

Key Points

An Audit Report on Purchases Subject to Local Control by Agencies

June 1998

Overall Conclusion

The three largest health and human services agencies generally have established adequate controls over their procurement expenditures. While the Departments of Health, Human Services, and Mental Health and Mental Retardation have established adequate controls, they could save between \$376,000 and \$1.6 million annually in long distance charges. The savings and improvements in this report are not exhaustive. Additional areas of potential savings are identified in the "Issues for Further Study" section. Although these and other identified savings represent a small percentage of these agencies' annual procurement expenditures of \$540 million, they are important in that they improve the State's ability to provide more services using fewer resources.

Key Facts and Findings

- Savings can be obtained by actively looking for cost-saving strategies directly related to types of items. As noted above, the three agencies could save between \$376,000 and \$1.6 million annually in long distance charges by handling some long distance calls differently. Also, we identified specific cost-saving strategies for supplies and materials, information technology, and fleet. For example, the Department of Human Services and the Department of Mental Health and Mental Retardation (MHMR) reduced their inventory holding costs by changing the way they order and ship supplies.
- MHMR uses more transactions and procurement employees than others to purchase the same dollar amount of expenditures. Although it will take some time, MHMR should be able to reduce its number of transactions. This should, in turn, allow it to reduce administrative costs, lower item costs, and reduce staff.
- Some of the problems identified were not under the control of the purchasing department. For example, some Texas Department of Health (TDH) programs ordered and received goods and services without going through established purchasing procedures. This decreased the likelihood that TDH got the best value for these purchases.

Contact

Charles Hrcncir, CGFM, CPA, Audit Manager (512) 479-4700



Office of the State Auditor

Lawrence F. Alwin, CPA

This audit was conducted in accordance with Government Code, Section 321.0131 and 0132

Table of Contents

Executive Summary	1
--------------------------------	---

Section 1:

The Texas Departments of Health, Human Services, and Mental Health and Mental Retardation Have Controls in Place	5
---	---

Section 2:

Cost Savings and Improved Service Are Possible in Some Areas	6
---	---

Actively Manage Telecommunications Expenditures	8
---	---

Centralize Ordering and Have Vendor Drop Ship to Save Time and Money	12
---	----

Fleet Purchases Should Analyze Costs Versus Benefits and Consider Alternatives	14
---	----

Use Same Care When Purchasing Services as When Purchasing Goods	16
--	----

Standardize and Coordinate Information Technology Purchases	19
--	----

Section 3:

Overall Agency Management Can Affect the Results of the Procurement Process	21
--	----

Improve Coordination Between Purchasing, Program, and Fiscal to Improve Results and Reduce Risk	21
--	----

Organizational Decisions Can Affect the Efficiency of the Procurement Process	22
--	----

Monitor Transactions to Make Sure They Are Documented and Processed as Intended	25
--	----

Section 4:

Issues for Further Study	26
---------------------------------------	----

Telecommunications - \$126 million	26
--	----

Fleet Management - \$68.2 million	26
---	----

Table of Contents

Interagency Contracts - Over \$400 million	26
Information Technology Purchases - \$424.9 million	26

Appendices

1 - Objective, Scope, and Methodology	27
2 - Analysis of Oversight.....	30
3 - Exemptions and Riders Associated with Procurement Categories	34
4 - Individual Agency Audits	37
5 - Analysis of Vouchers and Vendors for Five Largest Purchasers of Supplies and Materials.....	46
6 - Analysis of Staffing for Ten Agencies With Highest Total Procurement Salaries.....	49

Executive Summary

Overall Conclusion

The three largest health and human services agencies generally have established adequate controls over their procurement expenditures. While the Departments of Health, Human Services, and Mental Health and Mental Retardation have established adequate controls, they could save between \$376,000 and \$1.6 million annually in long distance charges. The savings and improvements in this report are not exhaustive. Additional areas of potential savings are identified in the "Issues for Further Study" section. Although these and other identified savings represent a small percentage of these agencies' expenditures of \$540 million, they are important in that they improve the State's ability to provide more services using fewer resources.

TDH, DHS, and MHMR Have Controls in Place

The Department of Health (TDH), the Department of Human Services (DHS), and the Department of Mental Health and Mental Retardation (MHMR) have developed adequate internal controls over purchases and have been actively improving their procurement processes. However, compliance with these controls could be improved.

Some of the tested transactions were not in compliance with state and agency-level policies and procedures. This noncompliance resulted in the following:

- Failure to request and document extensions on federal grants
- Possible misuse and/or overuse of emergency purchase exemptions

- Noncompliance with the Prompt Pay Rider
- Purchases not bid as required
- Insufficient documentation to support that the State got the best value

None of these exceptions were for obviously inappropriate items or obviously unreasonable quantities or prices. The federal grant extension was allowed. No significant loss of state funds occurred as a result of these exceptions.

Except for one purchase of basketball trophies and a hotel rental for a training event at DHS, there were no apparent instances of waste, fraud, or abuse in the transactions tested. See Appendix 4 for a more detailed description of the results for individual agency reviews.

Cost Savings and Improved Service Are Possible in Some Areas

Cost savings, efficiencies, and control improvements were identified by targeting specific procurement categories, analyzing available statewide information and information gained from the agency-level audits, and actively looking for improvement strategies directly related to those categories. For example:

- **Telecommunications** - Savings between \$376,000 and \$1,651,000 annually at the three audited agencies were identified by reviewing payments to vendors other than TEX-AN. In addition, agencies need better policies over cellular phone use to ensure that it is the most cost-effective

Executive Summary

alternative and to minimize non-business use.

- **Supplies and Materials** - Several agencies centralized the purchasing of high-volume items to reduce costs. The contracts specified delivery terms that reduced the need for inventories and provided additional assurance of product availability.
- **Fleet** - Additional controls are needed to ensure that (1) vehicles are purchased only after full consideration of the cost versus benefit when compared to other alternatives and (2) vehicles are actually used as intended.
- **Services** - Compliance with controls over purchases of services appears to be weaker than compliance with controls over purchases of goods. Documentation was sometimes insufficient to protect the State from potential problems with the service provider and to determine whether the State got the best value.
- **Information Technology** - Savings were obtained by standardizing equipment and software and using blanket contracts developed by the Department of Information Resources or the agency. One agency also outsourced its hardware maintenance and monitored the vendor to ensure timely service.

Overall Agency Management Can Affect the Results of the Procurement Process

Opportunities to further improve the controls, efficiency, and compliance of the procurement process at the agency level were also identified (see Section 3). Some of the problems identified were not the result of weaknesses within the purchasing department. The problems were the result of actions taken by agency management, programs, or functions before the transactions reached the purchasing department. For example, the purchasing department cannot ensure that the agency gets the best buy on computers if agency policy allows each program to select the computer it wants. The purchasing department cannot ensure the agency is protected from problems with service providers if a program contracts verbally for services and fails to notify the purchasing department before services are received. To fix these kinds of problems, agency management needs to:

- Clearly identify the roles and responsibilities of functions involved in procurement
- Consider the impact of the organization's structure on the efficiency of the procurement function
- Monitor the procurement function to ensure it actually operates as intended

Executive Summary

Summary of Management's Responses

The agencies generally agreed with the recommendations. More details and agency-specific responses can be obtained from the State Auditor's Office.

Summary of Objective and Scope

The objectives were to:

- Identify categories of purchases by state agencies that are exempt

from General Services Commission's authority.

- Test exempt purchases for weaknesses in agency-level internal controls, instances of fraud and abuse, and inefficiencies in the purchasing process.

We conducted detailed reviews of the controls over the approximately \$540 million of procurement expenditures made by MHMR, TDH, and DHS. Statewide data on \$3.64 billion in total procurement expenditures and on some specific types of items, such as cellular phones, was gathered and analyzed.

This page intentionally left blank.

The Texas Departments of Health, Human Services, and Mental Health and Mental Retardation Have Controls in Place

In general, the Texas Department of Health, Department of Human Services, and Mental Health Mental Retardation have developed adequate internal controls over purchases and have been actively making improvements in their procurement processes.

Texas Department of Health

The Texas Department of Health (TDH) has made some recent improvements to its procurement process, and it has more changes planned and in progress. However, additional opportunities exist for improvements to the management and implementation of this process as well as to the information system used. Although clearly inappropriate or wasteful transactions were not found, in some cases TDH could not document that it used procedures designed to obtain the best price. Specific opportunities for savings were also identified.

Management needs to clarify the authority, roles, and responsibilities of the program, purchasing, and fiscal functions in the overall procurement process and actively monitor and resolve any major disagreements between these functions. Otherwise, the money-saving opportunities that the checks and balances between these functions are intended to create will be overlooked or ignored.

Texas Department of Human Services

The Texas Department of Human Services' (DHS) procurement process provides reasonable assurance that it purchases the right quantity and quality goods and services at the right time, at the right price, from capable suppliers. DHS's policies and procedures follow General Services Commission's rules and also include adequate guidelines for purchases subject to agency control.

DHS generally does a good job of following these policies and procedures and had already taken some steps to address the problem of improperly-approved transactions prior to our audit.

Texas Department of Mental Health and Mental Retardation

The Department of Mental Health and Mental Retardation (MHMR) has made some recent improvements to its procurement process, and additional improvements are underway. In general, this process provides reasonable assurance that it purchases the right quantity and quality goods and services at the right time, at the right price, from capable suppliers for the areas covered in this audit. However, additional changes to

MHMR's management and implementation of its procurement process are needed. Some potential cost savings were also identified.

MHMR may be able to reduce costs by modifying its decentralized approach to procurement. This decentralization resulted in numerous small-dollar purchases processed by a large number of procurement staff. Expansion and consolidation of blanket contracts and the use of petty cash or credit cards for smaller purchases should reduce the number of transactions and eventually reduce the number of staff required for processing. MHMR has already used this approach on purchases of food and pharmaceuticals with good results. Ongoing analyses of expenditures should help identify additional opportunities for savings.

See Appendix 4 for a more detailed description of the results of the individual agency reviews.

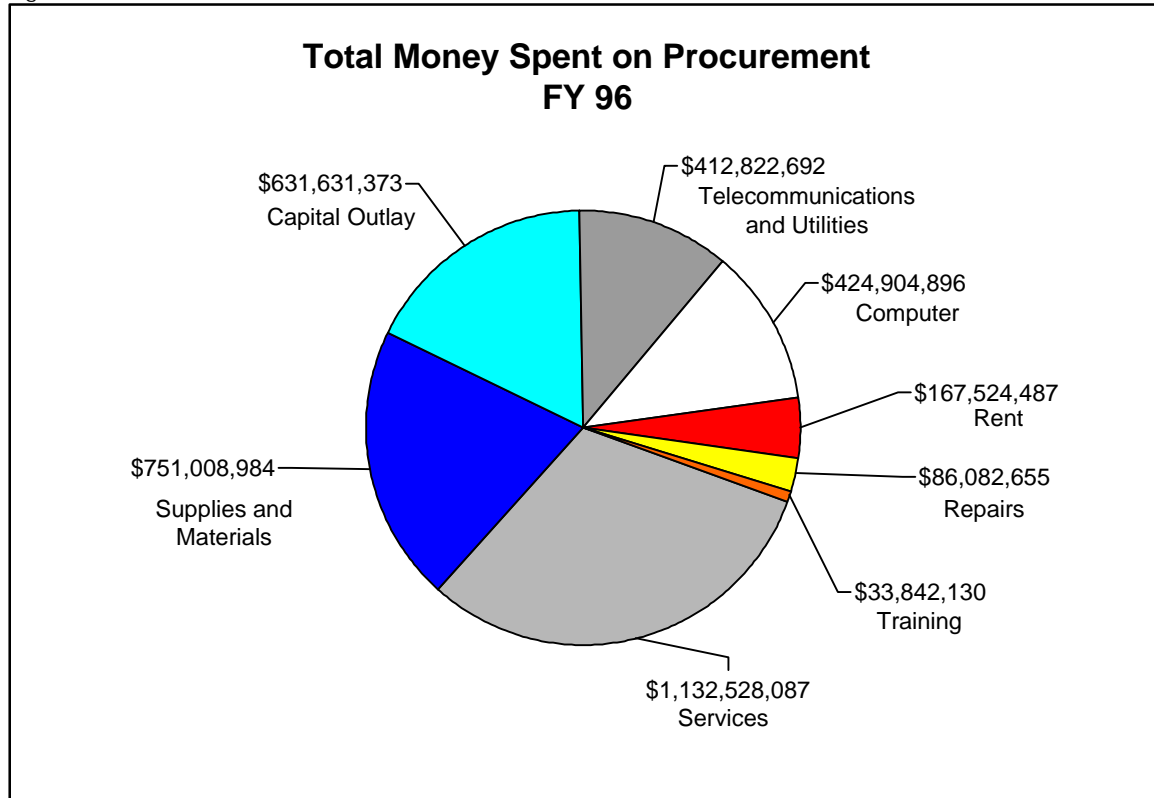
Section 2:

Cost Savings and Improved Service Are Possible in Some Areas

A variety of cost savings, efficiencies, and control improvements were identified during the three agency audits and as a result of additional statewide data analysis. Since the procurement of different types of items often requires different approaches to ensure that the best value is obtained, items are summarized according to procurement categories. Specific improvements were identified in the five largest procurement categories: services, supplies and materials, capital outlay, telecommunications and utilities, and information technology.

For fiscal year 1996, the State spent a total of \$3.64 billion on the procurement of the items listed in Figure 1.

Figure 1



Although \$3.64 billion is a large amount, it is relatively insignificant as a percentage of total appropriations—less than 10 percent. As a result, especially at the agency level, these expenditures may receive relatively less attention. Nonetheless, these items are important because:

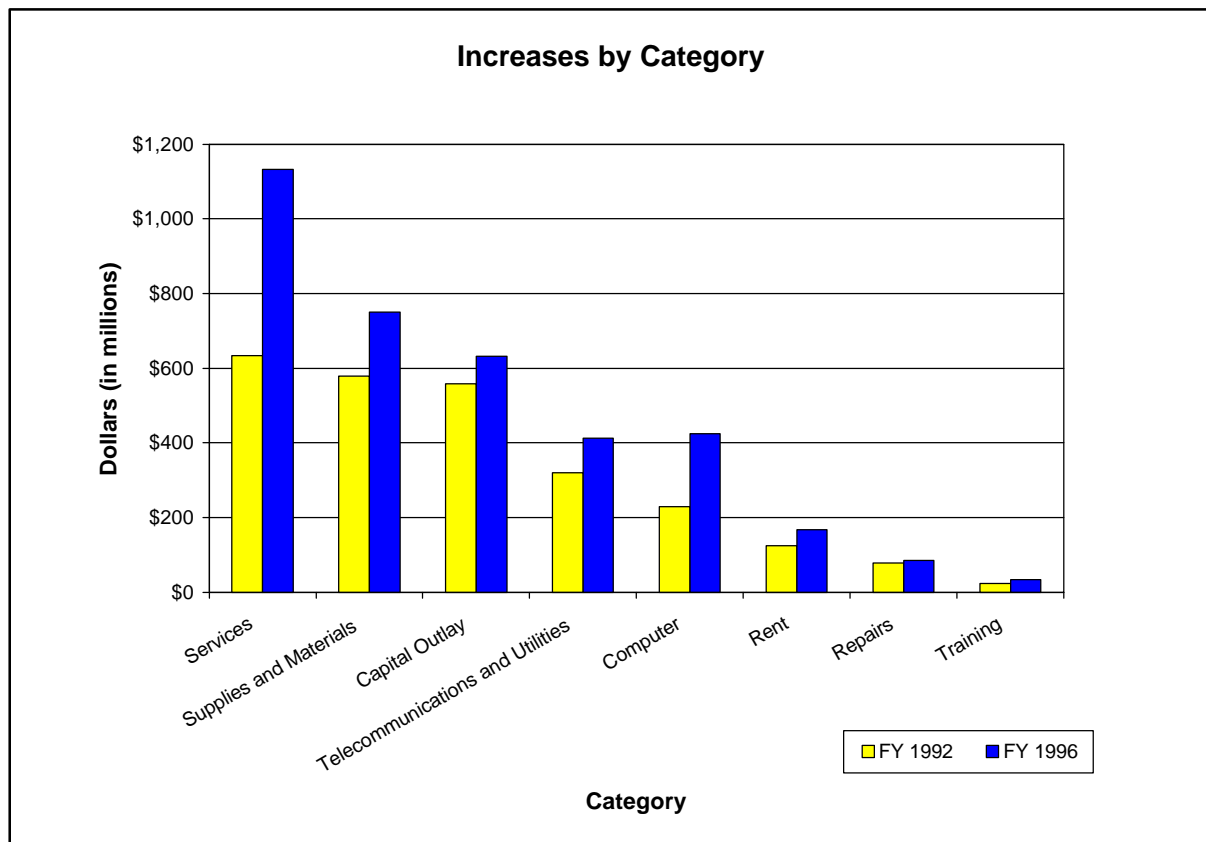
- These purchases are items the State buys regularly. Therefore, what appears to be a small savings on an individual item can translate to fairly large annual savings—and the savings will normally continue for each year thereafter. For example, a change in a phone rate from \$.30 to \$.15 per minute can significantly reduce long distance charges.
- The changes required to improve procurement may not only reduce item costs but can also improve service delivery and reduce holding costs. For example, pooling pharmaceutical purchases to obtain lower prices and, at the same time, specifying more favorable delivery terms can decrease the turnaround time from order to delivery. It can also reduce the need to stockpile large quantities of items.

A review of trends in procurement expenditures yields some interesting results:

- Overall procurement expenditures increased 43 percent from fiscal year 1992 to 1996.

- During the same time period, General Appropriations increased 35 percent and the number of state employees increased 13 percent.
- As the chart below indicates, expenditures for procurement categories increased at very different rates. In particular, the Services and Computer (information technology) categories increased at almost double the rate of all procurement expenditures. These two categories follow different rules, policies, and procedures than the other categories (see Appendices 2 and 3). Also, these transactions may require a higher level of expertise.

Figure 2

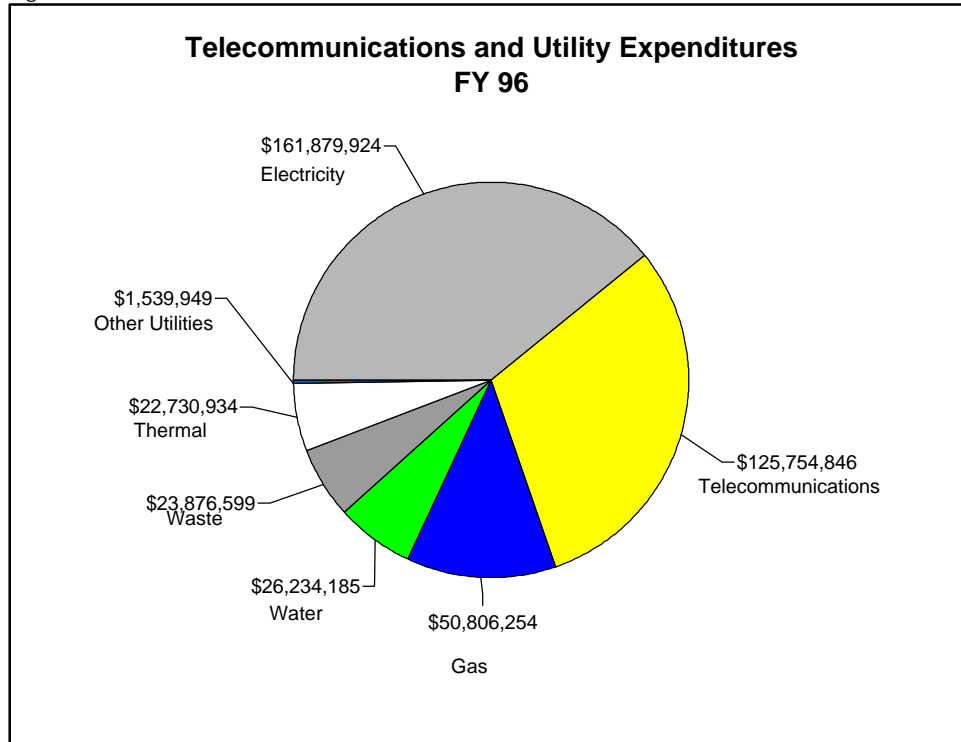


Section 2-A: Telecommunications and Utilities - \$412.8 million

Actively Manage Telecommunications Expenditures

It appears that the three audited agencies could save between \$376,000 and \$1,651,000 annually in long distance charges. Actual savings will be determined by the agencies. DHS estimates a savings of \$100,000 annually. Additional savings may be available at agencies that were not audited. In addition, controls over purchase and use of cellular phones could be improved.

Figure 3



The State spent \$412.8 million on telecommunication and utility expenditures in fiscal year 1996. Overall, these expenditures increased only 28.6 percent from 1992. However, some categories had higher increases than others. Water increased 81 percent and telecommunications increased 48 percent.

Section 2-A-1: Long Distance - \$12.8 million

Use TEX-AN or Negotiate Price for All Long Distance Telecommunications

It appears that substantial rate savings can be achieved if agencies use TEX-AN, the state-operated telecommunications system, more consistently. Based on the actual rates paid in our sample, we estimated that the three agencies could save between \$376,000 and \$1,651,000 annually. A review of the invoices indicated that the agencies were paying from \$.15 to \$1.04 cents per minute for approximately \$2.2 million of non-TEX-AN long distance services. TEX-AN averages \$.15 per minute for virtual service (service which uses an access code). Determining the total amount of the savings will require a more detailed review of the actual invoices. Other items that do not have the same rate savings may be charged to long distance. However, DHS has already identified a way to save an estimated \$100,000 annually. TDH has begun a utility audit designed to identify both rate-based and other types of telecommunications savings.

During fiscal year 1996 state agencies paid non-TEX-AN vendors approximately \$12.8 million for long distance services. The General Appropriations Act requires state agencies to use TEX-AN except when it is not available in a particular area or not cost-effective. If these exceptions apply, agencies are required to obtain a waiver from the General Services Commission (GSC) and the Department of Information Resources. This rider ensures that the State gets the best buy on its telecommunications services.

Although the majority of the long distance calls were made through TEX-AN, some lines and calls are not in compliance with the General Appropriations Act. Bills for long distance charges for three agencies were sampled and information from the internal audit departments of two other agencies was obtained. The results were as follows:

- Some phone lines were not connected to TEX-AN but could be.
- Some phone lines were connected to TEX-AN but calls were made through other, more expensive, service providers.
- Some phone lines could not be connected to TEX-AN, but the agency failed to get a waiver. In some cases the agency was paying an outside vendor what appeared to be fairly high rates.

Some agencies were unaware of the full range of services available with TEX-AN. In addition to dedicated access, which requires hard wiring the location to the network, TEX-AN can now provide virtual access (which only requires the use of an access code) and 1-800-HI-TEXAN. These alternative services are offered at rates that are still lower than most rates charged by other vendors.

Many of the calls reviewed were toll calls placed within the same area code as the caller (intralata calls). Using TEX-AN for these calls is somewhat difficult with some older types of phone equipment. Callers using older equipment must know that the call is a toll call and enter a code to connect to TEX-AN. Otherwise, the call goes through the local service provider. DHS found that it had a high number of intralata calls and negotiated with Southwestern Bell to get an alternative service plan that costs less. GSC is currently working with DHS to make sure that the contract terms are appropriate and it is the most cost-effective alternative. Other agencies are considering similar agreements.

Agencies interested in determining if they have potential savings should review payments to non-TEX-AN providers of long distance service and:

- Determine if the phone lines in question can be switched to TEX-AN.
- Switch the lines that can be switched.
- Obtain a waiver for those lines that are not cost-effective to switch.
- Review any other long distance charges not associated with specific phone lines, such as 1-800 numbers or calling cards, and determine if comparable TEX-AN service is available.
- Switch these services to TEX-AN.
- Determine if they have a high number of intralata calls. See if an alternative rate plan is available from the service provider.

- Continue to monitor long distance charges to make sure that new lines are set up under TEX-AN and that lines changed to TEX-AN are consistently used for all long distance calls.

The GSC Telecommunications Services Division can provide assistance with this review. It can be reached at (512) 936-4873.

Section 2-A-2: Cellular Phones - \$3.8 million

Improve Controls Over Purchase and Use of Cellular Phones

Some agencies were not using the state-negotiated contracts to reduce the cost of cellular service, had inaccurate or incomplete information on actual spending for cellular services, and did not have adequate controls over the use of cellular phones. Although cellular phones can enable an employee to conduct business in situations where it would not otherwise be possible, it is also true that these phones might be used when a cheaper alternative exists. Amounts paid to cellular phone vendors have increased 95 percent over the last 3 years, from \$1.9 million in 1994 to \$3.8 million in 1996. During the same period, charges for long distance services, including TEX-AN, remained relatively stable, increasing approximately 5 percent. These increasing dollar amounts indicate a need to consider more structured controls.

Agencies are not consistently using state-negotiated term contract vendors for cellular service. During fiscal year 1996, cellular vendors were paid approximately \$3.8 million, of which approximately \$1.2 million was paid to non-term-contract vendors. As a result, agencies may be paying more than needed for cellular service. GSC has multiple contracts in place statewide for cellular service. Agencies are required to use them unless these vendors do not provide service in their area or they are able to obtain the service at a lower rate.

It appears that many agencies may have inaccurate or incomplete information on how much money they spend on cellular phones based on what they reported to the Subcommittee on Emoluments (Subcommittee) during the 75th legislative session. The Subcommittee surveyed agencies regarding cellular phone expenditures and policies. Cellular phone service does not have a separate object code and agencies do not consistently code these expenditures to the object code identified by the Comptroller of Public Accounts (Comptroller). Therefore, total amounts agencies paid to cellular phone vendors and amounts reported to the Subcommittee were compared. Agencies under- and over-reported the amount paid to cellular phone vendors by significant amounts. For example, MHMR, which had the third highest total payments to cellular phone vendors, did not supply an expenditure amount to the Subcommittee. Our analysis indicates that it actually spend approximately \$470,000.

Some agencies also do not appear to have adequate controls in place to keep down cellular phone-related expenditures. Many agencies reported to the Subcommittee that they allow personal use of cellular phones as long as the agencies are reimbursed for the cost. However, the agencies may not have sufficient controls to identify these calls and ensure that the reimbursement actually occurs. For example, a policy that requires employees to account only for the calls listed on the bill instead of all calls made allows employees to make personal calls on "free minutes." Along with the

direct cost charged by the service provider, indirect costs could also increase when cellular phones are used for personal reasons. First, an administrative cost is incurred for receiving, recording, and depositing reimbursement from employees. There is also the added cost of monitoring cellular phones for unreimbursed personal use. Some agencies reported having controls which, if implemented, should help provide reasonable assurance that cellular phones are used efficiently and effectively. These include:

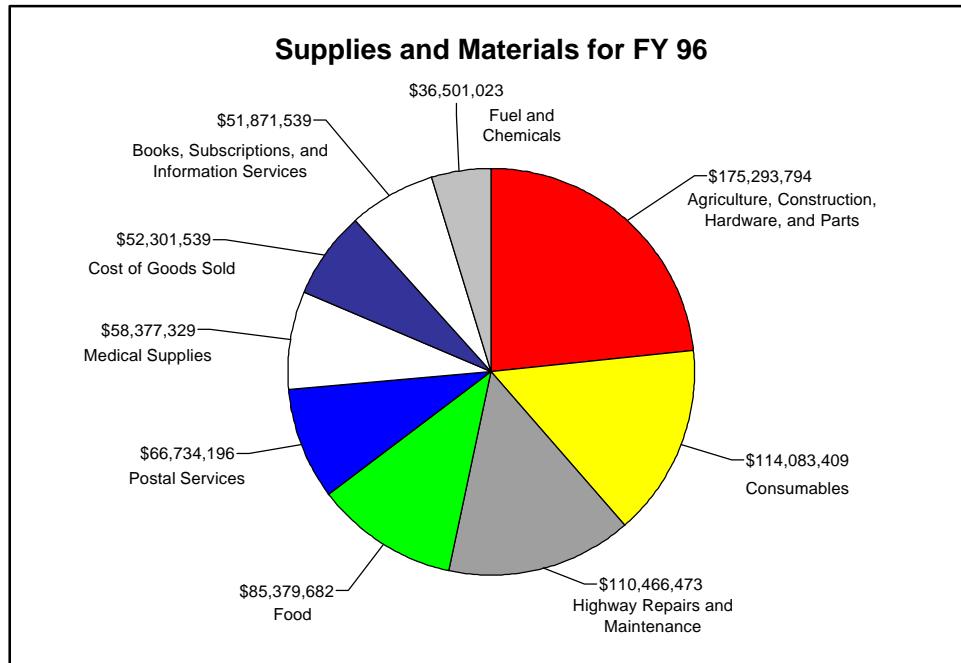
- Specifically identify the situations in which cellular phones can be used, for example:
 - Phones are used only for agency business.
 - Phones may be used only for emergency or travel status.
 - Phone may be used only when a pay phone is not available.
- Identify low-cost alternatives to cellular phone use, such as pagers. One agency coordinated pager and cellular phone use through a series of codes. A code sent through the pager told the employee whether to call when convenient or use the cellular phone to respond immediately to an emergency.
- Charge an administrative fee, in addition to air time charges, to reimburse the agency for processing reimbursements for personal use.
- Require employees keep a log of all calls and document the purpose of the call.

Section 2-B: Supplies and Materials - \$751 million

Centralize Ordering and Have Vendor Drop Ship to Save Time and Money

Two of the agencies reviewed have recently changed the way they order and inventory supplies and materials. These changes appear to have decreased item costs, improved service, and decreased inventories and related holding costs.

Figure 4



State agencies spent \$751 million on supplies and materials for fiscal year 1996. This represents a 30 percent increase from fiscal year 1992.

The basic strategy these agencies followed is to:

- Review previous purchases and identify high-volume items.
- Determine the amount used annually.
- Determine delivery terms that would minimize inventory but still ensure that items are available when needed.
- Bid out the contract, clearly specifying the delivery terms needed.
- Contract with the number of vendors needed.

For example, DHS identified the high-volume office supplies it used statewide and arranged to have the vendor drop-ship the items periodically to the different offices. Payment on these contracts is also centralized to minimize voucher processing. MHMR centrally developed a prime vendor contract for pharmaceuticals that allows facilities to order goods as needed, and it has a flexible delivery system that ensures delivery by noon on orders placed by 6:00 p.m. the previous day. It has also reduced its food inventories by 28 percent by ordering as needed instead of stockpiling.

Agencies should consider holding costs as well as item costs when determining whether or not to buy and hold items. If these costs are not included in purchasing decisions, an agency may spend more money purchasing, storing, and transporting items than it would cost to have the vendor store and ship them when they are needed.

Section 2-B-1: Postage - \$66.7 million

Use Lowest Possible Postage Rates

TDH has made improvements to its mail room. It purchased additional equipment and restructured its operations to provide more services for the same budget. For example, it employs machinery to sort mail so that it can take advantage of second class postal rates when appropriate. The second class rates are more favorable than first or third class rates under certain conditions. On one mailing, TDH saved the Texas State Board of Social Work Examiners \$2,800 by using second class postage rates. Although TDH's total postage cost has increased, the number of pieces of mail processed has also significantly increased over the last several years. As a result, according to the agency, the cost of an average piece of mail has decreased from 42 cents in fiscal year 1993 to 31 cents in fiscal year 1997. However, these savings do not include overhead or depreciation costs which may reduce the overall savings somewhat.

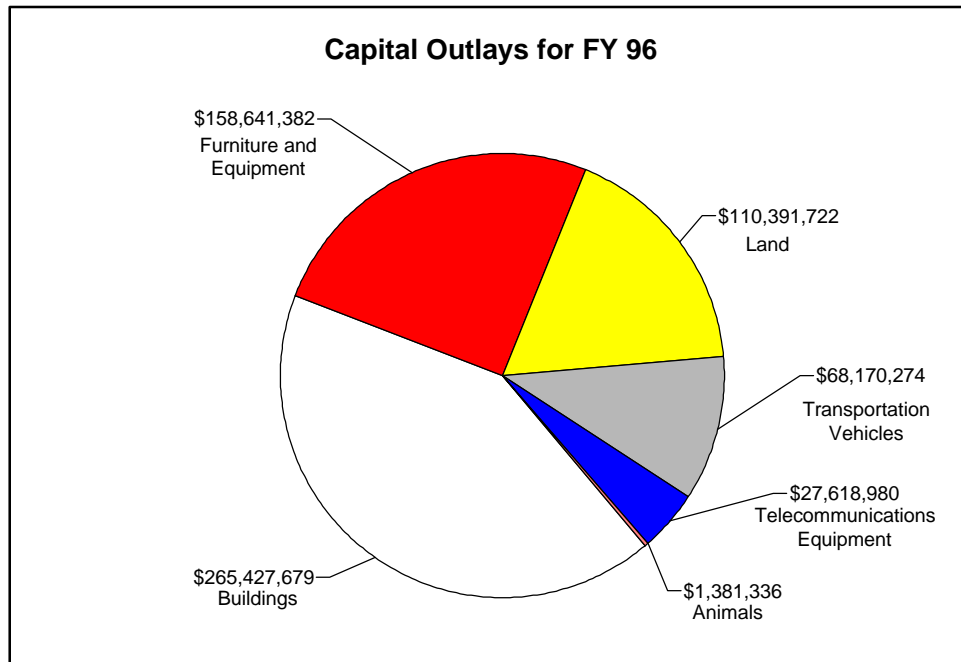
The State spent approximately \$66 million annually on postage from fiscal year 1992 to 1996. At a statewide level, the Council on Competitive Government has an ongoing project on reengineering mail services. It has already reviewed GSC, the Department of Public Safety, and the Texas Department of Transportation.

Section 2-C: Capital Outlay - \$632 million

Fleet Purchases Should Analyze Costs Versus Benefits and Consider Alternatives

One of the agencies reviewed had purchased a vehicle for employee travel without documenting whether this was less costly than mileage reimbursement. In another instance, it purchased a vehicle for security services, but the vehicle is being used for employee travel. Controls over motor vehicle purchases are important because of the high cost of each individual vehicle and because of the real risk that these items can be converted to personal use and/or under-utilized.

Figure 5



The State spent \$631.6 million on capital expenditures in fiscal year 1996. Overall, these expenditures increased only 13.3 percent from 1992. However, some categories had higher increases than others. Transportation purchases (boats, aircrafts, vehicles) increased 293 percent, virtually all of it for vehicles.

Article IX, Section 20 of the General Appropriations Act (75th Legislature), outlines the types of vehicles that agencies can purchase and under what circumstances. This Act requires agencies to submit a report, prior to acquisition of vehicles, to the Governor's Office of Budget and Planning and the Legislative Budget Board. In addition, agencies are required to report vehicle information to the GSC, which issues a Biennial Fleet Management Report.

However, individual agencies are responsible for developing the internal processes needed to make sure that they really need the vehicles, that the vehicles are the best value for that purpose, and that they are used as intended. If these processes are not in place, the State may not be making the best use of its resources.

Some elements of a successful process for managing vehicle purchases are as follows:

- Centralize planning and purchasing of vehicles where possible so that bulk discounts can be obtained.
- Establish criteria for vehicle replacement.
- Required documented justification for all vehicle purchases (including replacements) which includes a needs assessment, a projection of anticipated use, an analysis of cost versus benefit, and an identification of low-cost alternatives to purchasing a vehicle (mileage reimbursement or teleconference).
- Monitor the actual use of vehicles, and determine if they are being used as intended. This requires documenting the number of passengers, the purpose

of the trip, and whether the passengers are employees or clients. Otherwise, the agency will not be able to determine if it really used a vehicle to transport 8 people rather than 5 people.

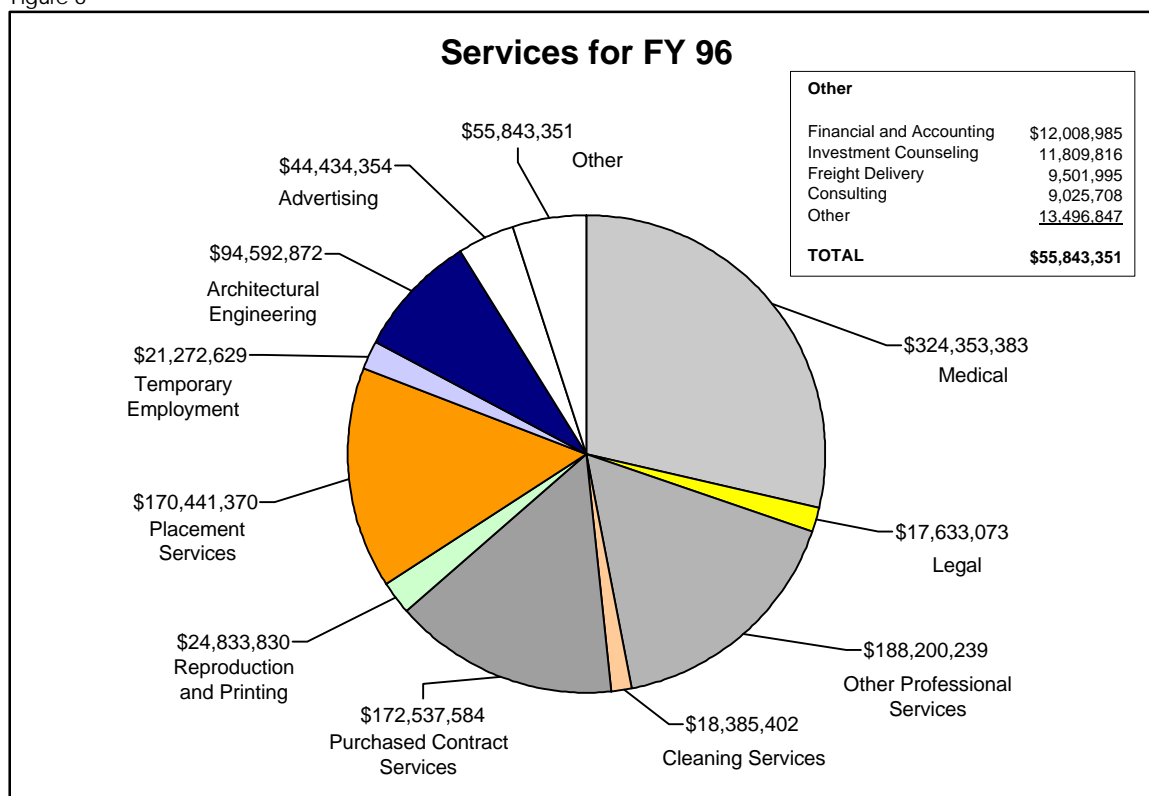
- Adjust purchase and replacement strategies accordingly.

Section 2-D: Services - \$1.132 Billion

Use Same Care When Purchasing Services as When Purchasing Goods

Compliance with controls over purchases of services appears to be weaker than compliance with controls over purchases of goods. Documentation was sometimes insufficient to protect the State from potential problems with the service provider and to determine whether the State got the best value.

Figure 6



State agencies paid \$1.1 billion in fiscal year 1996 for various types of services (excluding the lottery). This represents a 79 percent increase over the amount paid in fiscal year 1992.

Compliance problems exist with controls over purchased services, as follows:

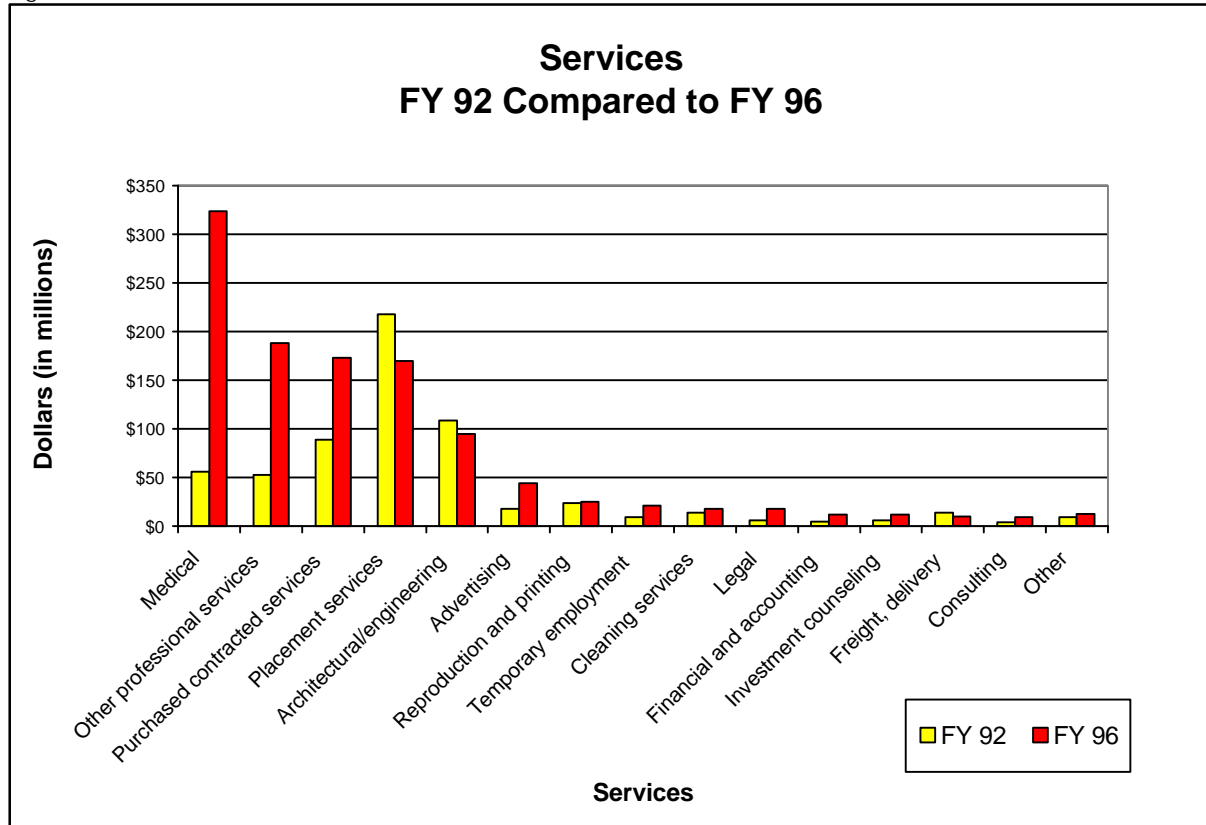
- Services were requested and provided before the contract was signed. The absence of a signed contract prior to contract execution puts the agency and the contractor at risk. Without a written and signed contract, disputes with contractors regarding performance or payment are more difficult to resolve. It is also harder to protect the agency's interests should the contractor fail to perform.
- Contracts which did not originally include renewal options were renewed without rebidding. This increases the risk that the agency did not obtain the best value.
- Services that should have been bid were not because the agency used the individual transaction amount to determine which procedures to follow. For example, if an agency pays \$1,000 for one month of temporary services, no bids are required. However, if they pay the same vendor \$1,000 each month the total transaction is really \$12,000 and they should solicit formal bids (under the 1996 GSC guidelines). This practice does not comply with GSC guidelines and may result in the agency not getting the best value. Service providers are often willing to charge less if a higher amount of services are going to be purchased over a longer period of time.
- Existing blanket contracts for services were not being consistently used. This results in higher administrative costs to process additional bids and may increase rates as well.

The degree of oversight varies between types of services and is different than it is over goods:

- Professional services and fees (accounting, architecture, surveying, medicine, optometry, professional engineering, real estate appraisal) as well as consulting services (service of studying or advising a state agency) are exempt from GSC rules, policies, and procedures. However, the law does identify specific requirements as to how these transactions should be handled.
- Delegated purchases of services have different rules than delegated purchases of goods. Although GSC only delegates purchases of goods under \$25,000 to the agencies (under the new rules), purchases of services are delegated unless they are over \$100,000 and even then can be delegated back to the agency. However, GSC does review all service contracts over \$25,000 for compliance with its rules, policies, and procedures prior to payment.

In addition, expenditures for some services have increased substantially more than others. (See Figure 7.)

Figure 7



Note: The current restrictions on the number of Full Time Equivalent employees and the increased focus on outsourcing would seem to indicate that expenditures for services will continue to grow.

However, some improvements were made in contracting for services. For example, the process TDH used to identify and contract with vendors selected to administer Medicaid claims was very detailed and thorough. Since TDH paid \$72 million in fiscal year 1996 for Medicaid claims processing, this contracting process is very important. In previous years, TDH contracted with one vendor to provide all of these services. Although this made the contract easier to monitor, it also resulted in very limited competition, as only one vendor had the interest and ability to carry out the entire Medicaid claims administration process. To ensure maximum competition, TDH has changed the way it contracts for these services. The new process includes:

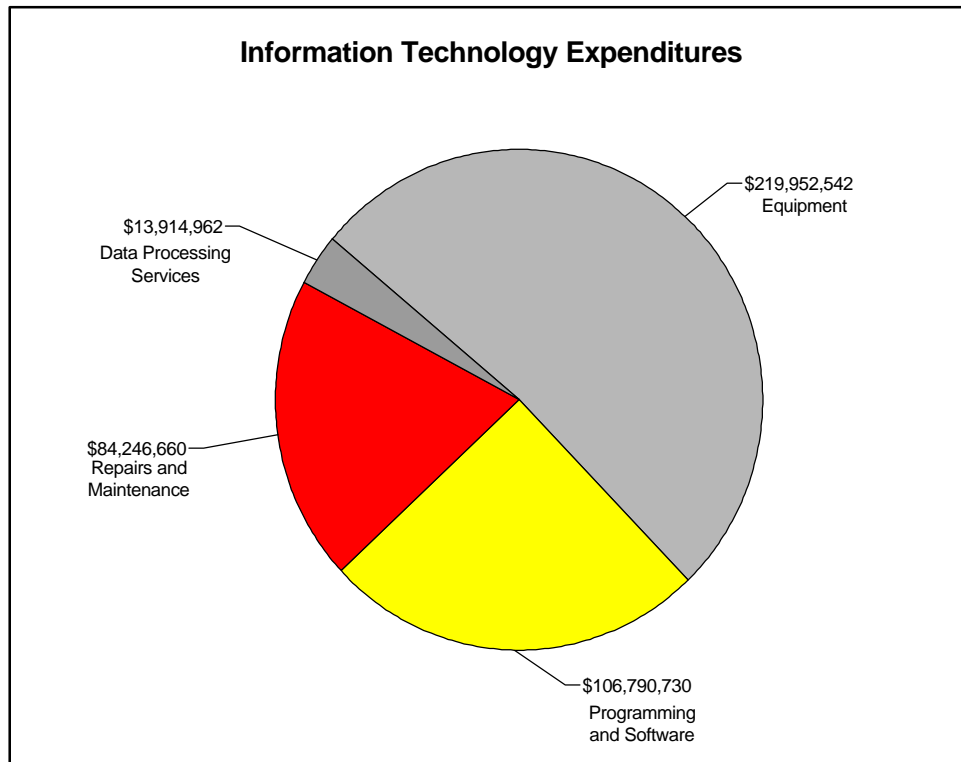
- Breaking down the Medicaid claims administration process into reasonable sub-functions that can be competitively bid
- Creating a detailed process for evaluating bidders
- Establishing a monitoring function

This attention to detail in the contracting process should contribute to lower costs and better service delivery.

Standardize and Coordinate Information Technology Purchases

Although some statewide controls over information technology purchases do not seem to be working as intended, several examples of successful strategies for obtaining the best value at the agency level were identified.

Figure 8



The State spent approximately \$425 million on information technology in fiscal year 1996. This represents an increase of 84 percent over fiscal year 1992. It is the fastest growing category of procurement in this analysis, even though it excludes the salaries of state employees paid to develop and maintain information technology in-house.

Information technology purchases have a separate procurement process, called the Catalogue Procurement Process. GSC maintains a list of vendors called Qualified Information Systems Vendors (QISV). State agencies are required to select vendors from this list and negotiate with them for "best value." GSC has provided a "Best Practices" guide, which is available on its Web page, to assist agencies in developing their internal policies and procedures. Agencies are required to evaluate three proposals when possible. In addition, agencies are required to submit a Biennial Operating Plan to the Department of Information Resources (DIR) outlining their plans for technology and telecommunications purchases.

However, some of these controls do not seem to have been implemented as intended:

- For the three agencies audited, a review of the actual purchases indicates that they did not always use approved QISVs for their information technology purchases.

- At the eight agencies with the largest computer expenditures, actual expenditures were significantly different than projected expenditures (per their Biennial Operating Plans). Some agencies spent more than planned while other agencies spent less. Further review on a couple of these agencies indicates that the actual operating budget for computer expenditures is developed independently from the Biennial Operating Plan (Plan). As a result, the Plan is not really acting as a control over these expenditures.

On the other hand, the following strategies were used by agencies to ensure that they received the best value for their purchasing dollars:

- Standardize computer hardware and software to the extent possible. This not only reduces maintenance costs but also allows the agency to negotiate for lower prices due to bulk purchases.
- Project annual purchases. This gives the agency more leverage during negotiations due to the higher total dollar amount of the purchase.
- Purchase site licenses for software rather than individual user copies. This reduces the cost per user.
- Contract with an external vendor for comprehensive, agencywide hardware maintenance.

Overall Agency Management Can Affect the Results of the Procurement Process

Some of the problems identified were not the result of weaknesses within the purchasing department. These problems were the result of actions taken by agency management, programs, or functions before the transactions reached the purchasing department. For example, the purchasing department cannot ensure that the agency gets the best buy on computers if the agency allows each program to select the type of computer it wants. The purchasing department cannot ensure the agency is protected from problems with service providers if a program contracts verbally for services and does not notify the purchasing department until after the services are received. To fix these kinds of problems, agency management needs to:

- Clearly identify the roles and responsibilities of functions involved in procurement
- Consider the impact of the organization's structure on the efficiency of the procurement function
- Monitor procurement to make sure it functions as it was intended

Section 3-A: Effectiveness/Safeguarding

Improve Coordination Between Purchasing, Program, and Fiscal to Improve Results and Reduce Risk

Management needs to clarify the authority, roles, and responsibilities of the program, purchasing, and fiscal functions in the overall procurement process. Otherwise, the money-saving opportunities that the checks and balances between those functions are intended to create will be overlooked or ignored. In several instances, these agency-level controls were not working as intended. For example:

- Program personnel ordered and received goods and services without going through established purchasing procedures. This forced purchasing to document the transaction after the fact. As a result, competitive bidding was not always used, which decreased the likelihood that the agency obtained the best value.
- Fiscal and procurement personnel identified some potential savings but did not feel they had the authority to require program personnel to follow-up. As a result, the programs continued to use goods or services that were not best value.
- Program personnel provided fiscal personnel with budgets that were generally based on prior year expenditures. Fiscal personnel did not generally establish agencywide guidelines for the reasonableness of procurement-related expenditures based upon activity drivers such as the number of employees or

number of customers served. As a result, the agency lacked an independent check on the reasonableness of some budgeted expenditures.

A good system of checks and balances between program, procurement, and fiscal functions includes the following:

- Program personnel need to make sure that the item is needed, determine the right quantity, and give procurement personnel sufficient, accurate information about the types of goods that are needed. To the extent possible, programs should plan their purchases ahead of time so that procurement personnel will have adequate time to use a competitive acquisition process.
- Procurement personnel need to ensure that the agency gets the right items, at the best value, and that the items are available when needed. This may also involve working with program personnel to project annual purchases so that bulk discounts can be obtained.
- Fiscal personnel need to make sure that the documentation supports the transaction and that the purchase is in accordance with the budget.
- All personnel need to actively analyze purchasing patterns to identify opportunities to improve the process.

Section 3-B: Efficiency

Organizational Decisions Can Affect the Efficiency of the Procurement Process

The organizational structure and philosophy of the agency can have a negative impact on the efficiency of the procurement process, in some instances. In general, this occurred when an agency that had decentralized program management also extended that philosophy to purchasing. This resulted in some apparent inefficiencies in terms of the number of transactions required to buy what was needed and the number of staff required to accomplish those tasks.

A decentralized procurement process, which allows individual programs and facilities to do their own purchasing (subject to guidelines), provides maximum flexibility in meeting the needs of individual facilities. However, this decentralization can also result in processing a higher number of smaller transactions and using more procurement staff to process these transactions because purchases are not consolidated across the agency. It is also much more difficult to ensure that transactions are carried out consistently and comply with laws and regulations.

A centralized procurement process, on the other hand, maximizes an agency's ability to obtain bulk discounts with vendors, which often reduces administrative costs. However, it can also cause problems for individual programs whose needs do not fit within the negotiated contracts and can result in timing delays.

Agencies were most successful when they used a mix of the decentralized and centralized approaches. For example, they might group statewide purchases to get discounts and reduce costs to bid, but require the vendor to allow individual programs and/or facilities to specify delivery terms and quantities (within certain parameters). To determine which mix is most appropriate, agencies should:

- Review their purchasing patterns.
- Review and adjust the staffing of the procurement process.

Section 3-B-1:

Review Purchasing Patterns for Opportunities to Reduce Transactions and Costs

Although the agencies that were reviewed all used blanket contracts, credit cards, and petty cash to minimize transactions and transaction costs, in some cases, the use of these strategies could be expanded (see Appendix 5). In addition, the fiscal department can reduce the number of vouchers paid by grouping invoices from the same vendor and paying them on a single voucher. The extent to which the number of small transactions can reasonably be reduced will also depend on the nature of the agency's mission and the items being purchased.

To make a high-level determination of whether an agency was minimizing transactions and associated costs, the following information was reviewed:

- Number of vendors and vouchers for a particular type of purchase (as defined by Comptroller object codes)
- Number and type of existing blanket contracts
- Number of different items and quantity purchased

This information was then analyzed, as follows:

- Determine the number of vouchers processed per million dollars spent per category (as defined by Comptroller or agency-defined object code[s]).
- Determine how many vendors are used to purchase \$1 million in a particular category or object code. A low number indicates the agency is consolidating its purchases; a high number indicates that it is not.
- Determine the number of vouchers issued that are less than \$500. TDH estimates that it costs approximately \$168 to process a procurement transaction through voucher payment. This means these small-dollar transactions can be very expensive to administer.
- Group the existing blanket contracts by vendor. If the agency has more than one blanket contract with the same vendor, see if they can be consolidated.
- Group the existing blanket contracts by item type. If the agency has several blanket contracts for the same item, see if they can be consolidated and re-bid.

However, in some cases, an agency may need to use multiple vendors for the same contract to ensure availability. This is true of pharmaceuticals, for example.

- Compare the existing blanket contracts with the actual purchases. Determine why blanket contracts were not developed for all substantial purchases. Determine why blanket contracts were not used when they were available.

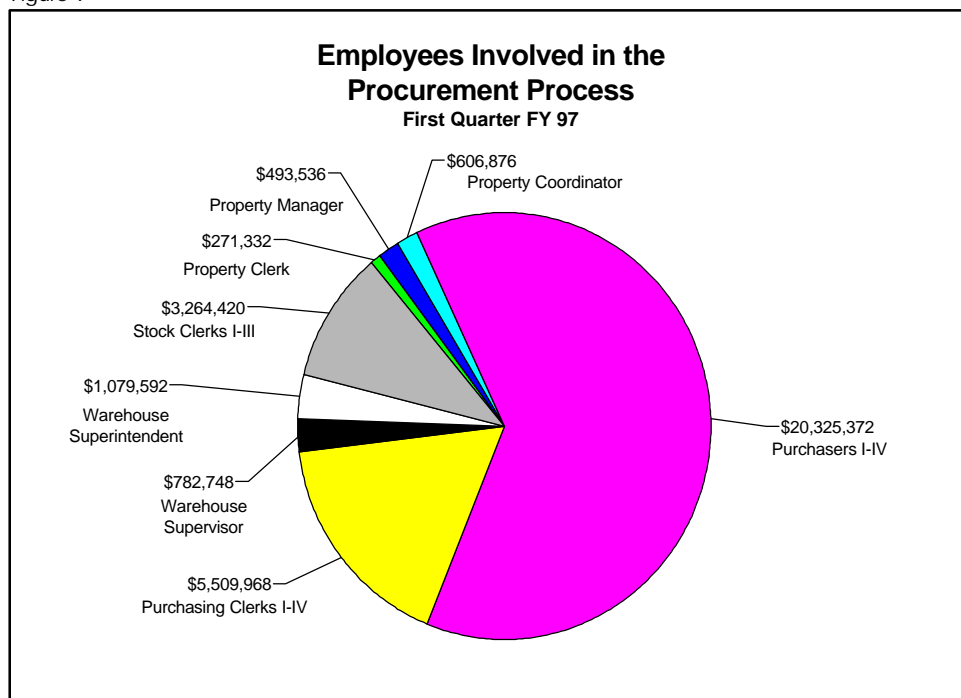
The above analysis was conducted on the five largest purchasers of supplies and materials. See Appendix 5 for detailed results.

Section 3-B-2:

Review Staffing and Align With Purchasing Patterns to Reduce Costs

Some agencies may be able to reduce the resources (such as procurement employees and administrative costs) spent on administering their procurement processes. Significant differences exist between some agencies in terms of the numbers of employees required to process the same dollar amount of transactions. Preliminary work indicates that the number of small-dollar transactions may be a cause of these differences at MHMR. It is also possible that some employees may be misclassified or may not be 100 percent involved in procurement-related activities. The extent to which the number and type of employees can reasonably be reduced will also depend on the nature the items purchased.

Figure 9



According to the Human Resource Information System, as of the first quarter of fiscal year 1997 the State had a total of 1,424 employees involved in the procurement process, for total annual salaries of \$32.3 million. These numbers include all employees in following positions throughout the agency, whether they are in the purchasing department or elsewhere.

To begin determining whether a particular agency had a reasonable level of procurement staff and associated costs, the following information was reviewed:

- Number of employees and their classifications
- Type and amount of expenditures and transactions processed

This information was then analyzed, as follows:

- Verify the staffing of the procurement function and where it falls on the organizational chart.
- Determine if the number of employees is reasonable based on what is being purchased.
- Determine how many transactions each employee is handling. The number of vouchers processed and the number of vendors paid can be used to determine this number. (See Section 3-B-1 "Review Purchasing Patterns for Opportunities to Reduce Transactions and Costs.") If this number is fairly reasonable, but the number of employees is still high compared to similar agencies, the agency may need to consider if it is possible to reduce the number of transactions.

The above analysis was conducted on the ten agencies with the highest total procurement salaries. See Appendix 6 for detailed results.

Section 3-C: Compliance/Reliable Data

Monitor Transactions to Make Sure They Are Documented and Processed as Intended

Each of the agencies reviewed provided sufficient direction to employees handling procurement transactions throughout the agency. In addition, the transactions that came through the purchasing departments were also actively reviewed and corrected. However, all of the agencies had problems identifying and controlling transactions that ignored existing policies and procedures. This resulted in numerous types of problems:

- Failure to request and document extensions on federal grants
- Possible misuse and/or overuse of emergency purchase exemptions
- Noncompliance with the Prompt Pay Rider
- Purchases not bid as required
- Insufficient documentation to support that the State got the best value

These transactions are difficult to identify and control because they either do not go through purchasing or go through purchasing after the items have been ordered, delivered, and used. Unless the agency's fiscal department is actively looking for these kinds of problems and reporting them to purchasing, the extent of the problem will be difficult to determine. Purchasing can distribute information and train staff on correct procedures; however, they do not always have the authority to enforce use of

these procedures. This lack of negative consequences means that programs are more likely to circumvent correct procedures when they perceive them to be burdensome.

Monitoring and reporting these transactions to management is one solution. For example, DHS now requires a special form for non-standard transactions. This information is collected and reported to management. DHS reports that collecting and reporting the information to agency management appears to have had an impact on behavior. It also provides the detailed information needed to identify particular programs or purchase types that are causing the most problems.

Section 4:

Issues for Further Study

Several cross-cutting procurement areas could benefit from further study. Additional cost savings and improvements in services may be available in the following areas:

Telecommunications - \$126 million

Besides long distance and cellular phones, the state also purchases data transmission lines, fax lines, teleconferencing services, and other types of telecommunications services. Although GSC negotiates rates for these services, it may be the case, as it was with long distance and cellular phones, that agencies are not uniformly taking advantage of these negotiated rates.

Fleet Management - \$68.2 million

All state agencies are required to report data on their fleet to the GSC. According to the GSC, this data is incomplete and sometimes inaccurate; therefore it does not allow GSC to make a comprehensive analysis of the State's fleet. GSC's initial analysis, however, indicates that savings from better fleet management are probable.

Interagency Contracts - Over \$400 million

Many different types of purchasing/sales agreements exist between state agencies. However, sometimes the "seller" does not have adequate cost information to determine the real cost of the item being sold. As a consequence, although the "buyer" may be getting a good deal, the State may be losing money because it may actually cost more to provide/construct the item in-house than to purchase it from the open market.

Information Technology Purchases - \$424.9 million

Purchases of information technology are growing rapidly. Our initial review in this area identified several problems and opportunities for savings. A more comprehensive review is needed to determine if the controls over these purchases are sufficient to ensure that the State gets the best value.

Objective, Scope, and Methodology

Objective

Our objectives were to:

- Identify categories of purchases by state agencies that are exempt from GSC's authority.
- Test exempt purchases for weaknesses in agency level internal controls, instances of fraud and abuse, and inefficiencies in the purchasing process.

Scope

For fiscal year 1996, the state had approximately \$32.278 billion in procurement expenditures. (This includes all agency, college, and university expenditures made through Uniform Statewide Accounting System [USAS] but excludes expenditures made with local funds.) However, only a portion of these expenditures were included in this audit, for the following reasons:

- Approximately \$25.725 billion of these expenditures were made through public assistance and intergovernmental programs. This includes federally pre-established payments to clients and providers (such as for Medicaid) and also includes negotiated contracts with service providers. These purchases—which are largely exempt from GSC rules, policies, and procedures, and are largely accomplished by grants to and/or contracts with service providers—were excluded from this review because they were the subject of several previous audits.
- Another \$2.913 billion involves specialized procurement procedures: highway construction (\$2.358 billion), textbook purchases (\$250 million), lottery (\$198 million), and travel (\$107 million). These items were excluded from this review because of their specialized nature.
- This review focuses on the remaining \$3.64 billion (see Section 2 for a breakdown by procurement categories).

Statewide data collected:

- Expenditure, vendor, and procurement code information from the Uniform Statewide Accounting System
- Classification and payment information from Human Resource Information System
- Business Operating Plans submitted to the Department of Information Resources

Major procurement categories reviewed include:

- Services
- Materials, supplies and equipment purchases
- Information technology
- Property and equipment rentals
- Communications and utilities
- Repairs and maintenance
- Education and training

Criteria used to select agencies for review included:

- Materiality of procurement-related expenditures
- Extent of previous procurement review(s) at agencies
- Materiality of administrative costs associated with procurement

Agencies audited:

- Department of Human Services (*A Management Letter to the Department of Human Services on a Review of Purchases Subject to Local Control*, SAO Report No. 98-314, February 1998)
- Texas Department of Mental Health and Mental Retardation (*A Management Letter to the Texas Department of Mental Health and Mental Retardation on a Review of Purchases Subject to Local Control*, SAO Report No. 98-327, April 1998)
- Texas Department of Health (*A Management Letter to the Texas Department of Health on Purchases Subject to Local Control*, SAO Report No. 98-336, April 1998)

Methodology

The audit methodology involved:

- Identifying key risks associated with the statewide and individual agency purchasing processes
- Collecting information on statewide and agency operations
- Performing audit tests, analyses, and other procedures
- Evaluating the information against established criteria

Specific procedures included:

- Review of statutes, new legislation, appropriation riders and agency policies, procedures and plans

- Interviews with management and staff
- Gaining an understanding of key processes and controls through testing or other means
- Analytical reviews of financial data

Other Information

Fieldwork was conducted from June 1997 through December 1997. The audit was conducted in accordance with applicable professional standards, including:

- Generally Accepted Government Auditing Standards
- Generally Accepted Auditing Standards

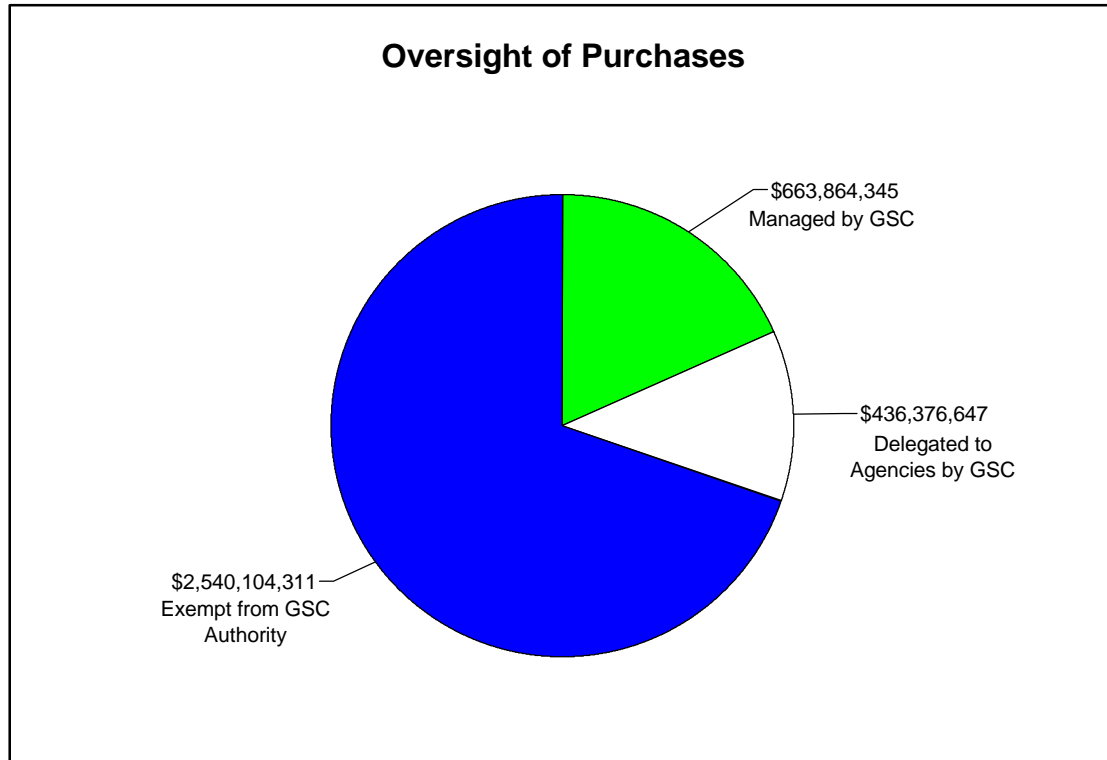
The audit work was performed by the following members of the State Auditor's staff:

- Linda C. Lansdowne, CPA (Project Manager)
- Margene Beckham, CGFM (Team Leader)
- Nick Villalpando, CPA (Team Leader)
- Larry Vinyard, CPA (Team Leader)
- Godfrey Baldwin, CPA
- Lisa R. Collier, CPA
- Dana Jung
- Lena Lui, CPA
- Ryan Simpson, MBA
- Cynthia Reed, CPA (Quality Control Reviewer)
- Charles R. Hrcir, CPA, CGFM (Audit Manager)
- Craig D. Kinton, CPA (Audit Director)

Analysis of Oversight

The State purchased \$3.64 billion in various goods and services in fiscal year 1996. Our review indicates that oversight on these purchases can be broken down into three main categories as follows:

Figure 10



These three categories can be further described as follows:

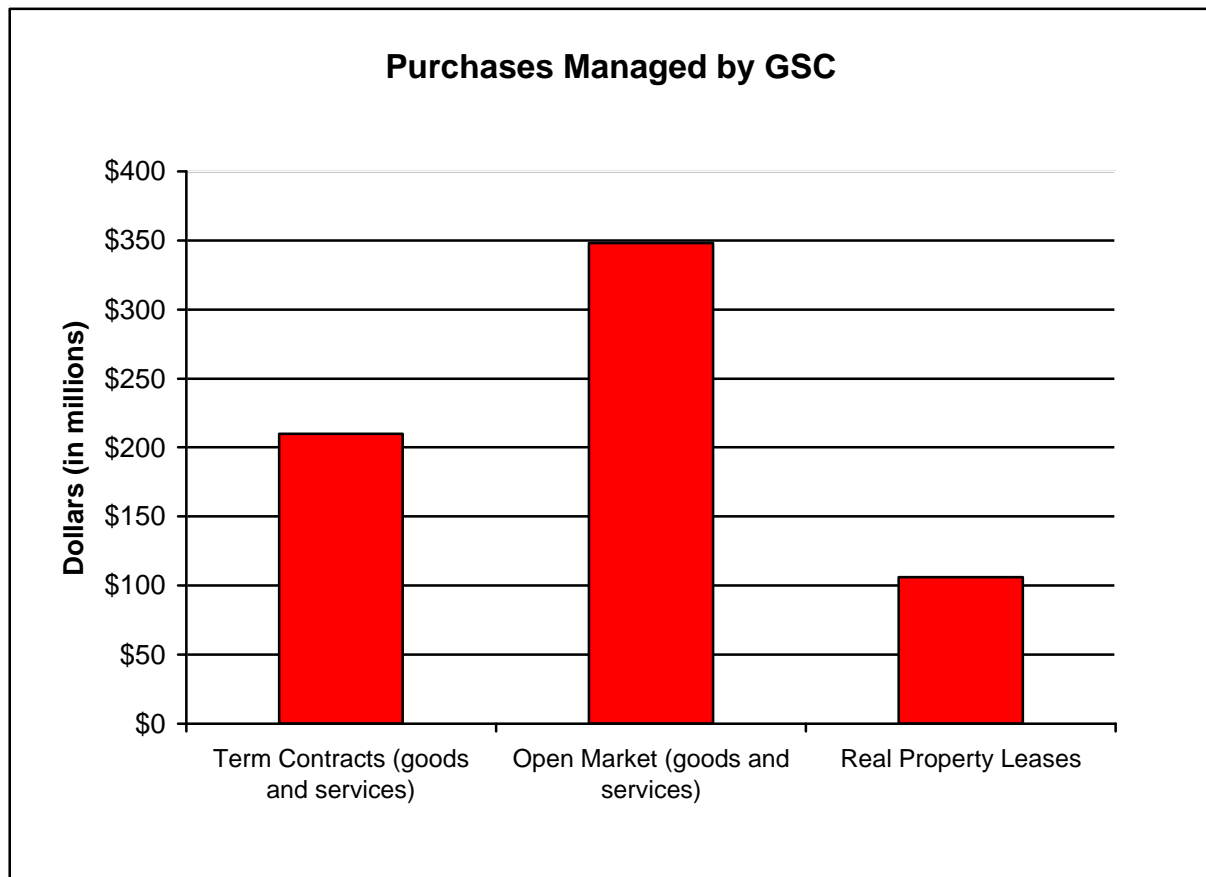
Directly Managed by GSC (18.24 percent)

Term contracts negotiated by GSC account for \$210 million in purchases. Agencies are required to use these contracts unless they can demonstrate that another vendor can provide a better value. However, these contracts do not exist for all types of goods and services.

Open market contracts negotiated by GSC account for \$348 million in purchases and are unique to the agency requesting them.

Real property leases negotiated by GSC account for \$106 million (see Figure 11.)

Figure 11

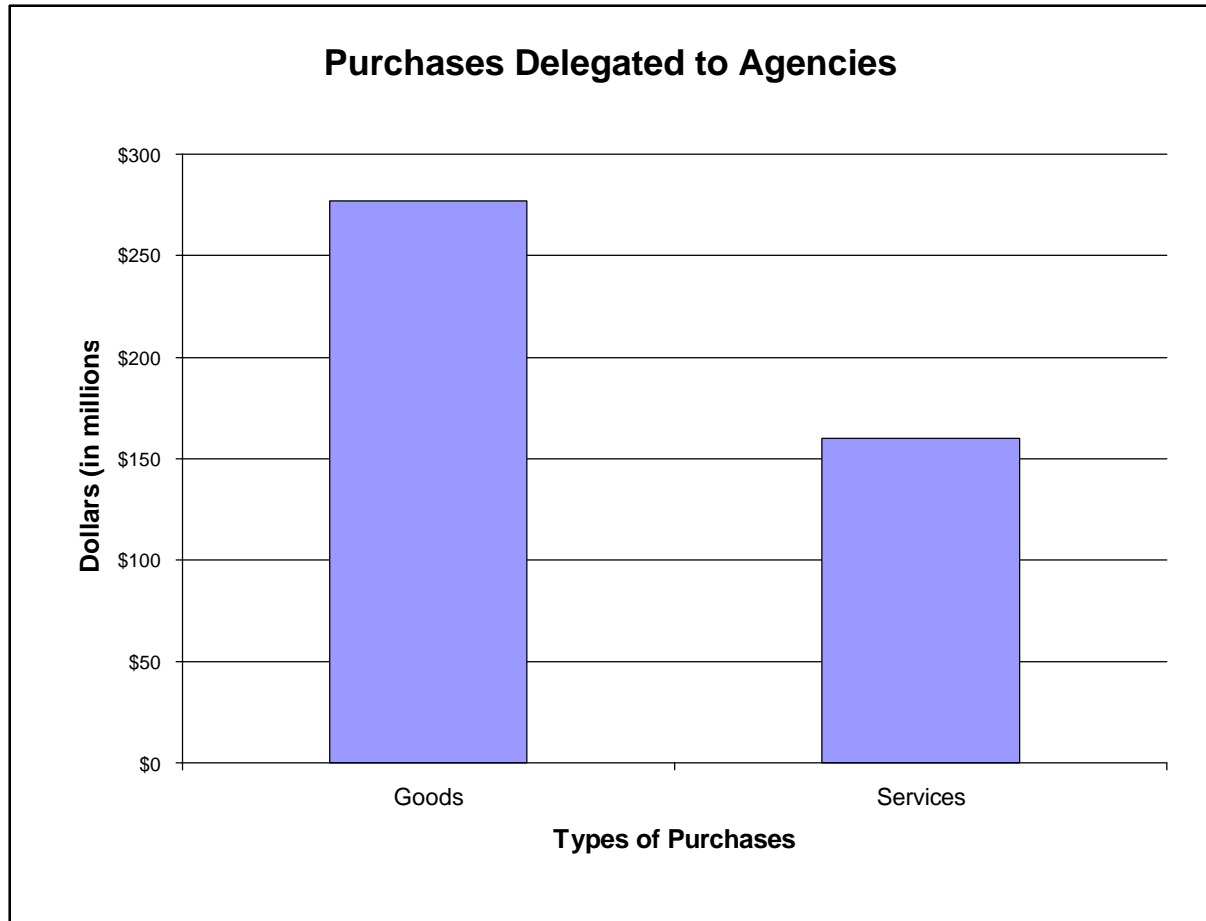


Delegated to Agencies (11.99 percent)

Delegated purchases are subject to GSC authority but are actually carried out by agencies using GSC rules, policies, and procedures, which vary according to type and amount of purchase. These purchases are periodically audited by GSC for compliance.

The level of delegation varies by the type of item being purchased. In general, a much larger percentage of service purchases are delegated or exempt than are goods purchases. However, the GSC recently passed a rule increasing the limit for delegated commodity purchases from \$15,000 to \$25,000. This is likely to increase the percentage of goods processed as delegated purchases for fiscal year 1998 (see Figure 12).

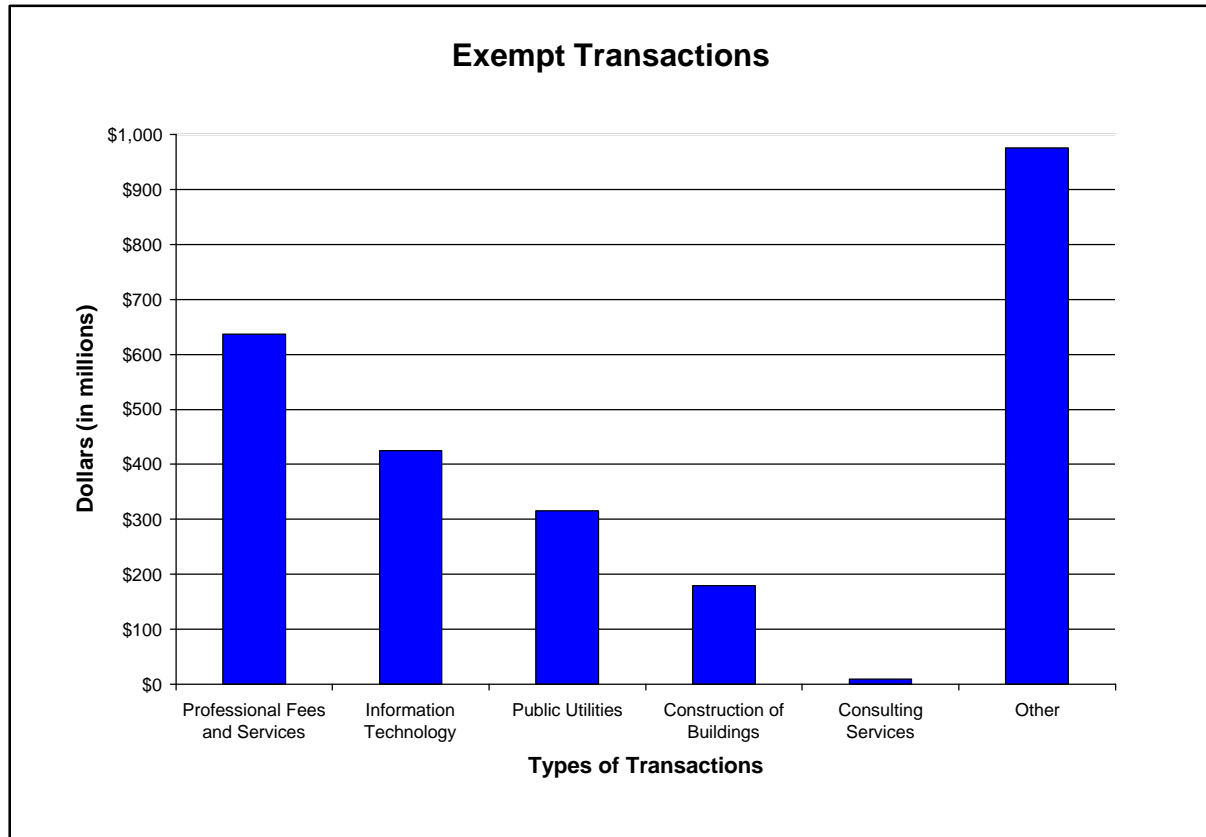
Figure 12



Exempt (69.78 percent)

The remaining \$2.54 billion of the \$3.64 billion worth of purchases is exempt from GSC rules, policies, and procedures. However, these transactions are subject to various requirements as outlined in state law. In addition, the Comptroller audits some of these transactions.

Figure 13



The above chart identifies some of the major transaction categories that are exempt from most agencies. The largest category is “Other” because many exemptions do not relate directly to specific object codes and cannot be associated with dollars using available data. In addition, there are many exemptions that are specific to just one agency. Interagency transactions are also included in this “Other” category. See Appendix 3 for a detailed listing of general exemptions and riders by procurement category.

Exemptions and Riders Associated with Procurement Categories

This chart summarizes the general exemptions and riders associated with the procurement categories identified in this report. General exemptions are transactions that are specifically exempted from the General Services Commission (GSC) authority by statute. This chart does not include all of the exemptions and riders that are specific to individual agencies.

Category	Exemptions From GSC Authority (Section Numbers Are in Parentheses)	75th Legislature General Appropriation Riders (Section Numbers are in Parentheses)
Services	<ul style="list-style-type: none"> • Consulting services (§2155.001) • Professional services and fees (§2155.001) • Library materials and services for higher education and state-owned hospitals and clinics (§2155.139) • Services of an employee of a state agency (§2155.001) 	<ul style="list-style-type: none"> • Establishes a fee schedule for prime-design professional fees (§48) • Specifies type of indemnification requirements that can be included in contracts for professional services (§51) • Places limitations on contracts with previous employees (§52) • Establishes that state agencies contracting for professional services must require the contractor to use Texas products and goods when comparable to market price and availability (§53) • Restricts state agencies from contracting with or issuing a license to a person or facility who has had a license revoked by another state agency (§163)
Supplies and Materials	<ul style="list-style-type: none"> • Library materials and services for higher education and state-owned hospitals and clinics (§2155.139) • Group purchases by two or more state-owned hospitals or clinics (§2155.061) • Care/treatment/education services for wards and clients of the State by Texas Youth Commission (§2155.143) • Items purchased for resale (§2155.141) 	<ul style="list-style-type: none"> • Limits purchases of awards for professional achievement or outstanding service to \$50 per employee (§12) • Restricts payments for postage (§38) • Restricts payments for preparing and distributing publications to certain types (§41) • Disallows expenditures for the purchase, rental, or maintenance of decorative plants (§54) • Restricts purchases of insurance (§61) • Provides guidelines for purchases of postal services (§132)

Category	Exemptions From GSC Authority (Section Numbers Are in Parentheses)	75th Legislature General Appropriation Riders (Section Numbers are in Parentheses)
Capital Outlay	<ul style="list-style-type: none"> • Construction projects by or under the supervision of any public authorities created by the laws of this State or state-aided local government projects of any character whatsoever (§2166.004) • Construction projects undertaken by the Department of Criminal Justice (§2166.003) • Repairs and renovations to buildings excluded by GSC (§2166.004) • Repairs and renovations to building and projects by agencies listed (§2166.003, §2166.004) • Veterans Land Board purchases in connection with improvements to, repairs to, or maintenance of land (§2155.142) 	<ul style="list-style-type: none"> • Limits purchases of vehicles to certain types and certain agencies (§20) • Establishes requirements for installment purchases of certain types of assets (§26) • Establishes an approval system and limitations for purchases of capital items (assets with a project or unit cost over \$25,000) (§42) • Limits expenditures for purchasing, remodeling, or repairing a personal residence or living quarters (§50) • Restricts expenditures for purchases and conversions of alternative-fuel vehicles (§65) • Limits purchases of talking-book machines (§127) • Provides guidelines for purchases of property from the Federal Government (§135) • Encourages participation in Master Lease Program if cost-effective (§159)
Communications and Utilities	<p>Services of public utilities: natural gas, electric, water, sewage and garbage, local telephone services, and other utility services (§2155.001)</p>	<ul style="list-style-type: none"> • Requires use of state telephone system with certain exceptions (§137) • Establishes guidelines for the Capitol Complex Telephone System (§139) • Requires agencies to use the TEX-AN network to the fullest extent possible (§140) • Requires use of state energy resources wherever possible (§143) • Sets guidelines for in-kind gas program (§144) • Requires state agencies to plan for efficient use of telecommunication technologies (§171)
Information Technology	<p>Requires use of catalogue purchasing procedure unless the best value may be obtained from another authorized purchase method (§2157.061 et seq)</p>	<ul style="list-style-type: none"> • Requires agencies to submit a plan for purchases of information technology (§43) • Establishes a review process for major information resources projects (§44) • Requires state agencies to consider energy costs when determining best value (§166)

Category	Exemptions From GSC Authority (Section Numbers Are in Parentheses)	75th Legislature General Appropriation Riders (Section Numbers are in Parentheses)
Rent	<ul style="list-style-type: none"> • Lease payments for district office space for Senate, House of Representatives, and Texas Employment Commission (§2167.001) • Residential space for MHMR and Texas Youth Commission (§2167.001) 	<ul style="list-style-type: none"> • Limits expenditures for leased space (§152) • Encourages participation in Master Lease Program if cost-effective (§159) • Requires use of state facilities for meetings and conferences unless unavailable or inadequate (§162)
Repairs	<ul style="list-style-type: none"> • Veterans Land Board purchases in connection with improvements to, repairs to, or maintenance of land (§2155.142) • Vehicle maintenance and repair: any contract for repair of vehicles made by the Inter-Agency Services Division of GSC (§2171.102) 	Limits expenditures for purchasing, remodeling or repairing a personal residence or living quarters (§50)
Training	Organized activities relating to instructional departments of institutions of higher education and similar activities of other state agencies (§2155.141)	Requests that state agencies coordinate technology training (§156)
Cross-Cutting (apply to more than one category)	<ul style="list-style-type: none"> • Auxiliary enterprises (§2155.141) • Blind-made goods or services offered for sale to state agencies (§2155.138) • Council on Competitive Government contracts (§2162.105) • Gifts or Grants: Industrial and Federal grants in support of research, grants-in-aid payments (§2155.140) • Items required by statute to be purchased from a particular source (§2155.132(e)(2)) • Legislative agency purchases: Senate, House of Representatives, Legislative Council, Legislative Budget Board, Legislative Reference Library, and State Auditor's Office (§2155.203) • Purchases made from gifts or grants, including industrial grants or contracts, in support of research or federal grants or contracts in support of research (§2155.140) • Purchases of products or services of workshops, organizations, or corporations whose primary purpose is training and employing mentally retarded or physically handicapped persons (TIBH set-aside contracts) (§2155.441) 	<ul style="list-style-type: none"> • Limits last-quarter expenditures (§28) • Requires agencies to use the Centralized Master Bidders List (Texas Department of Transportation and higher education agencies are exempt from this requirement) (§56) • Requires prompt payment for interagency goods and services (§78) • Requires agencies to negotiate prompt-payment discounts with vendors (§79) • Encourages agencies to purchase products and services provided by Texans with disabilities (§119) • Establishes guidelines for purchases from Historically Underutilized Businesses (§124) • Requires preference to prison-made goods when equivalent to market (§134)

Individual Agency Audits

Our review of the procurement process at the Departments of Health, Human Services, and Mental Health and Mental Retardation included consideration of procurement policies and procedures, review of a sample of actual transactions, review of previous General Services Commission and Comptroller of Public Accounts audit results, analysis of overall transaction information, and review of staffing.

The review also considered how the management of the agency controls the procurement process and supports and integrates procurement into overall operations. This included consideration of the extent of internal audit reviews, whether management has taken steps to ensure that programs comply with procurement policies and procedures, and whether the agency has taken steps to monitor its overall procurement expenditures and actively make improvements.

Attached are the transmittal letters from these reviews, which summarize the results of the audits. The agencies generally agreed with the recommendations. More detailed information, along with agencies' specific responses, can be obtained from the State Auditor's Office.

This page intentionally left blank.



OFFICE OF THE STATE AUDITOR

TWO COMMODORE PLAZA
206 EAST NINTH STREET, SUITE 1900
AUSTIN, TEXAS 78701

LAWRENCE F. ALWIN, CPA
State Auditor

April 22, 1998

William R. Archer III, MD, Commissioner of Health
Texas Department of Health
1100 West 49th Street
Austin, Texas 78756-7111

Dear Dr. Archer:

The Texas Department of Health (Department) has made some recent improvements to its procurement process, and it has more changes planned and in progress. However, additional opportunities exist for improvements to the management and implementation of this process as well as to the information system used. Although we did not identify any clearly inappropriate or wasteful transactions, we did find some transactions where the Department could not document that it used procedures designed to obtain the best price. We also identified some specific opportunities for savings.

Management needs to clarify the authority, roles, and responsibilities of the program, purchasing, and fiscal functions in the overall procurement process and actively monitor and resolve any major disagreements between these functions. Otherwise, the opportunities to save money that the checks and balances between these functions are intended to create will be overlooked or ignored.

The Department's information system needs improvement:

- Receiving reports should accurately reflect amended purchase orders so they can be used to ensure that all items ordered are received.
- The system for entering blanket orders results in incomplete and/or inaccurate information.
- It is difficult to print purchase orders accurately using the current system.

The Department generally follows its policies and procedures; however, we noted some transactions where this was not the case. Examples include:

- Emergency purchase procedures were overused and possibly misused by one or two programs.
- Purchase order obligations for a federal grant were not liquidated within the required time period.
- Transactions were not properly documented and approved prior to purchase.

Vouchers were not paid on time, violating the Prompt Payment Rider.

SAO Report No. 98-336

William R. Archer III, MD, Commissioner of Health
Texas Department of Health
April 22, 1998
Page 2

A detailed breakdown of these exceptions has been provided to your purchasing manager.

We identified some opportunities for savings:

- We estimate that the Department could save approximately \$252,000 annually if it expands the use of the General Services Commission statewide telephone service (TEX-AN) for long distance, 1-800, and calling-card services.
- Existing contracts for temporary services should be used more consistently. Only 67 percent of the approximately \$1 million spent on temporary clerical and administrative services used existing blanket contracts. Contracting with additional vendors adds administrative costs and may increase rates.

The Department has developed some improvements in its procurement process that are noteworthy:

- The Department has taken one of its largest contracts, which was essentially sole source, and divided it up into smaller contracts to encourage competition. It looks like the new methodology will result in reduced overall costs.
- Some contracts with medical professionals appear to be favorable to the Department.
- Central warehouse inventories are actively managed: inventory consumption is checked twice a year and used to adjust reorder points; inventory records are checked three to four times per year; and variances between actual counts and records are resolved and documented.
- The mailroom has consistently used technology to take advantage of favorable postal rates, process more pieces of mail, and slow the rising cost of processing a piece of mail.

These results will be included in an overall report on purchases subject to local control. The report should be published in June 1998. We appreciate the cooperation and assistance of the Department's management and staff during this project. If we can provide any further information or assistance as you implement these recommendations, please do not hesitate to call.

Sincerely,

Linda Lansdowne, CPA
Project Manager



OFFICE OF THE STATE AUDITOR

TWO COMMODORE PLAZA
206 EAST NINTH STREET, SUITE 1900
AUSTIN, TEXAS 78701

LAWRENCE F. ALWIN, CPA
State Auditor

February 12, 1997

Mr. Eric Bost
Commissioner
Texas Department of Human Services
701 West 51st Street
Austin, Texas 78751

Dear Commissioner Bost:

The Texas Department of Human Services' (Department) procurement process provides reasonable assurance that it purchases the right quantity and quality goods and services at the right time at the right price from capable suppliers. The Department's policies and procedures follow General Services Commission (Commission) rules and also include adequate guidelines for purchases subject to agency control.

The Department generally does a good job of following these policies and procedures. We did note some transactions where this was not the case, but these exceptions represent only a relatively minor portion of the transactions and dollars tested. The Department had already taken some steps to address the problem of improperly approved transactions prior to our audit. A detailed breakdown of these exceptions has been provided to your purchasing manager.

We also identified some opportunities for savings:

- We estimate that the Department could save from \$370,000 to \$700,000 annually if it expands the use of TEX-AN for long distance calls.
- Consolidation of Department blanket contracts for temporary services could potentially save administrative costs associated with multiple contracts as well as decrease some hourly rates by 4 percent to 21 percent. The Department paid 66 vendors a total of approximately \$3.3 million in fiscal year 1996. We will also suggest to the Commission that a statewide term contract for temporary services should be considered.
- Entering information on surplus property in existing State Property Accounting (SPA) system data fields would allow regional offices to review surplus inventory held by other regions prior to purchasing new items. This should result in reduced purchases of new items and a decrease in surplus.

We also noted some policies and procedures developed by the Department to improve its procurement process that are noteworthy. Examples include:

- Service contract vendors are asked to include escalation clauses in their bids and are evaluated based upon the overall contract cost.
-

SAO Report No.98-314

Mr. Eric Bost
Commissioner
Texas Department of Human Services
February 12, 1998
Page 2

- The contract for computer repair and maintenance services is monitored and results are reviewed with the vendor.
- Information technology purchases are centralized to take advantage of Department of Information Resources and internal blanket contracts.
- Supplies are centrally ordered to obtain lower prices and control quantities but drop-shipped directly to the regions to minimize warehouse and transportation costs.

These results will be included in an overall report on purchases subject to local control. The report should be published in March 1998. We appreciate the cooperation and assistance of the Department's management and staff during this project. If we can provide any further information or assistance as you implement these recommendations, please do not hesitate to call me at 479-4700.

Sincerely,

Linda Lansdowne, CPA
Project Manager



OFFICE OF THE STATE AUDITOR

TWO COMMODORE PLAZA
206 EAST NINTH STREET, SUITE 1900
AUSTIN, TEXAS 78701

LAWRENCE F. ALWIN, CPA
State Auditor

April 6, 1998

Mr. Don Gilbert, Commissioner
Department of Mental Health and Mental Retardation
909 West 45th Street
Austin, TX 78711-2668

Dear Mr. Gilbert:

The Department of Mental Health and Mental Retardation (Department) has made some recent improvements to its procurement process, and additional improvements are underway. In general, this process provides reasonable assurance that the Department purchases the right quantity and quality goods and services for the right price at the right time from capable suppliers for the areas covered in this audit. However, additional changes to the Department's management and implementation of its procurement process are needed. We also identified some potential cost savings.

The Department may be able to reduce its procurement costs by modifying its decentralized approach to procurement. This decentralization has resulted in numerous small dollar purchases that require a large number of procurement staff members to process. Expansion and consolidation of blanket contracts and use of petty cash or credit cards for smaller purchases should reduce the number of transactions and eventually allow for a reduction in the number of procurement staff members. The Department has already used this approach on its purchases of food and pharmaceuticals with good results. Ongoing analyses of expenditures should help identify additional opportunities for savings.

The Department's recently revised policies and procedures manual (New Internal Policies and Procedures on Materials Management), which went into effect April 16, 1997, is comprehensive and corrects problems already identified in the procurement process. While the overall process now appears to be well-designed, we identified opportunities for additional improvements:

- Policies are needed for the personal use of cell phones and long-distance phone service.
- All modules associated with the Automated Purchasing and Inventory Control System (APICS) need to be completed. The appropriate data needs to be entered into the database.

Although policies and procedures were generally followed, compliance could be improved. The Department's Internal Audit Office, the General Services Commission, and this audit all found examples of noncompliance. Our review indicated that compliance with policies and procedures over contracting for the purchases of service and the use of vehicles could be improved. To improve overall compliance, the Department should consider increasing regular communications between the Central Office and facility purchasers, business managers, and/or budget personnel

SAO Report No. 98-327

Mr. Don Gilbert, Commissioner
Department of Mental Health and Mental Retardation
April 6, 1998
Page 2

(and possibly other health and human services agencies) about current procurement practices and needed improvements through meetings, conference calls, and/or newsletters.

This audit also identified opportunities for cost savings:

- We estimate the Department could save between 1 percent and 75 percent on its current long distance rates by increasing its use of TEX-AN (Texas state government's long distance service).
- Decisions to purchase vehicles should be based on a comprehensive cost analysis that considers available alternatives, such as (1) reimbursing employees for the use of their own vehicles and (2) telecommunications technologies that would permit employees to teleconference.

There were several instances of noteworthy purchasing practices used by the Department, both at the Central Office and the facilities. These practices should result in more efficient purchases, reduced administrative costs, and increased vendor accountability.

- The Department's Office of Internal Audit has reviewed the procurement process and identified improvements. The State Auditor's Office was able to rely on the work of Department internal auditors and reduce the scope of its own work on this audit.
- Inventories decreased significantly in fiscal year 1997 because of the implementation of new blanket contracts for food and a buying group prime vendor contract for pharmaceuticals.
- One facility contained costs by negotiating a 12 percent discount with a community hospital for outpatient surgery.
- The selection of architects and engineers is strengthened by the use of forms submitted by professionals interested in working on state projects. The forms provide useful information on applicants' staff, work experience, and financial details.
- The Department includes the long-term costs of contracts, including renewal options as well as the initial cost of the contract, when evaluating contractors. This should reduce the administrative costs associated with rebidding the contract.

Mr. Don Gilbert, Commissioner
Department of Mental Health and Mental Retardation
April 6, 1998
Page 3

These results will be included in an overall report on purchases subject to local control. The report should be published in May 1998. We appreciate the cooperation and assistance of the Department's management and staff during this project. If we can provide any additional information or assistance as you implement these recommendations, please do not hesitate to call.

Sincerely,

Linda Lansdowne, CPA
Project Manager

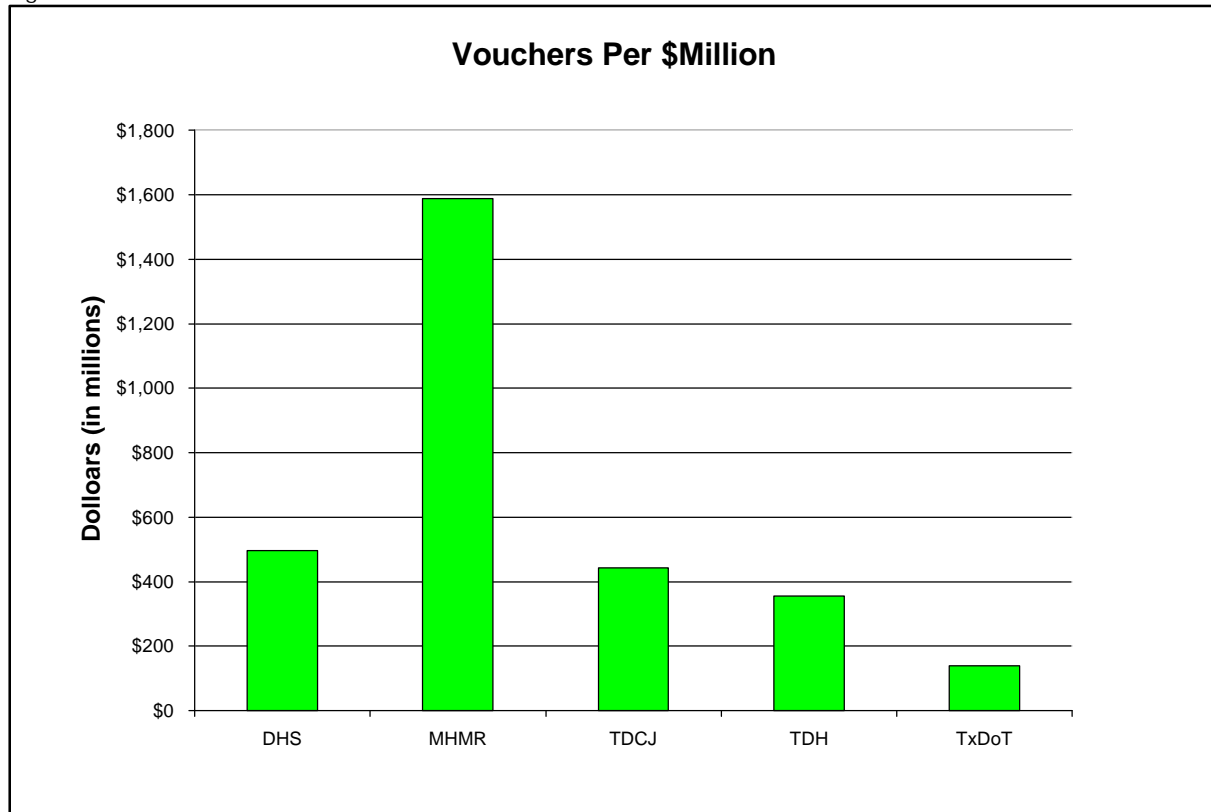
Analysis of Vouchers and Vendors for Five Largest Purchasers of Supplies and Materials

The purchasing patterns of the top five purchasers of supplies and materials were analyzed for fiscal year 1996. (It was not possible to complete this analysis for all agencies and all procurement categories because of the number of vouchers involved.) Procedures and results were as follows:

- Determine the number of vouchers processed per million dollars spent on supplies and materials (see Figure 14).

MHMR had over three times as many vouchers per million as DHS, which was the next highest.

Figure 14

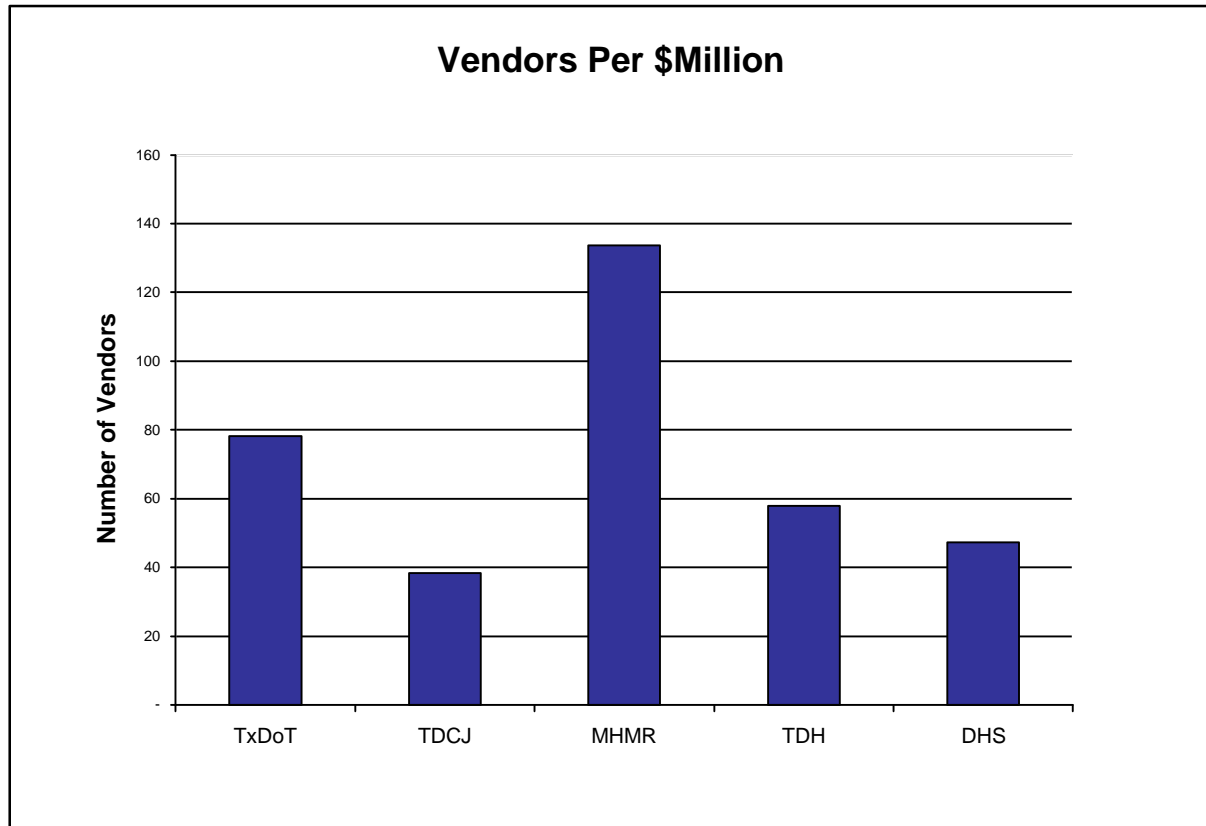


DHS - Department of Human Services
MHMR - Mental Health and Mental Retardation
TDCJ - Texas Department of Criminal Justice

TDH - Texas Department of Health
TxDOT - Texas Department of Transportation

- Determine how many vendors are used to purchase one million dollars of goods or services. A low number indicates the agency is consolidating its purchases. A high number indicates that it is not (see Figure 15).

Figure 15



DHS - Department of Human Services
 MHMR - Mental Health and Mental Retardation
 TDCJ - Texas Department of Criminal Justice

TDH - Texas Department of Health
 TxDOT - Texas Department of Transportation

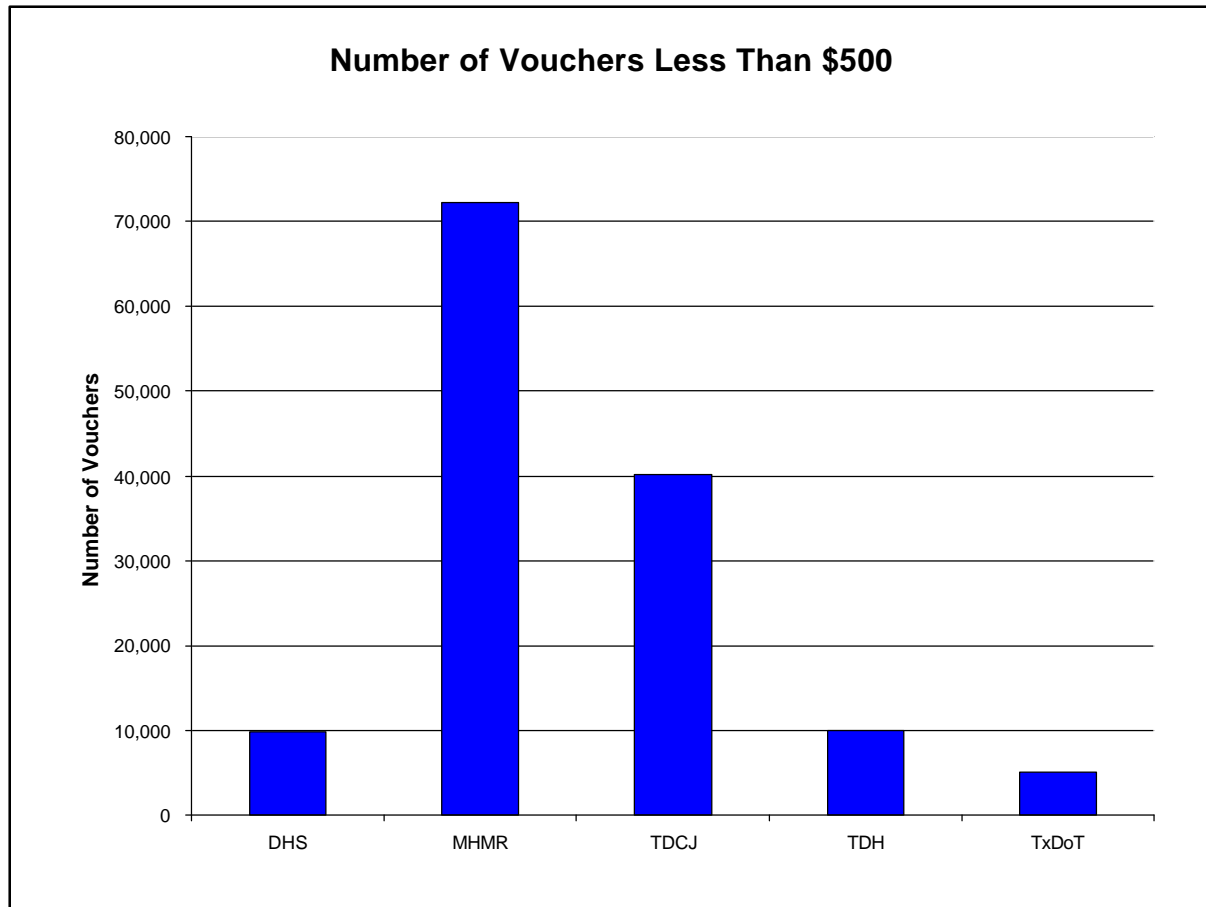
MHMR had the most vendors per million dollars spent, however, the difference between it and the other agencies was not as high as it was for the number of vouchers per million dollars spent. This suggests that it could reduce the number of vouchers by grouping payments to the same vendor.

- Determine the number of vouchers issued for less than \$500. The Department of Health estimates that it costs approximately \$168 to process a procurement transaction through voucher payment. This means small-dollar transactions can be very expensive to administer (see Figure 16).

MHMR and TDCJ had the highest number of vouchers for less than \$500.

- Group the existing blanket contracts by vendor. If the agency has more than one blanket contract with the same vendor, see if they can be consolidated.

Figure 16



DHS - Department of Human Services
 MHMR - Mental Health and Mental Retardation
 TDCJ - Texas Department of Criminal Justice

TDH - Texas Department of Health
 TxDOT - Texas Department of Transportation

- Group the existing blanket contracts by type of item. If the agency has several blanket contracts for the same item, see if they can be consolidated and re-bid. However, in some cases, an agency may need to use multiple vendors for the same contract to ensure availability. This is true of pharmaceuticals, for example.
- Compare the existing blanket contracts with the actual purchases. Determine why blanket contracts were not developed for all substantial purchases. Determine why blanket contracts were not used when they were available.

MHMR, in response to audit recommendations related to its number of vouchers and vendors, plans to review its use of blanket contracts, its use of credit cards and petty cash for small dollar transactions, and how invoices are grouped for payment.

TDH has reviewed its use of temporary services contracts to determine why some programs did not use the existing blanket contracts.

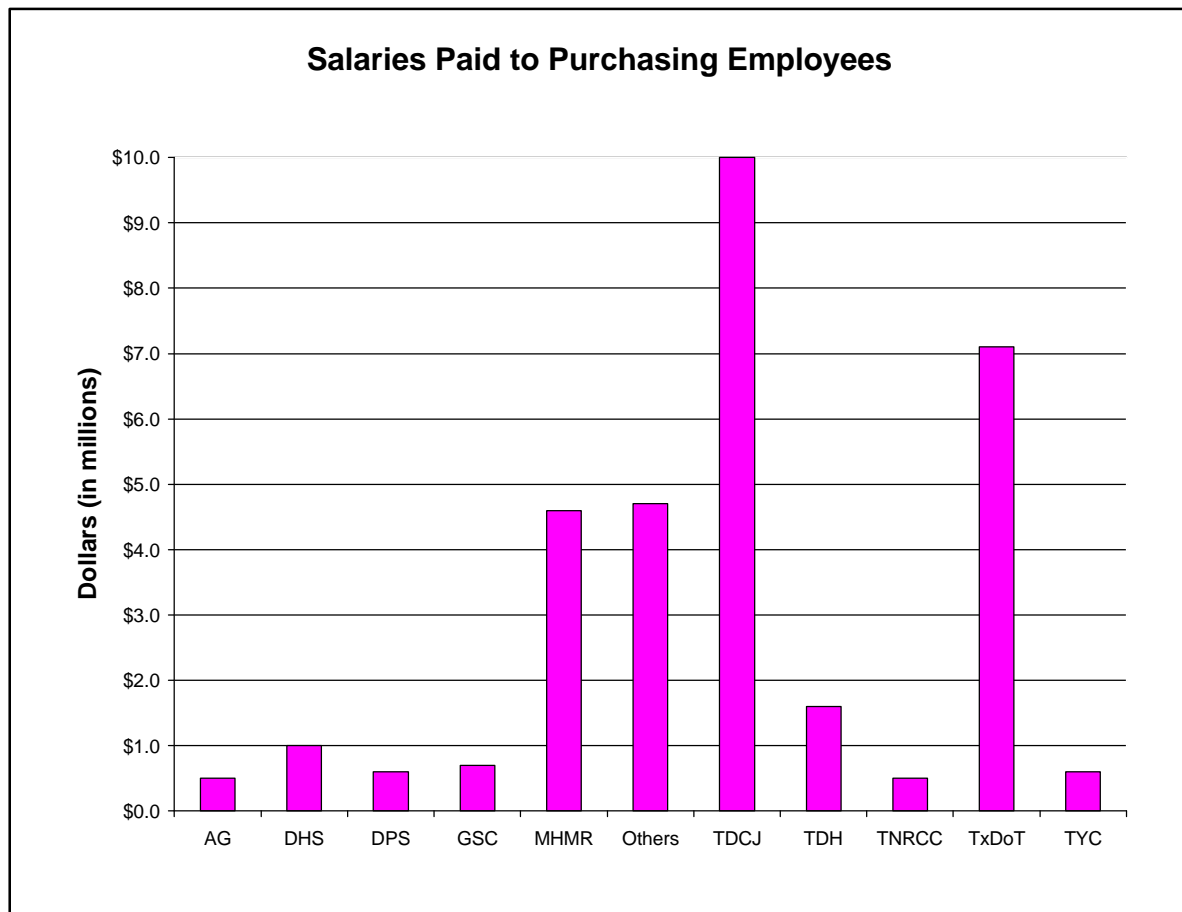
Analysis of Staffing for Ten Agencies With Highest Total Procurement Salaries

The staffing pattern of the ten agencies with the highest total procurement salaries in the State was analyzed. Procedures and results were as follows:

- Verify the staffing of the procurement function and where it falls in the organizational chart. Individual agencies had a wide variety of employment.

Individual agencies had a wide variety of employment patterns, both in terms of procurement employees and in the mix of positions staffed. The number of employees ranged from 0 to 437. The average per-employee salary ranged from \$16,044 to \$36,108 per year. Those agencies with lower average salaries typically used more purchasing clerks and fewer purchasers. The top ten agencies paid the following total salaries to employees classified in procurement-related positions:

Figure 17



AG - Office of the Attorney General
 DHS - Department of Human Services
 DPS - Department of Public Safety
 GSC - General Services Commission
 MHMR - Mental Health and Mental Retardation

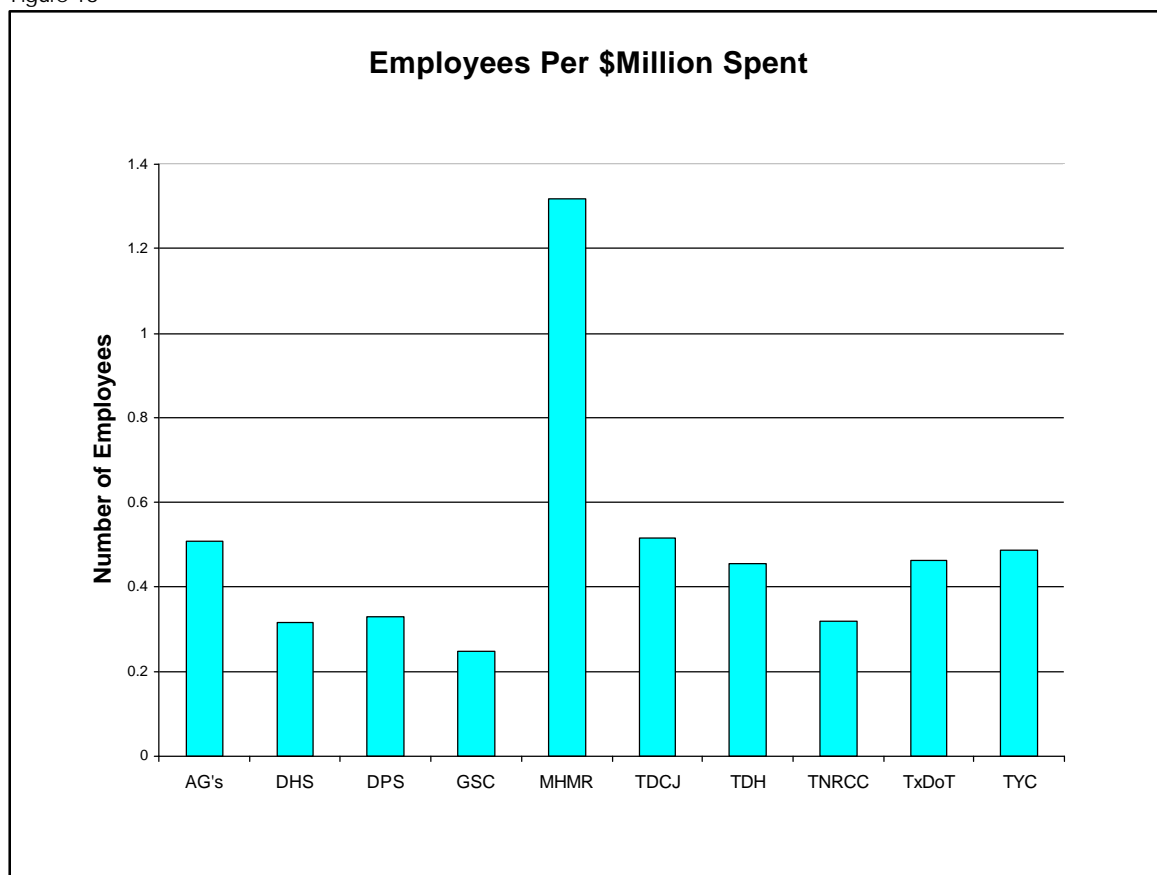
TDCJ - Texas Department of Criminal Justice
 TDH - Texas Department of Health
 TNRCC - Texas Natural Resource Conservation Commission
 TxDoT - Texas Department of Transportation
 TYC - Texas Youth Commission

Some of the agencies said that not all of the included employees (see Figure 9) were 100 percent involved in procurement-related activities based upon their position in the organization. Conversely, there were probably some employees involved in procurement that were not included. For example, some agencies may classify the head of their procurement department as a program director rather than a purchaser. MHMR is planning a classification review of its procurement personnel.

- Determine the if the number of employees is reasonable based on what is purchased.

As a first approximation of this analysis, the number of employees required to purchase \$1 million of procurement expenditures was calculated (see Figure 18) for the ten agencies with the highest total procurement salaries (see Figure 17).

Figure 18



AG - Office of the Attorney General
 DHS - Department of Human Services
 DPS - Department of Public Safety
 GSC - General Services Commission
 MHMR - Mental Health and Mental Retardation

TDCJ - Texas Department of Criminal Justice
 TDH - Texas Department of Health
 TNRCC - Texas Natural Resource Conservation Commission
 TxDoT - Texas Department of Transportation
 TYC - Texas Youth Commission

Note: Public assistance and intergovernmental expenditures have been excluded from this calculation under the assumption that the employees processing those transactions would most likely be classified as grant and contract specialists and not purchasers.

As can be seen from this graph, the agencies with the highest salaries did not necessarily have the most employees per million dollars spent. It might also be useful to calculate this ratio by procurement categories. The number and type of employees needed to purchase highly technical items is different than needed to purchase office supplies.

- Determine how many transactions each employee is handling. The number of vouchers processed and the number of vendors paid can be used to determine the answer to this question. (See section 3-B-1 "Review Purchasing Patterns for Opportunities to Reduce Transactions and Costs") If this number is fairly reasonable but the number of employees is still high compared to other similar agencies, the agency may need to consider if it is possible to reduce the number of transactions.

For example, in the case of MHMR, the analysis indicates that it was high in staffing (Figure 18), in transactions (Figure 14), and in "Number of Vouchers Less than \$500" (Figure 16). This indicates that the agency will have to determine the cause of the excess transactions prior to reducing staffing.

This page intentionally left blank.