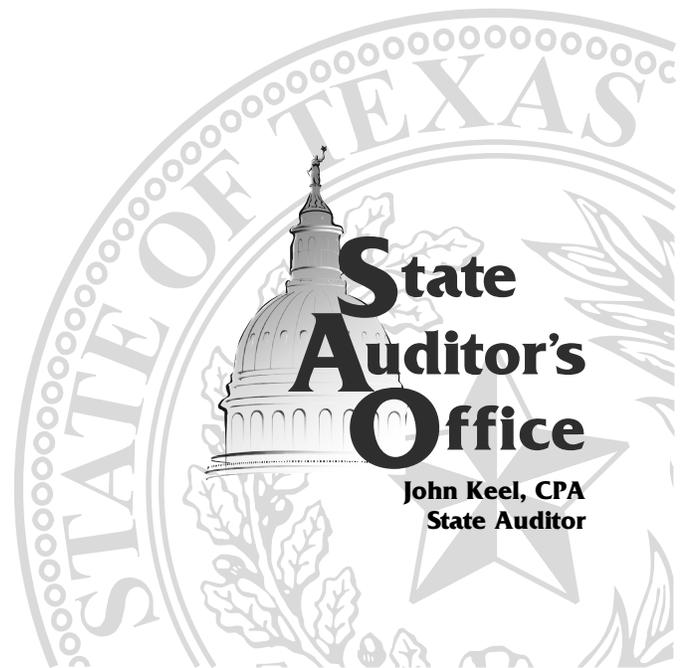


An Audit of

Selected Agencies' Compliance with Contract Workforce Requirements

December 2004

Report No. 05-014



Selected Agencies' Compliance with Contract Workforce Requirements

Overall Conclusion

Although none of the three agencies we audited was in complete compliance with the contract workforce requirements contained in a rider in the General Appropriations Act, each of the agencies had implemented some of the requirements. Each agency had developed a process for compliance, but improvements are needed to ensure that the intent of the rider requirements is addressed. The rider was designed to minimize the State's financial and legal risks (see text box).

We also audited selected workforce contracts at the three agencies to determine how effectively each agency was managing its contracts. The Texas Youth Commission and the Texas Workers' Compensation Commission were managing their workforce contracts effectively. However, we noted problems in the management of contracts at the Texas Workforce Commission. Effective contract management includes ensuring that contracts are well planned, are fairly procured, include necessary provisions, and are adequately monitored.

Also, self-reported fiscal year 2000 and 2003 contract workforce information that we tested in 2001 and 2004 may not be sufficiently accurate for it to be relied upon. The State Auditor's Office has been collecting this information from agencies and institutions of higher education since 2000.

We also noted that, during the last few years, many of the General Appropriations Act contract workforce requirements have been incorporated in other agency and institution of higher education reporting requirements. For example, the rider requires that agencies and institutions of higher education document how the use of contract workers fits with their missions, but the Texas Government Code now requires agencies and institutions of higher education to include staffing plans in their biennial strategic plans.

Our tests were designed to determine whether the three agencies we audited complied with the rider requirements associated with workforce contracts and whether they had good contracting processes in place for these contracts.

Background Information

The General Appropriations Act (GAA) requires agencies and institutions of higher education to report on how they complied with the requirements in the contract workforce rider (GAA, 78th Legislature, Article IX, Section 4.07, page IX-26). Agencies and institutions of higher education report on whether they have:

- Developed comprehensive policies and procedures
- Examined relevant legal and personnel issues
- Conducted cost-benefit analyses
- Documented how contract workers fit into their staffing strategies

In addition, they report on how many workforce contracts they have completed.

The text of the rider can be found in Appendix 2.



This audit was conducted in accordance with the General Appropriations Act (78th Legislature), Section 4.07, page IX-26.

For more information regarding this report, please contact Sandra Vice, Audit Manager, or John Keel, State Auditor, at (512) 936-9500.

Summary of Information Technology Review

We tested to ensure that contract workforce data that the three agencies we audited had transmitted electronically to the State Auditor's Office was received without error, but we did not test any information systems.

Detailed Results

Chapter 1

Agencies' Compliance with Contract Workforce Requirements Is Inconsistent

None of the three agencies we audited was in complete compliance with the contract workforce rider in the General Appropriations Act (78th Legislature, page IX-26; see Appendix 2). The rider instructs agencies and institutions of higher education to follow certain requirements when they contract with outside companies and individuals to perform activities that could otherwise be done by state employees. The requirements were designed to help ensure that the decision to contract makes economic sense and that the State's exposure to legal and financial risk is minimized. Table 1 identifies the areas in which the three agencies—the Texas Workforce Commission (TWC), the Texas Youth Commission (TYC), and the Texas Workers' Compensation Commission (TWCC)—did or did not comply with the requirements of the rider.

None of the three agencies reported its performance accurately. TWC and TYC reported that they had complied with all requirements. TWCC reported that it had not documented how contract workers fit into its staffing strategies and did not conduct cost-benefit analyses before amending contracts. See Table 1 for the actual results.

Table 1: Selected agencies' compliance with contract workforce requirements

The Rider Requires Agencies and Institutions of Higher Education to:	Results from Audited Contracts		
	Texas Workforce Commission (TWC)	Texas Youth Commission (TYC)	Texas Workers' Compensation Commission (TWCC)
Have comprehensive policies and procedures	Yes	Yes	No TWCC lacked procedures for reviewing legal and personnel issues and for incorporating staffing strategies.
Examine legal and personnel issues related to the use of a contract workforce	No TWC's review of amendments could not be substantiated.	Yes	Yes
Conduct a cost-benefit analysis prior to hiring additional workers, amending contracts, and renewing contracts.	No TWC had a process for documenting its cost-benefit analyses, but it did not actually require such analyses to be done.	No TYC did not perform cost-benefit analyses for the two contracts we audited until the contracts were in place. These analyses showed that TYC made good economic decisions in both cases.	No TWCC did not normally perform cost-benefit analyses on contract amendments.
Document why and how contract workers fit into staffing strategies	Yes	Yes	No TWCC's staffing strategy was not complete before money was spent on workforce contracts.
Number of total workforce contracts (self-reported/actual per testing)	187 / 182	297 / 301	11 / 11

Recommendation

TWC, TYC, and TWCC should implement good contract management procedures related to their workforce contracts. This should include an assessment of whether contracting for a function is a good economic decision. Agencies can consult the *State of Texas Contract Management Guide* at <http://tbpc.state.tx.us/stpurch/contractguide.html>.

Management's Response from the Texas Workforce Commission

TWC agrees that good contract management is critical to protecting the financial interests of the State and generating results that support the economic decision to contract. While the Agency has established contract management procedures that include cost-benefit analyses and review of legal and personnel issues in workforce contracts, it recognizes the need to improve its contract workforce contracting practices.

Specifically, TWC agrees that it needed to more clearly document cost-benefit analyses on workforce contracts for its journal publication and temporary services where the cost-benefit was historically known and cost-benefit criteria had not changed significantly. TWC agrees that even when the cost-benefit is historically known, it is still necessary to analyze and document at what point contracted costs outweigh contracted benefits.

- *TWC had analyzed cost and benefits in its initial decision to outsource publishing of its journal publication, but will update and document its analysis for the current contract.*
- *TWC's need for temporary workers centers primarily on its need for additional data entry staff during TWC's quarterly tax "rush." Because this need is seasonal and to ensure TWC is in compliance with State and federal 3-day deposit requirements, TWC needs approximately sixty-four temporary employees to process the quarterly tax returns and UI tax payments primarily for a 6-7 day period. To hire the number of staff needed during rush full time would not be prudent or justifiable. In the future, TWC will document each quarter the cost-benefit of hiring temporary staff quarterly versus the cost of hiring full-time employees.*
- *TWC reviewed the legal and personnel issues associated with using a contract workforce in its implementation of contract workforce rider requirements. TWC continuously reviews personnel issues annually through its staffing strategies, information technology project planning, and contract workforce contract renewals. Legal staff regularly reviews TWC contract workforce solicitations and contracts for special terms and conditions, compliance with contract workforce restrictions regarding former employees, contract formation, special remedies or other issues as identified. Legal does depend on staffs involved in procurement planning to identify special issues associated with a given contract, so a legal issue could be overlooked even though the solicitation or contract received a legal review.*

Effective immediately, TWC is revising its contract workforce cost-benefit worksheet instructions to clarify cost-benefit analyses and legal review needed to ensure that procuring contract workers is a good economic decision.

Management's Response from the Texas Youth Commission

We concur with the recommendations in the report. The Commission has in place policies and procedures for managing its contracts, including the performance of cost-benefit analyses prior to creating or amending contracts and the examination of legal and personnel issues. With the assistance of this audit and recent publications of the Texas Building and Procurement Commission and the Senate Finance Subcommittee, the agency is reviewing every aspect of its processes to strengthen contract management. The Commission expects to comply fully with contract workforce requirements.

Management's Response from the Texas Workers' Compensation Commission

The TWCC agrees with the issue and the recommendation concerning implementing good contract management procedures. Although the Commission has procedures related to contract management and contract workforce, it is always seeking ways to improve and enhance agency processes and plans to initiate changes.

The TWCC recently revised its Procurement Procedure, TWCC Procedure 16-01, which incorporated provisions of the State of Texas Contract Management Guide. This revision is currently being coordinated within the agency and is expected to be approved by December 31, 2004. The agency believes that the revised procedures, upon implementation, will improve the contract management within the agency for all contracts, including those related to the use of contract workforce resources.

In addition, the agency has an existing procedure, TWCC Procedure 16-03, Requesting Temporary/Contract Workers, that specifically addresses agency procedures for requesting temporary and contract workers. This procedure will be revised to better fulfill the requirements of the contract workforce rider contained in the General Appropriations Act. More specifically, the revision will document our procedures for examining legal and personnel issues related to the use of contract workforce; place emphasis on documenting why and how the use of contract workers fit into agency staffing strategies; and will place emphasis on performing cost benefit analyses prior to amending, renewing or extending contracts. The expected completion date of this revision is January 31, 2005.

Upon finalization of both procedures, necessary training and instruction will be provided to agency staff regarding the implementation of the revised procedures. The TWCC Director of Support Services will be responsible for revising both the above-mentioned procedures and for implementing corrective actions.

Some Agencies Managed Workforce Contracts Better than Others

TYC and TWCC made good decisions about the workforce contracts that we tested, but TWC did not. Because the contract workforce requirements are additional requirements and do not replace agencies' responsibility to properly manage contracts, we also tested to determine whether agencies' workforce contracts were being managed well, regardless of the agencies' compliance with the rider.

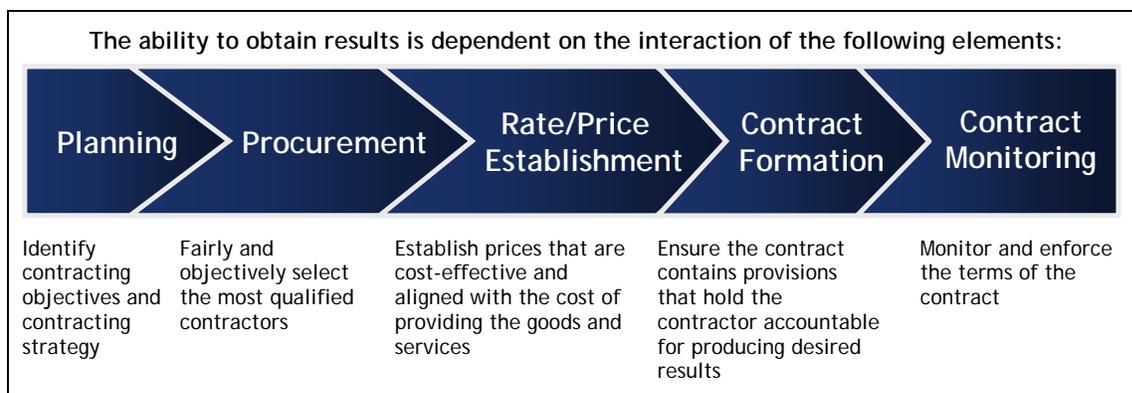
Our tests of workforce contracts in each agency focused on contracts that we considered to be high risk for one of the following reasons:

- The contract represented a large proportion of the contract workforce expenditures for the agency.
- The contract was for a relatively small dollar amount but was one of several similar contracts that, taken together, constituted a large proportion of the contract workforce expenditures for the agency.

For each of the selected contracts, we determined whether the agency's process included essential contract management elements (see Figure 1). This includes determining whether:

- The decision to contract was supported and documented.
- The procurement was fair (including whether the evaluation criteria were appropriate and whether those criteria were used and tabulated accurately).
- The rate paid was the contracted rate.
- The contract contained appropriate terms.
- The agreed-upon services were received.
- The contract was appropriately monitored.

Figure 1: Five Contract Management Elements



Source: *State of Texas Contract Management Guide* - Version 1.1, page 5

TWC Did Not Manage Its Workforce Contracts Well

TWC had significant weaknesses in its management of two of the three workforce contracts we audited. (Those two contracts totaled \$800,000). We identified problems with planning, procurement, contract terms, payment methodologies, and oversight of these two contracts. The problems we identified are described in Table 2 below.

The third contract, for translator services, was managed well. For this contract, any translator who met criteria set by an objective third party was eligible to provide services and was paid based on rates set by the courts. TWC also had a good system to make sure that translators were paid for the hours that they worked and that feedback was considered when determining whether to rehire translators.

Table 2: Problems identified in two contracts at TWC

	Temporary Services Contract	Journal Publication Contract
Contract Amount (rounded)	\$500,000 (spent \$330,000 as of October 31, 2004)	\$300,000
Planning	TWC did not adequately identify its needs before the request for proposal (RFP) process.	No findings
Procurement	The RFPs required that the bill rate be limited to 125 percent of the direct labor rate. At least one bidder chose not to submit a bid for this reason. TWC did not hold bidders to this requirement.	No findings
Rate/Price Establishment	The rates TWC used to pay contract workers were not the rates specified in the contract. Because the service categories billed were not those approved in the contract, there is no way to determine whether TWC paid the right amount to the temporary services contractor. Of the 503 weekly timesheets that the vendor submitted in fiscal year 2003 for the contract that began March 1, 2003, 462 (92 percent) could not be matched to approved rates for job classifications reasonably associated with the service description provided by the vendor. As a result, TWC may have paid the vendor more than necessary.	The contract was unclear as to payment methodology, making it difficult to determine whether TWC received the services it contracted for at the contracted price. For example, the contract asked for the "costs" to print and distribute the journal, but the vendors billed the agency for the agreed price rather than the cost. Also, the contract allowed the vendor to collect revenue and subtract the amount it collected from the amount it billed TWC. As a result, these revenues were not recognized in accordance with generally accepted accounting principles.
Contract Formation	Amendments to the contract significantly changed the rates and the terms from what the vendor originally bid. Also, the contract was informally amended when users instructed the vendor not to follow the billing processes described in the contract. Because the vendor followed the users' instructions instead of the contract terms, there was less control over the amounts paid for different job categories.	Ownership of intellectual property was not specified. The contract allows the vendor to sell the content of the journal to Oklahoma's Department of Human Services to publish under that agency's own cover. Because the ownership of the content is not addressed in the contract, there is no way to know whether it would be acceptable for the vendor to sell the content to others.
Contract Oversight	TWC had not monitored the contract for appropriateness of rates paid or job categories used. No contract manager had responsibility for ensuring that the contractor complied with the terms of the contract.	TWC's contract monitoring consisted primarily of making sure that the vendors did not receive more money than was specified in the contract. TWC did not review the publication's content before it was published.

Recommendation

TWC should manage its contracts in accordance with its own policies and procedures and in accordance with the new *State of Texas Contract Management Guide*.

Management's Response

TWC believes it generally manages its contracts in accordance with our own policies and procedures and in accordance with the new State of Texas Contract Management Guide. TWC agrees, however, that it should improve its contract oversight in its journal publication contract; and, that the temporary services contract, developed as a contract exception to TWC's procurement, contracting and payment procedures, could have been better planned and managed.

- *TWC agrees that better planning would have avoided the need to amend the temporary services contract 2 months after contract start. The action taken to add classifications, noted under Contract Formation in Table 2, however, was permitted under the terms of the contract.*
- *TWC regrets that one vendor chose not to respond to TWC's bid based on the bill rate cap of 125%. A total of ten vendors did choose to respond. While SAO and TWC interpreted the bill rate cap differently, TWC applied its method of calculation to all responses and a separate cost criteria formed the basis of a bidder's cost score.*
- *TWC agrees that contract controls and contract oversight could have been stronger. TWC established a unique receiving process for this contract due to the number of small, recurring purchases made through two primary users of temporary services. In an effort to expedite service delivery, TWC established the contract control at the point of payment, allowing receiving documents to confirm the purchase and process the payment, without processing through the procurement office or the contract manager.*

Upon discovery of rate establishment and oversight inconsistencies, TWC immediately revised procedures for procuring temporary services. Temporary services contracts are now managed through TWC's procurement office and controls to procure, receive and pay are consistent with other TWC contracted services and the Texas Contract Management Guide. With state contracts for temporary services in greater use, this contract continues to decrease in use. TWC estimates it will expend less than \$50,000 through this contract in FY 2005 and believes the contract's risks relative to its scope have been controlled.

- *TWC will reevaluate its journal publication contract terms and conditions. Necessary steps will be taken to revise procedures and ensure staff is knowledgeable with regard to the contract terms. TWC established standard terms for product ownership in its contracts, effective 11/05/04.*
- *TWC has added the State of Texas Contract Management Guide to its staff manuals on TWC's Intranet site and will communicate the resource to staff engaged in all aspects of contract management.*

TYC Adequately Managed the Contracts We Audited

Overall, TYC adequately managed the two contracts (one for food services and one for psychiatrist services) that we audited. In each case, the procurement process reliably selected qualified contractors, and contractors were paid the rates specified in the contracts. In addition, TYC has a process to oversee the quantity and the quality of the services received. For example, one of the contract files included a detailed memorandum of understanding between several TYC departments that described the specific oversight requirements of different groups at the agency so that individuals were responsible for only their areas of expertise.

For both of the contracts we audited, TYC's staff had performed cost-benefit analyses after the contracts were in effect. Both of these analyses showed that, although TYC did not document its decision to contract, the decisions to contract were cost-effective.

Recommendation

TYC should comply with the requirements of the General Appropriations Act contract workforce rider by performing cost-benefit analyses before a contract is awarded.

Management's Response

We concur with the recommendations in the report. The Commission expects to comply fully with contract workforce requirements.

TWCC Adequately Managed the Contract We Audited

Although TWCC did not adhere to some of the requirements specified in the General Appropriations Act for workforce contracts, it managed its contract for its business process improvement program well.

TWCC's vendor selection process was designed to objectively select the most qualified contractor using reasonable evaluation criteria. A team that included appropriate representatives from TWCC managed the contract, and an executive steering committee actively provided input. After TWCC awarded the contract, it used a number of different project management tools to monitor progress on deliverables, payments, and specifications. TWCC also tested deliverables before accepting them and did not pay the vendor until the deliverables were accepted.

Appendices

Appendix 1

Objectives, Scope, and Methodology

Objectives

Our objectives were to:

- Review contract workforce information submitted annually by agencies.
- Perform a risk assessment based on this information and verify accuracy of self-reported data at selected agencies.

For the selected agencies, we also performed other tests on selected contracts to determine whether the contracts were managed well.

Scope

We tested contracts that were in effect during fiscal year 2003. If there were contracts that were renewed or amended in fiscal year 2003, we also included the original procurement process and contract terms in our scope. We limited our testing to payments made from the 25 Uniform Statewide Accounting System (USAS) object codes associated with contract workforces.

Statute requires the State Auditor's Office to participate on the Quality Assurance Team (QAT), which monitors major information resource projects. Our involvement in the QAT could affect the appearance of independence in the reporting of results related to the business process improvement contract that we audited at the Texas Workers Compensation Commission. We considered this issue in relation to the size and risk of this contract and decided that both were significant enough to warrant including the contract in our audit.

With the exception of this potential effect on our independence, we conducted this audit in accordance with generally accepted government auditing standards. Our involvement in the QAT did not affect our audit conclusions.

Methodology

We selected three agencies—the Texas Workforce Commission (TWC), the Texas Youth Commission (TYC), and the Texas Workers' Compensation Commission (TWCC)—based on risk factors that included the dollars that were associated with the contract workforce object codes, other recent audit work, and self-reported compliance. At each of these three agencies, we selected contracts that were either large contracts (the temporary services contract and the journal contract at TWC, the food services contract at TYC, and the business process improvement contract TWCC) or that were smaller contracts that represented a class of contracts that was significant when individual contracts were combined (the translator contract at TWC and the psychiatrist contract at TYC.)

In each case, we tested the accuracy of the agency's report on its own compliance with contract workforce requirements. We recalculated the number of contracts that should have been reported and reviewed support for the agency's assertion of compliance with each area of the General Appropriations Act contract workforce rider as it related to the specific contracts we selected.

In addition, we compared the management of these contracts to standard best practices in contracting, as developed by the State Auditor's Office in classes taught to agencies since 1999. Many of these best practices have since been published in the *State of Texas Contract Management Guide*.

Project Information

We conducted fieldwork from March 2004 through August 2004. This audit was conducted in accordance with generally accepted government auditing standards, except as noted above. The following members of the State Auditor's staff performed this audit:

- Rachel Cohen, CPA (Project Manager)
- Jose Saucedo, CPA, CISA (Assistant Project Manager)
- Manijeh Azmoodeh
- Beverly Bavousett, CPA
- Jennifer Lehman, MBA
- Dennis Ray Bushnell, CPA (Quality Control Reviewer)
- Sandra Vice, CIA, CGAP (Audit Manager)

Contract Workforce Rider

(General Appropriations Act, 78th Legislature, Page IX-26, Section 4.07)

Sec. 4.07. Contract Workforce.

(a) In this section, contract workers are defined as independent contractors, temporary workers supplied by staffing companies, contract company workers, and consultants.

(b) No appropriated funds may be expended for payment of a contract workforce in which the contract is executed, amended, or renewed on or after September 1, 2003, until an agency or institution:

- (1) develops and documents comprehensive policies and procedures for its contract workforce;
- (2) examines and documents the legal and personnel issues related to the use of a contract workforce;
- (3) conducts and documents a cost benefit analysis of its current contract workforce prior to hiring additional contract workers or amending or renewing existing contracts; and
- (4) documents why and how the use of contract workers fit into agency staffing strategies, including consideration of agency mission, goals and objectives, existing and future employee skills needed, compensation costs, productivity, nature of services to be provided, and workload.

Agencies shall consult the *Best Practices and Guidelines for Effectively Using a Contract Workforce* (SAO Report No. 99-326) when planning for and implementing the requirements of this section.

(c) No later than December 1 of each year of the biennium, an agency shall file with the Legislative Budget Board, the Governor, and the State Auditor a report on the agency's use of a contract workforce in the preceding fiscal year. The report shall be prepared according to a format prescribed by the State Auditor and shall include:

- (1) a description of how the agency has complied with provisions of this rider; and
- (2) an evaluation of the work performed by a contract workforce, including an assessment of whether work was completed on time, within budget, and according to contract specifications.

(d) The State Auditor shall notify the Comptroller and the Legislative Audit Committee if an agency fails to comply with this section.

(e) The State Auditor may require an agency to provide interim reports or additional information as necessary to ensure compliance with this section. The State Auditor may review each agency's report and follow up based on identified risks.

Copies of this report have been distributed to the following:

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The Honorable Thomas “Tommy” Williams, Member, Texas Senate
The Honorable Jim Pitts, House Appropriations Committee
The Honorable Brian McCall, House Ways and Means Committee

Office of the Governor

The Honorable Rick Perry, Governor

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Mr. Edward J. Sanchez, Commissioner
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Mr. Robert L. Shipe, Executive Director

Texas Workforce Commission

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Mr. Ronald Congleton, Commissioner Representing Labor
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