



Lawrence F. Alwin, CPA

Two Commodore Plaza
206 East Ninth Street, Suite 1900
Austin, Texas 78701

Phone: (512) 479-4700
Fax: (512) 479-4884

A Report on Procurement Practices at the Texas Lottery Commission

August 30, 1999

Members of the Legislative Audit Committee:

Overall, the Texas Lottery Commission (Commission) does a good job of selecting contractors to run lottery operations and provide other goods and services. This is important because the Commission spent approximately \$428 million on its purchases in fiscal years 1997 and 1998 combined.

Over the last two years, the Commission has taken a number of steps to improve its contracting practices. However, because state law currently allows the Commission's executive director to exercise sole discretion over how contractors are selected, we recommend that the Commission exercise its rulemaking authority to specify which contractor qualifications should be formally evaluated and ranked in all future procurements.

The Commission generally agrees with our findings and recommendations and indicates that it is taking steps to continue to improve its procurement process.

We appreciate the cooperation of Commission staff and management during this review. Please contact Cynthia Reed, CPA, Audit Manager, at (512) 479-4700 if you have any questions about this report.

Sincerely,

Lawrence F. Alwin, CPA
State Auditor

cbg

Attachment

cc: Texas Lottery Commission
Ms. Linda Cloud, Executive Director
Ms. Harriet E. Miers, Chair, Commission
Mr. Anthony J. Sadberry, Commissioner
Mr. C. Tom Clowe, Jr., Commissioner
Ms. Kimberly Kiplin, General Counsel
Ms. Debra McLeod, Director, Internal Audit

SAO Report No. 99-050

Overall Conclusion

The Texas Lottery Commission (Commission) generally follows good business practices to select contractors to run lottery operations and provide other goods and services. However, we noted one instance in which the prior executive director limited the selection factors for the lottery operator contract. This action could have resulted in the State not getting the best value for its money if the contract had been awarded. The authority to limit the selection factors is granted by state law, which allows the executive director to exercise sole discretion over how contractors are selected. The lottery operator contract, which is the single most important contract entered into by the Commission, comprised approximately 64 percent (\$274 million out of \$428 million) of the Commission's procurement expenditures in fiscal years 1997 and 1998 combined.

Additionally, agency management requested our assistance to determine if the Commission received the services it paid for from its advertising vendor subcontractors. We identified \$343,000 in fiscal year 1999 payments to subcontractors for which the Commission may not have received the advertising services it purchased. Approximately 67 percent of the 249 print media subcontractors had not obtained independent verification that the advertisements were printed and reached the targeted audience. Based on the results of our review, the Commission has identified changes it plans to make in its current negotiations for advertising services contracts.

Has the Lottery Commission Improved Its Procurement Practices?

Over the last two years, the Commission has taken steps to improve its contracting practices. In our August 1997 audit report, *Management Controls at the Texas Lottery Commission* (SAO Report No. 97-092), we reported issues relating to the Commission's management of its relationships with contractors, including the need for improvements in the Commission's contract monitoring function. Since 1997, the

Commission implemented our audit recommendations by unbundling purchases, establishing a contract compliance unit, and developing formal procedures to monitor its primary contracts. The Commission has also drafted formal purchasing procedures and taken additional steps beyond those required to ensure that the best value is obtained.

In all except one request for proposal (RFP), which was eventually cancelled by the current executive director, the Commission used purchasing practices designed to fairly and objectively select the best contractor.

| Contents | |
|--|---|
| Overall Conclusion | 1 |
| Has the Lottery Commission Improved Its Procurement Practices? | 1 |
| Did We Identify Any Exceptions to Good Procurement Practices? | 2 |
| What Are Our Recommendations for Improving the Commission's Procurement Practices? | 2 |
| What is Management's Response? | 3 |
| Objective, Scope, and Methodology | 3 |
| Management's Response | 4 |

ATTACHMENT

Did We Identify Any Exceptions to Good Procurement Practices?

In the one exception identified, we questioned the selection factors used to solicit and evaluate the proposals for the multi-million dollar lottery operator contract in 1997. In the 1997 procurement process, potential contractors were initially screened to make sure that the proposals were responsive to the RFP and that the proposers were capable of performing contract requirements. However, from that point forward, proposals were evaluated solely on cost.

The decision to select the contractor based on cost was consistent with the broad grant of authority given to the executive director under Section 466.101 of the Government Code (under the Commission's oversight). However, this decision may not have been in the State's best interest. Considering the central importance of this contract to lottery operations, it appears that factors such as past performance, financial status, personnel, and experience should have been formally evaluated and ranked. According to Commission staff, communications were made to the prior executive director regarding the impact of his decision. Ultimately, the current executive director cancelled the request for proposal without awarding the contract.

Our review of state law did not identify other agencies where the law gives the executive director explicit authority to structure selection factors for major contracts. In most instances, these powers are granted to the governing board, which then delegates procurement duties to the executive director. These duties are then subject to board oversight.

What Are Our Recommendations for Improving the Commission's Procurement Practices?

The Legislature may wish to consider legislation that would provide for greater oversight and involvement by the Commissioners in the procurement of lottery goods and services.

In lieu of changes in legislation, or until changes in legislation can be considered, the Commissioners should develop a compensating safeguard to ensure that proper selection factors are used in the contracting process. For example, the Commission should consider exercising the rulemaking authority granted by Section 466.015(b)(11) of the Government Code to ensure that all appropriate qualifications are evaluated by the executive director when procuring goods and services. An explanation for any deviations from this rule should be formally documented and retained with other documents on contractor selection.

To ensure that it receives the services it pays for, the Commission should require that print advertising contracts include provisions requiring subcontractors to have independent verification of publication circulation in order to receive contracts for lottery advertisements. The Commission identified a concern about the effectiveness of a major contractor's oversight of print advertising that was provided through

subcontractors. As a result, the Commission requested our assistance. Our subsequent review identified that a key safeguard (independent circulation verifications) was not in place to ensure that all subcontractors were providing the services required by their contracts.

What Is Management's Response?

The Commission generally agrees with our findings and recommendations. The full text of management's response is included.

Objective, Scope, and Methodology

The objective of the audit was to examine the Lottery Commission's procurement practices to ensure that the best contractors were fairly and objectively selected and that quality goods and services were obtained at competitive prices.

The scope of this audit included Lottery Commission contracts for which payments were made in fiscal years 1997 and 1998. Our work included reviewing contracts for lottery operations, advertising, reproduction and printing, telecommunications, and computer related purchases. We tested 18 contracts that totaled 92 percent of the \$428 million in fiscal year 1997 and 1998 procurement expenditures. The most recent selection process for the instant ticket manufacturer was not included in the sample of contracts as it is currently under protest. Our work was conducted from February to July 1999.

The methodology we used on the audit consisted of reviewing, testing, and analyzing the processes used to award contracts and pay invoices submitted by contractors.

This audit was conducted in accordance with generally accepted government auditing standards.

Management's Response



Linda Cloud,
Executive Director

Commissioners:
Harriet Miers,
Chair
Anthony Sadberry
C. Tom Clowe, Jr.

August 19, 1999

Mr. Lawrence F. Alwin, CPA
State Auditor
Office of the State Auditor
Two Commodore Plaza
206 East Ninth Street, Suite 1900
Austin, Texas 78701

VIA HAND DELIVERY

Dear Mr. Alwin:

Thank you for the opportunity to provide a written response to your audit of the Texas Lottery Commission procurement practices as summarized in your letter to the Legislative Audit Committee. The Commission generally concurs with the findings and recommendations contained in your letter, as noted in my response below. Additional information related to that portion of the audit report concerning the assistance provided by the State Auditor's Office is provided only for clarification purposes to your oversight committee.

Management's Response:

The Commission has and will continue to improve its procurement process to ensure that the State of Texas is getting the best value for its money. With regard to the specific recommendations concerning the evaluation and ranking of factors such as past performance, financial status, personnel and experience on its major procurements, the Commission has taken this approach in its major procurements (as indicated by the State Auditor's report) except for the 1997 lottery operator RFP which was subsequently cancelled without award by this executive director. We do not anticipate using a different approach than has been our practice except for the 1997 lottery operator RFP. However, if a different approach is to be considered, we will more fully consider the impact, document it, and maintain this documentation in the agency's procurement file.

With regard to the State Auditor's statement that "the Legislature may wish to consider legislation that would provide for greater oversight and involvement by the Commissioners in the procurement of lottery goods and services," the Commissioners are the oversight authority of this agency and also act as the appellate body during the protest process of procurement.¹ Management understands your recommendations are designed to ensure that, in the future, appropriate criteria are used in evaluating proposals. With this in mind, the Commission will be asked to consider rulemaking consistent with your recommendations to ensure that any Executive Director will act consistent with

¹Under Texas Government Code, Section 466.101, the procurement procedures adopted by the executive director must allow a party aggrieved by the terms of a solicitation or the award of a contract an opportunity to protest the executive director's action to the Commission. Additionally, Lottery rule 16 TAC§401.101, relating to lottery procurement procedures, provides, in part, that the protestant may appeal the determination of the executive director to the Texas Lottery Commission.

Texas Lottery Commission PO Box 16630 Austin, Texas 78761-6630
Phone: 512 344-5000 FAX: 512 478-3682

ATTACHMENT

Lawrence F. Alwin, CPA
Page 2
August 19, 1999

your recommendations and the general past procurement practice of the agency, so that the one exception noted by the State Auditor's report with respect to a major lottery procurement will not reoccur.

Regarding the services paid by the Commission to the advertising vendor and services rendered by their print media subcontractors

Before the State Auditor's procurement practices audit began, the Texas Lottery Commission requested the State Auditor's Office assistance to help determine if services paid by the Commission to its advertising vendor had been performed by the advertising vendor's print media subcontractors. We had contacted other state agencies, including the Comptroller's Office, and noted that the Commission, like other state agencies, made payments to print media subcontractors based on tear sheets attached to invoices. There was no assurance that the advertisement ran in newspapers because we could not get access to the entire newspaper without paying for a subscription, nor could we confirm whether the print circulation was as represented by these 167 print media subcontractors. Once this issue was brought to my attention, and prior to the State Auditor's assistance, the Commission required its advertising vendor to cease paying the print media subcontractors that had not obtained independent circulation verification. After the State Auditor's review of this issue, the State Auditor advised us concerning which type of circulation audits were independently verified and which circulation audits needed to be performed annually or at least every two years. This information was useful and timely for the Commission during our recent negotiations with the new advertising vendor. We appreciate the State Auditor's assistance in this matter.

Sincerely,



Linda Cloud,
Executive Director

Cc: Ms. Harriet E. Miers, Chair, Commission
Mr. C. Tom Clowe, Jr., Commissioner
Mr. Anthony J. Sadberry, Commissioner
Ms. Kimberly L. Kiplin, General Counsel
Ms. Debra McLeod, Director, Internal Audit
Ms. Cindy Reed, Audit Manager, State Auditor's Office

ATTACHMENT