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Key Points of Report

An Audit Report on the State Use Program

September 2000

Overall Conclusion

Disputes over open records and inadequate resources have impeded the ability of the Texas Council on Purchasing From People With Disabilities (Council) to oversee the State Use Program (Program). The Council lacks clear access to critical financial and performance information it needs to ensure that the Program is run in a manner consistent with the best interests of the State. The Council has not formulated clear criteria for deciding which goods and services are suitable for the Program. These factors jeopardize the Program's ability to employ persons with disabilities and provide quality products and services to the State. The Program generated sales of over \$51 million and provided employment for more than 5,700 citizens with disabilities during fiscal year 1999.

Key Facts and Findings

- The central nonprofit agency that administers the Program has resisted the Council's efforts to obtain the information it needs to effectively oversee the Program. Although the central nonprofit agency derives virtually all of its revenue from the Program, it has asserted that many of its records are proprietary and therefore are not available to the Council or the public.
- The Council has no administrative rules or documented policies for deciding which goods and services are suitable for the Program. The lack of clear criteria creates uncertainty for affected stakeholders and could result in approval of contracts that do not align with the intent of the Program.
- The central nonprofit agency has spent approximately \$468,000 over the past three years on items that do not directly benefit community rehabilitation programs participating in the Program. Approximately \$214,000 of this amount was spent in litigation against the Council.
- The central nonprofit agency lost over 650 checks worth in excess of \$3.6 million due to weak financial controls over payment processing.
- Although the central nonprofit agency needs to improve its product development research, its marketing function has contributed to an increase in the Program's overall sales from \$36.6 million in 1995 to \$51.7 million in 1999.

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This audit was conducted in accordance with Government Code, Sections 321.0132 and 321.0133

Executive Summary

Disputes over open records and inadequate resources have impeded the ability of the Texas Council on Purchasing From People With Disabilities (Council) to oversee the State Use Program (Program). The Council lacks clear access to financial and performance information it needs to ensure that the designated central nonprofit agency runs the Program in a manner consistent with the best interests of the State. The Council has not formulated clear criteria for deciding which goods and services qualify for the Program. These factors jeopardize the Program's ability to employ persons with disabilities and provide quality products and services to the State. The Program generated sales of over \$51 million and provided employment for more than 5,700 citizens with disabilities during fiscal year 1999.

The Program was created in 1975 to encourage and assist persons with disabilities to achieve maximum personal independence by engaging in useful, productive work. Products and services provided by workers with disabilities are "set aside" for preferential purchasing priority by state agencies. The Council determines which products and services are suitable for the program, and the central nonprofit agency administers the daily operations of the Program.

Disputes Over Open Records and Inadequate Resources Impede the Council's Ability to Oversee the Program

- A dispute over the open record status of documents maintained by the central nonprofit agency has hindered the Council's ability to assess the reasonableness of the central nonprofit agency's expenditures, financial stability, or alignment of initiatives with policy directions set by the Council. The central nonprofit agency asserts that many of its records are proprietary and are therefore not available to the Council.

- The Council lacks the staff to monitor the Program and to fulfill its statutory responsibilities.

The Council Has No Administrative Rules or Documented Policies for Deciding Which Goods and Services Are Suitable for the State Use Program

- The lack of clear criteria creates uncertainty for community rehabilitation programs (CRPs), purchasers, and sectors of the business community affected by decisions to place products on set aside. This lack of criteria could result in approval of contracts that do not align with the intent of the Program.

The Council Should Re-Evaluate the Management Fee for the Central Nonprofit Agency

- Questions about the reasonableness of the management fee and the appropriateness of some expenditures by the central nonprofit agency indicate the need to re-evaluate the fee structure. Some CRPs believe the management fee they are charged to participate in the program is too high. The central nonprofit agency was paid \$2.97 million in management fee commissions in fiscal year 1999. Over the past three years, the central nonprofit agency has spent approximately \$468,000 on items that do not directly benefit CRPs participating in the Program. Examples of questionable expenditures by the central nonprofit agency include \$214,000 to sue the Council and \$64,000 to retain a legislative lobbyist.
- The central nonprofit agency does not track sufficient data to fully evaluate the cost of services provided to CRPs. All CRPs are charged the same management fee rates regardless of how much

Executive Summary, continued

assistance is provided by the central nonprofit agency. A number of CRPs perform their own product development, marketing, and contract negotiation without assistance from the central nonprofit agency.

The Central Nonprofit Agency Lacked Adequate Financial Controls to Safeguard Resources of the State Use Program

- The central nonprofit agency lost over 650 warrants totaling more than \$3.6 million because it did not have adequate accounting safeguards over payments received from state agencies and political subdivisions. The central nonprofit agency took more than five months to identify the problem even though its line of credit had a dramatic upward spike from August through December 1999. The central nonprofit agency estimates current costs associated with the missing warrants to be over \$92,000.
- While the central nonprofit agency is in the process of implementing a new automated accounting system, staff members do not have a clear understanding of the system's capabilities. Consequently, we were unable to determine if the new system will improve the central nonprofit agency's ability to properly record, report, and safeguard Program revenues.
- The central nonprofit agency has bank balances in excess of the federally insured limit of \$100,000, resulting in uninsured balances of approximately \$217,000. The central nonprofit agency has not taken action to insure the funds despite the fact that the problem has been pointed out by its external certified public accountant for the past two fiscal years.

The Integrity of the State Use Program Cannot Be Ensured Without a Monitoring Function and Additional Policies Regarding CRP Eligibility to Participate in the Program

- Without a mechanism to monitor CRP compliance with Program requirements, there is a risk that ineligible organizations will benefit from the noncompetitive market established for workers with disabilities.
- Data related to CRP compliance with program polices is self-reported by the CRPs without independent verification by either the Council or the central nonprofit agency. Additionally, there is no verification of worker disability. Verification of worker disability is required of CRPs that participate in the federal set aside program.
- One CRP participating in the Program entered into contractual agreements and financial transactions with a for-profit entity that pose potential conflicts of interest. The Council has no policy regarding related-party contracts and transactions.

The Central Nonprofit Agency's Marketing Function and Financial Support Assist CRPs

- The central nonprofit agency's marketing of the Program and financial support provided to CRPs have contributed to a 71 percent overall increase in sales over the past four years. Although product sales have declined and the central nonprofit agency has experienced turnover problems with its marketing staff, total sales increased from \$36.6 million in 1995 to \$51.7 million in 1999.

Executive Summary, concluded

- The central nonprofit agency has worked with the Department of Transportation and the General Services Commission to develop standard pricing formulas for litter contracts and temporary services. Although the formulas facilitate negotiations for Program contracts, they should be revised periodically to reflect changes in the labor market and actual costs to CRPs.
- The central nonprofit agency provides valuable support to CRPs by advancing payments, providing technical assistance grants, and on occasion, being flexible in collecting its management fee. This support facilitates CRPs' ability to employ persons with disabilities and provide quality products and services to the State.

The Central Nonprofit Agency Does Not Adequately Research Products for the State Use Program

- The central nonprofit agency relies heavily on CRPs for product development and does not adequately research new product initiatives for the Program. One computer contract approved by the Council was later suspended due to a conflict with the State's Qualified Information System Vendor Program.

The General Services Commission Does Not Provide Compliance Exception Reports to the Council as Required by Statute

The lack of exception reports impedes the Council's the ability to monitor whether products and services are procured through the Program when required by law.

Summary of Management s Responses

The central nonprofit agency disagrees with most of the findings and recommendations that apply to its administration of the Program. The central nonprofit agency's responses indicate an unwillingness to accept oversight from the State or accountability for its management decisions.

The Council and the General Services Commission are in general agreement with the report findings and recommendations.

The full text of each management response is in Appendices 5, 6, and 7.

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Section 1:

Disputes Over Open Records and Inadequate Resources Impede the Council's Ability to Oversee the State Use Program

Litigation, court ordered mediation, and requests for Attorney General opinions have failed to resolve fundamental oversight issues related to the State Use Program (Program). While the Texas Council on Purchasing From People With Disabilities (Council) and the central nonprofit agency have mediated some differences, the issue of open records, the Council's authority to competitively bid the contract of the central nonprofit agency, and transition procedures for a successor to the central nonprofit agency are unresolved. Disagreement about the open record status of documents maintained by the central nonprofit agency impedes the Council's ability to effectively oversee the \$51 million in Program revenues. The resulting lack of information prevents the Council from assessing the reasonableness of the central nonprofit agency's expenditures, the financial stability of the central nonprofit agency, or the alignment of central nonprofit agency's initiatives with policy directions set by the Council. (See Appendix 2 for a summary of litigation issues.)

The Council maintains that the central nonprofit agency, due to its unique position in administering the Program, is essentially a quasi-governmental entity, and that all records pertaining to the Program should be accessible to the Council and the public. The central nonprofit agency, which derives virtually all of its revenue from the Program, believes that as a private, nonprofit corporation, many of its records are proprietary and are not open to either the Council or the public. Although Human Resources Code, Chapter 122, allows the State Auditor, the Governor's Budget Office, and the Legislative Budget Board to inspect records pertaining to the Program, it does not specifically state whether the Council may access or possess records maintained by the central nonprofit agency.

Lack of a sufficient staff hampers the Council's ability to monitor the Program and impedes its ability to fulfill its statutory responsibilities. While the General Services Commission (Commission) provides some legal, administrative, and clerical support, the Council has no staff to support policy, management, and oversight functions.

Section 1-A:

The Council Lacks Adequate Financial and Performance Information to Effectively Oversee the State Use Program

The dispute over access to and possession of records maintained by the central nonprofit agency has impeded the Council's ability to assess the relative efficiency and effectiveness of the central nonprofit agency's administration of the Program. Although the central nonprofit agency has provided annual budgets and sales projections for the Program, the Council lacks detailed information about how the central nonprofit agency expends the management fee it receives for administering the Program. Information on expenditures for items such as employee salaries, benefits, and professional services are classified as proprietary by the central nonprofit agency. The appropriateness of some expenditures by the central nonprofit agency, noted in

Section 3, raise the need for oversight of how the central nonprofit agency expends the Program management fee commission.

The Council lacks information to assess the financial stability of the central nonprofit agency, as virtually all accounting and bank records are considered proprietary. For example, the Council lacks information regarding the central nonprofit agency's line of credit, accounts receivable, and cash reserves. The Council has not seen the central nonprofit agency's audited financial statements. Problems with the central nonprofit agency's internal financial controls, noted in Section 4, indicate the need for the Council to have information regarding the central nonprofit agency's financial position.

A lack of information about the central nonprofit agency's planning makes it difficult for the Council to assess the alignment of central nonprofit agency initiatives with the policy directions set by the Council. Both the Council and the central nonprofit agency have developed strategic plans. Although the central nonprofit agency's strategic plan has more detail and quantification of goals and objectives, the Council has not seen this plan for approximately three years. Operational plans developed by the central nonprofit agency for marketing and product development are similarly classified by the central nonprofit agency as proprietary.

While Program accomplishments are detailed in a statutorily required annual report, the Council lacks information to assess how resources, strategies, and outputs link to those outcomes. Problems associated with two new product development initiatives highlight the Council's need for more information in this area. Product development is discussed in Section 7.

Although the central nonprofit agency allowed the Council to review and copy documents after fieldwork for this audit was concluded, there is no guarantee of continued access by the Council to documents maintained by the central nonprofit agency. Given the litigious nature of the relationship between the Council and the central nonprofit agency, it appears that access to and possession of records maintained by the central nonprofit agency should be statutorily clarified.

Recommendation:

The Legislature should consider amending the enabling legislation for the Program to ensure that the Council, the State Auditor's Office, the Legislative Budget Board, and the Governor's Office of Budget and Planning have clear access to all records of a central nonprofit agency. Consideration should also be given to clarifying the public's right of access to records pertaining to the Program. One way to accomplish this would be to subject a central nonprofit agency to the Texas Public Information Act in the same manner as a governmental body as defined by the Act.

The Legislature should consider clarifying the Council's statutory authority to competitively bid the contract for a central nonprofit agency, including the Council's authority to contract with more than one central nonprofit agency.

The Legislature should consider statutorily clarifying transition procedures and property rights of a central nonprofit agency in the event a successor central nonprofit agency is chosen.

The Council, with input from the central nonprofit agency, should develop an integrated strategic and annual operating plan and an annual budget that details how Program resources will be used to implement strategies and accomplish objectives.

The Council should require by administrative rule and/or contractual term that the central nonprofit agency periodically report data on key financial indicators for the Program. The council should consider requiring the central nonprofit agency to report on financial indicators such as accounts receivable, cash reserves, line of credit loans and interest payments, and administrative overhead.

Section 1-B:

The Council Lacks Sufficient Staff to Effectively Oversee the State Use Program

Lack of staff hampers the Council's ability to monitor the Program and impedes its ability to fulfill its statutory responsibilities. While the Commission provides some legal, administrative, and clerical support, the Council has no staff to support policy, management, and oversight functions. This impedes the Council's ability to oversee the central nonprofit agency's administration of the Program. It also forces an over-reliance by the Council on the central nonprofit agency for independent analysis of self-reported data from community rehabilitation programs (CRPs) participating in the Program.

Because the Council is designated as oversight board, monitoring and compliance activities do not fall within the scope of Council members' duties. The Council needs the ability to ensure that CRPs that participate in the Program adhere to certain guidelines such as caps on administrative costs and direct disabled labor ratios. This type of data is currently self-reported by CRPs without independent verification. Issues noted in Section 5 underscore the need for independent monitoring of CRPs. With respect to oversight of the central nonprofit agency, even if the Council had access to central nonprofit agency records, this access would be of limited use without staff to review and analyze the documents.

The lack of staff also impedes the Council's ability to perform statutory responsibilities. The Council currently lacks staff to independently review and analyze:

- Cost analyses and pricing proposals from the central nonprofit agency and CRPs.
- New product and service contract proposals.
- State agency purchases made under exceptions from the mandatory requirements of the Program.
- The management fee of the central nonprofit agency.

The Council needs a better capability to function as an independent check on new product proposals brought forth by the central nonprofit agency. The central nonprofit agency has an inherent financial incentive to add new products and services to the Program, as it receives a percentage of the Program's gross sales. Currently, the Council's only mechanism to get answers to detailed, operational inquiries is to ask questions at quarterly meetings. It would be a more appropriate and efficient use of time to resolve such issues prior to the quarterly meetings. The Council's approval and subsequent suspension of new contracts for postage meters and computers indicates the need for independent analysis of proposed contracts.

The legal, administrative, and clerical support provided by the Commission is not sufficient to assist the Council with all of its responsibilities. The State Use Coordinator is a half-time position at the Commission dedicated to providing administrative and clerical support. The central nonprofit agency's management fee pays the Council's costs for travel, administration, and one quarter of the State Use Coordinator's salary expense. In fiscal year 1999, these costs totaled approximately \$26,000.

Recommendation:

The Legislature should consider giving the Council authority to employ its own staff. While consideration should be given to continuing the Commission's legal support for the Council, staffing for the Council should provide adequate support for both administrative and clerical activities as well as monitoring, policy, and management functions. Funding for Council staff could be paid from the central nonprofit agency's management fee.

Section 2:

The Council Has No Administrative Rules or Documented Policies for Deciding Which Goods and Services Are Suitable for the State Use Program

The lack of clear criteria creates uncertainty for CRPs, purchasers, and sectors of the business community affected by decisions to place products on set aside for the Program, and could result in approval of contracts that do not align with the intent of the Program. Lack of rules also makes the Program vulnerable to lawsuits and has the potential to undermine support for the Program. The Council's recent decisions to approve and later suspend postage meters for the Program illustrates the need for clear criteria for approving new contracts. (See text box.)

In 1997 the Council repealed an administrative rule (Texas Administrative Code, Chapter 40, Section 189.13) that outlined general value added parameters that new products or services must meet to be approved for the Program. The rule requirements included:

- CRPs should purchase raw materials or components through competitive bidding whenever possible.
- Workers with disabilities must make an appreciable contribution to reforming raw materials, assembly of components, or packaging of other products manufactured at rehabilitation facilities.
- Workshops may not act merely as receiving and shipping facilities.
- Workshops must establish and maintain 75 percent of handicapped direct labor hours in their operations.

In March 1999, the Council approved, and later suspended, a CRP proposal to market postage meters to state agencies. Although the proposal appeared to meet the Council's guidelines for the percentage of direct disabled labor hours in the contract, it contained several unusual features:

- The U.S. Postal Service licenses only four companies to manufacture postage meters and only allows the manufacturers to lease, not sell the meters.
- The postage meter contract combined a product rental with a servicing agreement.
- The incompatibility of accessories with other meters essentially precluded the CRP from competitively procuring meters from the other three companies licensed by the U.S. Postal Service to manufacture meters. This created a potential long-term monopoly for the company supplying the CRP with meters.

Although a number of CRPs transform or assemble raw materials and manufactured components, the raw material and components are generally obtained through competitive procurement from private sector vendors.

Since repeal of the administrative rule, the Council has operated without any formally documented rules or policies regarding criteria for approving new contracts. Although the Council adopted a value-added statement setting a goal of 75 percent direct disabled labor, this statement resides in Council meeting minutes and is not formally documented as policy by the Council. Since the repeal of the administrative rule in 1997, the Council has had no requirement that CRPs competitively procure goods that are reformed, assembled, or repackaged, nor has the Council had a formal requirement that CRPs not act merely as receiving and shipping facilities.

The Council is currently in the process of formulating administrative rules for the Program. The Council conducted a series of town hall meetings to gather input from stakeholders affected by the Program. The Council has a goal of finalizing its rules by December 2000.

The federal set-aside program has administrative rules documenting criteria for approving products for the federal program. The federal set-aside program, for example, requires competition in the purchase of materials and components used in commodities and services furnished to federal agencies. It also requires an economic impact analysis on the effect a new contract would have on a current contractor's sales.

Recommendation:

The Council should complete the current rule making process. In formulating criteria for products and services, the Council should specifically address:

- The amount of direct disabled labor necessary to approve a product or service for the Program.
- The competitive procurement of materials and components used in commodities and services provided to state agencies.
- The economic impact of proposed contracts on existing vendors.
- Whether CRPs should be required to own products proposed for lease or sale to state agencies.

Section 3:

The Council Should Re-Evaluate the Management Fee for the Central Nonprofit Agency

Questions about the reasonableness of the management fee charged to CRPs to participate in the Program and the appropriateness of some expenditures by the central nonprofit agency indicate the need to re-evaluate the fee structure. Some CRPs believe that the management fee is too high and that a fee for service structure would be more equitable. CRPs are charged the same management fee regardless of the level of service provided by the central nonprofit agency. The management fee is based on a percentage of a CRP's gross sales. The central nonprofit agency receives 6.5 percent of gross sales for products, 5 percent of gross sales for temporary services, and up to 6 percent of gross sales of services. CRPs paid \$2.97 million in management fee commissions to the central nonprofit agency in fiscal year 1999. Additional data is needed to evaluate how a change to the management fee might impact smaller CRPs that require more services from the central nonprofit agency.

Over the past three years, the central nonprofit agency has expended approximately \$468,000 on items that do not directly benefit CRPs participating in the Program. These areas of expenditures include (1) professional service fees for attorneys and lobbyists, (2) line of credit interest costs, and (3) startup costs for a subsidiary nonprofit corporation.

Section 3-A:

Cost Data Maintained by the Central Nonprofit Agency Is Inadequate to Fully Evaluate Alternative Management Fee Rates

The central nonprofit agency does not track sufficient data to fully evaluate the cost of services provided to CRPs. The central nonprofit agency currently lacks a cost model to assign or allocate direct and indirect costs to functions such as contracting and payment processing. Although the central nonprofit agency does track the time staff members spend on different types of services and activities, these data are not linked

to the individual CRPs receiving the services. Without this type of information, it is difficult to evaluate how much revenue the central nonprofit agency would lose under a fee-for-service structure or what impact such a loss would have on the central nonprofit agency's ability to provide services to smaller CRPs.

CRPs are currently charged the same management fee rates regardless of how much assistance they receive from the central nonprofit agency. This can result in a de facto subsidy from larger, more established CRPs that require minimal assistance to smaller, less established CRPs that require more assistance from the central nonprofit agency. A number of CRPs believe that the central nonprofit agency management fee should be changed from a set fee to a fee based on the level of service provided. Many CRPs do their own product development, marketing, and contract negotiation without assistance from the central nonprofit agency. In addition, while the central nonprofit agency may be heavily involved in developing new a contract, renewal of the same contract may require significantly less effort from the central nonprofit agency.

Recommendation:

The Council should evaluate the information needed to fully analyze the management fee of the central nonprofit agency. Requirements for additional cost data should be incorporated into the contract with the central nonprofit agency. The Council should consider the impact any changes to the current management fee would have on smaller CRPs.

The central nonprofit agency should build on the current employee time system to track the time spent at individual CRPs, particularly by field staff members.

Section 3-B:

The Central Nonprofit Agency Has Made Questionable Expenditure Decisions

Several areas of expenditures raise questions about the reasonableness of the management fee charged to CRPs participating in the Program. Over the past three years, the central nonprofit agency has expended approximately \$468,000 on items that do not directly benefit CRPs participating in the Program. These areas of expenditures include (1) professional service fees for attorneys and lobbyists, (2) line of credit interest costs, and (3) startup costs for a subsidiary nonprofit corporation.

From January 1998 through April 2000, the central nonprofit agency spent over \$214,000 on attorney fees to sue the Council. This amount does not include any litigation costs incurred since April 2000. During the same time period, the central nonprofit agency spent in excess of \$64,000 to retain a legislative lobbyist.

In addition to the expenditures for professional services noted above, the central nonprofit agency also incurred:

- \$92,000 of costs borrowing against its line of credit to compensate for over 650 lost state warrants worth \$3.6 million (see Section 4 for details).
- \$97,000 in costs related to a write-off for an unsuccessful research and development project to study the feasibility of using workers with disabilities to refurbish copier machines (see Section 7 for details).

While the \$468,000 in expenditures noted above represent only 5 percent of the central nonprofit agency's management fee commissions over a three-year period, these resources could have been used to support CRPs. We noted, for example, that the central nonprofit agency's initiative to provide technical assistance grants to CRPs declined from a high of \$89,692 in fiscal year 1996 to \$26,809 and \$30,866 in fiscal years 1998 and 1999, respectively.

Recommendation:

The Council should formulate an expenditure reporting format and require the central nonprofit agency to report categories of expenditures on a periodic basis. Professional services should be one category of expenditures included in the reporting format. Review of management fee commission expenditures should be incorporated into the evaluation of the central nonprofit agency during contract renewal discussions.

As noted in Section 1-A, the Council should require the central nonprofit agency to report periodically on key financial indicators such as accounts receivable and line of credit borrowing and interest costs.

Section 4:

The Central Nonprofit Agency Lacked Adequate Financial Controls to Safeguard Resources of the State Use Program

The central nonprofit agency needs to strengthen financial controls to safeguard Program resources. The central nonprofit agency lost over 650 warrants totaling \$3.6 million due to weak financial controls over cash receipts. Although the warrants are being re-issued, stronger controls would have shortened the five months required to detect the problem and would have significantly reduced the estimated \$92,000 in cost associated with the missing warrants. The central nonprofit agency also needs to take action to insure \$217,000 in bank deposits that are not covered by Federal Deposit Insurance Corporation (FDIC) insurance.

Section 4-A:

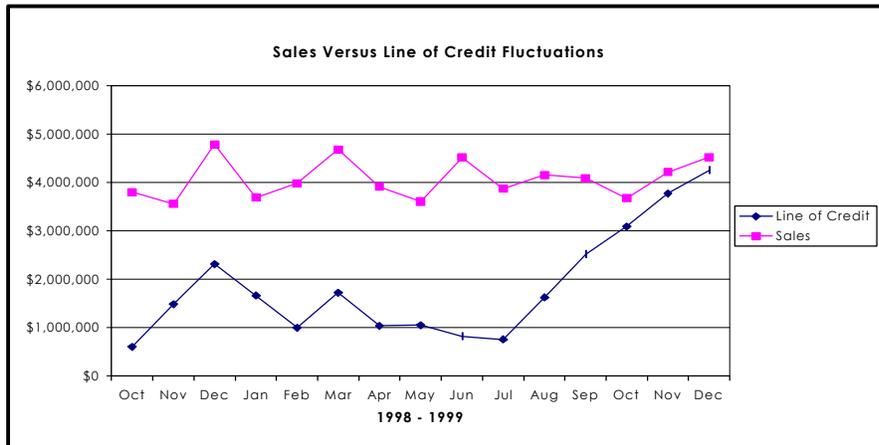
The Central Nonprofit Agency Lacked Adequate Financial Controls Over Payment Processing and Collections

The central nonprofit agency is missing over 650 warrants totaling more than \$3.6 million. The central nonprofit agency estimates its current costs associated with missing warrants to be over \$92,000. The \$92,000 includes \$87,000 for interest costs associated with its line of credit¹ and \$5,000 for temporary staff members to research payments. This amount does not include the cost to the agencies and political subdivisions that have had to re-issue the warrants.

The central nonprofit agency has been conducting an investigation into the cause of the missing warrants. The central nonprofit agency strongly suspects employee involvement. At present, they have not been able to determine a motive other than a possible cover-up of incompetence or to cause harm to the central nonprofit agency or some of the employees involved.

The State Auditor's Office performed an extensive review of the central nonprofit agency's payment, cash receipt, and collection processes. The central nonprofit agency processed over 35,000 invoices in calendar year 1999. We verified that none of the lost state warrants were cashed and performed extensive testing of the payment

Figure 1



process for each department (Services, Temporary Services, and Products) to determine whether this had been an ongoing problem at the central nonprofit agency or if it was isolated to a specific time period. As a result of our testing, we feel confident that the occurrence of missing warrants was isolated to August through December 1999.

The central nonprofit agency was slow to identify the missing warrants, thereby increasing the interest expense associated with the line of credit by nearly \$90,000. As shown in Figure 1, borrowing against the line of credit began to increase in July 1999 and had a dramatic upward spike in August through December 1999. The increase in the line of credit loans is clearly not proportional to the volume of sales processed by the central nonprofit agency.

The central nonprofit agency's ability to detect the missing warrants was hampered for the following reasons:

¹ The central nonprofit agency maintains a line of credit to borrow money to pay CRPs for their goods and services prior to receiving payment from ordering agencies.

- The methods for analyzing collections is decentralized, with each department given the responsibility to identify and handle delinquent billings for their own accounts.
- Inconsistent collection efforts were applied in each department. Two of the three departments were not maintaining documentation to indicate contact had been made with delinquent customers and what their current statuses were.
- Although the central nonprofit agency has an Aging Report in place to identify delinquent accounts, it is not used by all departments to monitor collections.
- The central nonprofit agency does not have a full-time financial manager.

Prior to March 2000, the central nonprofit agency had not developed or implemented adequate controls over cash receipts to provide reasonable assurance that central nonprofit agency receipts were protected from loss, misuse, or abuse. The central nonprofit agency was not logging cash receipts as a minimal control point for tracing information to and from source documents. In the time frame the warrants were missing, one person was opening the mail, and three separate departments with no standardized procedures in place were handling deposits. It appears that management has been slow to make changes because it felt its processes had worked well in the past.

Although the central nonprofit agency has made improvements with the creation of a cash receipts log in March and two individuals opening mail, the controls to account for the movement of the transactions from origination to data entry are still weak, and an improvement in segregation of duties is needed. The central nonprofit agency has one individual recording the checks in the cash receipts log and preparing the deposits.

The central nonprofit agency is currently operating in an Open System that allows the user to overwrite data and make changes without supervisory approval. The central nonprofit agency has reached its capacity with this system, which has produced inaccurate financial records in the past and made auditing the financial statements difficult and time consuming. A new system (Macola) is in the process of being developed and is scheduled to phase into central nonprofit agency operations in calendar year 2000.

The central nonprofit agency staff does not have a clear understanding of Macola's capabilities and what controls will be in place to improve the central nonprofit agency's operations. We were unable to determine whether the new system will improve controls because the project manager for the Macola project resigned, and a new person has yet to be assigned. As a matter of good business practice, the central nonprofit agency should ensure that the accounting system properly records, reports, and safeguards receivables.

Recommendation:

The central nonprofit agency should make the following changes to its cash receipts process:

- Standardize the payment process for all departments in order to establish a more efficient flow of data through the organization.
- Develop policies and procedures for the collection of cash receipts.
- Improve its ability to trace payments to source documentation by including batch numbers assigned and date of deposit on support documentation (vouchers) given to each department. Staff members should also include the name of the organization from whom the check was received on the Deposit Report.
- Ensure that an adequate segregation of duties exists between staff members who process cash receipts, disbursements, deposits, recording, and reconciliation. Separate individuals should perform the responsibilities for the preparation of deposits and the logging of cash receipts.
- Ensure that the new system has controls in place to prevent accidental or deliberate data override. The central nonprofit agency should ensure that it has a clear understanding of the capabilities of its new accounting system as well as the relevant controls. The new accounting system should also address concerns associated with inaccurate financial records and audit efficiency.

The central nonprofit agency should make the following changes to its accounts receivable and collection process:

- Consolidate collection efforts into one department, and develop a formalized written policy for collecting past-due accounts. At a minimum, a policy should document:
 - Initial collection steps for overdue accounts.
 - Timing of collection letters and legal action.
 - Authorization and decision process for settlement of bad debt forgiveness and write-off.
- Develop a Single Analysis Report to determine the age of accounts, the turnover of accounts, and the make-up of bad debt. The data to create these reports should be easily retrievable from the accounting system. This report can provide the above described information by reflecting:
 - Age of receivable.
 - Receivable divided by average daily collections.
 - Bad debt expense, percentage of receivables, budget adjustments for bad debt.

- Regularly monitor receivable accounts and line of credit, and analyze:
 - Age of receivables.
 - Turnover of receivables.
 - Amount of bad debt.
 - Established thresholds and explanations for significant increases in line of credit.

Section 4-B:

The Central Nonprofit Agency Has Uninsured Bank Balances of Approximately \$217,000

The central nonprofit agency has bank statement balances in excess of the federally insured limit of \$100,000, resulting in uninsured bank balances of approximately \$217,000. The central nonprofit agency's total of cash and cash equivalents at the end of fiscal year 1999 was \$331,831. Although the central nonprofit agency's accounts receivable management fee commissions are collateral for its line of credit loans, management states that cash reserves in excess of insured amounts are used as compensating balances to obtain lower interest rates. Excess funds are invested in Certificates of Deposit. The central nonprofit agency does not have formal investment policies and procedures or a set cash reserve goal. The central nonprofit agency states that it has been unable to identify a liquidity benchmark due to the uniqueness of its business. Uninsured deposits could be lost if the financial institution became insolvent.

The central nonprofit agency's external certified public accountant firm has criticized it for uninsured funds in the past and made recommendations in fiscal year 1998 and 1999 management letters. The central nonprofit agency has not taken action to insure these funds.

Recommendation:

- The central nonprofit agency should implement its external certified public accountant's recommendations, such as:
 - Monitor the balances to ensure they are within FDIC recovery limits.
 - Transfer excess amounts to another institution when bank balances exceed \$100,000.
 - Consider investing in overnight-insured accounts if it is not practical to transfer the excess funds to another institution.
- The Council should consider developing a policy that addresses the cash reserve needs of the Program. The central nonprofit agency should use the Council's policy as a guideline to develop and implement formal investment policies and procedures.

- The Council should incorporate the cash reserve needs of the Program when reviewing the central nonprofit agency's management fee commission rates.

Section 5:

The Integrity of the State Use Program Cannot Be Ensured Without a Monitoring Function and Additional Policies Regarding CRP Eligibility to Participate in the Program

All data pertaining to CRP compliance with Program policies is currently self-reported by CRPs without independent verification by either the Council or the central nonprofit agency. A policy regarding related-party contracts and transactions is needed to ensure that individual CRPs maintain managerial and financial control of their operations. Documentation on CRP eligibility to participate in the Program is not consistently collected and maintained. The Program also lacks a database and standardized procedures to track and analyze customer complaints.

Section 5-A:

There Is No Monitoring or Verification of CRP Compliance With State Use Program Policies

All data related to CRP compliance with Program policies is currently self-reported by CRPs without independent verification by either the Council or the central nonprofit agency. Council policies are designed to ensure that workers with disabilities are the primary beneficiaries of the Program. Without a mechanism to monitor CRP compliance with policies, there is a risk that ineligible organizations will benefit from the noncompetitive market established for workers with disabilities.

The Council's policy for products includes a goal that 75 percent of all direct labor be performed by workers with disabilities. The Council's policy for services includes requirements such as the following:

- A minimum of 35 percent of the contract price must be allocated to workers with disabilities in wages and benefits.
- Supply costs should not exceed 20 percent of the contract price.
- Administrative costs should not exceed 10 percent of the contract price.

Although the Council monitors exceptions to these policy requirements when approving or renewing contracts, the Council has no assurance that data is reported accurately by the CRPs. The central nonprofit agency maintains that it has no authority to audit or monitor CRP records.

In addition to the lack of monitoring of CRP compliance with the policies mentioned above, there is currently no verification of worker disability. Although the federal set aside program requires CRPs to verify that an individual is in fact disabled, the state Program lacks such a requirement. This again creates a risk that ineligible workers and organizations could benefit from the Program.

The federal program regularly monitors CRP compliance with a number of criteria, such as direct disabled labor ratios, and also requires documentation of individual worker disability. The responsibility for monitoring is shared between the two federal central nonprofit agencies and their oversight entity, the Committee for Purchase From People Who Are Blind or Severely Disabled. Federal monitors typically conduct site visits of CRPs every three to five years to review compliance with federal program rules. In the federal program CRPs with a history of compliance problems are monitored more frequently—approximately every 18 months. Federal monitors indicate that a site visit typically takes one person between one and one-and-a-half days to complete.

Recommendation:

The Council should formulate administrative rules to establish a monitoring function to ensure that CRPs comply with Program policies. A provision that CRP records be available for inspection for monitoring purposes should be incorporated into contracts with CRPs.

The Council should assume at least part of the responsibility for monitoring if it is given authority to employ its own staff to provide an independent check on the central nonprofit agency.

The Council should establish a rotating schedule for monitoring CRPs based on the availability of resources. The Council should also explore the possibility of sharing information with federal monitors for CRPs that participate in both the federal program and the State Use Program.

The Council should include verification of worker disability as a monitoring requirement in addition to verifying compliance with existing Program policies.

Section 5-B:

The Council Lacks a Policy on Related-Party Contracts and Transactions by Participating CRPs

One CRP participating in the Program entered into contractual agreements and financial transactions with a for-profit entity that pose potential conflicts of interest. The nature of these agreements and transactions make it difficult to discern whether an arms-length relationship exists between the nonprofit CRP and the for-profit entity. The Council has no policy regarding related-party contracts and transactions by CRPs participating in the Program.

The CRP in question entered into a management agreement² with a for-profit corporation that pays the for-profit corporation 8 percent of the CRP's gross sales. Based on the CRP's 1998 federal 990 tax return, total revenue of \$3.2 million would result in a payment to the for-profit corporation of approximately \$256,000. In return for such consideration, the for-profit corporation provides:

- Payroll and invoice processing.
- Financing of accounts receivable.
- Accounts payable processing.
- General bookkeeping.

There does not appear to be an arms-length relationship between the CRP and the for-profit corporation. The contractual relationship appears to vest financial and managerial control of the CRP in the for-profit corporation. In addition, terms of the management agreement provide no indication that the services provided to the CRP are done so at a reasonable market rate.

The president of the CRP entered into an employment contract with the for-profit corporation to manage the daily operations of the CRP. The contract provides the president an \$80,000 base salary and an annual bonus of either \$20,000 or a percentage of the CRP's gross margin. The for-profit corporation also retired \$153,000 of the CRP president's personal debt, which was incurred as start-up costs for the CRP. The CRP has received in excess of \$1 million in loans for operating capital from the for-profit corporation.

The for-profit corporation manages the daily operations of the CRP by employing its president. The for-profit corporation recommends hiring, firing, and personnel actions to the board of the CRP. The president of the CRP is on the CRP's board, and the other board members are employees of the CRP. As employees of the CRP, the other board members appear to lack the ability to exercise independent oversight. We noted, for example, that one board member was terminated as an employee in 1998.

While the Program requires all CRPs to be 501(c) 3 corporations, the circumstances noted above indicate the need for guidance on related-party contracts and transactions. The federal program, for example, requires nonprofit agencies to be able to demonstrate complete separation from for-profit corporations in the areas of finance and control of the agency.

Recommendation:

The Council should adopt a policy regarding related-party contracts and transactions to ensure that nonprofit CRPs maintain complete managerial control of their agencies and finances. The Council should consider adopting in whole or in part the federal

² The management agreement requires a four-year notice to terminate the contract.

policy on related corporations. The federal policy is included in this report in Appendix 3.

The Council should require CRPs participating in the Program to report any significant related-party contracts or transactions. The Council should also require CRPs to annually submit copies of their federal 990 tax returns to the Council for review. The 990 form includes information on professional service contracts and affiliated organizations.

Section 5-C:

Documentation and Record Maintenance on CRP Eligibility to Participate in the State Use Program Are Inconsistent

The central nonprofit agency does not consistently document or maintain records on CRP eligibility to participate in the Program. Although all central nonprofit agency field marketing representatives are familiar with the CRP certification checklist,³ field staff members have different understandings about who is responsible for completing the checklist. Some field staff members believe they are responsible for verifying items on the list. Other staff members believe that the central nonprofit agency main office is responsible for completing this form. In addition, field staff members are unclear as to whether CRPs are required to notify the central nonprofit agency of significant changes that could affect their status as a nonprofit entity.

There is no formal process for maintaining documentation on CRP eligibility to participate in the Program. Central nonprofit agency staff members provided conflicting statements about whether the field or central office is responsible for maintaining documentation. For example, one marketing representative stated that he keeps a copy of all documentation received and sends a copy to the central office, while another believes that all documentation is maintained by the central office. Conversely, a central office employee stated that field offices maintain all documentation and that the central office does not have copies of nonprofit designations or articles of incorporation.

The central nonprofit agency does not have clear policies and procedures to address responsibility for maintaining evidence of CRP eligibility to participate in the Program. Without clear policies and procedures, there is a risk that ineligible organizations may participate in the Program.

Recommendation:

The central nonprofit agency should establish, document, and implement clear procedures for receiving and maintaining documentation on the CRP certification checklist.

³ The certification checklist requires verification of the entity's corporate charter, bylaws, registration with the Secretary of State, and Internal Revenue Service nonprofit status.

Section 5-D:

Complaints About State Use Program Products and Services Are Not Consistently Tracked

The central nonprofit agency lacks a database and standardized procedures to track customer complaints. Although the central nonprofit agency appears to proactively resolve complaints at the lowest level possible, it does not consistently track customer complaints. Some field marketing representatives do not document complaints unless they are serious, while other representatives document and maintain all complaints. There is no centralized database to record customer complaints. Good business practices indicate that customer complaints can provide valuable information to improve vendor performance and ensure customer satisfaction.

Recommendation:

The central nonprofit agency should establish procedures to track the type, frequency, and severity of customer complaints. It should create a centralized database to track complaints. Complaints should be periodically analyzed to detect performance trends and identify improvement opportunities.

Section 6:

The Central Nonprofit Agency's Marketing Function and Financial Support Assist CRPs

The central nonprofit agency's marketing of the Program and financial support provided to CRPs have contributed to a 71 percent overall increase in sales over the past four years. Although product sales have declined and the central nonprofit agency has experienced turnover problems with sales staff members, total sales increased from \$36.6 million in 1995 to \$51.7 million in 1999. The central nonprofit agency has developed standardized pricing formulas for some service contracts that facilitate contract negotiations with Program customers. The central nonprofit agency provides valuable support to CRPs by advancing payments, providing technical assistance grants, and on occasion, being flexible in collecting its management fee. This support facilitates CRPs' ability to employ persons with disabilities and provide quality products and services to the State.

Section 6-A:

Marketing Is a Key Function for the State Use Program

Although the central nonprofit agency is experiencing problems with turnover among marketing staff members, the marketing function has contributed to a significant increase in total sales. From 1995 to 1999, total sales increased from \$36.6 million to \$51.7 million. Sales for service contracts alone increased from \$24.96 million in 1995 to \$42.37 million in 1999. Within this same time period, the number of persons with disabilities employed increased 25.32 percent and wages paid to persons with disabilities increased 52.73 percent. The central nonprofit agency's president indicates that it is having difficulty retaining its marketing staff. Eleven marketing

staff members have resigned within the past five-and-a-half years. Turnover is a concern due to the key role marketing staff members play in the Program's success and the costs associated with the central nonprofit agency's extensive training program for marketing representatives.

Training for marketing representatives lasts approximately three months and primarily consists of on-the-job training. Before assignment to a region, marketing representatives must demonstrate adequate knowledge of the Program and how to achieve its objectives. Central nonprofit agency marketing representatives are responsible for marketing the set-aside program to government agencies and encouraging the hiring of workers with disabilities. Marketing representatives communicate with CRPs on a regular basis and will communicate with CRPs more frequently if required. Assistance provided to CRPs for new contracts can be extensive. The level of assistance provided to CRPs for contract renewals consists of ensuring that both parties are satisfied with the contract and determining whether specifications or price changes are needed.

Market saturation as well as changes in the market place, such as warehouse decentralization, the implementation of contract catalog purchasing, and the overall decentralization of purchasing, have presented challenges for product sales in the Program. In addition, some CRPs have had difficulty obtaining the capital necessary to carry inventory for 30 to 60 days, resulting in delivery problems. In 1995, product sales reached an all time high of \$11.6 million. Product sales have declined over the past few years, totaling \$9.7 million in 1999.

The central nonprofit agency has explored possible solutions to these challenges. It has been working with Grainger Industrial Supply to develop a proposal to include Program products in Grainger's catalog. Federal set aside products are currently included in Grainger's catalog. The advantages to the Program include the following:

- Program products could be marketed to a national audience, including private sector purchasers.
- Grainger could warehouse Program products in its regional facilities, which would ease current distribution problems.
- Current problems associated with timely delivery could be solved by virtue of Grainger's regional distribution facilities, which can deliver in a short time frame.

Recommendation:

To minimize the number of marketing staff members who resign, the central nonprofit agency should determine why staff members are leaving, considering such factors as compensation, benefits, and the availability of resources. Based upon this assessment, the central nonprofit agency should implement changes as necessary to address the reasons marketing staff members are resigning.

The central nonprofit agency should continue to pursue options to increase product sales to mitigate the effects of changes in the market place.

Section 6-B:

The Central Nonprofit Agency Has Prepared Standard Pricing Structures for Some Service Contracts

The central nonprofit agency assisted with the development of standard pricing formulas for litter pick-up contracts and a commodity code list for temporary services. The preparation of these pricing structures reduces the amount of work required during contract negotiations and should ensure that Program prices for these types of services are consistent throughout the State and are comparable to market prices. Although pricing structures for services facilitate contract negotiations, there is no plan to periodically update the commodity code list to ensure that prices are at current market rates.

In conjunction with the Department of Transportation, the central nonprofit agency developed the Litter Input Data System (LIDS) due to the difficulty involved with determining a fair market price comparable to the open market for similar contracts. LIDS calculates prices for litter contracts based upon standard pricing formulas that consider the amount of litter picked up per cubic foot.

The central nonprofit agency and the Commission developed a temporary services commodity code list, which resulted in three suggested prices for 870 classifications of 24 purchasing districts. The development of the commodity code list required extensive research and analysis of low bids and state job classifications. The temporary services commodity code list provides state agencies the ability to sort and identify temporary workers by job description, class code, pay grade, or price.

CRPs have expressed concern that the commodity code list, which is currently three years old, does not accurately reflect market rates. There are currently no plans to assess or revise the commodity code list for temporary services.

Recommendation:

The Council should develop a plan to periodically review temporary service rates, compare them to the market, and revise as necessary.

Section 6-C:

The Central Nonprofit Agency Provides Financial and Technical Assistance to CRPs

The central nonprofit agency provides valuable support to CRPs by advancing payments, providing technical assistance grants, and on occasion, being flexible in collecting its management fee. This support facilitates CRPs' ability to employ persons with disabilities and provide quality products and services to the State.

The central nonprofit agency advances payment to CRPs for products and services provided to Program customers. The central nonprofit agency has a line of credit that allows it to pay CRPs for their products and services prior to receiving payment from the ordering state agency. This is a valuable service, as many CRPs have cash flow problems and struggle to continue operations.

The central nonprofit agency is making payments in a timely manner and in accordance with agency policy. On average, it takes the central nonprofit agency 18 days to remit payments to CRPs and 31 days to receive payments from customers. Timely payments to CRPs are critical to ensure that CRPs maintain adequate cash flow to meet payroll and pay bills. Timely receipt of customer payments contributes to the central nonprofit agency's ability to pay CRPs prior to receiving payment from the ordering state agency.

The central nonprofit agency maintains a technical assistance fund that is available for CRPs. The technical assistance fund permits CRPs to purchase equipment and technical support CRPs will use to fulfill contracts. The central nonprofit agency's technical assistance fund totals \$30,000 and is provided upon its approval of applications submitted by CRPs. Each CRP is eligible to receive a maximum of \$5,000 per year but can receive more upon the approval of the central nonprofit agency's Technical Assistance Grant Committee. Funds spent for technical assistance grants have been relatively stable from 1997 through 1999 and are spread out evenly among CRPs.

The central nonprofit agency provides assistance to CRPs that allows them the financial flexibility to continue operations:

- The central nonprofit agency is flexible in the collection of its management fee. During our review, we identified several examples in which the central nonprofit agency negotiated or suspended its management fee to reduce financial burdens for CRPs.
- The central nonprofit agency waived one CRP's management fee for six months to allow the CRP an opportunity to foster competition for a new product.
- The central nonprofit agency has negotiated with CRPs and written off outstanding management fees resulting from transferred contracts operating at a loss.

The Central Nonprofit Agency Does Not Adequately Research Products Developed for the State Use Program

The central nonprofit agency relies heavily on CRPs for product development and does not adequately research new product initiatives for the Program. Two major new product initiatives were recently canceled due to a lack of adequate market research by the central nonprofit agency. A contract for computers that was developed by a CRP was canceled because the central nonprofit agency was not aware of a conflict with existing purchasing laws. Another initiative was a pilot program to refurbish copiers overseen by the central nonprofit agency that suspended operations due to inadequate research by the central nonprofit agency on supply and demand for the products. These examples indicate the need for better research by the central nonprofit agency on new product development and market research.

Research and development for the computer contract was completed entirely by the CRP. After the Council approved this contract, the Commission expressed concern that the contract circumvented the Qualified Information Systems Vendor Program and requested an Attorney General opinion. The Attorney General determined that computers could not be purchased through the set-aside program by state agencies. This ruling did not affect political subdivisions, independent school districts, and universities. A central nonprofit agency product development specialist indicated that this situation was unavoidable, as the central nonprofit agency functions as a broker for CRPs and is obligated to bring new product contracts to the Council for consideration.

The central nonprofit agency oversaw a pilot program for Disabled Recyclers of Texas (DRT) in 1996. This pilot was a research and development project for refurbishing used copiers and lost approximately \$97,000 as a result of a slow turnaround time and small market demand. Although this venture was in line with the central nonprofit agency's overall mission of employing persons with disabilities, DRT did not adequately research and identify the availability of copiers for refurbishment or assess whether workers with disabilities could refurbish the copiers within an acceptable time frame. In addition, DRT primarily relied on initial sales to indicate success of the business and did not conduct adequate market research to determine the demand for refurbished copiers. DRT's board consists of three members who also serve on the central nonprofit agency board. The officers of the central nonprofit agency also serve as the officers of DRT.

Recommendation:

- The central nonprofit agency should adequately research current purchasing laws and ensure that there are no statutory restrictions on new product proposals. This is an essential function that should be completed early in the research and development phase.

- The central nonprofit agency should conduct more thorough research on supply and demand requirements affecting initiatives for new product proposals.
- The Council should require the central nonprofit agency to report any related-party transactions such as subsidiary or affiliated corporations.

Section 8:

The General Services Commission Does Not Provide Compliance Exception Reports to the Council as Required by Statute

The Commission does not provide compliance exception reports to the Council as required by statute. As a result, the Council lacks the ability to monitor whether products and services are procured through the Program when required by law. There are currently no other monitoring mechanisms in place. However, the statute may require modification relating to the frequency of reporting this information.

The Commission has never reported exceptions to the Council. According to the Human Resources Code, Section 122.016, the Commission is required to provide the Council with a list of all items purchased as an exception under statute. This list is to be provided to the Council on a monthly basis.

Although the Commission plans to report exceptions starting September 1, 2000, all required information will not be reported. The Commission plans to provide only a list of agencies that did not use the Program and that could not provide justification. Agencies that do not use the Program for various reasons that the Commission determines to be justified will not be considered an exception. The statute defines exceptions as the following:

- Under the rules of the commission, the product or service so produced or provided does not meet the reasonable requirements of the office, department, institution or agency; or
- The requisitions made cannot be reasonably complied with through provision of products or services produced by persons with disabilities.

Information on exception purchases could be used as a tool to identify and address the reasons state agencies do not use State Use products or services. In addition, exception lists could be used in conjunction with a centralized complaint tracking process as noted in Section 4. The coordination of exceptions and complaints between the Council and the central nonprofit agency could help validate agencies' reasons for not using State Use contracts and help identify CRPs that are consistently providing low quality products or services and/or late delivery. The Council and the central nonprofit agency would be able to pinpoint specific issues with individual CRPs, CRPs within a region, or specific products, and provide necessary assistance to resolve performance issues. Finally, reporting exceptions can serve as a mechanism to hold state agencies accountable to using State Use products and services when required by law.

Because the Council meets quarterly and currently has no staff, monthly reporting by the Commission does not appear to be practical. Less frequent reporting by the Commission would appear to meet the Council's information needs.

Recommendation:

The Commission should provide the Council with a list of all products and services purchased under the exception provisions of the Human Resources Code, Section 122.016.

The Legislature should consider amending the current requirement for monthly reporting of exceptions. The statute should permit the Council to define less frequent reporting to meet its information needs.

Objectives, Scope, and Methodology

Objectives

The primary objectives of this audit were to:

- Review the adequacy of the governance structure and oversight mechanisms of the State Use Program, including the respective roles and responsibilities of the Council, the central nonprofit agency, and the General Services Commission.
- Analyze the adequacy of administrative rules and policies formulated by the Council.
- Review the adequacy of financial controls over program resources and expenditures.
- Review the adequacy of product development and marketing functions.

Scope

The scope of this audit included:

- Review of the Council's statutory duties and responsibilities, including contract oversight of the designated central nonprofit agency.
- Review of criteria for approving products and services for the State Use Program.
- Analysis of the management fee commission paid to the central nonprofit agency.
- Review of the central nonprofit agency's financial controls.
- Review of contract administration of practices of the Council and the central nonprofit agency.
- Review of the marketing and product development functions of the central nonprofit agency
- Review of state agency compliance with the requirements of the State Use Program.

Methodology

Information collected included:

- Interviews with:
 - Members of the Council
 - Management and staff of the central nonprofit agency
 - General Services Commission staff members
 - Community rehabilitation program representatives
- Documentary evidence such as:
 - Council meeting minutes and subcommittee meeting minutes
 - Contracts, memoranda of agreement, and correspondence between the Council and the central nonprofit agency
 - Litigation documents and Attorney General opinions related to the State Use Program
 - General and subsidiary ledgers of the central nonprofit agency
 - Strategic, operational, and marketing plans developed by the central nonprofit agency
 - Central nonprofit agency contracts with community rehabilitation programs and professional service providers
- Observation of:
 - Central nonprofit agency cash receipts, payment processing, and collections activities
 - Quarterly meetings of the Council and its Performance and Pricing subcommittees

Procedures and tests conducted included:

- Fluctuation analysis of the central nonprofit agency's audited financial statement line items for cash and cash equivalents, accounts receivable, accounts payable, line of credit, revenues, and expenditures
- Testing of the central nonprofit agency's cash receipt, payment processing, and collection functions
- Testing of the central nonprofit agency's management fee commission deductions for accuracy and timeliness
- Analysis of bad debt write-off by the central nonprofit agency
- Analysis of program sales and associated line of credit loans

Criteria used:

- Texas Statutes and Administrative Code
- State Auditor's Office Contract Administration Model
- Federal Statutes and Administrative Code
- Other standards and criteria developed through secondary research sources, both prior to and during fieldwork

Other Information

Fieldwork was conducted from March through June 2000. The audit was conducted in accordance with *Government Auditing Standards*.

The audit work was performed by the following members of the State Auditor's staff:

- John C. Young, MPAff (Project Manager)
- Lisa Collier, CPA (Assistance Project Manager)
- Stacey Williams
- Courtney Ambres-Wade
- Herman Huck
- Bruce Truitt, MPAff (Quality Control Reviewer)
- Cynthia Reed, CPA (Audit Manager)
- Deborah Kerr, Ph.D. (Audit Director)

Litigation Background

In 1998, the Council attempted to competitively bid the contract of the central nonprofit agency, which has been held by the Texas Industries for the Blind and Handicapped (TIBH) since 1979. Competitive bidding was motivated in part by the Council's lack of financial and performance information about TIBH. Also, the Council believed that a competitive process would provide benchmarks for the relative efficiency and effectiveness of the central nonprofit agency, even if the current central nonprofit agency retained the contract.

TIBH, however, objected to numerous provisions contained in a February 1998 Invitation for Bids (IFB) and refused to participate. TIBH filed suit against the Council on February 17, 1998, to stop the IFB process. In its suit against the Council, TIBH asserted that:

- The Council lacks legal and statutory authority to select a central nonprofit agency through a competitive bidding process.
- The IFB provides for confiscation of TIBH's assets such as records and marketing plans.
- The IFB requires TIBH to brief and provide orientation to a new central nonprofit agency.

On March 9, 1998, pending further orders, a state district court prohibited the Council from:

- Requiring TIBH to submit to anyone any files, records, reports, or documentation related to the Program.
- Requiring TIBH to train, orient, or brief any successor central nonprofit agency.
- Awarding the contract in the IFB.

The court also ordered the parties to mediate their differences. The Council and TIBH proceeded to mediation on May 14, 1998. The mediation resulted in a memorandum of agreement (MOA) between the Council and TIBH that settled some areas of disagreement. The MOA, however, did not resolve the issue of access to and possession of records, transition procedures should a new central nonprofit agency be chosen, or performance standards and measures.

Prior to the scheduled trial on January 31, 2000, a second court ordered mediation session failed to resolve whether the Council and the public had a right to physical copies of TIBH documents as well as transition issues for a successor central nonprofit agency. On January 18, 2000, TIBH filed a Notice of Non-suit to its original petition. In a letter to the Council, TIBH stated that the non-suit would allow the parties to communicate in an atmosphere free of the threats of litigation. The non-suit, however, also avoided a judicial determination of the open records issue. The Council filed an appeal on June 12, 2000, to clarify whether the protective order preventing disclosure of Program documents in TIBH's possession is still in effect. The appeal is pending as of July 2000.

Federal Policy on Related-Party Transactions

At the federal level, the Javits-Wagner-O'Day Committee for Purchase From People Who Are Blind or Severely Disabled (JWOD Committee) oversees a program that parallels the State Use Program. Relevant portions of the JWOD Committee's policy on related-party transactions are provided below.

Related Corporations

Some nonprofit agencies are closely related to other corporations. The nonprofit agency may be one of several subsidiaries of a common parent corporation, or the parent or subsidiary of another corporation, or may otherwise be related to one or more corporations. If the nonprofit agency which wishes to participate in JWOD Program is related to any other corporation, the following criteria must be met for the nonprofit agency to be qualified to participate in the JWOD Program:

- a. The nonprofit agency must be an independent corporate entity:
 - (1) It must be incorporated as a separate nonprofit entity, with separate articles of incorporation and bylaws. These documents must not refer to another entity in a manner which implies control of the agency by that entity.
 - (2) It must maintain separate records to include payroll, accounting, personnel and, if applicable, rehabilitation.
 - (3) If the agency is paying commensurate wages, it must have a Department of Labor certificate in its own name.
- b. Agreements with other entities for support services to be provided to the nonprofit agency must provide for reimbursement at market rates and sufficiently detailed billing and payment records to permit compliance personnel to conclude that an arm's-length relationship exists.
- c. If any related entity is a for-profit corporation, the nonprofit agency must be able to demonstrate a complete separation from that entity in the areas of finance and control of the agency.

Source: Committee for Purchase from People Who Are Blind or Severely Disabled Compliance Memorandum No. 1, June 20, 1995

State Auditor Follow-Up Comment

The central nonprofit agency disagrees with most of the findings and recommendations that apply to its administration of the Program. The central nonprofit agency's responses indicate an unwillingness to accept oversight from the state or accountability for its management decisions. For example, the central nonprofit agency asserts that it has continuously provided the Council with adequate financial and performance information to oversee the Program. This response ignores the fact that it obtained a court order that prohibited the Council from requiring the central nonprofit agency to submit to anyone any files, records, reports, or documentation related to the Program. Copies of key financial and performance related records such as audited financial statements and marketing plans were only provided to the Council in July 2000 during contract negotiations.

The central nonprofit agency states that many of the audit findings and recommendations are based on erroneous facts and that audit staff lacked sufficient experience with nonprofit entities to assess its operations. Evidence gathered during the course of the audit was subjected to a rigorous quality control review process. While it is possible to draw different interpretations and conclusions from a given set of data, we stand by the facts as presented in this report. The audit staff possessed sufficient skills, knowledge, abilities, and qualifications to perform a thorough analysis of the Program and adhered to *Government Auditing Standards* throughout the project.

The Council and the General Services Commission are in general agreement with the report findings and recommendations.

Texas Council on Purchasing From People With Disabilities Responses



Texas Council on Purchasing
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September 1, 2000

HAND DELIVERED

Mr. John Young, Project Manager
State Auditor's Office
1501 North Congress Ave., Ste. 4-224
Austin, Texas 78701

RE: Audit Report on the Texas State Use Program

Dear Mr. Young:

The Texas Council on Purchasing from People with Disabilities (Council) submits the following response to the issues identified in your report:

Section 1: Disputes over open records and inadequate resources impede the Council's ability to oversee the State Use Program.

The Council agrees with this finding. TIBH had not cooperated with the Council's request to submit records relevant to evaluation of TIBH's performance under the contract to administer the State Use Program.

The Council also acknowledges that nine volunteers and part-time legal and administrative assistance from the General Services Commission (GSC) do not provide adequate personnel resources for the Council to properly address all the urgent issues a set-aside program of this complexity and magnitude generates.

Section 1-A: The Council lacks adequate financial and performance information to effectively oversee the State Use Program.

In July, after five fruitless years of efforts and a lengthy lawsuit Council obtained a sampling of documents from TIBH in order to evaluate its performance. Information was obtained on employee salaries, annual budgets, audited financial statements, marketing plans and other matters. However, the Council does not have the staffing necessary to perform a thorough analysis of the complete set of documents in TIBH's possession.

Mr. John Young
September 1, 2000
Page 2

Recommendation:

The Council is in agreement with the recommendations concerning clarification of its statutory authority.

Although the Council agrees that it should work with the CNA in the development of annual operating plans and budgets, it does not have the staffing required to perform this task. All Council members are currently engaged in full-time professions and cannot dedicate the amount of time needed to complete these projects.

The Council is currently working on administrative rules and will duly consider the recommendation regarding the CNA's financial reporting requirements.

Section 1-B: The Texas Council on Purchasing from People with Disabilities lacks sufficient staff to effectively oversee the State Use Program.

The Council agrees with this finding and concurs with GSC's analysis of staffing requirements as follows (subject to legislative goals for the State Use Program):

- Program Director to advise the Council regarding policy, budget requirements, program plan, program management and oversight ;
- Cost Accountant to review and analyze pricing proposals, new product and service contracts;
- Attorney to advise the Council regarding legal issues arising during the course of the administration of the State Use Program;
- Purchaser to advise the Council regarding actions on product proposals for the Program;
- Program Analyst to monitor state compliance with the Program;
- Field Inspector to monitor and verify self reported data from the CRPs
- Full-time Administrative Assistant to perform administrative support functions for the Program

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The Council also acknowledges that without adequate staffing, it cannot comprehensively review and analyze the impact of pricing proposals, product and service proposals, management fees and should not rely solely on the CNA for accurate and complete information regarding these issues.

Recommendation:

Council wholeheartedly agrees with the recommendation for staffing. However, the Council believes a conflict of interest would be created by requiring the CNA to fund staffing for the Council. The State should support the State Use Program just as it provides for the HUB program.

Section 2: The Council has no administrative rules or documented policies for deciding which goods and services are suitable for the State Use Program.

A draft set of rules has already been written and Committee and Council open meetings have been scheduled for September 7th and 22nd to review and adopt proposed rules. Public comment is invited and appreciated.

The Pricing Subcommittee recently adopted for its policy concerning direct labor, the federal definition found in 41 CFR Ch. 51-1.3: "all work required for preparation, processing, and packing of a commodity or work directly related to the performance of a service, but not supervision, administration, inspection or shipping." This subcommittee is responsible for recommending goods and services for the Program to the Council.

The Council also uses the guideline of a 75% cost of direct labor for approval of goods or services.

Recommendation:

The Council will consider the recommendations regarding criteria for approval of products and services during its rulemaking deliberations.

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Section 3: The management fee for the Central Nonprofit Agency should be re-evaluated.

The Council concurs with this finding and also believes that the management fee should periodically be evaluated. Again, the Council is limited by inadequate staffing in performing its oversight functions.

The Council was dismayed to find out through the State Auditor's Report that approximately \$500,000 was spent on legal and non-state use purposes. The Council is also concerned that the management fee is not being spent appropriately.

Section 3-A: Cost data maintained by the Central Nonprofit Agency is inadequate to fully evaluate alternative management fee rates.

The Council has not focused on the analysis of cost data needed to evaluate the management fee due to a lack of staffing.

The Council has long been aware that TIBH's fees may be disproportionate to services performed and that the more solvent CRPs' fees subsidize the minimally funded CRPs.

Recommendation:

The recommendation for evaluation of alternative fee rates is meritorious but must be prioritized among other urgent demands for the Council's oversight.

Section 3-B: TIBH has made questionable expenditure decisions.

Only upon reading of your report has the Council received information about the lost warrants, and the costs incurred for lobbyists and the lawsuit against the Council. The Council regrets that TIBH expended these funds in this manner rather using the funds to further the program goals. Nevertheless, the Council is hopeful that TIBH will rededicate its resources to supporting and enhancing the program.

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Recommendations:

The Council will consider the formulation of an expenditure report format when determining its priorities and time limits.

Section 4: TIBH lacked adequate financial controls to safeguard resources of the State Use Program.

This report was the first notice the Council has had regarding the inadequate financial controls, lost warrants representing \$3.6 million of sales, costs TIBH incurred for the warrants and uninsured bank deposits of \$217,000. The Council can only agree with this finding. These findings alarm the Council and should establish the urgent need for staffing to provide fiscally responsible oversight of the program.

Section 4A: TIBH lacked adequate financial controls over payment processing and collections.

The Council cannot dispute any of the State Auditor's findings regarding the deficiencies in TIBH's financial systems.

Recommendations:

The Council agrees with the recommendations that describe the proper handling of cash receipts, accounts receivable and collection functions by TIBH.

Section 4-B: TIBH has uninsured bank balances of approximately \$217,000.

Once again, this report is the first notice the Council has received about uninsured deposits.

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Recommendation:

The Council agrees with the first recommendation and also recommends that TIBH implement some tracking mechanism that can identify which deposits belong to each CRP and TIBH.

TIBH should prepare a documented analysis of their cash reserve requirements for the program and submit this to the Council. This will be requested when the Council has determined the order of its priorities.

The Council agrees to consider the cash reserve needs, among other items, when reviewing the CNA's management fee commission rates.

Section 5: The integrity of the State Use Program cannot be ensured without a monitoring function and additional policies regarding CRP's eligibility to participate in the program.

The Council recognizes that staffing is necessary to monitor the program. In its rulemaking process, the Council will consider formalizing criteria for CRPs' eligibility.

The Council also supports legislation that would require documentation from CRPs regarding managerial and financial information.

Section 5-A: There is no monitoring or verification of CRP compliance with State Use Program policies.

The Council is aware of the need for independent verification of data from CRPs. This verification cannot be performed without staffing. Furthermore, legislative authority is needed to require the CRPs to provide documentation that shows policy requirements are met for participation in the program.

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Recommendations:

The Council supports enabling legislation to obtain validated information from the CRPs but cannot undertake implementation of the first three recommendations without statutory authority or staffing.

The Council agrees to consider verification of worker disability in its proposed rules.

Section 5-B: The Council lacks a policy on related party contracts and transactions by participating CRPs.

There is not enough staff for the Council to investigate for potential conflicts of interest between the CRPs and parties contracting with them. However, the Council will consider addressing this issue in its rulemaking process.

Recommendations:

The Council agrees to consider adopting the federal policy on related corporations and will request its legal counsel to advise regarding its authority to obtain federal tax returns without statutory authority.

Section 5-C: Documentation and record maintenance on CRPs' eligibility to participate in the State Use Program are inconsistent.

This is the first notice the Council has received regarding inconsistencies in documentation and record maintenance for CRPs by the CNA. Again, this finding shows the need for staff and identifies other issues for the Council to consider in fulfilling its oversight duties.

Recommendation:

The Council concurs that TIBH should implement uniform policies and procedures for documentation and record maintenance.

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Section 5-D: Complaints that State Use Program products and services are not consistently tracked.

TIBH has reported customer complaints to the Council at its quarterly meetings, but the Council was not aware that no formal tracking or database existed until this report was submitted.

Recommendation:

The Council is in agreement with all elements of the recommendations and will request TIBH to implement a tracking system and develop a database for complaints.

Section 6: TIBH's marketing and financial support assists CRPs.

TIBH shares the credit with other stakeholders for the growth of the program. Since this precipitous growth has created a need for more intensive and diligent monitoring, the Council welcomes the support from the State Auditor and GSC for staffing and legislative authority to enable continued success of the program.

Section 6-A: Marketing is a key function for the State Use Program.

The Council will request more specific information from TIBH and Grainger regarding the impact on pricing that Grainger Industrial Supply's participation in the program will have. The Council's resources to oversee the program have been greatly surpassed by its growth and complexity.

Recommendations:

The Council agrees that TIBH should make efforts to train and retain marketing staff. The Council recommends that TIBH place more emphasis on marketing to the private sector.

Section 6-B: TIBH has prepared standard pricing structures for some service contracts.

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GSC has notified the Council that TIBH has misinterpreted the 75% guideline to apply to temporary services so that one fourth of the positions can be filled with able-bodied persons. This guideline contemplated that 75 % of labor be performed by a disabled individual when assisted by an able bodied person.

The CRPs have informed the Council that the commodity code list is dated. The task of reviewing an updated list is another issue to be prioritized by the Council, CNA, and staff.

Recommendation:

The Council will request that TIBH update the temporary service rates after prioritization of the numerous tasks identified by this report.

Section 6-C: TIBH provides financial and technical assistance to CRPs.

The Council has acknowledged the efforts of TIBH in supporting the CRPs and commends these activities.

Section 7: TIBH does not adequately research products developed for the State Use Program.

The Council is painfully aware of TIBH's lack of diligence in researching purchasing statutes and market demand. It is hoped that past mistakes in these areas have provided TIBH with the experience to avoid such problems in the future.

Recommendation:

The Council agrees with these recommendations.

Section 8: GSC does not provide compliance exception reports to the Council as required by statute.

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The Council has not received such a report from GSC, but has heard staff give verbal reports on exceptions in purchasing at various Council and committee meetings. The Council will work with GSC staff to address this statutory requirement.

Recommendation:

The Council agrees with the recommendations and supports legislation to require more appropriate reporting by GSC.

The Council appreciates the hard work of the State Auditor's staff and thoroughness of its analysis and recommendations.

Sincerely,



Dr. Robert A. Swerdlow, Chair
Texas Council on Purchasing from People with Disabilities

RAS:JK

cc: Ms. Meg Pfluger, Member
Texas Council on Purchasing from People with Disabilities
Mr. Terry Boyd, Member
Texas Council on Purchasing from People with Disabilities
Mr. Chuck Brewton, Member
Texas Council on Purchasing from People with Disabilities
Mr. Paul J. Capala, Member
Texas Council on Purchasing from People with Disabilities
Mr. Byron E. Johnson, Member
Texas Council on Purchasing from People with Disabilities
Mr. John W. Luna, Member
Texas Council on Purchasing from People with Disabilities
Mr. Bobbie F. Templeton, Member
Texas Council on Purchasing from People with Disabilities
Ms. Cathy J. Williams, Member
Texas Council on Purchasing from People with Disabilities
Mr. Jim Muse, Executive Director, GSC
Ms. Juliet King, Counsel to TCPPD, GSC

Central Nonprofit Agency Responses



300 Highland Mall Blvd., Suite 302 Austin, Texas 78752 (512) 451-8145

August 31, 2000

Mr. John Young
Project Manager
Office of the State Auditor
P. O. Box 12067
Austin, Texas 78711-2067

Dear Mr. Young:

Please find enclosed responses of the TIBH Board of Directors and staff to the recommendations stated in the Audit Report on the Texas State Use Program. The page numbers on the top of TIBH's responses correspond to the page number on the audit where there is the space for Management's Response. Also enclosed for your convenience is a diskette, which contains these management responses.

We appreciate having had the opportunity to comment on the audit. If you have any questions or would like copies of any of the documents referenced in the management responses, please call me at 451-8145.

Sincerely,

A handwritten signature in cursive script that reads 'Lyndal R. Remmert'.

Lyndal R. Remmert
President

LRR:mr
Enclosures

Working Together for Texas

Summary of TIBH Response

TIBH believes that some information provided by this audit concerning TIBH and the program is factually incorrect and cannot be substantiated and therefore, the conclusions and recommendations drawn from this information are highly questionable.

There is insufficient data to support that:

- **Disputes over open records and inadequate resources impede the Texas Council's ability to oversee the State Use Program.**
- **The Texas Council lacked access to performance and financial information by TIBH to perform its oversight function.**
- **TIBH made questionable expenditures of \$468,000 that did not benefit CRPs.**
- **TIBH's R & D is inadequate.**
- **The Texas Council needs its own staff.**

The audit staff acknowledged their unfamiliarity with the operational dynamics of a private, nonprofit social enterprise selling commercial products and services on a sales commission. There are fundamental operational differences between a state agency with appropriated funds to accomplish a mission and a private corporation, which is paid after its mission has been accomplished.

However, in considering recommendations regarding new legislation to clarify, give authority, accountability, etc., it should be noted that neither the letter nor intent of the current legislation (revised in 1995) has been followed. To come to the conclusion that the law is inadequate is simply ignoring the fact that none of the stated problems occurred before 1996 with basically the same law. Before legislation is amended as suggested by this report regarding proposed Council staff, expanded reporting, expanded government (Council authority and oversight), expanded requirements of TIBH and CRPs, the cost to the state and to all stakeholders should be considered. The stakeholders articulated their opposition to the cost of expanded government bureaucracy in the 1995 amendment hearings. Will more government employees be beneficial to the program or will these proposals be a retreat from one of the most successful examples in Texas of privatization?

TIBH Board and Staff

The Council Did Not Choose to Use the Oversight Authority in the Legislation and Previous Administrative Rules to Access Records, Review the Program, TIBH's Performance or Management Rate Even Though The Appropriate Documents were Forwarded to Them.

The characterization that TIBH is not providing financial and performance data to the Texas Council so it could evaluate performance and commission rates is totally inaccurate, and so are the conclusions drawn from that error of fact. TIBH, since the late 1980s, has regularly provided both performance and financial data that was required in the legislation, Council's rules, and in the Memorandum of Agreement. These included a financial budget; a program budget; performance goals and accomplishments; and the revenues (commission rates with estimated sales) to fulfill its duties and accomplish the program as outlined in Section 122.019. This was done even though the 1995 amendments to Chapter 122 eliminated the need for a budget proposal. Audited financial statements were also provided upon request. TIBH can document delivery of these items to the Council. TIBH continued to provide this information during the lawsuit even though some of these records were protected by court order. After TIBH dropped the lawsuit, and upon request of the Council, additional records were made available to Council members upon their request in July on three occasions. Some of these records were appropriately marked "proprietary" or "confidential," as agreed with the Council and as permitted under the Open Records Act. In addition, Council members have repeatedly been invited to visit TIBH to assess performance, view what they want, or ask the questions they want to ask. A few Council members have made full use of this invitation; some have not. The Council is always welcome at TIBH offices.

TIBH currently has no pending requests on record for documents of any nature that have been denied to the Council upon their request (A request for records involved with the 1998 open records request by a third party competitor during the Council's competitive bid process has been withdrawn).

The current legislation gives the Council access to program and revenue information. The Council could have exercised its oversight authority. The fact is that the Council has chosen since 1995 not to conduct any comprehensive review. In 1997 the administrative rules for the review process that TIBH and the previous Councils had operated under were abolished. TIBH has not had the benefit of:

- Any response by the Council after receiving financial and performance data from TIBH each year.
- Any request to provide any additional information concerning a review or oversight considerations in conjunction with commission rates, etc.
- Any request to meet and discuss goals, program objectives, etc.
- Any opportunity to truly "negotiate" a new contract until August 2 of this year.

- Any new rules replacing those that were abolished in 1997 to address performance, oversight, or review of the commission rate.

Competitive Bid – Multiple CNAs – Council Staff were all Rejected in 1995

The idea of competitive bid, multiple CNAs, and expanded government staff were addressed in the proposed amendments to the 1995 legislation, and with substantial input from the stakeholders, was rejected by the legislature. "Review and renegotiation" of a contract or agreement with the designated CNA was added to Section 122.019(d) to mirror the administrative rules in place in 1995. The rules were abolished in 1997 by the current Council. Both the acting chair and current chair were given the background on multiple CNAs and competitive bid on March 4, 1996 and April 10, 1996. (In addition, the entire State Use Program is housed in the current purchasing code in Exemptions from Competitive Bidding). To state in this audit that these issues were not resolved in the 1995 legislative amendments ignores the events of that session as reflected in the legislative history files.

Records – Access was Clearly Defined in 1995 Legislation

Amendments to Section 122.009 in the 1995 legislation further clarified the CNA's private and proprietary records by limiting review "specifically" to state purchases of products and services. The Council's access to records was not addressed because TIBH had always supplied the requested records as defined in the administrative rules that were in place (until abolished in 1997 by the current Council). TIBH has continued to supply these documents and records although the rules were abolished with no replacement rules concerning records. The records issue, transition procedures, and property rights are to still be worked out by TIBH and the Council according to commitments to each other during formal mediation. It is doubtful that statutes can be written to define all of these issues.

The Program Can Be Accountable Without the Expense of a Council Staff

TIBH does not agree that the Council lacked adequate resources to independently review and analyze the program and that the solution to this is to create a staff. The four areas of need outlined in this section of the report would have been satisfied had the Council members availed themselves of the information and resources available to them through TIBH and GSC and had not eliminated previous rules for the conduct of the program.

Amended legislation in 1995 gave the Council legal, administrative, and clerical support from GSC, and also set up a procedure under 122.019(f) for the Council to adjust the management fee to offset these added costs. Not since 1995 has the fee been adjusted. TIBH has only been asked to provide some \$25,000 annually to the Council even though it was originally estimated to cost an additional \$50,000 annually.

- An independent review of cost analyses, pricing proposals, and contract proposals could have been accomplished by GSC if the Council had expanded its budget request of TIBH to provide more commission dollars to GSC.
- GSC has always had the statutory responsibility under the law even before the financial legislative aid afforded them in 1995 to provide exception reporting. Did GSC not include these duties in its normal budget request to the legislature since 1979?
- Following the process outlined in the current law, and reviewing the financial performance and management fee proposals supplied by TIBH on an annual basis, would have accomplished much in satisfying the four needs listed.

However, should audit verification of CRP reports on labor ratios, wages, and benefits to people with disabilities etc., be now needed to verify the annual report, should these costs not be covered by State appropriations for a government body (GSC) that already has a staff in existence? Increasing commission on sales will only add to the cost of the products or services of the CRPs...making them less competitive, thereby limiting job opportunities for people with disabilities and negatively affecting the positive cost/benefit ratio the program now enjoys. As an alternative with very little added cost:

- The Council should use the provisions under the law for more administrative support from GSC.
- GSC, under the Council's direction, compile the State Use Wage Report, which is the basis for the annual report, and prepare the annual report as now defined in Section 122.022, Reports, in the legislation.
- TIBH, relieved of the above duty, use its earned commission revenue to selectively audit the CRP reports submitted to the Council.

TIBH Agrees that the Management Fee Should be Reviewed

TIBH agrees that the management fee rate should be re-evaluated as it is specified in the current legislation. Since 1995, TIBH has regularly supplied financial information, budgets, and program budgets to support the management fee rate. The Council has never chosen to review them with TIBH and has made no changes to the rate.

With regard to cost data, it is not difficult for TIBH to assign costs to large functional areas such as contract management or payment processing. In fact, it is done every year in the functional program budget that is shared with the Council. To suggest that the costs be tracked to provide each individual fee for service to each CRP on each contract is a prohibitively expensive proposition. It is clearly apparent that the big contracts help subsidize the small contracts. TIBH has always had a limited number of complaints from CRPs with large contracts about the subsidy of smaller contracts. It is a matter of bottom-line financial consideration of the individual CRP, versus the common good of the program with more opportunities for people with disabilities. Recognizing this, there is a movement nationwide to establish only one rate for both products and services, as used in the Federal Program. This program is a social enterprise. It should not routinely eliminate product or service contracts operating at a loss because of bottom-line profit considerations as a for-profit company might do.

The services provided by TIBH are relatively the same for all CRPs. These services include initial marketing for new contracts, specification and pricing negotiations, execution of contract documents, setting up invoicing and payment procedures, and reporting to the Council. Additional services include training of CRP staff, contract management in regards to monitoring quality and performance, and assisting with contract problem resolution.

TIBH should be and is actively involved in the negotiation and execution of renewal contracts since the same processes and reporting systems are in effect as they are for new contracts. The extent to which TIBH is involved in these additional services is dependent upon the degree of difficulty the CRP may be experiencing with a particular contract or with specifications or pricing issues.

A small number of the larger CRPs do not want TIBH involved and choose not to avail themselves of these services. In the past, bypassing TIBH has led to contractual abuses by CRPs contracting with political subdivisions. Involvement in renegotiations by TIBH, as well as involvement in new contract negotiations, is the check and balance to prevent this abuse. TIBH should be involved in the initial negotiation and or renegotiations to help solve performance issues.

TIBH has Made no Expenditures that were not Made in the Interest of Texans with Disabilities

The Board reserves the right to authorize its own expenditures. The auditor's conclusions and recommendation about expenditures are totally without merit for the following reasons:

- Lawsuit Expense – Had the law as written been followed by the Council regarding “review and renegotiate” of the CNA and the treatment of private records, there would have been no lawsuit expense. TIBH did not initiate the need for this expense. The suit involved a need for an objective interpretation of Chapter 122, by the Courts. For an organization of its size, TIBH has had lower-than-average litigation expenses during its existence; lawsuits have been rare. The State has chosen to prolong the lawsuit with its appeal, after TIBH dropped the lawsuit.
- Lobbyist Expense – From a CRP survey, the second most important thing that TIBH does for CRPs is to monitor legislation, and TIBH has done this over the years to protect the program against harmful legislation.
- Extra Interest Expenditures on the Line of Credit – When warrants to TIBH were missing, TIBH acted responsibly. At its own expense, TIBH continued to pay CRPs prior to the required 30-day period without disruption to the CRPs, so workers with disabilities could be paid. The missing warrants did not hurt the CRPs or program, it only reduced TIBH's fund balance.
- R & D – TIBH was fulfilling its duties as prescribed in Sec. 122.019(b) “The services of a central nonprofit agency may include marketing and marketing support services, such as”:
(3) “research and development of products and services”;

Any conclusions that TIBH expenditures, (actually TIBH investments in the future of the program) do not benefit Texans with disabilities should consider that the persons with disabilities have already benefited from the program when TIBH has earned and has been paid its commission. The R & D, contract negotiation, marketing, PR, education, accounting services, contract management, payment to CRPs, and a successful sale of a product have already occurred. More important, the person with a disability has already had the opportunity to work, performed the work, and has already been paid wages for his work. TIBH earns its revenue identical to any vendor, and any reasonable suggestion from the CRPs or Council on how TIBH revenues can be better utilized is always appreciated. However, to suggest that government (Council) become deeply involved in managing a private vendor's earnings and day-to-day expenditures destroys the whole concept of privatization and implies that the private citizens (TIBH Board and management) are incapable of authorizing legitimate expenditures for the benefit of the program.

TIBH had Already Strengthened Controls in January 2000 to Eliminate the Missing Warrant Problem

TIBH agrees that additional financial controls are necessary and will include a Financial Manager in its 2001 budget. TIBH took the necessary first steps in January to prevent another occurrence of warrants being unaccounted for, stolen or destroyed. In processing approximately 750,000 transactions and approximately \$485 million in warrants successfully over the last 20 years, TIBH had not faced this particular problem before. Since establishing some additional controls in January, no additional incidents of missing warrants have occurred.

It is fortunate that TIBH had the financial resources and line of credit to pay the CRPs while warrants are being re-issued. The CRPs did not suffer any direct financial loss because of the problem. TIBH considers this matter an open investigation and will refer it to law enforcement agencies if criminal prosecution is appropriate.

TIBH is also in the midst of the conversion of its 15-year-old accounting system to a new system that will provide essential reporting and facilitate detailed financial analysis by management. This conversion was scheduled for completion in the summer of 2000. The old system had been extensively customized over the years. TIBH searched for a new system requiring minimal modifications and custom programming. The timing of the audit interrupted TIBH's system conversion, which is now underway.

TIBH has, for several years, recognized some reporting deficiencies in the current accounting system. Some of those deficiencies are indirectly referenced in the audit recommendations. The new system, once implemented, will provide the necessary tools enabling management to quickly detect problems and employee actions such as those occurring last fall. TIBH agrees with the assessment that the missing warrants was an isolated incident confined to a brief time period. TIBH also strongly believe that conclusions of this isolated incident cannot be applied to the entire program and all of its assets. The weaknesses in our financial reporting and monitoring delayed our detection of the cause of the problem from September until December. August is the end of the state's fiscal year and often agencies fall behind in the processing of vouchers, especially at year-end. Even with new reporting systems in place, TIBH may have not detected the problem until early October. The specific situation where TIBH suspected an employee deliberately and routinely destroyed warrants began in mid December.

TIBH has already implemented appropriate financial and internal controls to protect such behavior in the future. However, all of the controls that could ever be implemented would not guarantee that future employees would always do their jobs and not deliberately destroy company documents and records. The controls and the reporting capacity of the new accounting system will give TIBH the missing tools to rapidly detect problems.

Any company or agency is vulnerable to intentional and malicious actions by employees. TIBH has taken every reasonable step to safeguard its assets and will continue to dramatically increase monitoring and analysis capacity with the new accounting and reporting system.

Other recommendations concerning cash receipts, accounts receivable, and collection functions will be implemented where possible.

TIBH Board of Directors Has a Cash Reserve Goal

TIBH Board policy has always been to establish a reserve cash goal of 6 months operating expense and to accomplish this by budgeting a 5% excess of revenues over expenditures in each annual budget. This has been difficult to attain without an increase in commissions because:

- CRPs indicated a need for assistance with equipment purchases and the Board decided to assist with grants since 1995 of some \$295,000.
- CRPs need help with early payment and in order to save contracts and jobs for Texans with disabilities, TIBH initiated early payment procedures, which cost TIBH some \$535,000 in interest for the last 5 years.

Both of these actions were TIBH long-term investments in the program at a TIBH expense of some \$830,000.

However, TIBH will, in the future, base its commission requests to build a 6-month cash reserve.

Uninsured Bank Balance

The \$200,000 uninsured bank balances are at no risk to TIBH. If Bank of America were to fail, the compensating balances on deposit would be offset against the loan balances. This was confirmed with F.D.I.C. Bank of America is one of the largest banks in the U.S. and provides TIBH its current line of credit of \$3.25 million. TIBH on a daily basis has loan balances in excess of \$1 million dollars for early payment funds to CRPs. When TIBH loan balances reduce below excess deposit amounts, TIBH will transfer funds to another financial institution. TIBH has begun transferring funds to other financial institutions.

The Council Needs Rules

TIBH agrees that the Council should establish rules to establish a monitoring function for CRPs and who will perform these functions. The Council has direct contact and the necessary information as often as it desires to monitor performance of TIBH.

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TIBH will do so as soon as the Council adopts clear rules and definitions regarding CRP eligibility.

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Product complaints are closely monitored, tracked, and recorded. Each quarter this report is sent to the CRPs for their review. These documents were shown to the audit staff and are available upon request. The emphasis of TIBH on service complaints is to solve them, not track them. However, TIBH will establish procedures to record and track service complaints.

TIBH Does Assess the Reasons for Staff Resignation

TIBH does assess the reasons for staff resignation. Of the field marketing staff who resigned, compensation, benefits, or the availability of resources was not determined to be a factor in any of these resignations.

The resignations were due to a feeling of lack of job security brought about by the uncertainty of TIBH's continued management of the program, difficulty in working with CRPs who challenge the CNA authority and duties as prescribed by law, and the inability of some of the employees to meet TIBH's performance standards.

TIBH will continue to pursue other market options to employ Texans with disabilities.

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TIBH will conduct another price survey before the end of the year.

TIBH has an Adequate R&D Program that has Provided for more Products than any other State Use Program

This conclusion about R&D appears to be based on non-factual information and is totally illogical as well as unreasonable. TIBH R&D efforts are not designed to be totally exclusive with the whole product or service proposal merely being handed to a CRP when TIBH has finished the proposal. Since TIBH has absolutely no production control over CRPs, all products have been researched and developed in a partnership relationship, with TIBH addressing the requested needs of the CRP in the Research & Development stage. This gives the CRP an investment in or stake in producing a successful product. This approach has provided more product lines and jobs than any other State Use Program. The only exception to this procedure is copiers, where TIBH took a much more direct role in the research and development because of the lack of CRP financial resources.

Facts – Computers

- TIBH was informed by GSC in 1993 when questioned by TIBH that the State Use Program had priority over QISV purchases. This was reaffirmed in the QISV catalog purchasing guidelines (documentation provided upon request).
- TIBH had done research on computers in the late 80's and again in the 90's, and in fact, the Council set computers aside, but the previous CRP backed out of the project. TIBH's R&D showed that computers had a legitimate value as a product candidate for the program.
- The new CRP bringing computers to the Council was already manufacturing them in the commercial market. TIBH verified value added by people with disabilities. There was no question about the capability of the CRP with regard to production capabilities.
- If GSC had the knowledge of a potential conflict with the QISV legislation, why did GSC not object and/or change its Administrative Code and inform everyone? Why was there a request for an Attorney General's opinion if GSC knew QISV had priority?

Conclusion: To blame TIBH's R&D effort for this problem has no basis in fact. TIBH had no reason to suspect any conflict after the guidance provided by GSC in their documents and policies.

Facts – Copiers

This was an R&D project where TIBH expended hours of extra human resources and substantial funds because CRPs did not have the resources. This project was intended to be researched, developed, and transferred to a CRP for the state purchasers of refurbished copiers, providing a consistent source of copiers for the CRP and a consistent market to sell them back. To criticize

R&D efforts in finding out whether persons with disabilities were capable of performing this work effectively (which they can do) reflects a clear misunderstanding of TIBH's R&D role. TIBH found out it could not be a financial success in the competitive commercial market – but that was not the total object of the R&D.

In TIBH's opinion, this project is still a viable project for some CRPs, but with all the questioning of higher tech set-aside products such as computers, CRPs might be reluctant to try it.

Conclusion: TIBH's R&D efforts with regard to copiers were extensive, thorough, and more complete than normally performed because the CRPs did not have the revenues to do this. The audit staff's conclusion that this is inadequate R&D is totally unfounded. TIBH did in fact do all the things correctly that the audit staff is using as a basis to conclude that TIBH R&D is inadequate.

This Recommendation in Itself is not Adequate to Enhance Compliance

One needs purchase exception information on a day-to-day basis, as the exception occurs to be of any real help to the CNA and CRPs in their marketing efforts. The CNA and CRPs need to have information about noncompliance as it occurs. They need to identify if:

- There a mismatch in specifications or delivery.
- There a CRP performance problem (complaints).
- There lack of knowledge about the program.
- There a specific lack of knowledge about products or services.

Although a quarterly exception report to the Council may be of some value to formulate overall policy as the recommendation suggests, it will be of little short-term value in the day-to-day operations of the CNA and CRPs.

TIBH believes that if GSC does not have the means to accomplish immediate notification of exception purchases, it would be much better to amend the legislation to require all agencies, or at least agencies of a certain size to have State Use Coordinators such as is being utilized for HUB purchases. TxDot has had a State Use Coordinator for years and the program has greatly benefited. The State Use Coordinator would be the key source of purchase exception information.

General Services Commission Responses



General Services Commission

1711 San Jacinto - P.O. Box 13047
Austin, Texas 78711-3047
Web Site: www.gsc.state.tx.us
(512) 463-3035

CHAIRMAN
Gene Stull
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Tomas Cardenas, Jr., P.E.
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Dionicio Vidal Flores, P.E.
Fred N. Moses
Barbara Rusting
EXECUTIVE DIRECTOR
Jim Mize

VIA HAND DELIVERY

September 1, 2000

Mr. John Young, Project Manager
State Auditor's Office
Robert E. Johnson Bldg.
1501 North Congress Ave., Ste. 4-224
Austin, Texas 78701

RE: Audit Report on the Texas State Use Program

Dear Mr. Young:

The General Services Commission (GSC) response to the issues identified in the captioned report is as follows:

Section 1: The Council lacks adequate authority and resources to oversee the State Use Program.

The Council maintains that all records pertaining to the State Use Program are subject to the Public Information Act. Insofar as disclosure of TIBH data to the public is disputed, the procedures mandated by the Act will be followed.

Section 1-A: The Council lacks adequate financial and performance information to effectively oversee the State Use Program.

GSC concurs that the lack of staff hampers the Council's ability to monitor the State Use Program. While GSC has provided legal advice and clerical support to the Council, GSC is not staffed or appropriated monies to do this.

While this statement is accurate as to the past history between the Council and the CNA, TIBH has provided all documents requested by the Council's letter of June 29. (See attachment 1-A). Records were provided with the understanding that TIBH considered all documents provided to be privileged (confidential proprietary data) and that the Council would notify TIBH when any Open Record request is made for this information.



An Equal Opportunity Employer

Mr. John Young
September 1, 2000
Page 2

The Public Information Act states the procedure for the owner of records to prove an exemption from public disclosure to the Office of the Attorney General. The Attorney General, not the Council, will make any decisions regarding the issue of open records as it pertains to TIBH data in accordance with the Act.

Recommendation:

GSC agrees with the first three recommendations and will provide legal support to the Council in its effort to provide input to the legislature regarding these recommendations.

GSC defers to the Council's discretion regarding the fourth recommendation. Execution of these duties will be dependent on funding for staff.

The GSC is currently providing assistance to the Council in drafting rules that will encompass the report data described in the fifth recommendation.

Section 1-B: The Texas Council on Purchasing from People with Disabilities lacks sufficient staff to effectively oversee the State Use Program.

GSC is in agreement with the staffing needs of the Council. In view of the dollar amount of products and services purchased under the Program and the complexity of the duties required to adequately support the Program, the following full-time employee positions are suggested as a starting point for consideration:

- Program Director to advise the Council regarding policy, budget requirements, program plan, program management and oversight;
- Cost Accountant to review and analyze pricing proposals, new product and service contracts;
- Attorney to advise the Council regarding legal issues arising during the course of the administration of the State Use Program;
- Purchaser to advise the Council regarding actions on product proposals for the Program;
- Program Analyst to monitor state compliance with the Program;
- Field Inspector to monitor and verify self reported data from the CRPs
- Administrative Assistant to perform administrative support functions for the Program

GSC also agrees that the access to TIBH records is of limited use without staff to review and analyze documents for the Council. Staff could also research and analyze issues that are anticipated to arise regarding product and service proposals, and other matters before the Council rather than putting the Council in a position to rely on outside sources which may not provide timely information.

Mr. John Young
September 1, 2000
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Recommendation:

GSC agrees with the recommendation regarding the need for staffing. GSC recommends that the funding be obtained from Legislative appropriations in order to avoid a conflict of interest with TIBH or other central nonprofit agencies.

However, GSC does not agree that it should continue providing legal support for the Council. The legal involvement for the Council has been overwhelming due to the mentioned lawsuits and disagreements between the CNA and the Council. As there appears to be no relief in the near future, GSC believes that the Council should be provided full time legal staffing.

Section 2: The Council has no administrative rules or documented policies for deciding which goods and services are suitable for the State Use Program.

In its meeting on June 16, 2000, the Pricing Subcommittee adopted the definition of direct labor as defined by federal law in 41 CFR Ch. 51-1.3: "all work required for preparation, processing, and packing of a commodity or work directly related to the performance of a service, but not supervision, administration, inspection or shipping." This criteria will be used as a policy guideline by the subcommittee to evaluate the proposed goods and services for the program. Approval by the Council is usually obtained on positive recommendations from the Pricing Subcommittee.

Although not formally adopted as a policy by the Council, the goal of a 75% direct labor by disabled persons is currently used by the Council as a guideline for approval of goods or services. (See Attachment 2).

Recommendation:

GSC legal support to the Council will advise that criteria for products and services be addressed in the Council's proposed rules.

Section 3: The management fee for the Central Nonprofit Agency should be re-evaluated.

GSC agrees that the management fee needs to be analyzed to determine its reasonableness. However, legislation authorizing staffing and appropriations for this is needed to assist the Council in undertaking this complex and laborious task.

The expenditures of TIBH on items that do not directly benefit CRPs were unknown to the GSC and the Council before the State Audit. This situation underscores the need for staffing to assist the Council with its oversight duties.

Mr. John Young
September 1, 2000
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Section 3-A: Cost data maintained by the Central Nonprofit Agency is inadequate to fully evaluate alternative management fee rates.

The Council needs staff to assist with the evaluation of alternative management fee rates and their impact on TIBH's ability to provide services to smaller CRPs. GSC did not have information before the State Auditor's Report about TIBH's lack of a cost model to allocate direct and indirect costs for each CRP.

The Council and GSC have recognized for some time that the current fee structure subsidizes the less well funded CRPs, but have not had the staffing to perform analysis of fee structures.

Recommendation:

Although GSC supports the recommendation for analysis of alternative fee rates, it is probably unrealistic to expect this from a Council without staffing.

Requirements for additional cost data from TIBH would be needed if there were staffing to review the data and perform a management fee analysis.

Section 3-B: TIBH has made questionable expenditure decisions.

Until the State Auditor's Report, GSC had no knowledge about the 650 lost state warrants, the amount of expenditures for suing the Council, lobbyist fees and unsuccessful research costs. The report does not elaborate on the purpose for the lobbyist expenses so the GSC has no other comment regarding this item.

The loss of the state warrants provokes great concern regarding the integrity of TIBH's internal financial controls. Since each state agency's warrants are processed through the State Comptroller of Public Accounts, GSC would not be able to put controls in place from its area of operations.

The expenditures for the lawsuit are also questionable. Since TIBH non-suited the Council, it is in the same position it was before the lawsuit in regard to the issues it sought to litigate--the Council's right to select a CNA through a competitive bid process and designation of certain records submitted to the Council as open records. There is no statutory right for TIBH to have a monopoly as the permanent CNA and the Public Information Act controls the process for determining whether specific documents submitted to the Council are open records (i.e. subject to public disclosure).

Research and development expenses could be more cost-effective if more time were spent on research of the state's procurement statutes and rules. Market research

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Page 5

would also identify the services and products, purchased by governmental entities, that could be supplied by the CRPs.

Recommendations:

GSC concurs that there is a need for report formats that are meaningful for the Council to be able to review all relevant categories of expenditures for use as an evaluation tool for a CNA. However, it is within the Council's discretion to determine and prioritize its requirements for information within its ability to accomplish its duties with its limited access to staff.

Section 4: TIBH lacked adequate financial controls to safeguard resources of the State Use Program.

Prior to the State Auditor's Report GSC had no knowledge of the lost warrants totaling \$3.6 million and uninsured bank deposits of \$217,000. These findings engender concern about the integrity of TIBH's financial management procedures. These findings also support the need for legislation to enable staffing for the Council. A program that generates receivables of this magnitude is at great financial risk without professional full-time staff to thoroughly analyze, evaluate and report on the progress and operations of the program.

Section 4A: TIBH lacked adequate financial controls over payment processing and collections.

The State Auditor's findings regarding the length of time TIBH took to identify missing warrants with the consequential incursion of \$87,000 of interest indicates the need for more professional staffing by TIBH and an overhaul of its collections and financial reporting systems.

Recommendations:

GSC concurs with the State Auditor's recommendations regarding cash receipts, accounts receivable and collection functions and further recommends that similar reports be generated for each of the CRPs, and that state purchases be coded to enable these reports to be generated specifically on state purchases.

Section 4-B: TIBH has uninsured bank balances of approximately \$217,000.

GSC had no information regarding this situation prior to the State Auditor's Report. If these uninsured bank balances represent receivables to the CRPs, then all such funds should be placed in federally insured accounts. If these funds represent TIBH's management fees, then TIBH should decide whether it could absorb a loss due to

Mr. John Young
September 1, 2000
Page 6

insolvency of its bank. Commingling of funds (CRPs' with TIBH's) would represent another issue.

Recommendation:

GCS concurs with the first recommendation to the extent that excess funds relate to the CRPs' receivables.

Regarding the second recommendation, since TIBH has all relevant data in its possession, GSC believes that it should develop a policy to address reserve needs of the State Use Program using historical data, projections and rational assumptions to present to the Council for its approval. Investment policies and procedures regarding non-CRP and CRP funds with supporting documentation should also be submitted to the Council for its approval.

GSC agrees that cash reserve needs of the program should be considered when reviewing the CNA's management fee commission rates.

Section 5: The integrity of the State Use Program cannot be ensured without a monitoring function and additional policies regarding CRP's eligibility to participate in the program.

Staff would be required to monitor and verify program compliance of the CNA, review managerial and financial control of CRPs, and analyze documentation on CRPs' eligibility to participate in the program.

Statutory authority would be necessary to require documentation for financial and managerial control from CRPs. Under the current statutory scheme, CRPs contract with the central nonprofit agency to be represented by the CNA and for other services performed by the CNA. Under Human Resources Code §122.009 Records, only the records of the CNA and Council are available for inspection.

Section 5-A: There is no monitoring or verification of CRP compliance with State Use Program policies.

Without staff, the Council cannot monitor policy requirements, including verification of worker disability, relating to the Program. TIBH is correct in its assertion that it has no authority to audit or monitor the CRPs' records. Although TIBH could require access to documentation in its contract with CRPs, the Council is not currently staffed to review reports on this issue.

Mr. John Young
September 1, 2000
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Recommendations:

GSC supports the first three recommendations in principle, but advises that statutory authority and staff would be required to support administrative rules regarding monitoring and inspection of CRPs' records.

GSC will recommend to the Council that it include verification of worker disability in its proposed rules; however, the Council's ability to independently verify data will be severely compromised without staff to perform this function.

Section 5-B: The Council lacks a policy on related party contracts and transactions by participating CRPs.

Recommendation:

GSC concurs.

Section 5-C: Documentation and record maintenance on CRPs' eligibility to participate in the State Use Program are inconsistent.

GSC has only been apprised of this situation from the State Auditor's report.

Recommendation:

GSC concurs.

Section 5-D: Complaints about State Use Program products and services are not consistently tracked.

GSC staffers have heard TIBH's reports regarding complaints only in response to questions from the Council during quarterly meetings but was not aware that TIBH lacked a database and tracking system.

Recommendation:

GSC concurs and recommends that TIBH also report its findings and responses to the Council on a regular basis.

Section 6: TIBH's marketing and financial support assists CRPs.

GSC commends TIBH for its support to the CRPs. The program's success is indicated by the 71% increase in sales over the last four years from \$36.6 million to \$51.7 million. However, the magnitude of the State Use Program and the findings in the State

Mr. John Young
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Auditor's Report underscore the need for state resources in the form of staffing, office space and appropriations. This level of support is needed for the Council to attain optimum performance of its oversight functions and to ensure the financial integrity and continuity of the program.

Section 6-A: Marketing is a key function for the State Use Program.

GSC will be issuing a questionnaire to all state agencies to assist the Council in determining the efficacy of TIBH's marketing initiatives and customer satisfaction. GSC has also observed that TIBH has not prepared a professional report to the Council showing estimated additional costs for set-aside products as a result of using Grainger Industrial Supply for warehousing and catalog sales. One of the goals of the State Use Program is to provide products and services that offer the best value.

Recommendation:

GSC concurs with the need for TIBH to implement strategies to retain marketing staff and pursue options to increase product sales. GSC also recommends that TIBH coordinate with GSC during its development of electronic purchasing of set-aside products.

Section 6-B: TIBH has prepared standard pricing structures for some service contracts.

TIBH has been notified by GSC that the 75% guideline applies to work which is performed by a disabled person when assisted by an able bodied individual. TIBH has misinterpreted the 75% guideline to apply to temporary services so that one fourth of the positions can be filled with able-bodied persons. This scheme is inappropriate for consideration in the pricing structure of the temporary commodities code list. (See attachment 6-B).

Recommendation:

GSC concurs with the recommendation that the Council should periodically review temporary service rates but believes that the CNA should present a market rate comparison to the Council upon request. This activity should be a part of the CNA's market research.

Section 6-C: TIBH provides financial and technical assistance to CRPs.

GSC commends TIBH for its services and support to the CRPs in the form of advance payments, technical assistance grants, and flexibility in its management fee collections.

Mr. John Young
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TIBH could enhance its support by generating sales of CRP products and services to the private sector and developing an electronic purchasing system.

Section 7: TIBH does not adequately research products developed for the State Use Program.

GSC acknowledges that TIBH does not adequately research purchasing laws, market demand or the impact of pricing structures proposed to the Council. Most recently, the Council approved pricing changes for copy paper which are tied to the quarterly pulp index. TIBH did not research the long-term impact of this pricing scheme on the CRPs' copy paper sales.

GSC purchases the copy paper for its copy service. This operation is self-funded through reimbursements from other state agencies for massive copying jobs. When the price of the copy paper rises on a quarterly basis, this situation plays havoc with agency budgets. Furthermore, state agencies may go to a private sector copy service to save money. If the GSC copy service can no longer fund itself, the operation will terminate and cause a substantial negative impact to the copy paper sales of the CRPs.

Recommendation:

GSC concurs with the State Auditor's recommendations.

Section 8: GSC does not provide compliance exception reports to the Council as required by statute.

The GSC will provide the Council with a list of state agencies not in compliance with the State Use Program when a procurement audit is completed by the staff. GSC performs post procurement audits on 10% of all purchases of goods and services by state agencies.

The GSC is aware of the exceptions reporting issues and should have a better capability for addressing this issue through the electronic procurement system. The Council has been verbally advised in the past of major exception trends in agencies' purchases. Staff presented these findings at formal Council meetings and Subcommittee meetings. GSC staff reported when state agencies found that the commodity set-aside program was not meeting specific needs; however, formal reports were not filed for record.

All state agencies are expected to transition into the electronic purchasing system by 2003. This will occur in phases as over 250 agencies and institutions of higher education will be involved. The GSC will coordinate and facilitate a focus group comprised of the top ten spending agencies to further develop methods of reporting

Mr. John Young
September 1, 2000
Page 10

purchase exceptions for the Council, provide educational opportunities and draft rules as necessary.

All agencies are encouraged to submit a Vendor Performance Form for purchases that involve exceptional or unsatisfactory performance. (See Attachment 8). Those related to TIBH will also be submitted to the Council upon its request. The format and frequency of these reports will be based on the Council's requirements for this information.

Recommendation:

GSC agrees as to the requirements of the statute but can only comply to the extent above described.

GSC legal support will advise the Council of its support for amendment of the requirements of the statute.

The substantial efforts of the State Auditor's staff are very much appreciated as are the insightful analyses and helpful observations regarding the State Use Program. The issues identified and detailed recommendations provide an opportunity for improvements in the oversight and management of the program.

A copy of our response has been distributed to the Council and related GSC staff.

Sincerely,


David Lawrence
Deputy Executive Director

DL:JUK:rrb

cc: Dr. Robert A. Swerdlow, Chair
Texas Council on Purchasing
From People with Disabilities

James Terry Boyd, Member
Texas Council on Purchasing from
People with Disabilities

Mr. John Young
September 1, 2000
Page 11

John W. Luna, Member
Texas Council on Purchasing from
People with Disabilities

Chuck Brewton, Member
Texas Council on Purchasing from
People with Disabilities

Meg Pfluger, Member
Texas Council on Purchasing from
People with Disabilities

Paul J. Calapa, Member
Texas Council on Purchasing from
People with Disabilities

Bobbie F. Templeton, Member
Texas Council on Purchasing from
People with Disabilities

Byron E. Johnson, Member
Texas Council on Purchasing from
People with Disabilities

Cathy J. Williams, Member
Texas Council on Purchasing from
People with Disabilities

Juliet King, Legal Counsel

Ann Dillon, General Counsel, GSC

Erica Goldbloom, Council Coordinator, GSC

Paul Schlimper, Division Director, CPS, GSC

Norma Barrera, Program Director, CPS, GSC

Ena Wady, Division Director, Internal Audit, GSC

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ATTACHMENT 1-A

**Texas Council on Purchasing
From People With
Disabilities**
1711 San Jacinto - P.O. Box 13047
Austin, Texas 78711-3047
(512) 463-3244

CHAIRMAN
ROBERT A. SWERDLOW, Ph.D.
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COUNCIL MEMBERS
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CHUCK BREWTON
PAUL J. CALAPA
BYRON E. JOHNSON
JOHN W. LUNA
BOBBIE F. TEMPLETON
GATHY J. WILLIAMS

June 29, 2000

Lyndal R. Remmert
President, TIBH Industries
300 Highland Mall Blvd.
Austin, Texas 78752

Dear Mr. Remmert:

Thank you for your letter dated May 15, 2000. As you requested, the following Council members will arrive at your offices to begin the inspection and designation of documents for copying. Please have all requested documents on hand and ready for inspection at your offices at the dates and times shown below.

Council Member Byron E. Johnson will arrive at your offices on July 7, 2000 at 10:00 A.M. to inspect and designate for copying;

- All TIBH's Internal Audits for the past four (4) years to the present;
- All Documents showing TIBH's current Line of Credit; and
- the last four (4) of TIBH's Internal Quarterly Product Reports.

Council Member Meg Pfluger will arrive at your offices on July 13, 2000 at 10:00 A.M. to inspect and designate for copying;

- All currently active contracts between TIBH, CRP's, State and Political subdivisions;
- All TIBH's Marketing Action Plans for the last four (4) years to present;
- All TIBH's Marketing Surveys for the last four (4) years to present; and
- All TIBH's Budgets for the last four (4) years to present.

Council Members John W. Luna and Chuck Brewton will arrive at your offices on July 26, 2000 at 10:00 A.M. to inspect and designate for copying;

- All Job Descriptions for the last year to present;
- All Organizational Charts for the last two (2) years to present; and
- All Office and Property Leases from January 1, 1999 to present.

Letter to Lyndal Remmert - Document Viewing by Council
June 29, 2000
Page 2

The Council will continue to give reasonable notice as to date, time and documents requested as transfer of TIBH documents to the Council continues.

In your May 15 letter, you state that there may be some delay in production of TIBH documents. All the documents listed come from the list of documents that was provided by TIBH and Mr. Douglas Becker to the Council, the General Services Commission (GSC) and the Office of the Attorney General (OAG). Since this is your list of documents and you have been given reasonable notice of the Council members arrival, the Council believes that there should be no delay in the production of any TIBH documents requested.

The final paragraph of your letter again raises your concerns about the release of proprietary and private TIBH documents. Briefly, the Council believes all documents relating to the State Use Program are subject to the Open Records Act and must be produced by TIBH to the Council. Under Attorney General Opinion OR98-1051 (April 27, 1998) only an order of the court may prevent Council access to these documents. Since TIBH filed non-suit in the recent litigation no order exists to prevent the Council from demanding and acquiring TIBH documents relating to the state use program. Moreover, the Council may use these documents to fulfill its statutory obligation to oversee the management and accounting of the program.

However, if TIBH feels that a particular document is proprietary in nature you may use the following statutory procedure under the Open Records Act:

1. TIBH must produce the document to the Council for copying in its non-redacted and uncensored form. TIBH may mark it as proprietary;
2. The Council will keep the document in its files. However, if that document is requested under the Open Records Act the Council will honor TIBH's concerns and give notice to TIBH of the request;
3. Upon timely notice from TIBH to the Council that TIBH contends the document to be proprietary in nature the Council will tender a request to the OAG for an opinion as to whether the document falls under the exceptions contained in the Open Records Act. The Council will accept the OAG's determination.

The use of this procedure will enable TIBH to mark the very small number of documents it believes fall under the exception contained in the Act and to receive notice of any Open Records requests to see these documents. The Council will have all the documents it requires on hand to fulfill its statutory duty of oversight and control of the State Use Program.

Letter to Lyndal Remmert - Document Viewing by Council
June 29, 2000
Page 3

Sincerely,



Robert A. Swerdlow, Ph. D. (EB)
Chairman

cc: Terry Boyd, Member
Texas Council on Purchasing from People with Disabilities

Chuck Brewton, Member
Texas Council on Purchasing from People with Disabilities

Paul J. Calapa, Member
Texas Council on Purchasing from People with Disabilities

Byron E. Johnson, Member
Texas Council on Purchasing from People with Disabilities

John W. Luna, Member
Texas Council on Purchasing from People with Disabilities

Meg Pfluger, Member
Texas Council on Purchasing from People with Disabilities

Bobbie F. Templeton, Member
Texas Council on Purchasing from People with Disabilities

Cathy J. Williams, Member
Texas Council on Purchasing from People with Disabilities

Juliet U. King, Legal Counsel
General Services Commission

Letter to Lyndal Remmert - Document Viewing by Council
June 29, 2000
Page 4

Douglas Becker, Esq.
Gray & Becker

Rande Herrell, Asst. Attorney General, Financial Litigation Division
Office of the Attorney General

Adrian Henderson, Financial Litigation Division
Office of the Attorney General

Erica Goldbloom, Council Coordinator
General Services Commission

Letter to Lyndal Remmert - Document Viewing by Council
June 29, 2000
Page 5

bcc: Ann Dillon, General Counsel
General Services Commission

ATTACHMENT 2

**TEXAS COUNCIL ON PURCHASING FROM PEOPLE WITH
DISABILITIES**

Performance Subcommittee
Rule Revision Definition Approved June 25, 1999
for Recommendation to Council

Value Added Statement

It is the intent of the council that the CRPs providing services or products to state agencies and political subdivisions should purchase raw materials or components through competitive bidding whenever possible and should make an appreciable contribution to the reforming of raw materials, the assembly of components, packaging of other products manufactured at rehabilitation facilities, or a combination thereof. A CRP may not act merely as a receiving and shipping facility. In addition, in order to be eligible to provide suitable products and services under this chapter, it is the intent of the council that a CRP must establish and maintain as least 75% handicapped direct labor hours in its operation. Violation of any portion of this section may result in suspension.



ATTACHMENT 6-B

General Services Commission

1711 San Jacinto - P.O. Box 13047
Austin, Texas 78711-3047
Web Site: www.gsc.state.tx.us
(512) 463-3035

CHAIRMAN
Gene Shull
COMMISSIONERS
Tomas Cardenas, Jr., P.E.
Jim Cox
Diosicio Vidal Flores, P.E.
Fred N. Mores
Barbara Rasling
EXECUTIVE DIRECTOR
Jim Muse

August 31, 2000

Mr. Lyndal R. Remmert
President
Texas Industries for the Blind and Handicapped, Inc.
300 Highland Mall Blvd., Suite 302
Austin, TX 78752

Dear Mr. Remmert:

Thank you for your clarifying response of July 26, 2000, regarding the set-aside temporary services contract and the employment of able-bodied persons under the contract. I cannot agree with your interpretation of the application of the contract for use by state agencies.

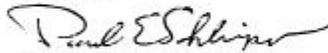
Article 2155.132(e) Government Code requires that any commodity or service procured by state agencies in excess of \$2,000 be competitively bid. The only exception to this law is for emergency procurements under very limited conditions as established by commission rule 113.2(13). While the Council may set-aside direct labor positions for handicapped persons, it has no authority to set-aside positions for non-handicapped persons. The 75/25 policy you mentioned applies when a CRP has to provide supervision for handicapped persons such as in roadside park maintenance or janitorial services. The contract we are focused on provides employees to state agencies who are supervised by state agencies not CRP's or TIBH staff. As I recall the discussion during the presentation to the full Council by the contractor, the statement was made that the cost of recruitment and training of handicapped persons for this contract was included in the hourly rates of the positions and that is where the 75/25 ratio comes into play for this service.

In summary, state agencies cannot accept any employees under your contract that are not disabled if the cost of the labor will exceed \$2,000 which is the statutory non-competitive bid limit. Your contractor should be so instructed. To provide the agencies with proper guidance in the legal use of this temporary labor services contract, I will be issuing a notice to advise agencies of this direction.

Mr. Lyndal R. Remmert
August 31, 2000
Page 2

Thank you for your continued cooperation with the state and for your dedication to proving constructive employment for handicapped persons.

Sincerely,



Paul E. Schlimper, CPPB
Director of Central Procurement Services
(512) 463-3443
e-mail: paul.schlimper@gsc.state.tx.us

PES:sw

cc: Mr. John W. Luna, Member
Texas Council on Purchasing from People with Disabilities

Mr. Chuck Brewton, Member
Texas Council on Purchasing from People with Disabilities

Ms. Meg Pfluger, Member
Texas Council on Purchasing from People with Disabilities

Mr. Paul J. Capala, Member
Texas Council on Purchasing from People with Disabilities

Mr. Bobbie F. Templeton, Member
Texas Council on Purchasing from People with Disabilities

Mr. Byron E. Johnson, Member
Texas Council on Purchasing from People with Disabilities

Ms. Cathy J. Williams, Member
Texas Council on Purchasing from People with Disabilities

Mr. Jim Muse, Executive Director, GSC

Mr. David A. Lawrence, Deputy Executive Director for Operations, GSC

Ms. Erica Goldbloom, Council Coordinator, GSC

Vendor Performance Form

Instructions: Complete this form to report exceptional or unsatisfactory vendor performance to the General Services Commission, Vendor Relations Section, 1711 San Jacinto Blvd, PO Box 13047, Austin, TX 78711-3047 or FAX to (512) 463-1223. Please forward a copy of this to the vendor and keep a copy for your agency records. Type or use black ball point pen to complete form.

GSC Purchase Order No.	Requisition No.	PO Date	Class/Items or Contract ID	Today's Date
To: Vendor Name, Address, Fax number and VID Number and 5 digit CMBL #			From: Agency/Co-Op Member Name and Address (please include contact name and phone number)	
Nature of report (Check all applicable boxes):				
<p style="text-align: center;"><u>POOR PERFORMANCE</u></p> <p>(005) Late Delivery (008) Failure to deliver (010) Delivery made at wrong destination (014) Failure to identify shipments per contract terms (016) Short weight or count (018) Vendor shipped incorrect merchandise (020) Failure to replace damaged goods (021) Slow replacement of damaged goods (022) Failure to pick up incorrect shipment (023) Improper product packaging (024) Failure to follow palletizing instructions (035) Failure to meet specifications (036) Poor product quality (038) Poor product performance (087) Failure to respond to letter or phone call (089) Failure to promptly notify GSC/Agency/Co-Op Member concerning manufacturer discontinuation of an item (090) Poor customer service (Requires comment) (091) Unauthorized substitution (095) Failure to supply performance bond (within required time) (100) Unsatisfactory installation (102) Service not performed within specifications (105) Repair parts not available (110) Incorrect invoices (111) Failed inspection (GSC USE ONLY)</p> <p style="text-align: center;"><u>ACTION TAKEN BY GSC/AGENCY/CO-OP MEMBER</u></p> <p>(006) 1st Written notice issued for late delivery (007) 2nd Written notice issued for late delivery (050) Inspection-Random (GSC USE ONLY) (051) Inspection-Requested (GSC USE ONLY) (112) Damages Assessed (201) Vendor commended (225) Shipment rejected (246) Vendor counseled</p>		<p style="text-align: center;"><u>RESOLUTION CODES</u></p> <p>(202) Complaint withdrawn (206) Vendor failed to receive purchase order (207) Delivery made after late notice sent (209) Performance corrected (210) Material or item replaced (212) Equipment performance corrected (217) Performance bond received (220) Invoice corrected (228) Item canceled from contract (Vendor failure-vendor initiated) (229) Item canceled from contract (Vendor failure-state initiated) (230) Item canceled from contract (No fault of vendor) (234) Entire order canceled (235) Entire contract canceled (Vendor fault) (236) Entire contract canceled (No fault of vendor) (237) Damages paid (246) Vendor counseled (249) Order completed (251) Correct shipment received (252) Damages not paid-Vendor suspended (GSC USE ONLY) (253) Performance not corrected-GSC action taken (GSC USE ONLY)</p> <p style="text-align: center;"><u>EXCEPTIONAL PERFORMANCE</u></p> <p>(002) Shipment made early upon agency/co-op member request (031) Product upgrade substitution suggested and accepted (060) Exceptional customer service response (063) Exceptional service provided for return of products (065) Provided technical/training/set-up assistance when not required (066) Price reduction for large order (201) Vendor commended</p>		
Detailed explanation (Please be specific; attach additional sheets if required):				
Vendor Instructions: Complete and return entire form with attachments to GSC (see above address) within 5 working days.				
Vendor Response (Attach additional sheets if required):				
Vendor Response Completed by:				
Printed Name and Signature		Title	Phone No.	Date
GSC USE ONLY: Purchaser code and comments				