract. An example is when a state agency is sued by a client who is seriously injured when he/she falls through a rotting front step at the contractor's place of business. If the client sues the state agency for those injuries, the contractor would have to pay costs for investigating, negotiating, defending, and settling the suit.

16.20.15.g **Personal information.** Contract records may occasionally contain personal information about citizens.

Privacy Notice: Safeguarding and disposition of personal information must be consistent with Executive Order 00-03 issued April 25, 2000, and chapter 42.56 RCW and other applicable statutes that protect personal information.

16.20.20
July 1, 2007

Performance measures and outcomes

Contract managers are encouraged to consider whether performance measures and outcomes are applicable to their contract. The purpose of performance measures is to provide a standard or measure for performance of the contracted services. Performance measures may also be used to determine if, and when, the contractor has successfully completed performance, and when and how much the contractor should be paid.

Contract performance measures may:

- Define the standards for measuring contractor performance;
- Provide a means to monitor performance;
- Measure satisfaction with the contractor; or
- Provide data for program evaluation.

Good performance measures are:

- Clearly written;
- Easily understood by contractors, state agencies, and the general public;
- Focused on the performance expected from the contractor;

- Well defined and consider both the quantitative (how much?) and qualitative (how well?) aspects of performance;
- Relevant, timely, verifiable and reportable; and
- Realistic in terms of available resources, funding and timelines, and recognize external factors beyond the control of the system.

Contract managers should check the funding source or statutory authority to determine whether any specific outcomes are mandated. They should also consider:

- How the agency will know the service has actually been provided to the client (other than accepting the contractor's word);
- How the agency will know the *quality* of the service has been provided and include a mechanism for measuring quality;
- What specific outcome the agency is looking for, such as enhanced job retention, reduced recidivism, or improved client health; and/or
- Whether payment is contingent on an event, product, or outcome and, if so, how the agency will ascertain that the contractor has satisfied the requirement. If payment points are not clear, consider the benefits of tying payment to an event, product or outcome.

16.20.25

July 1, 2007

Performance-based contracts

16.20.25.a

Performance-based contracts have several **characteristics** that distinguish them from more traditional types of service contracting. Those characteristics:

- Emphasize results related to output, quality and outcomes rather than how the work is performed;
- Have an outcome orientation and clearly defined objectives and timeframes;
- Use measurable performance standards and quality assurance plans; and/or
- Provide performance incentives and tie payment to outcomes.

Performance contracting may be used for a variety of types of services, but it is not applicable to or appropriate for all. Its use must be carefully considered since outcomes and performance standards need to be clearly identified in the contract, so that achievement of those outcomes and standards is apparent to all.

16.20.25.b Performance-based contracts offer **benefits**. For example, they:

- Encourage and promote contractors to be innovative and to find cost effective ways to deliver services;
- Result in better prices and performance;
- Give contractors more flexibility in how to achieve results;
- Shift more risk to contractors so they are responsible for achieving the outcomes; and/or
- Provide incentives to improve contractor performance and tie compensation to achievement.

16.20.25.c **Potential issues** associated with performance-based contracts include:

- Adequate management information systems may not be in place to correctly interpret data;
- Performance outcomes may be contingent on factors outside of the contractor's control;
- Contractors may have limited financial resources and capacity to assume risk;
- Contractors may provide reduced care to vulnerable clients to achieve an outcome or goal;
- Contractors fear a cash flow crisis and financial uncertainty; and/or
- Contractors may have under-developed financial information management systems.

16.20.30

July 1, 2007

Fiscal considerations and payment methods

16.20.30.a

Fiscal principles. Fiscal principles that apply to client service contracts include, but are not limited to:

- State agencies must pay reasonable and fair prices for services.
- Payment to the contractor must be made according to the terms of the contract. A clear statement of work should directly correlate to the method of compensation in the contract.
- Contractors must have accounting methods and systems that are describable, auditable, and applicable to the circumstances. Contractors must comply with accounting measures and principles appropriate to the contractor's type of business and as identified in the contract.
- State agencies must use the accounting methods and systems published in this manual.
- Payments made under client service contracts must be applicable to the services provided and consistent with the rates and fees agreed upon.
- Payments made under client service contracts must be adequately documented and supported by appropriate accounting records maintained by both the state agency and the contractor.
- Payments should not be made for the same or similar services more than once (no duplicate payments to contractors).
- State agencies are to pay contractors for services in a timely manner (RCW 39.76.010). This is contingent upon the contractor completing work satisfactorily and submitting accurate and complete invoices.
- State agencies should track fund sources to ensure over-payments do not occur in any particular fund.
- State agencies should have a means to recover contract over-payments if discovered.

16.20.30.b **Financial reporting.** Financial reporting provisions may require a contractor to report on or allow access to their financial information at defined intervals during the contract or upon contract completion or termination. The purpose of financial reporting provisions is to aid in monitoring contractor performance and/or verify fiscal accountability, and to allow contract managers to make informed decisions about the contractor's ability to perform or meet contract requirements.

Key considerations for financial reporting provisions are to:

- Define the type of financial information and documentation required;
- Specify dates or intervals for reports, if any;
- Require access to contractor staff, records, and place of business, as appropriate; and
- Authorize monitoring of financial records.

16.20.30.c **Payment methods.** Contracts must describe the basis upon which the contractor will be paid for services, whether based on an hourly, daily, weekly or monthly rate, per deliverable cost, fixed fee, progress payments, achievement of a performance target or outcome, or other applicable method.

The method, or combination of methods, selected should best ensure delivery of quality services, encourage efficiencies and effectiveness of services, and provide the best value to state agencies. Clearly defining the payment terms will ensure both the contractor and agency have the same understanding about payment and will help mitigate confusion or potential project delays and disputes.

Another type of contract payment method is used with performance-based contracts. Performance-based contracts describe either what the contractor is expected to accomplish or what outcome the contractor is to achieve, but do not specify how the work will be completed. Therefore, contractors provide more strategic input into determining the best method and approach for the services in order to achieve the outcomes desired by the agency.

Performance-based contracts typically tie payments to outcomes or deliverables, not just the number of hours of service provided, but they do state a maximum compensation that may be earned.

16.20.30.d **Payment documentation.** The contract should define the documentation required to authorize payment and to assist the contractor in invoicing correctly so that the contract manager can expedite approval of the invoice for payment.

At a minimum, invoices submitted should include the contract number or other evidence of authorization to contract, date(s) services were provided, description of services provided or any goods received, and approval for payment.

The approval for payment can be documented by the initials of the approving staff and date on the contractor's invoice, or by an electronic approval process. For further information, refer to Subsection 85.32.30 of this manual.

16.20.30.e **Contract overpayment.** If an overpayment to a contractor is discovered, the agency must take appropriate action. Contract managers should consult with their accounting or auditing staff, their internal legal staff, and/or with the Office of the Attorney General for guidance.

16.20.30.f **Federally funded contracts.** Contracts supported with federal funds, whether in whole or in part, are subject to federal requirements. Such requirements may be the result of federal statutory provisions, administrative regulations adopted by federal agencies, administrative guidelines distributed by federal agencies or contract award provisions.

There are basic federal rules that apply to virtually all expenditures of federal awards. Each federal agency and the U.S. Office of Management and Budget (OMB) publish these rules as listed below.

1. Uniform administrative requirements:

- a) State and local governments (including recognized Indian entities):
 - Grants Management Common Rule adopted by federal agency Code of Federal Regulation (CFR) (OMB Circular A-102).
- b) Institutions of higher education, hospitals, and nonprofit organizations:
 - Uniform Administrative Requirements adopted by federal agency CFR (OMB Circular A-110).
- c) For-profit organizations:
 - Administrative Requirements adopted by federal agency CFR.

2. **Cost principles requirements:**

- State and local governments (including recognized Indian entities) (OMB Circular A-87).
- Educational Institutions (OMB Circular A-21).
- Nonprofit Organization (OMB Circular A-122).

3. **Audit requirements** for all nonfederal entities:

- Audit common rule adopted by federal agency CFR.
- OMB Circular A-133, including Appendix B – Compliance Supplement.

Federal agency regulations including the CFR and OMB Circulars can be accessed on the Internet at: <http://www.gpoaccess.gov/cfr/index.html>, and <http://www.whitehouse.gov/OMB/circulars>.

The federal agency regulations and the OMB Circulars are routinely updated. Contract managers of contracts involving federal funds are encouraged to stay abreast of such changes by consulting with fiscal staff or other individuals that follow federal requirement amendments.

16.20.30.g

Sub-recipient or vendor. When federal funds are involved, a determination should be made before a client service contract is written as to whether the contractor is a sub-recipient or vendor. The administrative and management requirements for each differ significantly. The correct designation ensures compliance with applicable federal regulations and determines whether an audit is required of the contractor.

A **sub-recipient** is a non-federal entity that expends federal funds received from a pass-through entity to carry out a federal program, but does not include an individual that is a beneficiary of such a program.

A **vendor** is a dealer, distributor, merchant or other seller providing goods or services that are required for the conduct of a federal program. Refer to Section 50.30 for further guidance about the sub-recipient/vendor determination and OMB Circular A-133 Audits of States, Local Governments, and Non-Profit Organizations, Subpart B-Audits, 210 Sub-recipient and vendor determinations.

Contracts should be clearly written to support the determination of sub-recipient or vendor status.

A **sub-recipient** may:

- Determine who is eligible to receive federal assistance;
- Have its performance measured against whether the objectives of the federal program are met;
- Have responsibility for programmatic decision-making;
- Have responsibility for adherence to applicable federal program compliance requirements; and

Use federal funds to carry out an agency's program as compared to providing goods or services.

A **vendor**:

- Provides the goods or services within normal business operations;
- Provides similar goods or services to many different purchasers;
- Operates in a competitive environment;
- Provides goods or services that are ancillary to the operation of the federal program; and
- Is generally not subject to compliance requirements of the federal program.

In some instances, a contractor could be a sub-recipient for one state agency and a vendor for another. A contractor could also be a sub-recipient for one program within an agency, and a vendor for another program within the same agency.

16.20.30.h

Debarment/suspension. The federal suspended/debarred list identifies contractors who cannot be given federally funded contracts. No federal contracts may be awarded to contractors on the federal suspended/debarred list.

16.20.35

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Liability insurance

16.20.35.a

Before contracting for client services, the agency should analyze the type of services required and evaluate the State's exposure to legal liability that may result from the contract. State agencies can be financially protected from those who seek legal recourse by requiring contractors to carry insurance. To protect the State's interests on contracts where insurance is appropriate, liability insurance requirements should be included in either the solicitation document as a condition of responsiveness or in the contract document.

Injury or damage to a third party including clients may result in legal liability to the State if it occurs as a result of a contractor's negligence. Liability insurance covers legal liability of an insured. If a contractor provides liability insurance coverage and names the State as an additional insured on the policy, the State will have insurance protection for many types of tort claims that arise out of the contractor's activities.

16.20.35.b

The OFM, Risk Management Division (RMD), recommends that agencies include insurance requirements in their contracts, whenever applicable. At a minimum, RMD suggests that contractors be required to purchase general liability/automobile liability and employer's liability insurance and comply with workers compensation laws. For more information on RMD's suggested insurance specifications, refer to *Contracts: Transferring and Financing Risk*. This manual is available in hard copy through RMD or on OFM's RMD website at: <http://www.ofm.wa.gov/rmd/default.asp>.

If you have further questions, you may contact RMD at (360) 902-7301. Contract managers should contact internal agency staff, who may be knowledgeable about insurance requirements, before contacting RMD.

16.20.40

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Industrial insurance

16.20.40.a

When a state agency enters into a client service contract, the contractor's employees should be covered by industrial insurance also called workman's compensation. This protects the State's interest if either the contractor or someone employed by the contractor is injured while performing work under the contract.

With few exceptions, Title 51 RCW, Washington State's industrial insurance law, requires that all persons performing work under contract in Washington State be covered by industrial insurance. Contractors are required to provide industrial insurance coverage either through the Department of Labor and Industries (L&I) or as self-insured employers certified by L&I. Agencies can verify a contractor's compliance by contacting L&I, Field Audit Compliance, in Olympia at (360) 902-4752 or 902-4750, or by sending an e-mail to: verifystatecontracts@lni.wa.gov.

Employments excluded from mandatory coverage are listed in RCW 51.12.020 and include sole proprietors, partners, corporate officers, and others.

- 16.20.40.b Under RCW 51.12.050, the contracting agency is responsible for ensuring that the prime contractor and any subcontractors have industrial insurance coverage or the agency may be liable for unpaid industrial insurance premiums. As appropriate, agencies should incorporate into their client service contracts a provision stating that the contractor agrees to comply with the industrial insurance requirements of Title 51 RCW and to cover its employees with industrial insurance.

16.20.45

July 1, 2007

Risk assessment approach to contracting

16.20.45.a

Risk assessment approach. The risk-assessment approach to contracting is intended to assist contract managers in analyzing the contract services and contractor's qualifications in order to better focus their oversight efforts on higher risk contracts. A risk assessment evaluates risk factors to determine how much monitoring and/or auditing should be done to protect the agency's interests.

The risk assessment may be conducted informally or formally depending on the dollar value of the contract, complexity of the services, experience of the contractor, etc. An informal risk assessment is the analysis conducted by the contract manager to make effective contracting decisions and is not required to be in writing. A formal risk assessment is conducted in writing and documents the types of activities and factors considered. The contract manager may not know the answers to all these types of questions and may need to seek further information from the contractor, from others in the agency, from other state agencies with oversight (such as current licensure), etc.

Sample risk assessment checklists are provided on OFM's Additional Contract Resources website at:

<http://www.ofm.wa.gov/contracts/resources/default.asp>.

16.20.45.b

Risk assessment categories. Risk factors can be broken into two broad categories: 1) risks associated with services and 2) risks associated with contractors.

1. **Risks associated with the services.** Examples of factors that may be considered in assessing risk include the following:
 - **Program history** – Is it a new or long established program or service? Have any significant changes occurred?
 - **Total funding** – Does this contract represent a significant portion of the total program funding?
 - **Complexity** – Are program requirements simple or complex?
 - **Client health and safety** – How vulnerable are the clients that the program serves?
 - **Responsibility for key decisions** – Does the state agency, federal government or the contractor make decisions about eligibility and amount or type of service to be provided to a client? For federal funds, is the contractor a vendor or sub-recipient?
 - **Federal risk assessment** – Has the U.S. General Accounting Office and U.S. Office of Management and Budget identified the program as being high risk?
 - **Payment method** – What type of payment method is used (e.g., cost reimbursement, fee for service, fixed fee, performance-based, etc.)? What experience does the state agency have with the method?
 - **Procurement method** – Are contracts awarded on a competitive basis, which includes detailed evaluations of the service proposal, costs, and contractor qualifications or are they awarded on a sole source or non-competitive basis?
 - **Monitoring methods** – Are the existing methods of monitoring effective for this program? Do these monitoring methods effectively mitigate the other types of possible risks?

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- **Client choice** – Is the client choosing the contractor, as required by some federal programs?
- 2. **Risks associated with contractors:** Examples of factors that may be considered in assessing risk include:
 - **Funding that the contractor receives from the agency** – Is the amount of funding from the agency small or large? Does the contractor have many or few contracts with the State?
 - **Multiple funding sources** – Is the contractor receiving funding from several sources for similar services? Are multiple funding sources involved and to what extent?
 - **Collaboration** – Has the contractor promoted collaboration on service delivery and contract expectations between itself and all of its funding partners?
 - **Length of time in business** – Has the contractor been in business for several years or is it a start-up client service provider?
 - **Experience and past performance** – Does the contractor have contracts for similar services with other governmental entities? How extensive is the contractor's experience providing this type of service for the State? What is their performance history?
 - **Accreditation/licensure** – Are contractors subject to accreditation or licensure requirements?
 - **Financial health and practices** – Is the contractor's financial condition good? Does the contractor demonstrate sound financial practices? Is the contractor's financial record keeping system adequate for the number and complexity of funding sources being managed? Is the contractor's cost allocation methodology equitable?
 - **Current and prior audit experience** – Has the contractor had weaknesses in internal control over federal or state programs?
 - **Oversight exercised by funding agencies** – Have there been monitoring or other reviews by other funding agencies that could indicate the degree of risk? Is the contractor proposing to operate under a waiver from customary program and financial management requirements?

- **Board of directors** – If the contractor is a nonprofit organization, does the board take an active role in directing the organization, establishing management policies and procedures, and monitoring the organization's financial and programmatic performance? Is the board comprised of individuals who are unrelated? Do employees or ex-employees of the organization serve as board members?
- **Subcontracting** – Does the contractor subcontract key activities? Does the contractor have an effective monitoring function to oversee subcontractors?
- **Organizational changes** – Has there been frequent turnover of key contractor management, senior accounting staff or key program personnel? Has the contractor started any new services within the last twelve months? Has the contractor experienced a recent rapid growth or downsizing? Has the contractor experienced reorganization within the last twelve months? Has the contractor changed major subcontractors recently?
- **Management structure** – Is the organization centralized or decentralized? How much control does the organization have over decentralized functions?
- **Legal actions** – Have any lawsuits been filed against the contractor within the last 12 months?
- **Defaulted contracts** – Has the contractor defaulted on any of its contracts within the past five years? If so, what were the circumstances?

Based on the results of the risk assessment, contract managers may decide whether it is advisable to contract for the services. If so, the contract manager will decide which contractor to select, and the scope, frequency, and methods of monitoring and/or auditing to use to ensure sufficient oversight, given the risks involved. Risk assessment results may also be used to devise more stringent controls and tighter contract language, when appropriate, to adequately monitor and/or audit the use of public funds.

It is also important to note that contract risk is dynamic. Therefore, the risk assessment should be updated periodically to provide a current record of risk factors associated with the contract.

Risk assessments, linked to a monitoring plan, should be documented. Contract managers may choose how to document this. Several examples of risk assessment tools can be found on OFM's Additional Contract Resources website at: <http://www.ofm.wa.gov/contracts/resources/default.asp>.

16.20.45.c **Transferring risk.** Risk management strategies include transferring risk to the contractor, minimizing or mitigating the risk, eliminating the risk, or sharing the risk with the contractor. Contract managers may:

- Add clauses to the contract to address specific risk factors;
- Require contractors to provide proof of insurance;
- Develop and implement effective monitoring plans and contractor reporting requirements;
- Link payments to deliverables/performance measures; and/or
- Consider payment bonds or liquidated damages clauses.

16.20.50

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Contract management principles

Contract managers must be mindful of the following:

- In almost all instances, written contracts must be signed by both parties before work can begin under the contract.
- Written contract amendments must be signed prior to the contract expiration date (end date) whenever there is a change to the scope of work, period of performance, or maximum dollar amount (or other financial terms) of the contracts.
- When signing a contractor's contract form, provide appropriate review of the contract to ensure adequate protection for the State is included in the contract.
- Services should be performed to the satisfaction of the contract manager before payment is approved.
- Coordination among state agency staff is important to ensure the same client services to the same client are reimbursed only once.
- All work must be completed within the contract period of performance, including deliverables.

16.20.55

July 1, 2007

Managing and monitoring contracts

16.20.55.a

Proactively manage and monitor. Once the contract is fully executed by all parties, agency staff must proactively manage and monitor the contract to ensure the quality and quantity of services are received. Effective management and monitoring of client service contracts are keys to successful contracting results.

16.20.55.b

Managing the contract. Contract management includes any activity related to contracting for client services, including the decision to contract, contractor screening, contractor selection, contract preparation, contract monitoring, auditing, and post-contract follow up.

While the contractor has responsibility to perform under the terms of the contract, the state agency has responsibility for reasonable and necessary monitoring of the contractor's performance to ensure compliance with the contract provisions.

Many contracts name a contract manager who serves as the primary point of communication between the agency and the contractor and who provides the principal contract management and monitoring function. More than one individual can be named as having responsibility for various aspects of the contract.

The chief objective of the contract manager, however, is to ensure that the contractor fulfills all contractual obligations in a quality manner within budget and schedule. To accomplish this task, the contract manager should be completely knowledgeable of the terms of the contract and maintain requisite controls throughout.

16.20.55.c

Monitoring the contract. Monitoring means any planned, ongoing or periodic activity that measures and ensures contractor compliance with the terms and conditions of the contract. The level of monitoring should be based on a risk assessment of the services provided and the contractor's ability to deliver those services. Every communication with a contractor is an opportunity to monitor activity.

The **purpose of monitoring** is to ensure the contractor is:

- Complying with the terms and conditions of the contract and applicable laws and regulations;

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- Adhering to the project schedule and making appropriate progress toward the expected results and outcomes;
- Providing the quality of services expected;
- Ensuring the health and safety of clients; and
- Identifying and resolving potential problems and providing constructive, timely feedback.

Effective contract monitoring can assist in identifying and reducing fiscal or program risks early in the process, thus protecting public funds.

Monitoring activities may include, but are not limited to, the following:

- **Periodic contractor reporting.** Contractors submit progress reports or other appropriate data or deliverables to report on services being provided, adherence to the contract, and degree of progress being made. Substandard performance can also be determined.
- **On-site reviews and observations.** Contract managers may conduct on-site reviews, interview contractor staff to ascertain their understanding of program goals, interview clients about services received, review key systems and service documentation, review client case records, review personnel records to ensure staff have appropriate credentials, review fiscal records, and observe operations whenever possible. The results of these reviews should be documented in writing and compared with contract requirements.
- **Invoice reviews.** Contract managers compare billings/invoices with contract terms to ensure the costs being charged are accurate, consistent with the contract requirements, and within the compensation limits set by the contract. Verifying that funds are tracked by fund source will help prevent over-payments by fund.
- **Audit report reviews.** Contract managers review any required audit reports and audit work papers and ensure the contractor takes appropriate and timely corrective action, if required.
- **Client surveys.** Contract managers, or the contractors, may survey clients concerning contract service delivery and quality. Contract managers should require the contractor to resolve client complaints. Contractors should keep records of both the complaint and method of resolution.

- **Other periodic contact with contractor.** Meetings and other periodic contact with the contractor to review progress facilitates continuous dialog and mitigates problems.

Documentation of monitoring activities must be maintained by the agency to verify that monitoring has been conducted. Contract files should include, for example, copies of letters and e-mail, meeting notes, and record of key phone conversations as evidence that conscientious monitoring has occurred during the contract. This is especially important where there are issues with the contractor's performance.

16.20.60
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Executing amendments to existing client service contracts

As work progresses, it may be necessary to make changes to the contract to enhance or improve the deliverables or services. Any written alteration to an existing contract is called a contract amendment. Amendments are executed by all parties to document the changes being agreed upon.

16.20.60.a

Principle terms amended. The principle areas of contract changes that require amendments are:

- **Scope of work.** This may include adding, modifying or deleting tasks, services or deliverables, or revising specifications. Changes must be within the scope of the original contract.
- **Cost.** If the total amount of the contract is increased, a contract amendment is required. If the contract amount is decreased, it is advisable to execute an amendment to clarify the scope of work and dollar amount being decreased.
- **Period of performance.** An extension to the end date of the contract is the most common change to the period of performance.

16.20.60.b

Within the scope of work. Changes to contracts may be awarded as amendments, rather than as new contracts, if the changes are **within** the general scope of work of the original contract. Work that would be considered within the general scope of the original contract is that which would be fairly and reasonably within the contemplation and intent of the parties when the contract was awarded. If the amendment provides for services that are essentially the same as those in the original contract, the amendment would likely be within the general scope of the contract.

Changes that are within the scope of work, but which represent **substantial** changes in the quantity, duration, cost, or nature of the work may not be appropriate for contract amendments and may need to be addressed in a new procurement or new contract. When the agency includes in its solicitation document the option to extend the contract for additional periods or to add subsequent phases, such amendments, though they may represent substantial changes, are appropriate. They were specified in advance of contract award and all firms who competed were made aware of these potential additions to the contract.

Changes that are outside the general scope of the contract are **not** appropriate to award through contract amendment. Such changes would have the effect of making the work performed substantially different from the work the parties bargained for at the time the original contract was awarded.

If a contract has expired, it is generally not appropriate to amend it; rather it is more appropriate to award a new contract.

16.20.60.c

Amendment is in the best interest of the state. The agency must determine that a proposed amendment is in the best interest of the State, considering such factors as service continuity for clients, time savings, cost effectiveness, and the learning curve for a new contractor.

When adding funding to a contract, agencies should generally include in the amendment both the dollar amount of the additional funding and the revised contract maximum (the amendment amount added to the current contract maximum). In addition, agencies should consider specifying what additional services are being provided under the amendment and include any new deliverable dates resulting from the additional dollars being authorized.

16.20.60.d

New contract option. If an amendment is not **clearly** determined to be the best choice, the agency must execute a new contract. A new contract is generally appropriate where there is a substantial change in the scope of work, duration, nature of work, or cost, or where there is a logical break in service.

16.20.65

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Corrective action

Contract problems must be addressed as soon as they are discovered to prevent them from becoming recurring or serious. Corrective action is suggested when direct negotiation and other less formal means have failed. Corrective action means action initiated by the agency and taken by the contractor that corrects identified deficiencies, produces recommended improvements, or demonstrates that deficiencies or findings are either invalid or do not warrant action.

Contract problems that warrant corrective action include:

- Failure to ensure client health or safety;
- Monitoring or audit findings;
- Poor quality of key deliverables;
- Inferior quality of services;
- Failure to perform all or part of the contract;
- Ongoing late performance;
- Inadequate, unclear, or excessive billing; and
- Late submission of reports on a recurring basis.

A first step in corrective action would typically be to communicate in writing to the contractor describing where performance is deficient. Corrective action activities should be coordinated with the agency's management, in-house counsel, and/or Assistant Attorney General, as applicable, to avoid waiving any rights that might be available to the State.

All corrective action initiated by the agency must be documented in writing. If the corrective action is successful in resolving problems, the contractor should be notified in writing that resolution has been achieved and the documentation retained in the contract file.

If corrective action is unsuccessful at first, state agency staff may continue to work with the contractor until deficiencies are resolved, or they may proceed with a dispute process or take other appropriate courses of action.

16.20.70

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Contract disputes

A contract dispute is typically the result of a serious difference of opinion between the agency and contractor about contract terms, conditions, or performance. The contract disputes process generally follows a corrective action process that has reached an impasse. The contract should contain a disputes clause setting forth the process to be followed. Invoking the disputes clause is an option available to either party, but is not required. If the dispute process is elected, the process must be followed as described in the contract.

Disputes provisions may take different approaches. One approach is for the disputing party to submit a written statement of the issues to the other party at a higher level within the organization. If that does not resolve the issue(s), a neutral third party can be appointed to review the position of both parties and submit a written decision. Another approach is to convene a dispute panel with each party to the contract appointing one member and a mutually agreed upon third panel member being appointed with the majority prevailing. Other appropriate disputes approaches may also be utilized, as agreed upon.

Dispute activities should be coordinated with the agency's Assistant Attorney General. Unless otherwise directed by the Office of the Attorney General, dispute processes are to precede any court action.

16.20.75

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Contract remedies and sanctions

After efforts to resolve issues through either or both the corrective action and/or dispute processes have failed, a contractor who is deemed to be noncompliant with the terms and conditions of the contract may be determined to be subject to remedies or sanctions, such as:

- Withholding payment;
- Collection of liquidated damages per the contract terms;
- Federal debarment or suspension of the right to contract with an agency or agencies, if federal funds are involved;
- Suspension of the contract; or
- Termination of the contract.

16.20.80

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Contract termination

Contracts may be terminated prior to the completion date of the contract either for convenience of the parties or for cause as provided under the contract terms.

16.20.80.a

Termination for convenience. The termination for convenience clause is intended to handle changed conditions under the contract, particularly when the expectations of the parties have been subjected to substantial change.

Termination for lack of funding, referenced under the “Savings” clause of the model contract, is processed as a “Termination for Convenience.” It is intended to handle the situation when funding from federal, state or other sources is no longer available to the agency or not allocated for the purpose of meeting the agency’s contractual obligation.

The Attorney General's Office may be contacted when an agency is considering invoking the termination for convenience clause.

16.20.80.b

Termination for default. To terminate a contract based upon the contractor's default, the agency asserting default must demonstrate that the contractor has not performed according to the contract. This step follows the validated corrective action and/or disputes processes. By invoking the termination for default clause, the agency is generally in a position to claim damages due to the other party's breach of the contract. Again, either the agency’s in-house legal counsel or Assistant Attorney General should be consulted whenever an agency is considering invoking this clause.

16.20.85

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Review and implement contractor’s final product

16.20.85.a

When the contract is almost complete, contract managers are responsible to:

- Assess whether all services have been provided and contract objectives and outcomes met;
- Determine the agency’s next steps based on the contractor’s work;
- Ensure contractor has accounted for any state property or equipment used for the contract, has turned in building access cards, etc.; and
- Ensure all invoices are received and authorize final payment, when appropriate, to the contractor.

16.20.85.b

Final written report. As part of completing contract work under the terms of the contract, the contractor may be required to submit a final written report. Not all contracts will require such a report, but when they do, the final written product should address, at a minimum, the following areas as appropriate to the type of service provided:

- Statement of the services provided and clients served;
- Benefits or results to be realized by clients; recommendations for further improvements, if any; and/or
- Other matters that should receive management emphasis or attention.

Generally, the final report is submitted before final payment is made to the contractor.

16.20.90

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Evaluate contractor's performance

Upon contract completion, the agency contract manager may want to prepare a contractor evaluation. This evaluation will be useful if agency management wants an analysis of contractor performance and if other agencies inquire about the contractor.

The evaluation may address the following:

- Timely completion of work;
- Quality of work performed;
- Quantity of work;
- Professional manner and conduct;
- Client satisfaction;
- Working relationship with agency staff; and/or
- Quality of project management.

Contract managers should share with other state agency staff information gained from administering the contract so that those responsible for future contracts can gain from these experiences.

16.20.95

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Documenting the contract file

Agencies are required to maintain adequate documentation regarding the contract and services provided by the contractor. Agencies may maintain contract documentation in more than one location as well as by multiple media. Contract payment documentation may be maintained in the fiscal office, while the contract manager may maintain a monitoring file in his/her location and the contract office may maintain the procurement files. The information may be available in electronic or hard copy format.

16.20.95.a

Documentation. Documentation in the contract file, at a minimum, must include the executed contract and all attachments and exhibits incorporated into the contract.

Monitoring activities conducted under the contract such as meeting minutes, copies of reports submitted, fund tracking records, etc., are all examples of the types of documentation that may be part of a contract file and must be maintained somewhere in the agency.

16.20.95.b

Records retention. Records retention of client service contracts must follow the requirements published by the Office of the Secretary of State in the General Records Retention Schedule for Agencies of Washington State Government at: <http://www.secstate.wa.gov/archives/gs.aspx>.

16.20.98

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Auditing contracts

16.20.98.a

Auditing. Auditing is broadly defined as the independent examination of an entity's records or actions in order to evaluate compliance with financial, legal, contractual, or policy requirements.

Several types of audits are performed, including:

- **State audits** – As with all expenditures made by agencies, client service contract expenditures are subject to audit by the State Auditor's Office.
- **Federal audits** – When agencies award federally funded client service contracts, the agency needs to determine whether the contract constituted a sub-recipient or vendor relationship with the contractor. If the contract constituted a sub-recipient relationship, an OMB Circular A-133 audit may be required.

If the contract established a vendor relationship, in general, vendor contracts will not be covered by an OMB Circular A-133 audit. Determining whether a contractor is a vendor of the agency or an agency's sub-recipient can be difficult. Guidance is available in Subsection 50.30.60, and at:
www.whitehouse.gov/omb/circulars/a133/a133.html.

Audits initiated by the agency or contractor: State agencies should use a risk assessment to consider whether an audit of the contractor is needed. When an audit is deemed appropriate and necessary, the expectations for the audit scope, methodology, and due date should be included in the written contract.

An audit can be designed to accomplish one or more of the following:

- Provide reasonable assurance as to the accuracy of financial information reported by or obtained from the contractor;
- Assess the financial condition of a contractor;
- Assess the internal control system of a contractor;
- Assess the performance of a contractor; and
- Assess compliance with applicable laws and contract regulations.

While an audit can be an effective monitoring tool, it carries a cost. Therefore, care should be exercised in calling for audits. Regardless of whether an audit is performed, the agency still must monitor its contracts to ensure it receives the services for which it paid.

16.20.98.b

Audit resolution. State agencies should evaluate appropriate resolution to the audits where findings and/or questioned costs have been identified. If federal funds are involved, OMB Circular A-133 Section 315 requires follow up and corrective action on all federal findings.

Normally, if a finding exists in a published audit report, whether issued by Federal auditors (Office of Inspector General), an independent audit firm, the State Auditor's Office, or a state agency's internal audit staff, resolution of audit findings is warranted.

16.20.98.c **Questioned costs.** Questioned costs are normally those costs identified as the result of an audit that may have inappropriately been paid to the contractor. The agency should investigate further and determine whether costs should be recovered.

Methods for recovering questioned costs may include:

- Billing the contractor;
- Adjusting future payments until the questioned costs have been recovered; and/or
- Deducting the questioned costs from the final payment.

There may also be good reasons not to pursue recovery of the questioned costs, such as when the costs to recover a small dollar amount are more than the over-payment. Sufficient reasons, generally based on Assistant Attorney General guidance, should be documented when exercising the option not to pursue recovery.

Contracts using federal funds may require different processes, as prescribed by the federal government.

16.20.98.d **Performance audits.** In 2005, Initiative 900 gave the State Auditor's Office authority to conduct performance audits of state and local governments. The State Auditor developed the following definition of a performance audit:

An objective and systematic assessment of the performance and management of an entity, program, activity, or function in order to:

- Provide information to improve performance and operations;
- Facilitate decision-making by parties with responsibility to oversee or initiate corrective action; and
- Improve accountability to the public.

Performance audits conducted will cover broad areas but will include those of the greatest public interest, matters that affect all agencies, and other identified recurring challenges.

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