**Standards for Procurement Systems**

In essence, a good procurement system ensures that a recipient of federal grant funds obtains goods or services through processes which maximize the value of federal funds.

Of course, procurement has always played a significant role in education at all levels, but the No Child Left Behind Act’s (NCLB’s) emphasis on services typically performed by third parties, such as specialized professional development activities, outside technical assistance and supplemental educational services (SES), has led to a dramatic increase in federally funded procurement at the K-12 level. Accordingly, a greater proportion of federal funds are now expended through contracts with private entities. In this environment, the U.S. Department of Education (ED) is placing a strong emphasis on ensuring that federal grant recipients have appropriate procurement and contracting procedures in place.

ED is also focusing on procurement and contracting issues due to federal legislation that requires ED to monitor and evaluate fiscal controls over federal funds. For example, ED is subject to Improper Payments Information Act of 2002, which requires federal agencies to review annually certain programs and activities they administer and identify those that may be susceptible to significant improper payments (e.g., misexpenditures). The act specifically requires ED to scrutinize incorrect payment amounts, payments to an ineligible recipient, any payment for an ineligible service, any duplicate payment, payments for services not received, and any payment that does not account for credit for applicable discounts. In 2005, ED conducted a review of the student financial assistance program authorized by the Higher Education Act and Title I of NCLB with a particular eye on procurement and payments as required under the Improper Payments Information Act.

ED reviews other grant programs for procurement compliance by conducting a sophisticated “risk analysis” using data from the Federal Audit Clearinghouse’s Single Audit Database, ED’s G5 system (which recently replaced the Grant Administration and Payment System, otherwise known as GAPS) and the department’s Audit Accountability and Resolution Tracking System.

Finally, ED is subject to the Federal Manager’s Financial Integrity Act of 1982, which requires federal agencies to develop and maintain effective internal controls over the federal programs they administer. Each year, ED must assess its internal controls and assure that significant weaknesses will be prevented or detected in a timely manner. In this context, ED is placing greater emphasis on compliance with fiscal rules, such as procurement.

A review of recent audit findings by the Office of the Inspector General (OIG) certainly demonstrates that ED’s auditors are paying increased attention to procurement and contracting issues. The OIG has found instances in which grant recipients paid invoices before the expenditure was approved or goods or services were received, as well as cases where recipients altered contractual terms without demonstrating that amendments were reasonable. Other recent audits have found payments made to vendors that exceeded the contract’s limit. Grantees and subgrantees risk monetary audit findings, requiring a repayment of funds, if they do not maintain sufficient documentation to show expenditures were made properly.

In the 2005-2006 monitoring cycle, members of the Office of the Chief Financial Officer (OCFO) for the first time accompanied program staff as they made site visits to monitor state and local grant programs, particularly NCLB Title I, Part A. The OCFO staff focused on recipients’ procurement and disbursement controls. As a result, the OCFO announced in April 2006 that procurement and disbursement control finding represented over 50 percent of all findings in Title I monitoring reports issued during the 2005-2006 monitoring cycle, suggesting the magnitude of the problem.

An important practical point is that procurement systems are “easy to audit”- a broken paper trail is, in itself, a finding. As a result, during a monitoring or auditing visit for procurement, entities typically are subject to a high level of scrutiny.

Determining which particular federal rules apply in a legal sense to an entity’s procurement system depends on (1) what type of entity is receiving the federal funds, and (2) whether the funds are allocated through a state administered program or a direct grant program. From a practical perspective, however, it is essential to note that the Office of Management and Budget (OMB) circulars containing “cost principles” (A-21, A-87, and A-122) all require expenditures of federal funds to be necessary, reasonable, allocable and legal. As explained below, a good procurement system is essential to demonstrate compliance with these cost principles.

**Which Standards Apply to Different Entities**

The standards that apply to different entities are established by different regulations.

**Institutions of Higher Education, Hospitals and Other Nonprofit Organizations**

The general procurement standards for institutions of higher education, hospitals and other nonprofit organizations are articulated in Sections 74.40 through 74.48 of Education Department General Administrative Regulations (EDGAR).

**States and Local Governments**

The procurement standards for states and local governments that are recipients of federal education grants are articulated in Section 80.36 of EDGAR. In turn, different subsections of 80.36 may apply depending on the specific character of the entity and the type of grant being administered.

**Procurement Rules That Apply to States Generally and to Local Governments in State-Administered Programs**

In general, when procuring goods or services with federal funds, Section 80.36(a) permits states to use the same procurement policies and procedures they use for procurements made with state funds. Local governments receiving funds through states, including local educational agencies (LEAs), are permitted to use the same procurement policies and procedures they use for procurements made with state or local funds. Note that most major education programs – such as Title I, Part A the Individuals with Disability Education Act (IDEA) Part B program and Perkins – are state administered programs.

In the context of state-administered program funds, it is the state’s responsibility to ensure that local government subgrantees, such as school districts, meet state and local procurement requirements. ED program monitors have issued findings against states where subgrantees could not demonstrate compliance with state and local procurement requirements.

**Procurement Rules That Apply to Non-State Entities in Direct Grant Programs**

Non-state grantees, including school districts, that receive funds directly from ED, may follow state and local procurement procedures only if those procedures meet the requirements outlined in Sections 80.36(b)-(i) of EDGAR. If state of local procurement procedures do not comply with the requirements outlined in EDGAR, entities are vulnerable to findings regarding the adequacy of their procurement systems and the possible questioning of federal funds.

**Summary of EDGAR-Specific Procurement Requirements**

Recipients that receive funds directly from ED must ensure that their procurement processes comply with specific minimum thresholds outlined in EDGAR. These threshold requirements are summarized in this section. In addition, this section describes certain contracting requirements that apply to all recipients of federal funds.

Even where specific EDGAR threshold procurement standards may not formally apply to certain entities, such as states and LEAs administering state-administered programs, it is important for all recipients of federal funds to be familiar with the EDGAR requirements for procurement systems from a “minimum standards” perspective. This is because ED monitoring reports seem to indicate that the closer a state or LEA administering a state-administered program comes to implementing the threshold EDGAR standards described below, the better protected that entity is against possible findings event though the specific EDGAR threshold requirements do not formally apply to it.

**Procurement Requirements by Grantee Type**

|  |  |
| --- | --- |
| Type of Grantee or Subgrantee | Procurement Procedures to Be Used  (Caveat: Even where an entity is legally permitted to follow state or local procurement procedures, entities must still ensure the basic cost principle requirements of necessary, reasonable, allocable, and legal are met, as well as other state, local and federal rules.) |
| States  Local government receiving ED funds through states | Use existing state and local procurement procedures |
| Local governments receiving funds directly from ED  “Other grantees and subgrantees” | Use existing state or local procurement procedures if they comply with Sections 80.36(b)-(i) of EDGAR.  Otherwise, implement procedures specified in those sections of EDGAR |
| Institutions of higher education (IHEs)  Hospitals  Other nonprofit organizations | Implement policies and procedures that comply with Sections 74.40-74.48 of EDGAR. |

Below is a summary of the minimum procurement standards contained in EDGAR Section 80.36 (which applies to state and local governments) and Part 74 (which applies to institutions of higher education and nonprofits). It is important to note while these two sections of EDGAR are similar with regard to procurement, there are differences. Entities are advised to consult counsel to determine which standards apply in a given circumstance. For simplicity, this summary is aligned to the organization of Sections 80.36(b)-(i) of EDGAR; entities are advised to consult the appropriate Part that applies to their particular grant and circumstance before expending funds.

**Procurement Standards**

Where applicable, EDGAR requires that grantees and subgrantees have in place a procurement system that conforms to certain minimum requirements. A procurement system should include the following.

1. Contract Administration System

A system must be in place that ensures contractors perform in accordance with the terms, conditions and specifications of their contracts or purchase orders. EDGAR does not specifically define what constitutes a “good” contract administration system; however the section below outlines certain functions the Office of Inspector General and the program monitoring offices appear to expect in a “good” contract administration system, based on audit and monitoring reports. For IHEs, Part 74 places an affirmative obligation for recipients to ensure that adequate and timely follow up of all purchases has occurred, including evaluation and documenting contractor performance and meeting the terms of the contract.

1. Written Code of Standards of Conduct, Including Conflict-of-Interest Standards

Grantees and subgrantees must maintain a written code of conduct governing the performance of employees that award and administer contracts. This code must address conflicts of interest. Specifically, EDGAR defines a “conflict of interest” as arising when any of the following has a financial or other interest in the firm selected for award:

* The employee, officer or agent
* Any member of that person’s immediate family
* That person’s partner
* An organization which employs, or is about to employ, any of the above or has a financial or other interest in the firm selected for award

A grantee’s or subgrantee’s officers, employees or agents are not permitted to solicit or accept gratuities, favors or anything of monetary value from contractors, potential contractors or sub-contractors. Grantees and subgrantees may set rules allowing an employee to participate in a procurement transaction where the employee’s financial interest is not substantial, or allowing a gift when the item is unsolicited and of nominal intrinsic value.

The written code of conduct must provide for penalties, sanctions or other disciplinary actions for violations by the grantee’s or subgrantee’s officers, employers or agents, or by contractors or their agents, to the extent permitted under state and local law. The awarding agency may establish additional rules prohibiting real, apparent or potential conflicts of interest.

1. Procedures for Review of Proposed Procurements and Encouragement to Employ Certain Economies in Purchasing

Recipients should maintain review procedures to avoid the purchase of unnecessary or duplicative items. This is a distinct procurement requirement and it is consistent with the requirement of the cost principles that all federal expenditures must be necessary, reasonable and allocable. Specifically, EDGAR encourages grantees and subgrantees to consider consolidating or breaking out procurement to obtain the most economical approach. In addition, grantees and subgrantees are encouraged to:

* Enter into intergovernmental agreements for purchases, where appropriate;
* Use federal excess and surplus property in lieu of new purchases, where feasible; and
* Use value-engineering clauses in construction projects (note that most federal education programs do not permit funds to be used for construction).

1. Awards to Responsible Contractors

Awards should only be made to contractors that have the ability to perform successfully under the terms and conditions of the proposed procurement. Consideration should be given to integrity, compliance with public policy, record of past performance, and financial and technical resources.

Grantees and subgrantees may not enter into contracts with entities that have been suspended or debarred from participating in contracts supported with federal funds. Nonfederal auditors are required to review compliance with this requirement each year. Grantees and subgrantees may verify a contractor’s status by searching the federal government’s Excluded Party List System at: http//www.epls.gov.

1. Maintenance of Records

Records detailing the significant history of the procurement must be maintained, including materials on:

* the rationale for the method of procurement;
* selection of the contract type;
* contractor selection or rejection; and
* the basis for the contract price.

Lack of adequate documentation is a very common reason for audit and monitoring findings.

1. Time and Materials Contracts

“Time and materials contracts” are permissible only under very limited circumstances. In general, the federal government disfavors contracts that do not establish a firm fixed price or rate because of the increased risk of cost overruns or unscrupulous contractors that may overcharge in order to obtain a higher fee. Thus, as described in EDGAR Section 80.36, time and materials types of contracts may be used only (1) after a determination that no other contract is suitable, and (2) if the contract includes a ceiling price that the contractor exceeds at its own risk. Both EDGAR Section 74.44 and Section 80.36(f)(4) prohibit a “cost-plus-a-percentage-of-cost” contract, so if a time and materials contract is on a cost-plus basis, it would not be permissible method of procurement for any entity covered by one of these sections.

1. Settlement of Issues Arising out of Procurements

Grantees and subgrantees alone are responsible for the settlement of all contractual and administrative issues arising out of procurement disputes. The federal government will not substitute its judgment unless the matter is primarily a federal concern. The types of issues that can arise include, but are not limited to, source evaluation, protests, disputes and claims.

1. Protest Procedures to Resolve Disputes

Protest procedures must be maintained to handle and resolve disputes by bidders and contractors. Grantees and subgrantees must in all instances disclose information regarding the protest to the awarding agency.

**Competition**

EDGAR requires that all procurement transactions (with limited exceptions) be conducted with full and open competition. The competition requirements are outlined in Sections 80.36(c) and 74.43 of EDGAR depending on the type of entity administering funds. The Section 80.36(c) standards for state and local agencies are much more prescriptive than the Section 74.43 standards applicable to IHEs, although many of the Section 80.36(c) standards might be considered “best practices” for IHEs.

In general, grantees and subgrantees should ensure that their procurement systems maximize competition so they can demonstrate that a good value was obtained by the federal program under which the service or item was procured. Examples of situations that could be considered restrictive or competition are outlined in Section 80.36(c):

* Placing unreasonable requirements on firms in order for them to qualify to do business
* Requiring unnecessary experience or excessive bonding
* Noncompetitive pricing practices between firms or between affiliated companies
* Noncompetitive awards to consultants that are on retainer contracts
* Organizational conflicts of interest
* Specifying only a “brand name” product instead of: (a) allowing an “equal product to be offered; and (b) describing the performance requirements of other relevant elements of procurement.
* Any arbitrary action in the procurement process

In addition, the regulations require the following procedures to ensure adequate competition.

1. Geographical Preferences Prohibited

Statutorily or administratively imposed in-state or local geographical preferences are prohibited by EDGAR Section 80.36(c), except when an applicable federal statue expressly mandates or encourages geographical preferences. For IHEs, Part 74 does not expressly prohibit geographical preferences in the same manner; however, the OMB Circular A-133 compliance supplement still largely restricts the use these preferences by IHEs, and suggests that auditors by wary of these arrangements.

1. Written Selection Procedures

EDGAR requires grantees and subgrantees to develop written procedures for selecting vendors. Because each procurement transaction is unique, these procedures will vary depending on the procurement. In fact, many of the federal rules and regulations governing grants management require grantees and subgrantees to develop written procedures for certain processes. Written procedures are an important control activity to ensure federal funds are spent appropriately.

Another important part of managing federal funds is ensuring that federal programs receive the best value for the federal funds spent on the program. As described above, arm’s –length bargaining through free and open competition is the best way to guarantee a good value. Part of this process is applying clear, uniform and, to the maximum extent possible, objective criteria for selecting vendors. EDGAR is very specific as to what should be contained in written selection procedures, stating that all solicitations must:

* incorporate a clear and accurate description of the technical requirements for the material, product or service to be procured. This description should not unduly restrict competition. For example, the grantee or subgrantee should not specify a brand name or draft such a detailed description that only a brand name will fit the description.
* identify all requirements that the vendor must fulfill and all other factors to be used in evaluating bids or proposals.

1. Pre-Qualified Lists

All pre-qualified list of persons, firms or products must be current and ensure that enough qualified sources are included to ensure maximum open and free competition. (Certain states maintain pre-qualified lists, where state procurement rules may be more flexible because the state has already engaged in competition on behalf of other entities; these rules vary from state to state, and federal grant recipients should be familiar with the rules within their own states). For IHEs, Part 74 does not place similar, explicit restrictions on pre-qualified lists.

**Methods of Procurement to Be Followed**

Where the specific EDGAR threshold standards apply, grantees and subgrantees must meet baseline requirements for procurements by small-purchase procedures, sealed bids and competitive proposals. These types of procedures are outlined EDGAR Section 80.36(d) and described below. Section 74.44 has similar, but much less prescriptive requirements.

1. Small-Purchase Procedures Using a Simplified Acquisition Threshold

Grantees and subgrantees may follow relatively simple and informal “small purchase” procedures when the goods or services cost $100,000 or less. This $100,000 threshold is the federal government’s “simplified acquisition threshold”; however, a state or local government may set a lower threshold for a “small purchase,” in which case a state or local government is bound to use its lower threshold. If a state or local government has a threshold higher than $100,000 for purchases made with state or local funds, then the $100,000 threshold applies to federal funds. The federal government occasionally revises its small-purchase threshold, so it is important to check current federal regulations. If small-purchase procedures are appropriate, grantees and subgrantees typically must simply solicit quotes from an adequate number of qualified sources. The precise methods by which quotes must be obtained are usually established by state or local procurement rules or procedures.

1. Procurement by Sealed Bids (Formal Advertising)

A “sealed bid” is a formal method of procurement where the grantee or subgrantee publicly invites vendors to submit bids offering to provide goods or services at a specific price. Under sealed bidding, a firm fixed-price contract is awarded to the responsible bidder whose bid conforms with all terms and conditions of the invitation and is the lowest in price. The invitation for bids (IFB) is usually very detailed and includes a description of the item to be purchased or service to be rendered, as well as all of the terms and conditions that will be included in the contract.

Sealed bids are appropriate when:

* A complete, adequate and realistic specification or purchase description is available;
* Two or more responsible bidders are willing and able to compete effectively for the business; and
* The procurement lends itself to a firm fixed-price contract and the selection of the successful bidder can be made principally on the basis of price.

If sealed bids are used, the following requirements apply:

* The invitation for bids must be publicly advertised, and bids must be solicited from an adequate number of known suppliers, providing them sufficient time to reply.
* The invitation for bids must include any specifications and define the items or services the vendor is expected to deliver in order for the bidder to properly respond.
* All bids must be publicly opened at the time and place prescribed in the invitation for bids.
* A firm fixed-price contract award must be awarded in writing to the lowest responsive and responsible bidder. A firm fixed-price contract establishes a fixed, lump-sum payment for delivery of a specific good or performance of a specific service.
* Any or all bids may be rejected if there is a sound documented reason.

Again, grantees and subgrantees may use state or local sealed-bidding requirements if they meet the above threshold requirements. Additionally, more stringent state or local procurement requirements may also be required as dictated by state or local law.

1. Procurement by Competitive Proposals

A “competitive proposal” is another formal method of procurement. The grantee or subgrantee issues a public request for proposals, often known as an RFP, and vendors respond with proposals for the types of goods or services they will submit. It is normally conducted with more than one source submitting an offer, and results in the awarding of either a fixed-price or cost-reimbursement type contract. Competitive proposals are generally used when conditions are not appropriate for the use of sealed bids. For example, competitive proposals may be appropriate when expertise is important, as is often the case with professional services, or when the item to be purchased or services to be rendered are difficult to describe in an invitation for bids.

If competitive proposals are used, the following requirements apply:

* Requests for proposals must be publicized and identify all evaluation factors and their relative importance. Any response to publicized requests for proposals must be honored to the maximum extent practical.
* Proposals must be solicited from an adequate number of qualified sources. (ED does not define “an adequate number”; the number for “adequacy” will vary in every case depending on the subject of the procurement.)
* Grantees and subgrantees must have a method for conducting technical evaluations of the proposals received and for selecting awardees.
* Awards must be made to the responsible firm whose proposal is most advantageous to the program, with price and other factors considered. It is important to note that price is not the only factor considered in making the determination.
* Section 80.36(d)(3)(v) of EDGAR contains special rules for contracts for architectural and engineering services.

Grantees and subgrantees subject to the specific EDGAR requirements must ensure that their processes meet these threshold standards.

1. Noncompetitive (Sole-Source) Proposals

As discussed above, ED expects grantees and subgrantees to maximize competition. However, in certain limited situations, noncompetitive proposals are permitted if one of the following circumstances applies:

* the time is only available from a single source;
* there is a public exigency or emergency;
* the awarding agency authorizes noncompetitive proposals; or
* after soliciting a number of sources, competition is determined to be inadequate.

These are the only valid reasons to permit noncompetitive proposals. It is essential to note that even if one of the above situations applies and the entity is permitted to make a noncompetitive procurement, the grantee or subgrantee is required to ensure the contract price is reasonable by conducting a cost analysis, as explained in the following section.

**Contract Cost and Price**

Either a cost analysis or a price analysis must be performed for all procurement transactions, such as a contract, a contract amendment of any other type of contract modification that involves the expenditure of funds. Cost analysis generally means evaluating the separate cost elements that make up the total price. Price analysis generally means evaluating the total price, without looking at the individual cost elements.

Which method to use and the degree of the analysis will vary depending on the situation, but the regulations require grantees to make independent estimates before receiving bids or proposals as a method of determining the reasonableness of the contract price.

EDGAR makes clear that a cost analysis must be performed even when a transaction goes through a noncompetitive process-such as sole source procurements, contract modifications and change orders – unless price reasonableness can be established on the basis of a catalog or market price of a commercial product sold in substantial quantities to the general public or based on prices set by law or regulation.

**Awarding Agency Review**

ED has the authority to review all procurements made with its funds. In addition, the awarding agency (in the case of state-administered programs, the state education agency, or SEA) may ask to review documents during the entire cycle of the procurement process.

**Contract Provisions**

In addition to any contract provisions that may be required by an individual program statute or regulations (for example, the required statutory provisions detailed in NCLB for an SES contract), state and local governments in astate-administered programs must ensure that all contracts and purchase orders include all clauses required by federal statutes and executive orders. Because these requirements may change, recipients are encouraged to contact counsel to determine what clauses are currently required in a contract supported with federal funds.

EDGAR Section 80.36(i) requires non-state grantees and subgrantees, as well as non-state entities managing direct grant programs, to develop contracts that contain the following:

* administrative, contractual or legal remedies in instances where contractors violate or breach contract terms;
* language allowing termination for cause and for convenience;
* notice of the awarding agency’s reporting requirements;
* notice of the awarding agency’s requirements and regulations governing patent rights associated with any discovery or invention developed during or under the contract;
* notice of the awarding agency’s requirements pertaining to copyright;
* access by the grantee, the subgrantee, the grantor agency and the Comptroller General of the United States to records;
* retention of records for at least three years after payments are made and all pending matters are closed (as noted earlier, since the statute of limitations is five years, recipients may wish to specify retention for a minimum of five years rather than three): and
* additional clauses that must be included for certain federal legal requirements (such as compliance with the Davis-Bacon Act and the Clean Air Act) as specified in Section 80.36(i) of EDGAR.

EDGAR requires institutions of higher education (IHEs), hospitals and other nonprofit organizations to meet the contract provisions contained in Section 74.48, as well as Appendix A to Part 74.

It should be noted that these are similar to the requirements listed above derived from Section 80.36(i), but there are some differences. For example, Part 74 does not sate that an IHE must include contract provisions relating to patent rights and copyrights. Also, only negotiated contracts that exceed the small purchase threshold must include a provision granting access by the recipient, ED and the Comptroller General of the United States to records. Additionally, compliance with the Davis Bacon Act or the Clean Air Act are not referenced in Section 74.48.

**Contracting With Faith-Based Organizations**

EDGAR contains relatively new regulations that pertain to contracting with faith-based organizations. These regulations establish that faith-based organizations are eligible to contract with grantees and subgrantees, including states, on the same basis as any other private organization. Grantees and subgrantees may not discriminate for or against an entity based solely on its religious character or affiliation.

In general, a faith-based organization that participates in a contract supported with federal funds may retain its independence and religious character. For example, the organization may continue to carry out its mission, use its facilities to provide services without removing or altering religious symbols, and include religious references in its mission statement. The organization must, however, carry out any inherently religious activities (such as religious worship, instruction or proselytizing) separately in time or location from any programs or services supported by the contract.

**Practical Advice Regarding Procurement Systems: Importance of Cost Principles in Relation to Procurement**

All recipients of federal education funds must comply with the “cost principles” applicable to them through the OMB circulars. While different cost principles apply to different entities (e.g., OMB Circular A-87 applies to state and local governments; A-21 applies to IHEs; A-122 applies to nonprofit organizations) all of the circulars contain the basic concept that expenditures of federal funds must be necessary, reasonable, allocable and legal for the proper administration of the federal program.

Within the context of the cost principles, it becomes clear why it is critical that a recipient have a strong procurement system that appropriately manages the manner in which goods and services are obtained with federal funds. Without an effective procurement system, it becomes difficult for a recipient of federal funds to demonstrate that goods or services were necessary, obtained for a reasonable price, benefited the program at issue (allocable) and complies with state and local laws (legal).

Recent audit and monitoring findings regarding procurement indicate that (1) entities, particularly school districts, often do not comply with their won state, local or institutional procurement rules (thus violating the requirement that all expenditures be “legal” under state or local law), and (2) there are certain “minimum standards” with regard to procurement that ED appears to expect recipients of federal funds to implement to ensure appropriate internal control over procurement and compliance with the cost principles. The practical advice below is based on recent ED finding in monitoring and audit reports.

**Compliance With State, Local and/or Institutional Rules Regarding Procurement**

State and local governments managing state-administered programs (such as Title I, Part A) are required to implement procurement systems that are compliant with state and local procurement rules. Accordingly, it is incumbent upon all recipients of federal funds to ensure that (1) they are in compliance with current state, local or institutional rules regarding procurement, and (2) that those policies “make sense” in the context of implementation.

Because federal auditors and monitors will hold entities responsible for implementing state, local or institutional rules regarding procurement, if these policies do not “make sense,” entities risk a finding where procurement rules are being ignored. Accordingly, entities are well-advised to regularly review procurement rules to determine:

1. if they are complying with current rules,
2. if the procurement rules make sense from a practical perspective, and
3. if the procurement rules do not make sense, to make revisions to the rules as required (revisions to procurement rules can be more or less burdensome depending on state or local laws).

**Written Procurement Policies or Guidance Regarding Procurement Transactions That Ensure Strong Controls over Federal Funds**

As a response to deficiencies identified in several monitoring reports, ED has required certain states to develop written procurement guidance for school districts describing minimum standards that should be met regarding procurement transactions. While ED did not specify where it derived the authority to mandate the development of such guidance in the context of state-administered programs, presumably this authority originates in part from ED’s responsibility to ensure federal funds are spent correctly and from recipients’ responsibility to ensure that all federal expenditures comply with the cost principles.

Absent written procurement rules (or guidance) it is hard for a recipient to demonstrate there are sufficient internal controls and processes in place to ensure that a transaction supported with federal funds is necessary, reasonable, allocable and legal. If there are no written state, local or institutional procurement policies, recipients of federal funds are well-advised to have written procurement rules or guidance at least federally supported procurement transactions.

**Written Contracts or Purchase Orders Containing Clear Deliverables**

ED is monitoring recipients to ensure that they impose proper procurement controls over transactions supported with federal funds. This is because a strong procurement system maximizes the likelihood that federal funds will be expended in a manner that is both necessary to meet an entity’s specific objective and reasonable regarding price. It is very difficult to prove compliance with the “necessary and reasonable” requirements without a written contract or purchase order describing the specifications needed by the entity – otherwise known as “deliverables.” In addition, in order to demonstrate a valid obligation of federal funds, an entity must have a “binding written commitment”.

Further, having a written contract or purchase order is an important internal control to ensure there is no disagreement regarding the terms and conditions contractors must fulfill under the contract. This is essential to protect federal funds where a contractor does not perform what the entity requested.

For example, if an entity requests a contractor to provide five professional development sessions, and the contractor then only provides two professional development sessions, it may be more difficult for the entity to ensure all five requested sessions are delivered, or to deny payment based on the lack of performance on three sessions, without a written contract. (Depending on state law and the specific circumstances, it also may be more difficult to sue the contractor for lack of performance without a written contract.) This example highlights the importance of written, clear deliverables.

As a practical manner, it is difficult to demonstrate a contract is reasonable and benefits the relevant program (allocable), as required under the federal cost principles, without a clear description of what good or service the entity purchased under the contract. It is also difficult to demonstrate that a contractor performed in accordance with the terms, conditions and specifications of its contract unless the contract clearly describes what the contractor is supposed to do. Therefore, ED monitors and OIG auditors recommend that contracts be sufficiently detailed to leave nothing to the imagination. Specifically, it is important to include a description of:

* the services to be performed or goods to be delivered;
* the dates when the services will be performed or goods will be delivered;
* the locations where the services will be performed or goods will be delivered; and
* the number of intended beneficiaries to be served, if relevant.

It is important to clearly specify when payments will be made.

Finally, EDGAR requires all contracts supported with federal funds to contain certain contract provisions, such as compliance with anti-kickback laws, equal employment opportunity, fair wage and hour requirements, and the like.

In sum, it is practically impossible to demonstrate compliance with contract requirements without a written contract. It should be noted that LEAs increasingly are being cited for poor contracts under NCLB. That law requires the provision of supplemental educational services for students in schools in the second year of “improvement,” and these services are frequently provided through contracts with independent providers. Not uncommonly, federal monitors have found that these contracts are vague.

Likewise, LEA contracts with entities that provide Title I services to eligible children attending private schools are frequently found to be deficient.

**Written Invoices**

Written invoices are an important internal control activity and will facilitate an effective audit. It is important to include on the invoice a description of:

* the services the vendor performed or goods it delivered;
* the dates when the services were performed or goods were delivered;
* the locations where the services were performed or goods were delivered; and
* the number of eligible beneficiaries that were served, if relevant.

This information should match the terms agreed upon in the contract.

In parallel with their findings regarding vague contracts, federal monitors have often cited LEAs for failure to obtain adequately detailed invoices from their contractors.

**Proper Segregation of Duties**

Several recent monitoring reports had findings related to recipients of federal funds not having processes that ensure the proper segregation of duties. A lack of “segregation of duties” typically means that either one person (such as a superintendent or principal), or a small group of people, has sole final authority for approving various stages of procurement transactions. For example, duties are likely not properly segregated if one individual has authority for selecting a contractor, authorizing payment to that contractor and issuing the check. In this environment, the likelihood that fraud or unintentional errors will not be detected by a “system” is greatly increased.

To correct this problem, ED has required recipients to ensure that policies and procedures are put into place to ensure that duties are segregated properly – meaning that ED is requiring recipients to establish systems that ensure that all aspects of the procurement process are not delegated to one person(or a small group). In the context of state-administered programs, ED does not clearly articulate where it derives the authority to mandate that recipients ensure the proper segregation of duties over procurement transactions, but this authority likely comes from the EDGAR requirement that grantees have proper internal controls in order to effectively administer their grants. To the extent that vesting authority over all or most aspects of a procurement process in a single person (or a small group) may increase the risk of abuse or inadvertent misexpenditure of federal funds, recipients are wise to ensure that procurement duties are properly segregated so that there are numerous checks within the grantee’s system for facilitating and processing all procurement transactions.

**Clear and Timely Payment Processes**

It is important for entities to establish and enforce controls over their payment processes. Grantees and subgrantees must be able to prove that all expenditures of federal funds are reasonable; thus an appropriate official should review proposed payments to ensure the contractor has met all of its responsibilities under the contract and payment is appropriate. This review should be documented to facilitate an effective audit. In addition, ED is interested in seeing that vendors are paid in a timely fashion in order to maximize the market of potential vendors that wish to do business with an entity.

**Appropriate Documentation**

The importance of maintaining adequate and appropriate documentation in easily accessible procurement files cannot be understated. Many audit and monitoring findings are issued because files, receipts, or other supporting documentation cannot be located, required signatures or dates are missing from the documentation that is there, or there is a mismatch between invoice and payment amounts. Therefore, all recipients of federal grant funds should ensure that they have a documentation system that ensures that there is an adequate paper trail to validate every procurement made with federal funds. This is essential in order to prove compliance with the federal cost principles.

**Audit Tips**

Keep a printout from the Excluded Party List System Web site to documents that you’ve verified the contractor’s status and complied with the requirement.

Make sure that each step in a procurement transaction takes place in proper order and is adequately documented. In particular, purchase orders dated after the receipt of goods or services, or evidence that purchase orders have been backdated, can by symptomatic of weak internal controls and could result in audit findings.

If a recipient determines that competition is not necessary because of “sole source” exception, be sure to document how the decision was reached. Documentation should show the uniqueness of the services sought, the dearth of other providers in the area and the specific experience of the vendor selected. Remember that reasonable price is always required. The documentation does not necessarily need to include memoranda to the file. Retaining intra-agency emails for the recipient’s vendor file, for instance, can aid in demonstrating that the grantee’s personnel were reasonable in utilizing a sole source, given the particular circumstances.

Tie payment to deliverables. In other words, the contract should specify that the grantee or subgrantee is not responsible for paying until the contractor delivers what is promised under the contract. ED disfavors contracts where the grantee or subgrantee pays over time regardless of the contractor’s performance (e.g., a lump-sum contract paid in periodic installments).

As a matter of good practice, many institutions document procurements with what is termed the “three-way” match: Every purchase must have a purchase order, an invoice, and a receiving record or voucher to demonstrate that the number and specifications for the goods received match the purchase order. For services, evidence that services were provided, such as vendor time sheets or sign-in/sign-out sheets, would provide the third “leg” of the three-way match. Only when all three documents are in hand will the finance office cut the check.

Referenced from: Federal Grants Management: What Administrators Need To Know, 3rd Edition, Thompson Publishing