



John Keel, CPA
State Auditor

An Audit Report on

Contracts Related to The Texas Workers' Compensation System

June 21, 2006

Members of the Legislative Audit Committee:

The Department of Insurance (Department) became responsible for the development of and contracts related to the automated Texas Workers' Compensation System (TxCOMP) in September 2005, six years after the project was initiated. The scope of this audit covered TxCOMP contracts entered into between January 2002 and December 2005.

During the initial six years of TxCOMP system development and implementation, there was poor contract management and the project experienced delays and cost increases. TxCOMP was originally budgeted at \$13.18 million with an estimated completion date of August 2007. As of March 2006, at least 74 percent of the funds appropriated to the project had been spent and the project was only 30 percent complete.

The Department has taken steps to improve the management of the TxCOMP project. Specifically, it has:

- Restructured the TxCOMP project to allow for better accountability and decision-making.
- Assigned an employee who is a certified project manager and who has extensive project management experience to be the TxCOMP project manager.
- Hired a contractor to assess the current state of TxCOMP development and determine what is necessary to stabilize the current technical environment.

TxCOMP's Scope Has Been Adjusted to Improve the Likelihood of Meeting Project Timeframes within the Amount Appropriated

At the beginning of this audit in December 2005, the Department informed auditors of numerous problems it was experiencing with the TxCOMP system. As a result of the lack of system functionality, project delays, and cost increases during system development and implementation, the Department revised the scope of the TxCOMP system to improve the likelihood of meeting project timeframes within the amount appropriated to the project.

The Texas Workers' Compensation System (TxCOMP)

The 76th through 79th Legislatures appropriated \$13.18 million in general revenue for a re-engineering project related to workers' compensation processes (\$9.62 million was appropriated to the former Texas Workers' Compensation Commission, and \$3.56 million was appropriated to the Department of Insurance).

An initial study completed in September 2000 recommended a number of modifications to workers' compensation business processes, replacement of the automated workers' compensation management system (COMPASS), and acquisition and implementation of imaging technology to reduce internal paper processing. As a result, TXCOMP, a new workers' compensation system is now under development.

The 79th Legislature abolished the Texas Workers' Compensation Commission effective September 1, 2005, and transferred its functions to the Department of Insurance.

As of March 2006, at least \$9.7 million had been spent on consultation, software, and hardware.

Part 2 of the attachment to this letter contains additional background information on the TxCOMP project and contracts.

Auditors identified the following issues regarding the TxCOMP project:

- **Project Completion.** The December 2005 quarterly report to the State's Quality Assurance Team stated that the TxCOMP project was 55 percent complete. However, the March 2006 quarterly report to the Quality Assurance Team revised the estimated completion percentage to 30 percent. In addition, \$9.7 million of the \$13.18 million (or 74 percent of the amount appropriated to the project) had reportedly been spent.
- **Functionality.** The March 2006 report to the State's Quality Assurance Team also stated that users experienced significant downtime and unacceptable performance from the new TxCOMP system, which resulted in delays in implementing system functionality. The report stated that stabilization of the TxCOMP technical environment was required before further applications could be implemented. As a part of the stabilization process, the Department's information resources staff and contractors have completed work on 398 of 474 defects and enhancements.
- **Costs increases.** Changes that resulted in the addition of staff resources to eight contracts resulted in a 47 percent (\$630,472) increase in the total authorized cost of those contracts. Costs increased for 8 of 26 contracts auditors reviewed because staff hours were added through purchase orders.
- **Total project costs may be higher than reported.** The amount spent on the business process improvement project and TxCOMP development may be higher than the \$9.7 million amount reported as of March 2006. The former Texas Workers' Compensation Commission (TWCC), where the project was initiated, received two appropriations for information technology expenditures: one was for the Business Process Improvement Division's budget, which funded TxCOMP, and the other was for the Information Resources Division's budget. Auditors identified \$112,427 in expenditures that were inappropriately coded and charged to the Information Resources Division instead of to the Business Process Improvement Division. As a result, auditors can conclude only that at least \$9.7 million had been spent on the TxCOMP project as of March 2006.

The State's Quality Assurance Team

Because the TxCOMP project was considered a major information resources project under Texas Government Code, Section 2054.003, quarterly reports to the State's Quality Assurance Team on the project's status were required. This team consists of representatives from the Department of Information Resources, the Legislative Budget Board, and the State Auditor's Office. The purpose of this team is to provide oversight and evaluate the development of major projects.

Contractors for TxCOMP Were Selected Fairly, but Monitoring Was Inconsistent

Time and materials contracts are generally considered high-risk and, therefore, should incorporate clearly defined deliverables to hold contractors accountable. The TxCOMP contractors were generally selected using a fair and competitive process. The contracts also contained most of the provisions that the Texas Building and Procurement Commission's *State of Texas Contract Management Guide* recommends be included in all contracts (see Part 3 of the attachment to this letter for a list of those provisions). However, there was not a formal process to monitor, manage, and execute contracts to ensure that state funds were spent appropriately.

Audit testing also identified the following issues regarding how the project was monitored:

- **Contract payments for \$158,366** were made through an interagency agreement for work performed by two contract employees who were known to have performance problems.

- Of the 13 contract employees who were required to submit periodic status reports, 3 (23 percent) did not submit any status reports; 8 (62 percent) submitted some, but not all, status reports; and 2 (15 percent) submitted all required status reports during their contracting period. The content of status reports also was inconsistent. Some reports contained very detailed information regarding tasks completed, tasks for the next period, and the criticality of certain tasks, but others did not.

Auditors also were unable to verify whether there was sufficient support for payments made to contractors. We tested 10 (38 percent) of the 26 contracts related to the TxCOMP project for contract payments totaling \$4.26 million. Of those 10 contracts, we sampled 33 invoices totaling approximately \$926,000. Audit testing identified the following:

- Five (15 percent) of the 33 invoices tested were not supported by timesheets or could not be reconciled to the hours billed on the invoice. These five invoices totaled \$243,555.
- Some of the timesheets supporting the invoices were not dated. Therefore, auditors could not determine whether timesheets were approved before or after payment to the contractor. In addition, timesheets and status reports were not tracked or reconciled to ensure that payments to contractors matched the amount of work performed.

The Department Has Taken Steps to Improve Management of the TxCOMP Project

The Department has restructured the organization of the TxCOMP project with defined responsibilities. According to the Department, the applications that comprise TxCOMP will still be delivered by the project deadline. To accomplish this, the Department had to change the project's scope significantly and contracted with a vendor to identify software and infrastructure modifications that will be necessary before any further implementation occurs.

The Department also made significant changes to the project's organization that should allow for better accountability. According to the Department's April 2006 project charter, the following additional roles have been created:

- Executive sponsor. This individual selects the members of the Executive Steering Committee, determines the strategic direction of the project, and approves changes to project priorities.
- Business process improvement program sponsor. This individual oversees project delivery from a business perspective and signs off on user requirements, project planning, procurement planning, and quality assurance reporting. This individual also presents the current status of prioritized projects and projects that are in process to the Executive Steering Committee.
- Technology sponsor. This individual oversees project delivery from a technology perspective and provides technical oversight to ensure that TxCOMP will meet agency security standards.

Additionally, the Department has assigned a full-time information technology project manager to the TxCOMP project. This individual, who is a certified Project Management Professional with a strong information technology and project management background, will be responsible for planning and administration of the overall project and for monitoring and reporting the status of the project and deliverables to appropriate parties.

Recommendations:

The Department of Insurance should:

- Review all expenditures paid with information resources appropriations during the 2004-2005 biennium to ensure that these expenditures were coded correctly and that reported costs for the TxCOMP project are accurate.
- For all future contracts:
 - Ensure that all contracts contain the necessary provisions specified in the Texas Building and Procurement Commission's *State of Texas Contract Management Guide*.
 - Consider all aspects of contract management, including the most appropriate contractor payment methodology (for example, fixed price or time and materials) and related monitoring mechanisms, to ensure that contracts protect the State's financial interests.
- For future time and materials contracts, including contracts established through the completion of the TxCOMP project, ensure that:
 - Each contract's statement of work contains formal deliverables and that the statement of work accurately describes expected services and products.
 - Contractors submit appropriate timesheets, status reports, and invoices with detailed information regarding tasks performed. These timesheets, status reports, and invoices should reconcile with service dates. Timesheets should also contain an approval date.

The Department agrees with the recommendations in the report, and its responses are included in Part 4 of the attachment to this letter. We appreciate the Department's cooperation during this audit. If you have any questions, please contact Sandra Vice, Assistant State Auditor, or me at (512) 936-9500.

Sincerely,

John Keel, CPA
State Auditor

Attachment

cc: Mr. Mike Geeslin, Commissioner of Insurance, Department of Insurance



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Attachment

Part 1

Objective, Scope, and Methodology

Objective

The objective of this audit was to determine whether the administration of contracted services for the Texas Workers' Compensation System (TxCOMP) project ensures appropriate use of state funds.

Scope

The audit scope included the processes and procedures for contract administration for the Business Process Improvement project, including the processes and procedures for contract selection, contract payments, contract establishment, and contract monitoring.

The audit scope covered contracts entered into between January 2002 and December 2005. Although the Business Process Improvement project began in fiscal year 2000, due to record retention restrictions, contracts entered into prior to fiscal year 2002 were unavailable for examination.

This audit was conducted in compliance with generally accepted government auditing standards, which require independence in both fact and appearance.

Statute requires the State Auditor's Office to participate on the Quality Assurance Team (QAT), which approves and monitors major information resource projects. This condition could be seen as potentially affecting our independence in reporting results related to TxCOMP. However, we proceeded with this audit as required by the State Auditor's Office Audit Plan—Fiscal Year 2006. The condition did not affect our audit conclusions.

Methodology

The audit methodology consisted of collecting information and documentation; analyzing and evaluating data; performing selected tests and other procedures; and conducting interviews with Department of Insurance management and staff, as well as former Texas Workers' Compensation Commission (TWCC) employees.

Auditors also contacted the Department of Information Resources to obtain payment information related to interagency agreements between the Department of Information Resources and TWCC.

Information collected and reviewed included the following:

- Contract files including:
 - ♦ Purchase requisitions
 - ♦ Selection and evaluation documentation
 - ♦ Invoices
 - ♦ Timesheets
 - ♦ Purchase vouchers
 - ♦ Contract correspondence
- Vendor status reports
- TWCC internal audit files.
- TWCC purchasing policies and procedures
- Quarterly Quality Assurance Team monitoring reports

Procedures and tests conducted included the following:

- Analytical tests of contract payments, including verification of supporting documentation, approvals, and appropriate Uniform Statewide Accounting System codes.
- Review of contracts and purchase orders files to identify:
 - ♦ Appropriate contract provisions
 - ♦ Appropriate selection methodology
- Review and evaluation of purchasing policies and procedures including contract establishment, contract management, and contract monitoring.

Criteria used included the following:

- TWCC purchasing procedures
- The Texas Building and Procurement Commission's *State of Texas Contract Management Guide*
- Texas Government Code, Section 771.004
- Texas Government Code, Section 2261.051

Other Information

We conducted the audit from December 2005 through April 2006. The following members of the State Auditor's staff performed this audit:

- Michael Simon, MBA (Project Manager)
- Courtney Ambres-Wade, CGAP (Assistant Project Manager)
- Anca Pinchas
- Bill Vanecek
- Michael Yokie, CISA (Information System Audit Team Member)
- Chuck Dunlap, CPA, Quality Control Reviewer
- Worth Ferguson, CPA, Quality Control Reviewer
- Sandra Vice, CGAP, CIA, CISA (Assistant State Auditor)

TxCOMP Project Background Information and List of Contracts

The Division of Worker's Compensation within the Department of Insurance provided the following background information on the TxCOMP project.

In 1999, the former TWCC identified the need for a new technology infrastructure that would be more suitable for the business needs of the workers' compensation environment in Texas. It was determined that the old mainframe system was too expensive to support and required technical resources that were difficult to attract or retain. Additionally, TWCC was facing criticism regarding its paper-intensive processes, and House Bill 2511 (76th Legislature, Regular Session) required a reduction in paper filing requirements within the Texas workers' compensation system by 60 percent over a three-year period.

As part of its Business Process Improvement Project, in fiscal year 2003 TWCC began the development and deployment of its automated system known as TxCOMP. The mission of TxCOMP was to:

- Provide improved services to workers' compensation customers by combining streamlined business processes with up-to-date technology.
- Facilitate efficient and effective communication of information between all workers' compensation system participants.
- Capture and provide access to comprehensive, accurate, and reliable workers' compensation information.

The 79th Legislature abolished TWCC effective September 1, 2005, and transferred its functions to the Department of Insurance. The operations of the former TWCC are now conducted by the Division of Worker's Compensation within the Department of Insurance.

Table 1 on the following page lists the TxCOMP contracts from years 2002 through 2005.

Table 1

TxCOMP Contracts			
	Fiscal Year Contract Was Executed	Vendor	Total Cost
Contracts Reviewed by the State Auditor's Office During this Audit			
1	2004	Ascential Software Corporation	\$4,900
2	2005	Catapult Systems	\$4,680
3	2005	Datacap	\$9,875
4	2005	Department of Information Resources	\$1,927,309
5	2004	Department of Information Resources	1,557,358
6	2006	Department of Information Resources	1,037,831
7	2003	Department of Information Resources	190,591
8	2002	Department of Information Resources	78,689
		Total for the Department of Information Resources	\$4,791,778
9	2005	Mark III System Inc.	\$7,700
10	2004	Mark III System Inc.	2,800
		Total for Mark III System Inc.	\$10,500
11	2005	Mustang Technical Consultants	\$750
12	2002	National Human Resource Group Technical Service	\$76,500
13	2005	OSS Inc.	\$15,708
14	2005	SHI Government Solutions	\$163,800
15	2004	SHI Government Solutions	110,148
16	2005	SHI Government Solutions	102,120
17	2005	SHI Government Solutions	35,000
18	2004	SHI Government Solutions	29,575
19	2005	SHI Government Solutions	28,000
20	2005	SHI Government Solutions	19,750
21	2005	SHI Government Solutions	14,000
22	2005	SHI Government Solutions	244,125
23	2004	SHI Government Solutions	37,575
		Total for SHI Government Solutions	\$784,093
24	2005	The Quaternity Corporation	\$3,350
25	2004	Triangle Technology Inc.	\$397,379
26	2005	Triangle Technology Inc.	35,625
		Total for Triangle Technology Inc.	\$433,004
		Subtotal	\$6,135,138
Contracts Not Reviewed by the State Auditor's Office During This Audit			
27	2000	Spectrum Maximus (unavailable for review due to agency's record retention policy)	\$1,415,430

TxCOMP Contracts			
	Fiscal Year Contract Was Executed	Vendor	Total Cost
28	2003	IBM/Price Waterhouse (reviewed during previous State Auditor's Office audit)	\$1,436,749
			Subtotal \$2,852,179
			Total \$8,987,317

Source: Department of Insurance

Contract Provisions Recommended by the Texas Building and Procurement Commission's State of Texas Contract Management Guide

Texas Government Code, Section 2262.052, requires each state agency to comply with the Texas Building and Procurement Commission's *State of Texas Contract Management Guide*. Table 2 lists the provisions that this guide specifies should be included in all contracts.

Table 2

Essential Contract Clauses in The Texas Building and Procurement Commission's <i>State of Texas Contract Management Guide</i>	
▪ Introduction	▪ Specifications
▪ Dispute Resolution	▪ Right to Audit
▪ Scope of Work	▪ Funding Out Clause
▪ Contractor Responsibilities	▪ Force Majeure
▪ Term of Contract	▪ Antitrust
▪ Indemnification/Damage Claims	▪ Ownership/Intellectual Property
▪ Consideration/Price	▪ Payment
▪ Abandonment or Default	▪ Independent Contractor
▪ Affirmation Clauses	▪ Technology Access Clause
▪ Termination	▪ Buy Texas

Source: Texas Building and Procurement Commission's *State of Texas Contract Management Guide*, pages 57-58.

Management's Responses from the Department of Insurance



Texas Department of Insurance

Commissioner of Insurance, Mail Code 113-1C
333 Guadalupe • P. O. Box 149104, Austin, Texas 78714-9104
512-463-6464 telephone • 512-475-2005 fax • www.tdi.state.tx.us

June 13, 2006

John Keel, CPA
State Auditor
State Auditor's Office
P.O. Box 12067
Austin, Texas 78711-2067

RE: Management Response to Audit Report on Contracts Related to the Texas
Workers' Compensation System

Dear Mr. Keel:

The Texas Department of Insurance (TDI) appreciates the time and attention the State Auditor's Office spent reviewing the TxCOMP contracts and expenditures during the recent audit. TDI is in agreement with audit report recommendations. The report provides a balanced assessment of the issues that TDI encountered when the Texas Workers' Compensation Commission merged with the agency in September, 2005.

TDI's existing policies and procedures regarding procurements and contracts are in compliance with the requirements specified in the Texas Building and Procurement Commission's *State of Texas Contract Management Guide*. TDI understand the risks associated with the management of large projects of this type. The agency remains committed to ensuring accountability, program results and the efficient use and protection of resources. The attached document details steps we immediately took to address contracting differences between the two agencies and our action plan for implementing the audit recommendations.

As noted in the last progress report to the Quality Assurance Team (QAT), we are making progress towards stabilizing the TxCOMP system, as well as adjusting the scope of the project to improve our ability to meet the project timeframes within the amount appropriated to the project.

Sincerely,

A handwritten signature in black ink that reads "Mike Geeslin".

Mike Geeslin
Commissioner of Insurance

A handwritten signature in black ink that reads "Albert Betts".

Albert Betts
Commissioner of Workers' Compensation

**Texas Department of Insurance
Implementation of Audit Recommendations
Action Plan**

Recommendations:

Review all expenditures paid with information resources appropriations during the 2004-2005 biennium to ensure that these expenditures were coded correctly and that reported costs for the TxCOMP project are accurate.

TDI will review 2004-2005 expenditures paid with information resources appropriations to ensure that these expenditures were coded correctly and that reported costs for the TxCOMP project are accurate. If additional discrepancies are found, they will be notated in the December 2006 Quality Assurance Team (QAT) report.

Responsibility – Division of Workers' Compensation (DWC) Executive Deputy Commissioner for Operations, Chief Financial Officer (CFO), and Information Resource Manager (IRM)

Implementation date - January 15, 2007

For all future contracts:

- **Ensure that all contracts contain the necessary provisions specified in the Texas Building and Procurement Commission's *State of Texas Contract Management Guide*.**
- **Consider all aspects of contract management, including the most appropriate contractor payment methodology (for example, fixed price or time and materials) and related monitoring mechanisms, to ensure that contracts protect the State's financial interests.**

DWC began using TDI's existing contract management policies and procedures on September 1, 2005. TDI's contract procedures include planning, procurement, price establishment, contract formation, and contract monitoring as specified in the Texas Building and Procurement Commission's *State of Texas Contract Management Guide*.

Responsibility – Purchasing and Contract Administrator and HUB Coordinator, Legal and Compliance Agency Counsel Section Chief, and requesting TDI program area senior leadership

Implementation date – September 1, 2005 (TDI updates policies and procedures as necessary and publishes an updated operations manual each biennia.)

**Texas Department of Insurance
Implementation of Audit Recommendations
Action Plan**

For future time and materials contracts, including contracts established through the completion of the TxCOMP project, ensure that:

- **Each contract's statement of work contains formal deliverables and that the statement of work accurately describes expected services and products.**
- **Contractors submit appropriate timesheets, status reports, and invoices with detailed information regarding tasks performed. These timesheets, status reports, and invoices should reconcile with service dates. Timesheets should also contain an approval date.**

DWC began using TDI's existing contract management policies and procedures on September 1, 2005. Any contract established after this date contains a statement of work that includes formal deliverables and expected services. In addition to this, the IRM and DWC Executive Deputy Commissioner for Operations sign all TxCOMP purchase requisitions.

TDI supervisors/team leaders began reviewing weekly status reports and approving time sheets in December 2005. Business Process Improvement (BPI) tracks the contractors hours and expenses. The IRM reviews status reports and time sheets prior to approving payment.

TDI has no plans to use time and materials contracts for the TxCOMP project in fiscal year 2007. Delivery based contracts will be used.

Responsibility – DWC Executive Deputy Commissioner for Operations and IRM

Implementation dates – September and December 2005