

An Audit Report on
**Two Cost-Recovery Programs at the
Department of Information Resources**

September 10, 2004

Members of the Legislative Audit Committee:

During the planning phase of our audit, we identified that the Department of Information Resources (Department) has not operated its Cooperative Contracts Program (CCP) as a cost-recovery program, despite expectations that it do so. In fiscal years 2002 and 2003, customers of the CCP paid \$6 million more than it cost the Department to provide the contracted goods and services. The Department's customers have paid higher prices because (1) the Department has charged more than needed to recover its costs, and (2) it has not implemented sufficient procedures to ensure that its contracts with vendors for information technology commodities are at the best price. The Department voluntarily transferred \$3 million of the \$6 million to the State's general revenue fund at the end of fiscal year 2003.

We also found that most accounting controls in place over CCP revenues and disbursements are well designed. However, the Department does not have sufficient controls in place to ensure that vendors report all sales made through Go DIRECT, which is one program within the CCP. Without sufficient controls, the Department may not be collecting all the contract payments due from vendors. In the Go DIRECT program, agencies purchase directly from vendors using Department-negotiated contracts. The Department receives a portion of each sale from the vendor.

Management has agreed that it needs to address the issues identified in CCP and has developed a corrective action plan. Because management has agreed to resolve the issues identified in our preliminary work and because these issues were identified as having the highest risk, we believe further audit work is not necessary at this time. Instead, we will monitor the Department's progress toward completing its action plan. Our recommendations and the Department's action plan are attached.

In addition to the work we did related to the CCP, we also followed up on recommendations we made in May 2002 regarding the State's internal telecommunications systems (SAO Report No. 02-045, *An Audit Report on the Accuracy of the Fiscal Year 2001 Balance Sheets for the State's Telecommunications Systems*). The Department has substantially implemented these recommendations. The improvements include making progress toward operating telecommunications services as a cost-recovery program and addressing weaknesses in accounting controls.

Background

The Cooperative Contracts Program (CCP) helps state agencies and other governmental entities acquire information resources. Customer agencies can either contract through DIR (internal sales) or use the Go DIRECT program in which the agencies work with vendors directly using DIR-negotiated contracts. In fiscal year 2002 and 2003, DIR had \$68.8 million and \$67.8 million in internal sales, respectively. During the same years, customer agencies purchased \$300.3 million and \$470.3 million through the Go DIRECT program, respectively.

The State's internal telecommunications programs are the Texas Agency Network (TEX-AN) and the Capitol Complex Telephone System (CCTS). These programs had combined sales of \$54.5 million in fiscal year 2002 and \$70.6 million in fiscal year 2003.

SAO Report No. 05-001

Members of the Legislative Audit Committee
September 10, 2004
Page 2

We appreciate the Department's cooperation during this audit. If you have questions, please contact Susan A. Riley, CPA, Audit Manager, at (512) 936-9500.

Sincerely,

Lawrence F. Alwin, CPA
State Auditor

ejm

Attachment

cc: Mr. Larry Olson, Executive Director, Department of Information Resources
Chairman and Members of the Department of Information Resources' Governing Board

Attachment

Recommendations

We recommend that the Department of Information Resources (Department) develop an action plan that includes:

- Ensuring that the Cooperative Contract Program (CCP) fees reflect the Department's costs.
- Implementing procedures to ensure that it gets the best price possible for the purchase of information technology commodities and that the State's purchasing power is taken into consideration.
- Monitoring prices for the commodities it purchases to ensure that its contracted prices remain the best possible.
- Developing a method for gathering complete Go DIRECT sales data to ensure that it recovers the correct amount of funds. One option would be to construct a portal on its Web site through which all Go DIRECT sales must pass.

The action plan should include time lines, assigned responsibility, and adequate detail so that the Department's progress can be evaluated.

The Department's response and action plan begins on the next page.

Objectives, Scope, and Methodology

Our audit objectives were to determine whether (1) revenue and expenditures for the Department's cost-recovery programs (CCP and telecommunications) are received and spent in accordance with state laws, regulations, and contract terms; (2) the Department has maintained effective accounting controls over revenue, expenditures, assets, and liabilities for the cost-recovery programs; and (3) the Department adequately addressed the issues identified in our May 2002 report. Our preliminary work indicated that the areas outside the CCP do not pose a risk significant enough to warrant further work. Therefore, we did not conduct testing to determine whether controls were operating as intended or whether funds are spent in accordance with state laws, regulations, and contract terms.

Our scope consisted of financial information from fiscal years 2002, 2003, and the first three quarters of fiscal year 2004 for the Telecommunications Services and the Business Operations divisions.

Our methodology consisted of reviewing applicable laws, policies, and procedures; identifying the controls in place for the two cost-recovery programs; analyzing financial information; and following up on issues from our May 2002 report.

This audit was conducted according to generally accepted government auditing standards.

Department of Information Resources' Response and Action Plan

Thank you for the opportunity to comment on your report Two Cost-Recovery Programs at the Department of Information Resources.

As noted, the Department of Information Resources (DIR) recovered \$6 million over a two-year period above breakeven on \$907 million in sales of IT goods and services. Of that amount, \$3 million was voluntarily returned by DIR to the state's unappropriated general revenue fund to assist with balancing the state's budget in fiscal 2003. The remaining \$3 million, .0033 of total sales, was carried forward to fiscal 2004 in accordance with DIR rider #2 that established the DIR Clearing Fund Account. The account must be used to pay costs attributable to the services DIR provides to state agencies and units of local government. The volume of sales as well as the mix of cost recovery on sales is estimated each year, but actual results differ from those estimates.

We support and applaud your office in reducing the audit time by your estimate of over 2,000 hours in recognition that DIR had already changed its organizational structure and was in the process of developing a corrective action plan to improve contract management prior to the audit engagement. As you know, we have already begun implementing this plan (see attached). When fully implemented, the plan will insure the following three key objectives:

- *DIR staff responsible for managing contracts will have a specific level of experience and knowledge in this field,*
- *all DIR contracts will be managed according to a consistent set of quality standards, and*
- *all DIR contracts and associated revenues will be reviewed regularly and adjusted to reflect current conditions and customer input.*

We agree with the importance of monitoring Go DIRect vendor activity and we currently require that all vendors report sales activity monthly and make timely remittance to DIR for the cost recovery on those sales. DIR also periodically compares the reported sales to information provided by the Texas Comptroller of Public Accounts listing state agency payments to vendors under contract through the Go DIRect program. DIR's cost recovery on Go DIRect sales is approximately .007. DIR, working with our contracted internal auditor, weighed the cost of on-site review and analysis of Go DIRect sales documents against the risk of under-reporting. We determined that the cost of on-site review and analysis exceeded the potential risk and have developed an approach to manage the potential exposure to these risks.

<i>Task</i>	<i>Description</i>	<i>Target date</i>	<i>Assigned (Primary in bold)</i>
Staff			
<i>Establish Job Requirements</i>	<i>Management will determine the minimum and ideal requirements for all staff responsible for contract negotiations and contract administration/management. This will include education and work experience levels as well as a career path within the Service Delivery Division (division responsible for all contract management activity in DIR).</i>	<i>November-04</i>	<i>Director, Service Delivery Division; Assistant Director, Service Delivery Division; Contracts Manager, Service Delivery Division</i>
<i>Evaluate Staff Skills</i>	<i>Management will review and evaluate the qualifications of staff currently responsible for contract management relative to the new requirements. This evaluation will determine which employees should continue in this function and, if necessary, establish a training plan to advance their skill set up to the new standards.</i>	<i>October-04</i>	<i>Assistant Director, Service Delivery Division; Contracts Manager, Service Delivery Division</i>
<i>Establish Training Requirements for Staff</i>	<i>Management will establish a training program based on industry standards and best practices that is designed to:</i> <ol style="list-style-type: none"> <i>1) bring existing staff skills up to the new job requirement</i> <i>2) maintain a designated level of professional proficiency</i> <i>3) educate experienced staff on new contract management methods</i> <i>4) regularly inform staff of updates in law and procedures</i> 	<i>November-04</i>	<i>Director, Service Delivery Division; Assistant Director, Service Delivery Division; Contracts Manager, Service Delivery Division</i>
Contract Management			
<i>Establish Contract Management Standards</i>	<i>Examine existing DIR and state contract management guidelines, rules and laws and establish a documented set of standards that all DIR employees involved in "contract management" will follow.</i>	<i>January-05</i>	<i>Director, Service Delivery Division; Assistant Director, Service Delivery Division; DIR General Counsel; Legal Counsel, Service Delivery Division</i>
Contract Review			
<i>Establish Procedure for Contract Reviews</i>	<i>Develop and implement a procedure for conducting regularly scheduled reviews of all DIR contracts. This will include:</i> <ol style="list-style-type: none"> <i>1) a method for selecting contracts for review between renewal date/ before re-bid date</i> <i>2) criteria outlining which elements of the contract will be reviewed (e.g., price, admin fee, products/services)</i> <ol style="list-style-type: none"> <i>a) research will be conducted, by a team already created in the new organization, on vendor prices and products</i> <i>b) research will include prices available to other gov't entities and/or listed on vendor web-sites & ads</i> <i>c) the team will also research product changes for potential inclusion in MSA's</i> <i>3) criteria to determine what will trigger a change, renegotiation or rebid.</i> 	<i>January-05 (review is on-going)</i>	<i>Director, Service Delivery Division; Assistant Director, Service Delivery Division; DIR General Counsel; Legal Counsel, Service Delivery Division</i>

<i>Task</i>	<i>Description</i>	<i>Target date</i>	<i>Assigned (Primary in bold)</i>
<i>Conduct Contract Reviews and/or Renegotiations</i>	<i>Continue practice currently underway of reviewing and re-negotiating contracts to improve prices, services and products available for agencies' use. Renegotiation includes discussion of prices relative to state's requirements and market activity. (Current focus is on PC products.)</i>	<i>On-going</i>	<i>Assistant Director, Service Delivery Division; Contracts Manager, Service Delivery Division; Special Contracts Manager, Service Delivery Division</i>
<i>Establish Procedures for Admin Fee Review</i>	<i>Develop and implement a documented procedure for reviewing the DIR administrative fee on each contract on a regular basis. This will include a procedure for modifying the fee as necessary and informing our customers and vendors of the change. The review will include at a minimum an examination, by the CFO, of all the costs associated with supporting of the program including projections for growth and indirect obligations. It will also include a review of the past and projected revenue generated by the program The review will not be conducted at the single contract level, but rather at the program level. Customer notification of rate changes will be conducted through the Customer Service group.</i>	<i>February-05</i>	<i>Director, Service Delivery Division; Assistant Director, Service Delivery Division; Contracts Manager, Service Delivery Division; DIR Chief Financial Officer</i>
<i>Establish Customer Feedback Mechanism</i>	<i>Develop and implement formal and informal methods for collecting feedback from our customers. This should include surveys, focus group meetings, phone contacts and, when appropriate, direct meetings. (Customer Service Mgr will be hired 1st Qtr FY05)</i>	<i>2nd Qtr FY 05</i>	<i>Director, Service Delivery Division; Assistant Director, Service Delivery Division; Customer Svc Mgr (To Be Hired)</i>
<i>Establish Vendor Feedback Mechanism</i>	<i>Develop and implement formal and informal methods for collecting feedback for our vendors. This should include surveys, focus group meetings, phone contacts and, when appropriate, direct meetings. (Customer Service Mgr will be hired 1st Qtr FY05)</i>	<i>2nd Qtr FY 05</i>	<i>Director, Service Delivery Division; Assistant Director, Service Delivery Division; Customer Svc Mgr (To Be Hired)</i>