

**Metro**

***Contracting: A Framework for  
Enhancing Contract Management***

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**December 2000**

A Report by the Office of the Auditor



**METRO**

2000-10669-AUD

**Alexis Dow, CPA**  
**Metro Auditor**

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**METRO**

## Office of the Auditor

December 12, 2000

To the Metro Council and Executive Officer:

Metro currently has more than \$1 billion in contractual obligations outstanding. This level of expenditure requires an effective contract management system to ensure that public funds are protected and that contractors provide quality goods and services at reasonable cost. We found Metro's procedures are generally in line with best practices for selecting the most qualified contractor, but can be improved in other areas.

The accompanying report presents a framework Metro can use to enhance its contract management system. We developed the framework with management's support. The framework is based on sound management controls and best practices identified by other government agencies.

Metro can enhance its contract results and reduce contracting risks by establishing greater oversight of contract activities and providing more guidance and training for contract managers. Our specific recommendations are on pages 2 and 3. The last section of this report presents the Executive Officer's written response to a draft of this report.

We sincerely appreciate the cooperation and assistance we received from Metro staff, particularly Contract Officer Scott Moss and Chief Operating Officer Bruce Warner. Their early commitment to improve Metro's contract results enabled us to concentrate on developing a framework for enhancing contract results. We appreciate this opportunity to work with management in a collaborative way.

Very truly yours,

A handwritten signature in black ink, appearing to read 'Alexis Dow'. The signature is fluid and cursive, with a long, sweeping tail on the 'w'.

Alexis Dow, CPA  
Metro Auditor

Auditor: Jim McMullin, CPA

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## Executive Summary

Metro currently has more than \$1 billion in contractual obligations, ranging from waste management services to campground construction to purchasing the expertise of software developers, planning experts and others. Metro management acknowledges that it would like to improve contract management. With management's support, we conducted this review to help management identify how Metro's contract results can be improved in terms of costs, schedules and deliverables, and enhance protection of public funds.

Using best practices identified by other government agencies as a guide, we found that Metro's contract operations need improvement in several respects. Best practices show that effective contract management must focus on four key elements:

- selecting the most qualified contractor
- specifying contract requirements
- paying fair and reasonable costs
- overseeing the contractor's performance.

Metro's procedures are generally in line with best practices for the first element, but not for the three others. For example, clear statements of expectations and performance are not uniform in Metro contracts, nor do Metro managers formally evaluate contractor performance to ensure that Metro is getting what it pays for.

How can Metro best improve its efforts? We believe the answer is to do two things.

First, based on proven management approaches of other government agencies, Metro needs to develop a more comprehensive contract management system.

This system requires:

- stronger central contracting oversight and guidance
- management reporting systems that keep effective track of contracts and flag matters needing attention
- a formal risk assessment mechanism for identifying and managing high-risk situations
- procedures for evaluating employees responsible for managing contacts.

Second, to put such a system in place Metro needs to develop various procedures and guidelines and train staff how to apply them.

Our more specific recommendations are presented on the following page.

## Recommendations

We recommend that Metro take the following specific actions to improve its management of contracts. Doing so will better ensure that contractors produce quality results and public funds are protected from fraud, waste or inefficient use.

1. Define and document the authority, roles and responsibilities of the various organizational units and positions involved in contracting activities, including the Contract Office, departments and project managers. In this regard, Metro should enhance the role of the Contract Office by providing it the resources, authority and responsibility for the following oversight, quality control and support activities.
2. Improve contract oversight by:
  - strengthening the role of the Contract Office in guiding and reviewing departmental contracting activities
  - conducting formal risk assessments to identify contracts requiring close monitoring and audits
  - establishing a management reporting system geared toward providing oversight information to top management and departmental managers.
3. Enhance departmental quality control by:
  - Designating a formal “Contract Coordinator” in each department responsible for assuring that contracts are properly planned and monitored. This would be a professional position with the authority to counsel and direct project managers in developing contracts and evaluating contractor performance.
  - Establishing minimum agency-wide qualifications for project managers and other contracting personnel. Persons would be considered qualified after attending appropriate training programs.
  - Formally evaluating the performance of project managers and other contracting personnel in relation to their contracting duties and responsibilities.
4. Provide better support to project managers and other contracting personnel by developing procedures, guidelines and training in:
  - determining the appropriate contract type
  - establishing scope of work requirements and performance standards
  - monitoring and evaluating contractor performance
  - evaluating contractor proposed prices and contractor billings
  - conducting risk assessments.

5. Capitalize on the depth of experience of some Metro contracting personnel by forming interdepartmental workgroups to develop procedures, guidelines and training programs. Appendix A contains a list of resources which may be helpful.
  
6. Consider using performance-based service contracting methodology on a pilot basis. Federal experience shows that this methodology can reduce overall service contract costs 15 percent while obtaining better results.

## Introduction and Background

### **Contracting Is a Major Activity at Metro**

Contractors are involved in almost every aspect of Metro’s wide-ranging activities. They provide goods and services in support of transportation and land use planning, regional garbage disposal, acquiring parks and greenspaces, operating the Oregon Zoo, and constructing facilities such as the Oregon Convention Center.

Thus, it is not surprising that Metro spends a lot of money through contracts and grants. As of October 2000, its contract commitments totaled more than \$1 billion. The 737 contracts in force ranged from small consulting contracts for a few thousand dollars to large construction, planning and management contracts costing millions of dollars. Two waste management contracts accounted for almost \$895 million. Table 1 provides a glimpse of the wide variety of important goods and services for which Metro contracts.

**Table 1**  
**Examples of Goods and Activities Obtained Through Contract**

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- Waste disposal and transport services
  - Urban reserve planning
  - Oregon Zoo exhibit construction
  - Oregon Zoo sea lion and sea otter food
  - Transportation alternatives studies
  - Software licensing and maintenance
  - Local park improvements
  - Oxbow campground construction
- 

### **Individual Metro Units Handle Most of Metro’s Contracting Responsibilities**

Metro’s 737 contracts are spread among 13 different departments, including Regional Environmental Management, Regional Parks and Greenspaces, Transportation and the Oregon Zoo. The actual work of preparing contracts is done at the departmental level. Department employees designated as project managers are responsible for such things as deciding on the type of contract, preparing statements describing the scope of work to be provided, evaluating contractor performance, and reviewing invoices submitted by contractors.

Metro's departments are guided in their contracting activities by contracting policies established by the Metro Council and state law and also by the activities of Metro's Contract Office. The Contract Office develops operating procedures for contracting, maintains these procedures in a Contracting Manual, and trains departmental personnel in their use. The Contract Office also conducts a compliance review of each contract to ensure that it is properly procured, authorized, awarded and documented in the official contract files.<sup>1</sup> These compliance reviews are made to assure that procedures are followed and do not evaluate the quality of work done by the departments. The Contract Office, which is part of the Administrative Services Department, has 2.3 full time equivalent positions, as follows: a contracting officer (.30 FTE), a contract analyst (1.0 FTE), and a contractor outreach specialist for minority, women and emerging small business outreach (1.0 FTE).

**Metro's Interest in  
Strengthening  
Contract  
Management Led  
to Revised Audit  
Focus**

Contract-related problems have been identified in various audits of Metro departments and functions over the years. Table 2 contains several examples of these findings. When we began this current audit, which we initially intended as a systematic review of how service contracts were being managed, Metro management acknowledged that improvements were still needed and indicated a strong interest in determining how best to strengthen contract management. Metro's Chief Operating Officer acknowledged that agency-wide improvements are warranted so that contracting results can be improved.

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<sup>1</sup> The Office of General Counsel also reviews contracts for more than \$25,000 and most contract amendments.

**Table 2**  
**Contracting Weaknesses Disclosed in Prior Audits**

<b>Audit</b>	<b>Contracting problems identified</b>
<i>Performance Audit Report, Metro's Contracting Process</i> March 1993	Limited performance standards and no formal practices or requirements for monitoring contractor performance.
<i>Purchasing Benchmarks and Opportunities</i> May 1999	Essentially no monitoring of service contractors
<i>Parking Revenue: Better Controls Are Needed</i> September 1999	No monitoring or evaluating parking contractor, and poor controls over parking revenues
<i>Portland Oregon Visitor's Association Contract</i> September 2000	No objective basis for evaluating the contractor's performance

These acknowledgements led us to modify our approach to this audit. Normally, auditors may need to spend considerable time determining the extent of problems so they will know whether to recommend improvements. In this case, whether improvements were needed was no longer the issue. The central question was *what* improvements would be best. Consequently, we focused our efforts on identifying a set of controls and best practices identified by other government agencies to ensure that contracts are managed in such a way that public funds are protected and that contractors provide quality goods and services at reasonable prices. This approach enabled us to collaborate with agency personnel in developing practical solutions to areas needing improvement.

To accomplish our objective we:

- reviewed the Metro Code and Metro Contracting Manual
- reviewed the Oregon Attorney General's Model Rules relating to contracting
- reviewed relevant standards for management and internal controls<sup>2</sup>

<sup>2</sup> a. *Internal Control – Integrated Framework*, Committee of Sponsoring Organizations of the Treadway Commission, September 1992

b. *Standards for Internal Control in the Federal Government*, U.S. General Accounting Office, November 1999

c. *Government Auditing Standards*, U.S. General Accounting Office, June 1994

- reviewed the Federal Transit Administration Best Practices Procurement Manual
- performed Internet research to identify best practices relevant to Metro's contracting operations
- interviewed Metro's Chief Operating Officer, Contract Officer, General Counsel and departmental personnel involved in contracting
- requested selected departmental personnel to answer a questionnaire regarding their contracting duties and responsibilities
- reviewed selected contracts and contract files
- reviewed prior audit reports dealing with Metro contracting processes.

Our recommendations for improving Metro's contract management system are based on two main sources of sound contracting practices:

- First, the best practices identified by other government agencies. These practices are practical techniques that stem from actual experience in dealing with problems in managing and administering contracts.
- Second, accepted management practices for organizing and managing contracting activities.

The information in this report relates primarily to Metro units other than the Metropolitan Exposition-Recreation Commission (MERC). MERC, the unit of Metro responsible for managing the regional convention, trade and performing arts facilities, has a contracting system separate from the rest of Metro. Our work in relation to MERC was limited to reviewing its Purchasing and Contract Manual, obtaining basic information on their procedures and reviewing prior audit reports. Matters discussed in this report are basic to any contract management system and we believe MERC can benefit by adapting our recommendations to its contracting activities.

Our audit was performed in accordance with generally accepted government auditing standards.

## Metro's Contract Practices Need Improvement in Several Key Areas

Effective contract management is essential for ensuring that contractors produce desired results and that public funds are protected from fraud, waste or inefficient use. Our review of best practices shows that effective contract management needs to focus on four key elements<sup>3</sup>:

- Contractor selection: methods for fairly and objectively choosing the most qualified contractor
- Contract requirements: contract types and specifications that hold contractors accountable for delivering quality goods and services
- Contract costs: processes used to ensure that the prices paid for services are fair and reasonable
- Contractor oversight: processes used to monitor the contractor's performance.

Metro has focused primarily on the first element, where it has agency-wide procedures in place for selecting contractors. Metro's management of the three other areas can be improved in a number of ways when compared with best practices. According to Metro's Contracting Officer, this situation is typical of many local government agencies.

### **Methods for Selecting Contractors Are Generally Sound**

An effective procurement process must ensure that the best contractors are fairly and objectively selected. Best practices show that contractor selection should be based on three factors: competition, established criteria for assessing strengths and weaknesses, and past performance. Metro has agency-wide procedures addressing the first two factors. The Metro Contracting Manual, for example, specifies the number of proposals required in various situations, and requires that each proposal be evaluated by at least two persons using criteria defined in the Request for Proposal. In addition, the Contract Office reviews the official

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<sup>3</sup> These elements are adapted primarily from a Contract Management Model developed by the Texas State Auditor's Office. Best practices related to each element are summarized in Table 4, page 19. We revised the Texas Auditor's model and best practices to reflect our research and to adapt them to Metro's activities.

contract file to assure that these procedures have been followed and documented.

Metro is also taking steps to consider the third factor, a contractor's past performance, in its procurement process. Metro's Contract Office, in response to a prior audit recommendation, recently established PER\*form, a set of procedures for project managers to comment on the performance of contractors and vice versa.<sup>4</sup> PeopleSoft, Metro's management information system, is being modified so these evaluations will be available to all contracting personnel considering a contractor for other work in the future. These subjective evaluations are a step in the right direction, and can be enhanced by systematically evaluating contractor performance against well-defined deliverables and performance standards.

**Methods for  
Setting Contract  
Requirements Can  
Be Strengthened**

Setting contract requirements is essential to establish contractor accountability and ensure appropriate and efficient use of public funds. Two main processes are involved in setting contract requirements. One is selecting the appropriate type of contract; the other is including contract language that contains clear statements of expected goods and services, clearly defined performance standards, and clear statements of how the contractor's performance will be evaluated. In both areas, Metro's procedures do not have the full range of best practices that appear necessary for holding contractors accountable and ensuring the appropriate and efficient use of public funds.

*Contract Type  
Selection*

Selecting the contract type is probably the single most important decision made in obtaining a contracted service, because it determines how the contract's scope of work is written, how much risk Metro assumes for results, and the type and level of contract monitoring and administration required. There are two main types of contracts: fixed-price and cost-reimbursement. Table 3 compares some basic features of the two.

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<sup>4</sup> Purchasing Benchmarks and Opportunities, May 1999, Metro Office of the Auditor

**Table 3**  
**Fixed-Price vs. Cost-Reimbursement Contracts**

	<b>Fixed-Price</b>	<b>Cost-Reimbursement</b>
<i>Price determination</i>	Contract contains an agreed-upon price the contractor will receive, regardless of contractor's eventual costs.	The contractor is reimbursed for all reasonable, allowable and allocable costs incurred during performance.
<i>Payment basis</i>	Payment is for the end result of the contract effort. Contractor agrees to complete the performance of the work before being paid (though work can be broken down into stages of contract performance).	Payment is for the contractor's effort and is paid upon incremental receipt of that effort.
<i>Payment limits</i>	Amount of payment agreed to cannot be exceeded.	Amount to be paid to the contractor is not fixed at the outset; the initial ceiling price can be increased if circumstances warrant.
<i>Typical use</i>	Generally used when the agency can clearly specify what it wants to buy and no unreasonable uncertainties are anticipated.	Used when unknown potential cost risks exist and when it is unreasonable to ask a contractor to assume these risks alone.

Differences between the two types affect the extent of performance monitoring and payment review required. Under a fixed price contract, the agency assumes little cost risk and therefore does not have to monitor contractor costs or perform contract closeout audits. Under a cost-reimbursement contract, the agency agrees to pay the contractor's reasonable, allocable and allowable costs of performance regardless of whether the work is completed. This type of contract has a high cost risk, which means the agency must do considerable monitoring and evaluation of costs.

Because of the advantages to the government, best practices emphasize that service contracts should be fixed priced whenever possible. Federal agencies are finding that more service contracts can be awarded on a fixed-price rather than a cost-reimbursement basis. Within Metro, the Contract Manual contains no guidance on this issue and project managers receive no training in this area. In addition, the Contract Office's compliance reviews do not evaluate the type of contract selected.

*Clear Expectations  
and Performance  
Standards*

Best practices call for a contract's scope of work statement to communicate to contractors what is required of them in clear, measurable statements of expected services (outputs) and clearly defined performance standards (quality, quantity and timeliness) whenever possible. Well-defined service requirements can result in better service, at lower cost, and with far fewer claims and delays during the life of the contract.

Such clear statements of expectations and performance are not uniform in Metro contracts. Metro's Chief Operating Officer, Contracting Officer and General Counsel told us that service contract requirements (deliverables) in Metro contracts often can be more clearly defined and performance standards more consistently established. They said the scope of work specifications only broadly and imprecisely define what is to be done under the contract. We did, however, see some Metro contracts with carefully crafted specifications. For example, the Transportation Department contracts we reviewed were clearly defined and measurable. This apparently is due to the very detailed federal requirements and federal reviews involved in these contracts.

**Processes for  
Ensuring  
Reasonable  
Contract Costs  
Can Be Improved**

To ensure that fair and reasonable prices are paid for services, best practices call for actions in two main areas: conducting a price or cost analysis<sup>5</sup> before awarding a contract or before making change orders to the contract, and relating contractor payments to specific work completed.

Metro project managers are making price analyses whenever they compare competing bids or proposals. They also should make independent cost estimates or compare a contractor's proposed costs to its own records when evaluating change orders. Metro currently provides no guidance to assist project managers in determining when or how these cost analyses should be conducted.

Metro can also benefit by improving its procedures related to contractor payments – more specifically, by requiring contractors

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<sup>5</sup> Price analysis is a comparison of the proposed price to comparable pricing data, such as competing bids or independent cost estimates. Cost analysis is a comparison of the proposed price to the contractor's own costs, and an evaluation of the difference, i.e. profit. A cost analysis is necessary whenever adequate price competition is lacking and for sole source procurements, including change orders.

to follow a prescribed billing format. One Metro department – Transportation – has first-hand experience using such a format. According to department personnel, before adopting this format they often had difficulty relating invoices and supporting documentation to particular tasks. The new format allows them to spend much less time reviewing invoices, while at the same time being much better able to identify unallowable costs. Department personnel said they believe the new format resulted in considerable dollar savings, though they did not have an estimate of the amount.

Under the new format, the department requires the following:

- a letter signed by the contractor certifying the costs have been incurred in the performance of the scope of work
- an invoice itemizing labor charges (name, title, rate, hours) and including documentation to support direct expenses
- a text narrative describing, by task, all expenses billed
- a contract budget spreadsheet that includes original budget amount, expended to date amount, current billing amount, and remaining budget.

**Procedures Not in Place for Adequate Contractor Oversight**

Effective contractor oversight begins before the contract is awarded by developing clear, concise performance based statements of work to the extent possible. Doing this establishes the basis for holding contractors accountable. In addition, best practices call for the contract to contain a plan for measuring the contractor’s performance. The plan can be simple or complex, depending on the criticality of the service or task and the resources available. The plan should address the following:

- who will administer the contract
- how and when the contractor will be monitored and evaluated and how these efforts will be documented
- the need for contractor, project manager and customer satisfaction surveys.

Metro’s General Counsel told us that Metro contracts seldom, if ever, contain such plans for evaluating contractor performance. In addition, past audits of various Metro programs have pointed out that contract supervision is weak or nonexistent. Examples of these findings can be found in Table 2 earlier in this report. For example,

a 1993 performance audit of Metro's contracting practices<sup>6</sup> found that Metro had limited performance standards and no formal practices or requirements for monitoring contractor performance. The audit recommended that Metro establish specific performance standards and criteria for each project, detailing progress reporting, phase completion dates, meeting dates and documenting these in the contract file. To date, this has not been done.

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<sup>6</sup> "Performance Audit Report, Metro's Contracting Process", March 1993 by Talbot, Korvola and Warwick, Certified Public Accountants

## Improving Metro's Contracting Practices Involves Action in Several Areas

Metro should take two main types of action if it is to effectively address the limitations in its contracting procedures. First, using proven management control ideas from other government agencies, Metro should develop a more comprehensive contract management system. Second, to put such a system in place, Metro should develop various procedures and guidelines and train staff in how to apply them. In addition, Metro may benefit by using performance-based service contracting methodology on a pilot basis. Federal experience shows that this methodology can reduce overall service contract costs about 15 percent while obtaining better results.

These steps are worth taking because they can potentially have a significant dollar effect. Metro has over \$1 billion in contracts outstanding at any one time. At this level of expenditure, if improved contract administration saves just 1 percent of the total, the savings would total \$10 million.

Metro management acknowledges that its contracting results can be improved in terms of costs, schedules, deliverables and contractor relationships. Because Metro does not systematically gather information on these matters, the extent to which improved management could affect contractual expenditures cannot be determined. Management, however, acknowledges that the issues are significant enough to warrant agency-wide solutions.

### **Comprehensive Contract Management System Needed**

To put best practices in place, Metro should develop a comprehensive contract management system with the following:

- an organizational structure that has clearly defined roles and responsibilities and that can provide oversight, guidance and accountability of contracting activities
- a performance reporting system designed to determine the status and results of each contract and identify matters needing attention
- a formal risk assessment mechanism for identifying and mitigating high-risk situations
- procedures for evaluating employees who are responsible for managing contracts.

*Organizational structure* The cornerstone of an effective contract management system is a central contracting office with the authority and responsibility for providing oversight, guidance and training. Currently, Metro departments manage much of the contracting function with limited central guidance and oversight. Within departments, project managers are usually responsible for deciding the type of contract, preparing scope of work statements and administering contracts, including evaluating contractor performance and billings.

Metro can benefit by making its Contract Office responsible for greater oversight, guidance and support of departmental contract activities. The Office should be responsible for:

- defining and documenting organizational roles and responsibilities of the Contract Office, departments and project managers in managing contracts
- establishing a performance reporting system to make contract results visible and identify areas needing improvement
- performing risk assessments to identify and conduct audits of high-risk contracts
- developing agency-wide procedures and guidelines for defining contract requirements, monitoring contractors and assuring reasonable contract costs
- providing for training of contracting personnel
- reviewing departmental compliance with prescribed procedures
- establishing minimum qualifications for project managers and other contracting personnel
- establishing agency-wide procedures for departments to use in evaluating the performance of project managers and other contracting personnel.

Metro can also benefit by designating a formal “Contract Coordinator” in each department to be responsible for assuring that the department’s contracts are properly planned and monitored. The Coordinator would act as liaison with the Contract Office, keep up to date on contract management practices and assist project managers in developing and managing contracts.

Some departments already have procedures for assisting project managers in planning contracts. For example, in the Regional Environmental Management department, an experienced contract manager, on request, assists other contract personnel in developing scope of work statements and other contract provisions.

*Contract performance reporting system* Metro should have a contract performance reporting system to enable top management and departments to monitor and evaluate the status and results of contracts. Such a system would enable Metro managers to identify issues needing attention, point to specific training needs, and help ensure better contract results. Because Metro does not have such a system, we were not able to determine in a cost-effective manner how many contracts have cost, schedule or performance problems.

The information in these reports will come from measuring contractor performance in relation to contract requirements and performance standards. Not all contracts would have to be tracked in detail, only those over certain dollar values or of high risk.

Performance reporting generally involves collecting and disseminating performance information on scope, schedule, cost and quality and can be categorized as follows:

- status reporting – describing where a contract stands now
- progress reporting – describing what has been accomplished
- forecasting – predicting future status and progress
- risk reporting – describing areas of uncertainty and vulnerability.

Performance reports may be prepared comprehensively or on an exception basis to meet varying management needs. For example, top management and the Contract Office might, on an exception basis, want information on:

- significant issues involving particular contracts/contractors
- high-risk contracts/contractors and plans for managing risks.

Basic performance reports could include information on:

- number of deliverables met out of the total
- original cost versus final cost
- original schedule versus final schedule
- number and nature of change orders
- change order costs as a percentage of total cost
- satisfaction levels, including customers, project managers and contractors.

*Risk assessment* Every contract has the potential for many things to go wrong. For example, key contractor personnel could quit, materials or supplies could be delivered late, equipment could breakdown or

the contractor could go out of business in the middle of the contract. Metro can reduce these risks by training project managers to assess, document and manage the risks of high-dollar or otherwise significant contracts. The Contract Office should conduct formal assessments of known high-risk contracts as part of its oversight activities.

Risk assessment is the process of identifying, analyzing and managing risks that can adversely affect achieving project objectives. Methods of identifying such risks include qualitative and quantitative ranking activities, management conferences, forecasting and strategic planning, and considering findings from audits and other assessments. Analyzing risks for their possible effects generally includes estimating the risk's significance, assessing the likelihood of its occurrence, and deciding how to manage the risk and what to do if it occurs.

*Evaluating performance of contract personnel*

Metro should have agency-wide procedures for evaluating how well project managers perform their responsibilities. These evaluations would provide the basis for guiding and training managers to be more effective and for identifying areas where all managers need more training. Metro should establish minimum qualifications or training requirements for a person to become a Project or Contract Manager. Currently, departments often designate persons to be project managers regardless of background or training in contracting.

**New System Requires Development of Procedures, Guidelines and Training**

Putting this contract management system in place, as well as addressing the specific lapses from best practices identified earlier in this report, will require development of procedures and guidance on many fronts. Table 4 shows the kinds of matters that will need to be developed to address the key elements of contract management. These steps need to be taken so that every project manager knows and is able to apply these elements and their best practices to their contracting activities. Doing this will foster greater consistency among the departments and provide a framework for accountability and reporting. In this regard, Metro has contract personnel with considerable depth of experience and knowledge who can assist in developing needed guidance and training.

**Table 4**  
**Elements of an Effective Contract Management System**

<b>Contractor Selection</b>	<p>Procurement process should be sufficient to ensure that the best contractors are fairly and objectively selected.</p> <ul style="list-style-type: none"> <li>• Whenever feasible, contractors should be selected through competitive procurement procedures.</li> <li>• Past performance should be considered in selection/contract renewal decisions.</li> <li>• Formal, documented procedures should be used to assess prospective contractors' strengths and weaknesses.</li> </ul>
<b>Contract Requirements</b>	<p>Contract requirements should be sufficient to hold contractors accountable for delivering quality services and to prevent the inappropriate or inefficient use of public funds.</p> <p>Setting contract requirements requires:</p> <ul style="list-style-type: none"> <li>• Selecting the appropriate type of contract</li> <li>• Clear statements of services and goods expected from the contractor</li> <li>• Clearly defined performance standards and measurable outcomes</li> <li>• Clear statements of how contractor performance will be evaluated.</li> </ul>
<b>Contract Costs</b>	<p>Methods for determining contract costs should be sufficient to ensure that Metro pays fair and reasonable prices for services.</p> <ul style="list-style-type: none"> <li>• Prior to the contract award and for change orders, proposed contractor prices should be analyzed using price or cost analysis.</li> <li>• Contractor billings should relate to specific work completed.</li> </ul>
<b>Contractor Oversight</b>	<p>Contractor oversight should be sufficient to ensure that contractors consistently provide quality services (by measuring performance against well-documented expectations) and that public funds are spent effectively and efficiently.</p> <ul style="list-style-type: none"> <li>• Monitoring functions should focus on the outcomes of services provided.</li> <li>• Results of monitoring reviews, audits and investigations should be routinely followed up on to ensure corrective actions have been taken and to identify common problem areas.</li> <li>• A formalized risk assessment process should be used to select contractors for review and identify the level of review necessary at each contractor.</li> </ul>

**Metro May Be Able to Conduct More Performance-Based Service Contracting**

Performance-based service contracting is a contracting approach that has achieved considerable success at the federal level. Under this approach, contractors receive flexibility in deciding how to meet specified performance objectives and receive payment only if their services meet appropriate levels of quality. Table 5 shows the basic elements of this approach.

**Table 5  
Basic Elements of Performance-Based Service Contracting**

<b>Element</b>	<b>Explanation</b>
<i>Work statement</i>	Defines performance requirements in measurable, mission-related terms
<i>Performance standards</i>	Specify quality, quantity and timeliness of contract deliverables
<i>Quality assurance plan</i>	Describes how the contractor's performance will be measured against the performance standards
<i>Positive or negative incentives</i>	Used if the acquisition is either critical to mission accomplishment or requires a relatively large expenditures of funds

Tests at the federal level show that performance-based service contracting can save money and improve services. The Office of Federal Procurement Policy initiated a large-scale pilot project in 1994 and found that on average, contract prices decreased by 15 percent.<sup>7</sup> In addition, customers were much more satisfied with contractors' work. The pilot project also concluded that performance-based service contracting will help correct problems commonly associated with services contracts, including cost overruns, schedule delays, and failure to achieve specified results. Federal procurement policy now requires all federal agencies to use performance-based service contracting unless the agency specifically justifies some other method.<sup>8</sup>

<sup>7</sup> In addition, inflation-adjusted price increases would likely have increased the non- performance-based service contracts by another 16 percent, further adding to the cost savings achieved under performance-based service contracting.

<sup>8</sup> Applying only selected aspects of the total performance-based service contracting methodology is not likely to be nearly as successful, and can even cause a reduction in the value of services provided, according to the report on the pilot project. Federal agency experience shows that problems arise by failing to define the work in completion terms, to develop or enforce measurable quality assurance plans based on contract performance standards or to place sufficient financial risk on the contractor.

We believe many Metro contracts for services can benefit by using performance-based service contracting methods. Metro already has some limited experience with performance-based service contracting, having used it on the renewal of its janitorial service contract. Under this approach, the contract's annual cost was reduced by \$5,625 to \$130,108. In addition, MERC agreed with our audit recommendation to convert its marketing contract with the Portland Oregon Visitors Association to a performance-based contract.<sup>9</sup>

At the federal level, the approach has been used successfully in contracting for a wide range of services, including training, security, computer and software maintenance, and facility operation and maintenance. Such methods may not initially apply if a contract involves complex requirements, or if performance uncertainties make it difficult to predict the costs of performance in advance. However, as requirements are repetitively acquired, and a history is established, the agency should be able to more clearly define the requirement, and contractors should be able to assume greater risks of performance at fixed prices.

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<sup>9</sup> Portland Oregon Visitors Association Contract, September 2000, Metro Office of the Auditor

## **Appendix A**

Resources for Developing Contracting Procedures and Guidelines

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## Resources for Developing Contracting Procedures and Guidelines

1. Federal Transit Administration, Best Practices Procurement Manual  
<http://www.fta.dot.gov/library/admin/BPPM/>  
Also available in Metro's Transportation Department
2. National Transit Institute workbooks for the following courses:
  - Orientation to Third-Party Contracting
  - Contract Administration
  - Cost and Price AnalysisAvailable in Metro's Transportation Department
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## **Response to the Report**

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METRO

December 12, 2000

The Honorable Alexis Dow, CPA  
Auditor  
Metro  
600 NE Grand Avenue  
Portland, OR 97232

RE: Response to Contracting: A Framework for Enhancing Contract Management

Dear Ms Dow:

Thank you for the opportunity to respond to *Contracting: A Framework for Enhancing Contract Management*. I recognize the extensive effort you and your staff applied to this audit. I also appreciate the collaborative style in which this audit was performed.

I concur with all your recommendations for contract enhancements and best practices. I have directed staff to focus on maintaining core business functions and to minimize risk by compliance with Council policy, along with legal and professional standards. Implementation of all recommendations of contract best practices will exceed available administrative staff resources and cannot be in place immediately, however I will direct staff to move forward with these recommendations as resources permit.

My responses to your specific recommendations are as follows:

- 1. Define and document the authority, roles and responsibilities of the various organizational units and positions involved in contracting activities, including the Contract Office, departments and project managers. In this regard, Metro should enhance the role of the Contract Office by providing it the resources, authority and responsibility for the following oversight, quality control and support activities.**

Agreement with Recommendation: I agree with this recommendation.

Proposed Action Plan: I have directed staff to begin by establishing an interdepartmental work team. The interdepartmental work team will be given the charge to document roles and responsibilities, identify "at risk" contracts, develop a reporting mechanism, develop core curriculum for contract coordinators and project managers, and establish guidelines for project performance.

Proposed Timetable: I expect this team to begin meeting the first quarter of 2001 and continue to meet regularly.

## 2. Improve contract oversight by:

- **Strengthening the role of the Contract Office in guiding and reviewing departmental contracting activities**
- **Conducting formal risk assessments to identify contracts requiring close monitoring and audits**
- **Establishing a management reporting system geared toward providing oversight information to top management and departmental managers.**

Agreement with Recommendation: I agree with this recommendation.

Proposed Action Plan: As part of the work team discussed above, I will direct the team to determine the appropriate enhancements to the role and authority of the Contracts Office, resources needed, contracts needing close monitoring, and a reporting function to assure quality and internal controls.

Proposed Timetable: Ongoing.

## 3. Enhance departmental quality control by:

- **Designating a formal "Contract Coordinator" in each department responsible for assuring that contracts are properly planned and monitored. This would be a professional position with the authority to counsel and direct project managers in developing contracts and evaluating contractor performance.**
- **Establishing minimum agency-wide qualifications for project managers and other contracting personnel. Persons would be considered qualified after attending appropriate training programs.**
- **Formally evaluating the performance of project managers and other contracting personnel in relation to their contracting duties and responsibilities.**

Agreement with Recommendation: I agree with this recommendation.

Proposed Action Plan: I have directed staff to define roles and responsibilities for "contract coordinators." Once job duties and core competency requirements are approved, Department

Directors will be asked to appoint contract coordinators for their departments and allow for core training. Accountability in job performance will be critical component of this effort.

Proposed Timetable: Job descriptions will be completed the second quarter of 2001. The work team will develop the core training required.

**4. Provide better support to project managers and other contracting personnel by developing policies, procedures, guidelines and training in:**

- **determining the appropriate contract type**
- **establishing scope of work requirements and performance standards**
- **monitoring and evaluating contractor performance**
- **evaluating contractor proposed prices and contractor billings.**

Agreement with Recommendation: I agree with this recommendation.

Proposed Action Plan: Staff is currently putting together contract training courses and will coordinate their efforts with the work team in designing core curriculum for all contract and project managers.

Proposed Timetable: Classes will begin in the first quarter of 2001 and continue as needed.

**5. Capitalize on the depth of experience of some Metro contracting personnel by forming interdepartmental workgroups to develop policies, procedures, guidelines and training programs.**

Agreement with Recommendation: I agree with this recommendation.

Proposed Action Plan: I am a proponent of such teams to breakdown departmental boundaries and share knowledge and skills throughout Metro. This should be accomplished with the team proposed in item number 1.

Proposed Timetable: Ongoing

**6. Consider using performance-based service contracting methodology on a pilot basis. Federal experience shows that this methodology can reduce overall service contract costs 15 percent while obtaining better results.**

Agreement with Recommendation: I agree with this recommendation. Consideration will be given to use performance based contracting as we develop solicitation documents and contracts.

Proposed Action Plan: Along with your staff who performed this audit, several of my staff members attended a performance-based contracting course. While my staff perceived many challenges and limited application of these concepts, I will direct staff to continue to learn

more about its principles and apply those that are pertinent and utilize performance-based principles where appropriate.

The PERforms pilot program, which evaluates project managers and vendors, was introduced recently. The pilot study is scheduled to conclude the second quarter of 2001. At the conclusion of pilot study, the program will be carefully assessed and improved.

Proposed Timetable: This will be an ongoing effort.

I appreciate your report noting that Metro is following best practices in many areas. Your recommendations will continue our efforts to ensure that our contractors produce quality results and public funds are protected.

Sincerely,

A handwritten signature in black ink that reads "Mike Burton". The signature is written in a cursive, flowing style with a long horizontal stroke at the end.

Mike Burton  
Executive Officer



# Metro Auditor Report Evaluation Form

## Fax... Write... Call... Help Us Serve Metro Better

Our mission at the Office of the Metro Auditor is to assist and advise Metro in achieving honest, efficient management and full accountability to the public. We strive to provide Metro with accurate information, unbiased analysis and objective recommendations on how best to use public resources in support of the region's well-being.

Your feedback helps us do a better job. If you would please take a few minutes to fill out the following information for us, it will help us assess and improve our work.



**Name of Audit Report:** \_\_\_\_\_

Please rate the following elements of this report by checking the appropriate box.

	<b>Too Little</b>	<b>Just Right</b>	<b>Too Much</b>
Background Information	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Details	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Length of Report	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Clarity of Writing	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Potential Impact	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Suggestions for our report format: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Suggestions for future studies: \_\_\_\_\_  
\_\_\_\_\_  
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Other comments, ideas, thoughts: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Name (optional): \_\_\_\_\_

**Thanks for taking the time to help us.**

Fax: 503.797.1831  
Mail: Metro Auditor, 600 NE Grand Avenue, Portland, OR 97232-2736  
Call: Alexis Dow, CPA, Metro Auditor, 503.797.1891  
Email: [dowa@metro.dst.or.us](mailto:dowa@metro.dst.or.us)