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State Auditor

An Audit Report on

Selected Contracting Processes at the Commission on Environmental Quality

April 2006
Report No. 06-029



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Overall Conclusion

The Commission on Environmental Quality (Commission) has systems and processes for contract management that provide reasonable assurance that contract payments and encumbrances comply with contract terms, state laws, Comptroller of Public Accounts guidelines, and Commission policy. While the Commission's financial processes provide reasonable assurance of compliance, they include inefficiencies that increase the risk of data-entry error in financial systems.

The Commission's Contracting Practices

The Commission on Environmental Quality enters into contracts for environmental services such as monitoring air and water quality and cleaning up hazardous areas.

According to auditors' recalculations, in fiscal years 2004 and 2005, the Commission had approximately 2,300 active contracts totaling approximately \$839 million.

The Commission has not established adequate processes and controls for data management to ensure that (1) it complies with its internal contracting policies and the Texas Building and Procurement Commission's *Contract Management Guide* or (2) complete and accurate information is recorded in the contracts database, hard-copy contract files, and contractor performance evaluations database.

The lack of enforcement of internal contracting policies has led to inaccurate and incomplete data in the contracts database and has hindered the Commission's ability to accurately report on its contracting activities to executive management and external parties. For example, as of December 14, 2005, the contracts database showed a total dollar amount for contracts active during fiscal years 2004 and 2005 that was understated by approximately \$200 million, or 25 percent. The contracts database is a stand-alone database, and the issues identified regarding this database have no negative impact on the Commission's annual financial report. In addition, the Commission's procedures for managing contract information have led to inefficiencies because the same data is entered into multiple systems for different information needs.

Summary of Management's Response

The Commission agrees with the findings and recommendations in this report.

Summary of Information Technology Review

Overall, the Commission has good physical security controls for its information technology (IT) systems and data center, where electronic contract data is stored.

The measures the Commission has established for controlling access to its IT facilities are adequate, and system back-up tapes are stored offsite in accordance with the Commission's policies.

The Commission's primary contracts database has weaknesses in technical controls that are intended to prevent incomplete or inaccurate data. For example, a key software setting had been turned off, which resulted in required fields being left blank. The weaknesses in technical controls exist, in part, because the contracts database uses an older, stand-alone software package.

Network and Internet security was not within the scope of this audit.

Summary of Objectives, Scope, and Methodology

The audit objectives were to determine whether the Commission has:

- Systems and processes related to contract payments that ensure that payments are made in accordance with contract terms and state law.
- An effective change management process in place for contracts that protects against unwarranted cost increases, schedule extensions, the circumvention of management controls, and diminished contractor accountability.
- Systems and processes for encumbering funds that provide reasonable assurance of compliance with statutes, rules, Comptroller of Public Accounts guidelines, and Commission policy.

The audit scope included encumbrances, lapses, unobligated and unexpended balances, and payments regarding contracts and contract-related activities from fiscal years 2004 and 2005. The contract change management process was also included in the audit scope.

The audit methodology consisted of collecting information and documentation, performing selected tests and other procedures, analyzing and evaluating the results of the tests, and conducting interviews with Commission management and staff.

Other SAO Products

Number	Product Name	Release Date
04-016	An Audit Report on Permitting and Enforcement Functions at the Commission on Environmental Quality	December 2003

Detailed Results

Chapter 1

The Commission's Systems and Processes for Contract-Related Encumbrances and Payments Provide Assurance of Compliance with Contract Terms, Laws, and Applicable Guidelines

The Commission on Environmental Quality (Commission) has systems and processes for encumbering funds that provide reasonable assurance of compliance with statutes, rules, Comptroller of Public Accounts guidelines, and Commission policy. The Commission also has systems and processes in place to help ensure that contract-related payments are made in accordance with contract terms and state law. The Commission made contract-related payments of \$203.9 million and \$187.8 million during fiscal years 2004 and 2005, respectively.

While the systems and processes provide reasonable assurance of compliance, they include inefficiencies that increase the risk of data-entry error and the need for rework to make corrections. For example, Commission staff enter contract-related encumbrances and payments into separate spreadsheets or systems before entering them into the Uniform Statewide Accounting System (USAS), which the Commission uses as its accounting system of record. Auditors identified discrepancies in only 3 (3 percent) of 95 encumbrances and payments tested. In all cases, the information in USAS was correct.

Recommendation

The Commission should reduce duplicate data entry of encumbrance and payment information to decrease the amount of rework and risk of error.

Management's Response

We agree with the recommendation to reduce duplicate data entry of encumbrance and payment information. We will accomplish this by enhancing the agency's voucherizing system to allow a direct upload between the voucherizing system and USAS. The Financial Administration Division Director, in collaboration with the Information Resources Division Director, is responsible for accomplishing this by August 31, 2006.

The Commission's Processes for Information Management Do Not Ensure Compliance with Internal Policies and State Guidelines

The Commission has not established adequate processes and controls to ensure that (1) it complies with its internal contracting policies or the Texas Building and Procurement Commission's *Contract Management Guide* (Guide) or (2) complete and accurate information is recorded in the contracts database, hard-copy contract files, and contractor performance evaluations database.

The lack of enforcement of internal contracting policies has led to inaccurate and incomplete data in the contracts database and hindered the Commission's ability to accurately report on its contracting activities to executive management and external parties. For example, the "current contract amount" as of December 14, 2005, in the contracts database for contracts active during fiscal years 2004 and 2005 was understated by approximately \$200 million, or 25 percent. The contracts database is a stand-alone database, and the issues identified regarding this database have no negative impact on the Commission's annual financial report.

The Guide specifies that having "one complete master contract administration file" is critical. The Commission does not have one place designated to maintain accurate and complete information on its contracts. The current process of managing contract information has led to inefficiencies because the same data is entered into multiple systems for different information needs. Commission staff in the various program areas track their contracts in several spreadsheets, rather than relying on the contracts database.

Chapter 2-A

The Commission's Contracts Database and Hard-Copy Files Lack Complete and Accurate Information

The Commission has not established policies and procedures for the contracts

database (see text box) that provide reasonable assurance of accurate and complete data. As a result, it has inaccurately reported on its Web site statutorily required contract amount information. In addition, the database did not match the hard-copy contract files for 75 percent of the files tested. Neither the contracts database nor the hard-copy contract files contain all information required by Commission policy and recommended by the Guide.

Contracts Database

The contracts database is a small, stand-alone system for tracking information on contracts and amendments. Commission policy requires contract information to be entered into the contracts database.

The contracts database is the Commission's official means of complying with requirements to report contract activity to the Legislative Budget Board, the Texas Building and Procurement Commission, executive management and Commissioners, and the public. Texas Government Code, Section 2054.126 (D)(4), requires state agencies to publish information on active contracts that exceed \$100,000.

Contracts Database

The Commission's contracts database has several weaknesses in controls over data entry and in edit

check functions. Such controls are intended to detect invalid entries, but the weaknesses identified allow inaccurate and missing data to go undetected and uncorrected.

The contracts database contains inaccurate data. Auditors identified several instances of inaccurate information in the database. For example:

- As of December 14, 2005, the amount in the “current contract amount” field for contracts active during fiscal years 2004 and 2005 was understated by approximately \$200 million, or 25 percent. The understatement resulted from the removal of a formula in the contracts database that calculates the current contract amount.

As a result of the miscalculations, the *Active Contracts Greater than \$100,000* report on the Commission’s Web site was understated by at least \$5.7 million (26 percent) for a sample of contracts tested that were active as of November 1, 2005. Six of 12 contracts tested were incorrectly reported, four were missing, and two were reported correctly. Texas Government Code, Section 2054.126 (D)(4), requires the Commission to publish information on active contracts that exceed \$100,000.

- The fields for the contract start and original end dates contained invalid years, such as 1906 and 3003.
- The amendment number field contained some alphanumeric data but should have contained only numeric data.

The inaccurate dates and other inaccurate information could have been prevented through the use of edit checks. Automated edit and reasonableness checks can accomplish a variety of things, such as inform individuals who are inputting data that they have entered an invalid date or have not entered data in a required field.

The contracts database does not contain all information required by Commission policies. Auditors identified several instances in which information was missing from the database. Specifically, 43 of 45 required data entry fields that the Commission identified as critical for contracts lacked certain information because controls were circumvented in the system. For example:

- 547 (24 percent) of 2,280 contracts had blank current contract amount fields.
- The fields for the contract start and original end dates were blank for approximately 250 (2 percent) of 10,312 records. In addition, the new end date field for the contracts, after amendments, was blank for 10,517 (84 percent) of 12,548 records.
- The USAS contract number field was blank on 1,435 (14 percent) of 10,312 records.

Auditors determined that the feature intended to ensure that information is entered in certain fields had been disabled. Without this feature, the Commission was not complying with its own policies and could not determine the current total amount of contracts or the start and end dates for every contract. Because the database software does not record who makes programming changes, the Commission cannot determine who disabled the feature or when it was disabled.

Hard-Copy Contract Files

The Commission's central hard-copy contract files do not contain all items recommended by the Guide or by Commission policy. The Commission asserts that all contract documentation is maintained but that it is kept in various divisions throughout the agency.

In addition, the Commission's policies regarding file documentation and the routing of documents are not being consistently followed. Specifically:

- Contract files for 9 (7 percent) of 136 amendments did not contain Procurement Form Change Requests or Contract Amendment Initiation Forms. The 136 amendments were related to the 28 contracts tested.
- For 20 (71 percent) of 28 contracts, the central contract files were not sufficiently detailed to demonstrate the need for a given amendment. For example, 85 (63 percent) of 136 amendments tested contained explanations that said only "change funding" and provided no justification.
- Various Commission divisions executed 57 contracts and amendments totaling almost \$19 million without routing them through the Procurements and Contracts section. This section was created to promote a consistent, agencywide process for ensuring compliance with procurement requirements and to serve as a check and balance, independent of agency programs. Bypassing the Procurements and Contracts section creates a risk that the Commission may not comply with procurement statutes and policies.

The Guide recommends that agencies keep "one complete master contract administration file," and Texas Government Code, Section 2262.052, requires agencies to comply with the Guide. The files tested do not contain items such as:

- Information on prior contracts with the contractor.
- General correspondence.
- Contractor reports.
- Contractor invoices and adjustments.

Multiple Systems to Manage Contracts

Because the Commission does not have one complete master contract administration file, either in hard-copy or in electronic format, Commission staff use multiple systems to manage contract budgets, amendments, and expenditures. This has led to inefficiencies. Contract managers maintain their own electronic files in eight different computer programs and track different contract information. These files do not interface with each other, making it difficult to ensure that information updated at the contract manager level is communicated to Procurements and Contracts staff and other users.

In addition, this results in redundant data entry and increases the risk of data inaccuracies and inconsistencies. For example, the contracts database does not contain payment information for contracts, so staff in the program areas must track that information separately.

Recommendations

The Commission should establish adequate processes and controls to reasonably ensure (1) compliance with Commission contracting policies and the Guide and (2) complete and accurate information for contract management.

Specifically, the Commission should have complete and accurate contract information in a single master contract administration file in accordance with the requirement in the Guide. If the current contracts database is maintained for this purpose, the Commission should ensure that:

- Current contract amount totals are accurate.
- Edit checks to identify invalid and incomplete information are implemented.
- Reports generated from the database are complete and accurate.
- Staff comply with procedures to enter data into all required fields.

In addition, the Commission should:

- Perform quality control reviews of contract files to verify that all documentation is complete and accurate.
- Route all contracts and amendments through the Procurements and Contracts section unless specifically exempt by formal policy.
- Review various automated systems used for contract management to maximize efficiency and effectiveness.

Management's Response

TCEQ Management agrees with the recommendation to strengthen processes and controls to (1) ensure compliance with Commission contracting policies and the Guide and (2) complete and accurate information for contract management.

The Support Services Division Director will work with the Information Resources Division (IRD) to restore the integrity of the data through two efforts:

- 1. For the long term, an LAR capital request is being prepared and submitted to purchase a fully integrated procurement system to replace the Contracts Database, for FY2008 funding.*
- 2. For the short term, we will repair Contracts Database by restoring the security levels and required fields. By August 31, 2006, we will establish controls to assure that:*
 - Current contract amount totals are accurate.*
 - Edit checks to identify invalid and incomplete information are implemented.*
 - Reports generated from the database are complete and accurate.*
 - Staff comply with procedures to enter data into all required fields.*

In addition, we will establish control procedures to assure that:

- Quality control reviews are performed on all contract files to verify that documentation is complete and accurate.*
- All contracts and amendments are routed through the Procurements and Contracts section unless specifically exempt by formal policy.*

Lastly, we will review various automated systems used for contract management with a focus on maximizing efficiency and effectiveness.

Chapter 2-B

The Commission Lacks Effective Controls over Its Contractor Performance Evaluation Process

The Commission lacks effective processes and controls to ensure that contractor performance evaluations are performed, documented, and made available Commission-wide as required by its policy. The Commission has not designated a responsible party to monitor contract managers and ensure that all evaluations are conducted and submitted for data entry. By not

documenting all contractor performance evaluations or making them available to all divisions, the Commission risks extending contracts with or rehiring poor performers.

Auditors noted the following issues:

- Risk assessment results are not recorded in the contracts database or otherwise communicated to the Procurements and Contracts section. Therefore, Procurements and Contracts staff cannot (1) identify how many evaluations should be completed and submitted for the agency as a whole or (2) verify that contractors have been evaluated as required.
- The Commission did not document contractors' performance evaluations in the contract performance evaluations database, as required by Commission policy, for 18 (64 percent) of 28 contracts tested. For all 2,280 contracts active during fiscal years 2004 and 2005, only 242 (11 percent) contractor performance evaluations were recorded in the database. Of those, 141 (58 percent) were entered after auditors began audit work.
- Two (7 percent) of 28 contractors tested were awarded an additional \$1.1 million despite having received marginal performance evaluations. This brought their combined contract total to \$2 million.

Contractor Performance Evaluations

The contractor performance evaluation database is a stand-alone database that records the evaluation ratings, time frames evaluated, and contractor names related to contracts awarded by the Commission.

Commission policies and guidelines require that contractor evaluations be performed at least once annually, provided organization-wide, and considered when hiring or extending contracts. Contract risk assessments are also required, and these risk assessments determine the frequency of contractor evaluations. The policies also state that evaluation results should be entered into the contractor performance evaluation database, but contracts designated as exempt are not required to have evaluations.

Source: The Commission's training materials, *General Administrative Procedures* manual, and intranet.

- The Commission's *General Administrative Procedures* manual does not:
 - ♦ Include policies on how to designate contracts as low-, medium-, or high-risk.
 - ♦ Specify how to determine the necessary frequency of evaluations.
 - ♦ Specify which contract types are exempt from evaluations.

For example, the Commission's evaluation guidelines on the intranet specify that low-risk contracts should be evaluated no less than once per year, medium-risk contracts twice per year, and high-risk contracts four times per year, but this information is not in the *General Administrative Procedures* manual. In addition, the manual does not state when the evaluations should be completed and entered into the evaluations database. Auditors found that the average time period between the end of the evaluation period and the entry of scores for the 242 evaluations was approximately seven months.

Recommendations

The Commission should:

- Designate a responsible party to ensure that all relevant contractor performance evaluation information is submitted. The information should include the risk ranking of the contract, as well as the evaluations.
- Review contractor performance evaluations when determining whether to rehire contractors or extend contracts and document justification for using contractors who have been rated poorly in the past.
- Establish objective criteria in its *General Administrative Procedures* manual that address contract risk ratings and the frequency of and exemptions from contractor performance evaluations. It should also provide information and training to staff so that they understand the policies.

Management's Response

TCEQ Management agrees with the recommendations. The Support Services Division Director is responsible for implementing the following actions by August 31, 2006.

- *Designating the System Support Specialist to be the responsible party to ensure that all relevant contractor performance evaluation information is submitted.*
- *Establishing control procedures to ensure contractor performance evaluations are reviewed when determining whether to rehire contractors or extend contracts and document justification for using contractors who have been rated poorly in the past.*
- *Establishing objective criteria in the General Administrative Procedures manual that address contract risk ratings and the frequency of and exemptions from contractor performance evaluations.*
- *Providing information and training to staff and management so that they understand the policies.*
- *Assigning a staff person, as a primary job function, the duty to ensure consistency in assigning risk and inputting vendor performance information.*

Although the Commission Generally Has Good Physical Security Controls over Its Data Center, Certain Improvements Are Needed

Overall, the Commission has good physical security controls for its information technology (IT) systems and data center. The measures the Commission has established for controlling access to its IT facilities are adequate, and system back-up tapes are stored offsite in accordance with the Commission's policies.

The fire extinguishers in the data center were last inspected in September and October 2004 and are overdue for their annual inspections. The management of the Commission's building (including the data center) and testing of the fire suppression system and fire extinguishers are the responsibility of the Texas Building and Procurement Commission.

The Commission has Emergency Response Actions Checklists that detail staff responsibilities in various emergency situations, including emergency evacuations, but these checklists are not posted in the data center.

The Commission has a business continuity plan (which includes a disaster recovery plan) that is in the process of being updated to a newer version. Title 1, Texas Administrative Code, Section 202.24, requires agencies to either formally or informally test their business continuity and disaster recovery plans at least annually. The Commission is in compliance with this requirement, having informally tested its business continuity plan, but it has not conducted a system recovery test in a real-life environment. Testing the system recovery in an actual environment would allow the Commission to identify weaknesses that may otherwise go undetected and correct them. The Commission plans to perform this testing in the summer of 2006.

Recommendations

The Commission should:

- Work with the Texas Building and Procurement Commission to ensure that the fire suppression system and fire extinguishers in the data center are tested annually.
- Post Emergency Response Actions Checklists inside the data center.
- Carry out its plans to perform a system recovery test in a real-life environment.

Management's Response

TCEQ Management agrees with the recommendations.

Information Resources Division has contacted Texas Building and Procurement Commission to schedule testing for the fire suppression system and the fire extinguishers. TCEQ will coordinate and ensure TBPC completes the testing of the fire suppression system and fire extinguishers by July 31, 2006.

Emergency Response Action Checklists have been posted inside the Data Center.

The TCEQ Information Security Officer will lead a “live” recovery test of a critical application by August 31, 2006.

Appendix

Objectives, Scope, and Methodology

Objectives

The objectives were to determine whether the Commission on Environmental Quality (Commission) has:

- Systems and processes related to contract payments that ensure that payments are made in accordance with contract terms and state law.
- An effective change management process in place for contracts that protects against unwarranted cost increases, schedule extensions, the circumvention of management controls, and diminished contractor accountability.
- Systems and processes for encumbering funds that provide reasonable assurance of compliance with statutes, rules, Comptroller of Public Accounts guidelines, and Commission policy.

Scope

The audit scope included active contracts during fiscal years 2004 and 2005. This included contract-related encumbrances, lapses, unobligated and unexpended balances, contractor performance evaluations, payments, and amendments. The scope also covered the automated systems that are significant to contract management. Information tested included hard-copy and automated information.

Methodology

The audit methodology consisted of collecting information and documentation, performing selected tests and other procedures, analyzing and evaluating the results of the tests, and conducting interviews with Commission management and staff.

Information collected and reviewed included the following:

- Hard-copy contract files and Petroleum Storage Tank program files from Procurements and Contracts, Financial Administration, and program areas
- Data from the Uniform Statewide Accounting System (USAS) for encumbrances, vendor payments, lapses, over-obligations of funds, and unexpended balances
- Contract and amendment data from an extract of the contracts database

- Contractor performance evaluations from an extract of the contractor performance evaluation database
- Binding encumbrance report provided by Commission staff
- Information from interviews with Commission staff

Procedures and tests conducted included the following:

- Reviewed USAS access controls for Commission employees
- Reviewed the process to extract financial information from USAS for reporting purposes
- Reviewed access, input, and output controls for the contracts database
- Analyzed the extract of data from the contracts database and the contractor performance evaluations database
- Reviewed and assessed physical security controls at the data center
- Conducted a fluctuation analysis of encumbrances and expenditures
- Reviewed and tested lapsed appropriations, pre-encumbrances, unobligated balances, and unexpended balances
- Tested the *Encumbrance Mismatch Report* to determine whether discrepancies were identified and properly corrected
- Reviewed expenditures to analyze the number of correcting entries made in USAS
- Selected a sample of 131 payments and 92 encumbrances and tested compliance with Commission and state policies and guidelines
- Selected a judgmental sample of 28 contracts and 136 related amendments and tested for compliance with Commission and state policies and guidelines

Criteria used included the following:

- The Texas Building and Procurement Commission's *Contract Management Guide*, Version 1.1
- The Commission's *General Administrative Procedures Manual*
- *Commission on Environmental Quality Operating Policies and Procedures*, Chapter 19 - Information Security

- Emergency Response Actions Checklists, Business Continuity Plan version 2.1 section 5.
- General Appropriations Act, 78th Legislature
- Texas Administrative Code, Title 30, Chapter 334
- Texas Administrative Code, Title 1, Chapter 202
- Texas Water Code, Section 26.3573
- Performance evaluation guidelines on the Commission's intranet
- Commission training materials: "Contractor Performance Evaluation" from July 22, 2005; "Contract Initiation and Monitoring" from November 30, 2005
- Texas Government Code, Section 2054.126, and Chapter 2262
- House Bill 2835 (76th Legislature)
- *Procurements and Contracts Desk Reference Guide*

Project Information

We conducted fieldwork from November 2005 to February 2006. This audit was conducted in accordance with generally accepted government auditing standards. The following members of the State Auditor's staff performed this audit:

- Ann E. Paul, CPA (Project Manager)
- John Swinton, CGFM, MPAff (Assistant Project Manager)
- Judy Choban
- Yi Hubert
- Lisa M. Thompson
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- Serra Tamur, MPAff, CISA CIA (Information Systems Audit Team)
- Leslie P. Ashton, CPA (Quality Control Reviewer)
- John Young, MPAff (Audit Manager)

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The Honorable Tom Craddick, Speaker of the House, Joint Chair
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The Honorable Rick Perry, Governor

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Ms. Kathleen Hartnett White, Commission Chair
Mr. Larry R. Soward, Commissioner
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