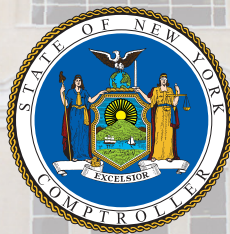




Department of Health

Contracts for Personal and Miscellaneous Services

Report 2010-S-13



Thomas P. DiNapoli

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Table of Contents

	Page
Authority Letter	5
Executive Summary	7
Introduction	9
Background	9
Audit Scope and Methodology	10
Authority	11
Reporting Requirements	11
Contributors to the Report	12
Audit Findings and Recommendations	13
Justification of Service Contracts	13
Reassessment of Service Contracts	14
Recommendations	16
Agency Comments	17

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State of New York Office of the State Comptroller

Division of State Government Accountability

March 3, 2011

Nirav R. Shah, M.D., M.P.H.
Commissioner
Department of Health
Corning Tower, Room 1495
Empire State Plaza
Albany, NY 12237

Dear Dr. Shah:

The Office of the State Comptroller is committed to helping State agencies, public authorities and local government agencies manage government resources efficiently and effectively and, by so doing, providing accountability for tax dollars spent to support government operations. The Comptroller oversees the fiscal affairs of State agencies, public authorities and local government agencies, as well as their compliance with relevant statutes and their observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving operations. Audits can also identify strategies for reducing costs and strengthening controls that are intended to safeguard assets.

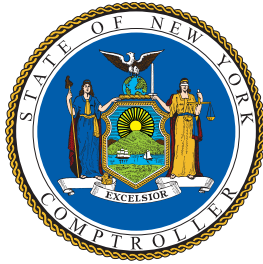
Following is a report of our audit of Contracts for Personal and Miscellaneous Services. The audit was performed pursuant to the State Comptroller's authority under Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law.

This audit's results and recommendations are resources for you to use in effectively managing your operations and in meeting the expectations of taxpayers. If you have any questions about this report, please feel free to contact us.

Respectfully submitted,

*Office of the State Comptroller
Division of State Government Accountability*

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State of New York Office of the State Comptroller

EXECUTIVE SUMMARY

Audit Objectives

One objective of our audit was to determine whether the Department of Health (Department) justified the need to contract for personal and miscellaneous services. Another objective was to determine whether the Department periodically reassessed personal and miscellaneous service contracts to identify what work could be deferred, eliminated or reduced to save State funds.

Audit Results - Summary

Various directives from the New York State Division of the Budget and the Governor's Office include the need for State agencies to justify their personal and miscellaneous service contracts (Service Contracts) and to reassess whether they can be deferred, eliminated or reduced to help achieve overall budgetary reductions and related cost savings. These directives have added significance because in August 2008, the Governor required State agencies to achieve spending reductions of 10.35 percent for State fiscal years 2008-09. On October 15, 2009, the Governor also ordered State agencies to reduce their fiscal year 2009-10 operating budgets by another 11 percent.

For the period, April 1, 2006 through April 1, 2010, according to the Department's Grants and Procurement unit, the Department had approximately 400 State-funded Service Contracts valued at more than \$684 million. We reviewed a sample of 20 Service Contracts valued at \$320 million and found the Department generally justified the need for Service Contracts. For example, most contracts (18 of the 20) generally were supported by legislative mandates for the services (including some that were required to be done by independent entities), or involved technical components beyond the resource capability of the Department. We found the Department did not maintain sufficient documentation to justify the need for 2 contracts totaling \$1.3 million. While officials informed us of the need to contract for these services, supporting documentation is necessary to adequately establish that the Department has reached the correct conclusions about the need for contractual services.

Department officials reported they met their 10.35 percent budget reduction target for 2008-09, in part by reassessing and reducing Service Contracts. In accordance with Budget Bulletin H-1025, which required agencies to review all contracts to determine which contracts could be eliminated, reduced or done by state employees, the Department was able to provide support showing that 19 of the 20 contracts we sampled were reassessed and/or reduced during 2008-

09. However, Bulletin H-1025 expired in September 2009 and the Department was unable to provide supporting documentation and analyses showing all Service Contracts were again examined after this Bulletin ended. Based upon our review, we believe additional savings opportunities likely exist.

Our report contains three recommendations to improve the Department's use of Service Contracts. Department officials generally agreed with our recommendations.

This report, dated March 3, 2011, is available on our website at: <http://www.osc.state.ny.us>.

Add or update your mailing list address by contacting us at: (518) 474-3271 or

Office of the State Comptroller

Division of State Government Accountability

110 State Street, 11th Floor

Albany, NY 12236

Introduction

Background

The mission of the Department of Health (Department) is to ensure that high quality appropriate health services are available to all New York State residents at a reasonable cost. The Department is the principal State agency that interacts with the Federal and local governments, health care providers and program participants for the State's health care programs. Major programs include the State's Medicaid program, New York's Child Health Plus program, and the Family Health Plus program. To help achieve its mission, the Department enters into personal and miscellaneous service contracts (Service Contracts). Service Contracts typically cover such items as research and analysis, data processing, computer programming, engineering, environmental assessments, health and mental services, accounting or auditing, or other similar services.

According to the Department's Grants and Procurement unit, the Department had approximately 400 State-funded Service Contracts (excluding construction, commodities and certain other contracts) during the period April 1, 2006 through April 1, 2010. These contracts had a value of \$684 million.

The following directives issued from the New York State Division of the Budget and the Governor set forth expectations for State agencies to make sure that expenditures, including Service Contracts, are justified and periodically reassessed:

- State Budget Bulletin H-1025 which became effective July 31, 2003, requires agency management to review all contracts (both new and renewals), including those that involve service delivery to affected citizens, to ensure that lower priority, overlapping or otherwise inefficient activities are eliminated. This Bulletin was in effect until September 2009.
- State Budget Bulletin B-1178, which became effective April 21, 2008, requires agency management to scrutinize all programs and operations to identify opportunities to eliminate activities and spending on non-essential items. It further requires agencies to develop plans to identify cost-savings and recurring savings. In this regard, under B-1178, agencies are required to scrutinize spending for contractual services among other items. Furthermore, B-1178 requires agencies to develop plans that include a framework for continuing fiscal year 2008-09 savings through to fiscal year 2011-12.

- State Budget Bulletin B-1183, which became effective August 21, 2008, requires State agencies to review all agency programs and operations to identify opportunities for eliminating less essential activities and spending on non-essential items.
- On June 4, 2008, the Governor issued Executive Order No. 6 (Order) requiring State agencies not to enter into Qualified Personal Services Contracts (e.g. engineering, research and analysis, data processing) exceeding \$1 million or more of personal services over any 12-month period unless the agency first determined that: (a) the contractor can carry out the task more efficiently or effectively than state employees; (b) the contractor can carry out the task for a lower cost than state employees; or (c) the contract is necessary to protect the public health or safety, or is for some other compelling reason.

Both the Budget Bulletins and the Order have added significance given the State's increasing fiscal difficulties. In this regard, in August 2008, the Governor directed that State agencies evaluate all programs and operations to identify opportunities to eliminate less essential activities and achieve spending reductions of 10.35 percent in State fiscal year 2008-09. As part of this responsibility, State agencies were to develop a detailed plan that described the agency's proposed process for reviewing/approving non-personal service spending. Agencies were expected to balance personal and non-personal service reductions so as to not disproportionately impact either, and to ensure recurring savings in both categories. On October 15, 2009, the Governor also ordered State agencies to reduce their fiscal year 2009-10 and 2010-11 operating budgets by another 11 percent.

Audit Scope and Methodology

We audited whether the Department justified the need to contract for personal and miscellaneous services. Another objective was to determine whether the Department periodically reassessed personal and miscellaneous service contracts to identify what work could be deferred, eliminated or reduced to save State funds. For purposes of our audit, Service Contracts are those in which the majority of the costs associated with the contracts are for services and labor. We did not include contracts for commodities or capital construction, contracts that included federal funding, or contracts that were for legislative member items. Our audit period was April 1, 2006 through August 31, 2010.

To accomplish our objectives, we interviewed Department personnel, and reviewed contracts and other supporting documentation provided by the Department. We also reviewed relevant State laws, the Order and Budget Bulletins. We selected a judgmental sample of 20 Service

Contracts totaling \$320 million from the 117 active contracts during our audit period. We selected our sample from contracts over \$50,000. The selection includes contracts for evaluation, research and analysis, data processing, computer programming, health services, and auditing services.

We conducted our performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds, and other payments. In addition, the Comptroller appoints members to certain boards, commissions and public authorities, some of whom have minority voting rights. These duties may be considered management functions for purposes of evaluating organizational independence under generally accepted government auditing standards. In our opinion, these functions do not affect our ability to conduct independent audits of program performance.

Authority

The audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law.

**Reporting
Requirements**

We provided a draft copy of this report to Department officials for their review and comment. Department officials generally agreed with our findings and recommendations and indicated the steps they have already taken or will take to address the recommendations. The Department's comments are included in their entirety at the end of this report.

Within 90 days of the final release of this report, as required by Section 170 of the Executive Law, the Commissioner of the Department of Health shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons why.

**Contributors to
the Report**

Major contributors to this report include Steve Sossei, Ed Durocher, Andrea Inman, Michele Turmel, and Emily Wood.

Audit Findings and Recommendations

Justification of Service Contracts

We selected a sample of 20 Service Contracts totaling \$320 million based on contract information provided by the Department's Grants and Procurement unit. We reviewed the Department's available documentation to determine whether the need for the services and the decision to contract for services were justified with supporting documentation. The Department was able to demonstrate that it had formally evaluated and justified the need for 18 contracts totaling \$318.7 million. However, the Department did not maintain sufficient documentation showing it formally evaluated the justification for the remaining two contracts, which total \$1.3 million. These contracts involve information technology and outside services to conduct a physical inventory of equipment. The specifics regarding these contracts follow:

- The contract for information technology was for an upgrade of a Department fiscal purchasing system, as well as the costs associated with the maintenance and support of this system. We asked officials why they contracted for these services given that this system is slated to be replaced by the implementation of the New York State Single Statewide Financial System. Department officials responded that the new statewide system will not replace their purchasing system for a few years and this contract was necessary because their current system was no longer going to be supported by the vendor. However, we did not see documentation to support the project need or rationale for the scope of contract services.
- Regarding the contract for outside services for an annual physical inventory of equipment, while we recognize the high value of the equipment and need for a physical inventory, the equipment being inventoried utilizes a computerized bar coded system. We asked Department officials why they do not conduct the inventory in-house since the Department has bar code readers and maintains the database of inventory. Officials indicated that it would be too costly to do this work in-house. However, we did not see documentation of alternatives considered or cost-benefit analyses showing comparative costs of doing the work in-house.

We acknowledge there are times when outside consultants must be hired. However, even in these cases, a documented analysis is important to fully support the Department's conclusions are correct and that opportunities and options for cost savings have been fully considered. Further, the Department's policies and procedures for contract processing date back to

November 1990. We determined the Department does not have updated formal written policies on what constitutes thorough and comprehensive written justifications for all Service Contracts regarding the need for the service, the level of the service, and the need to contract out.

In July of 2008, the Department communicated an information bulletin to Department employees on the requirements of the Order. As part of this directive, the Department implemented the use of a Determination of a Qualified Personal Service Contract form, which incorporated requirements of the Order. While the use of this form complies with the Order, we recommend the form be modified to include (1) an explanation of the reason(s) why the contractor can carry out the task more efficiently or effectively than state employees, or for a lower cost than state employees (as opposed to simply checking off one of these designations); and (2) information that reasonably supports these conclusions, including any data or analysis used. Further, use of the new form only applies to contracts with an annual value greater than \$1 million. We recommend the new form be used for all Service Contracts. Department officials agree they could modify their contract procedures to formally document their decision to utilize Service Contracts.

In response to our audit, Department officials noted that the State has been enforcing hiring freezes and, as a result, the Department has been limited in its ability to hire state employees to carry out work. We recognize that with the implementation of spending controls in Budget Bulletin B-1162 (effective 2001) and again with Budget Bulletin B-1182 (effective 2008) hiring freezes were enforced. Nevertheless, Department management remains responsible for determining the cost effectiveness of its operations and advocating for exceptions to hiring freezes whenever it is clearly cost beneficial to do so. However, we determined that nine of our sampled contracts did not have all or some of the necessary forms required by G-Bulletin 226. These forms are annual reports from contractors indicating, among other items, the total number of employees providing services under the contract (including employees of subcontractors) and the number of hours worked by the employees. This information could be useful in assessing contract costs and comparing them to the cost of replacing consultants with state employees. Department officials acknowledge they need to do a better job in documenting their compliance.

**Reassessment of
Service Contracts**

Based upon our review of the Department's efforts to scrutinize Service Contract spending, we believe additional savings opportunities may be possible. Department officials reported they met their 10.35 percent budget reduction target for 2008-09, in part by reassessing and reducing Service Contracts. In accordance with Budget Bulletin H-1025, which

required agencies to review all contracts to determine which contracts could be eliminated, reduced or done by state employees, the Department was able to provide support showing that 19 of the 20 contracts we sampled were reassessed and/or reduced during 2008-09 (the Department did not provide documentation showing one contract for outside services for an annual physical inventory of equipment was reassessed). However, Bulletin H-1025 expired in September 2009 and the Department was unable to provide supporting documentation and analyses showing all Service Contracts from top-to-bottom were examined after this Bulletin ended. Although Department officials contend there is no longer a requirement to perform this type of analysis, they acknowledge there is an opportunity to implement a process whereby they would periodically reassess the need for Service Contracts.

On October 15, 2009, the Governor again called for agencies to reduce spending in future fiscal years and ordered State agencies to reduce their fiscal year 2009-10 and 2010-11 operating budgets by another 11 percent. Given the State's fiscal crisis, the Department needs to document its reassessment of all Service Contract spending. If officials conduct periodic top-to-bottom reviews of every contract, they may find some other services that could be reduced to achieve savings.

We determined the Department did not demonstrate that it scrutinized all Service Contract spending as part of its 2009-10 budget reduction efforts. According to Department officials, the Department reassesses the need for Service Contracts as part of its Expenditure Plan process. However, officials were unable to identify the Service Contracts that have been reassessed for cost savings from elimination or reduction. Such analyses and documentation is essential to ensure that management has identified all opportunities where the scope of contract work may be modified to generate cost savings.

In addition, the Department is required to adhere to the Order and report to the Order's Task Force all Qualified Personal Service Contracts it entered into and list these contracts on its website. The Department is required to report, among other items, the amount of the contract, a brief description of the reason for entering into the contract, and the reason for not using state employees to carry out the Service Contract tasks. The Department has a total of 21 contracts on their website that are reportable under the Order. However, we determined that it took the Department more than one year to post five of these contracts (totaling approximately \$51 million) to their website. Timely reporting of Qualified Personal Service Contracts in accordance with the Order's requirements is essential to help ensure transparency of contractual services and allow for appropriate public scrutiny.

- Recommendations**
1. Executive management should communicate to appropriate staff the requirement to support Service contracts with written justifications of the need for the service, the appropriate level of the service, and the need to contract out. As part of these efforts, the Department should:
 - Modify the Determination of a Qualified Personal Service Contract form to include: explanations of the reason(s) why the contractor can carry out the task more efficiently or effectively than state employees, or for a lower cost than state employees; information that reasonably supports these conclusions, including any data or analysis used; and apply the use of the form to all Service Contracts.
 - Update Department policies and procedures in accordance with the new Personal Service Contract form requirements.
 2. Instruct managers to periodically reassess all Service Contracts to identify opportunities to suspend, eliminate, reduce or bring them in-house, and to document their determinations.
 3. Report all Qualified Personal Service Contracts affected by Executive Order No. 6 in a timely manner on the Department's website as required.

Agency Comments



STATE OF NEW YORK DEPARTMENT OF HEALTH

Corning Tower The Governor Nelson A. Rockefeller Empire State Plaza Albany, New York 12237
www.health.ny.gov

Nirav R. Shah, M.D., M.P.H.
Commissioner

James W. Clyne, Jr.
Executive Deputy Commissioner

January 27, 2011

Edward J. Durocher, CIA, Audit Manager
Office of the State Comptroller
Division of State Government Accountability
110 State Street – 11th Floor
Albany, New York 12236

Dear Mr. Durocher:

Enclosed are the New York State Department of Health's comments on the Office of the State Comptroller's draft audit report 2010-S-13 on "New York State Department of Health Contracts for Personal and Miscellaneous Services."

Thank you for the opportunity to comment.

Sincerely,

James W. Clyne, Jr.
Executive Deputy Commissioner

Enclosure

cc: Robert W. Reed
Lawrence S. Sturman, M.D.
Marybeth Hefner
Frederick Genier
Diane Christensen
Stephen Abbott
Stephen LaCasse

**Department of Health Comments
on the Office of the State Comptroller's
Draft Audit Report 2010-S-13
on Department of Health
Contracts for Personal and Miscellaneous Services**

The following are the Department of Health's (Department) comments on Office of the State Comptroller's (OSC) draft audit report 2010-S-13 on "New York State Department of Health Contracts for Personal and Miscellaneous Services," including general comments followed by responses to the specific recommendations contained in the report.

General Comments:

The OSC audit sample consists of 20 Department contracts totaling \$320 million. OSC found that the Department had formally evaluated and justified the need for 18 of the contracts totaling \$318.7 million, but did not maintain sufficient documentation demonstrating that it had formally evaluated the justification for the remaining two contracts worth \$1.3 million. It is important to distinguish that the audit findings relate to documentation and records maintenance issues and not to the appropriateness of the contracts themselves. The two contracts associated with the audit findings are necessary and appropriate, and the Department has since formally documented these justifications which are available for OSC review.

Further, the Department has taken steps to ensure that all of its expenditures are necessary and appropriate, including those for personal and miscellaneous services contracts. It has significantly reduced expenditures over the past several years, due in part to reductions in the number and value of service contracts. These contract reductions have been driven by the economic environment, and implemented based on available funding levels and not because the contracting activities were not appropriate or necessary.

Recommendation #1:

Executive management should communicate to appropriate staff the requirement to support Service Contracts with written justifications of the need for the service, the appropriate level of the service, and the need to contract out. As part of these efforts, the Department should:

- Modify the Determination of a Qualified Personal Service Contract form to include: explanations of the reason(s) why the contractor can carry out the task more efficiently or effectively than state employees, or for a lower cost than state employees; information that reasonably supports these conclusions, including any data or analysis used; and apply the use of the form to all Service Contracts.
- Update Department policies and procedures in accordance with the new Personal Service Contract form requirements.

Response #1:

The Department agrees and will modify the Division of the Budget's (DOB) Qualified Personal Service Contract form and also update relevant policies and procedures, as recommended by OSC. These changes will be communicated to appropriate staff.

Recommendation #2:

Instruct managers to periodically reassess all service contracts to identify opportunities to suspend, eliminate, reduce or bring them in-house, and to document their determinations.

Response #2:

The Department currently reviews its expenditure activities at least annually, including those for service contracts. In addition, it is expected that the current state of the economy will result in further funding reductions, posing challenges for the Department in determining the specific activities to reduce or eliminate. As this occurs, affected service contracts will be suspended, eliminated, reduced or brought in-house, as appropriate.

Recommendation #3:

Report all Qualified Personal Service Contracts affected by Executive Order No. 6 in a timely manner on the Department's website as required.

Response #3:

The Department agrees and will re-prioritize the public notice requirements of Executive Order #6. It is relevant to note, however, that the backlog in website posting is a result of the 70 percent reduction in central contract staffing since the most recent hiring freeze and early retirement incentive, which has strained the Department's ability to adhere to the myriad of reporting requirements surrounding the contracting process.