

Information and Communications Technology  
Cooperative Contracts Program

# **Contract Establishment and Monitoring Process**

**Internal Audit Report  
11-101**

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# Table of Contents

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Executive Summary.....	1
Introduction .....	3
Objective, Scope, and Methodology of Work.....	3
Background .....	3
The ICT Program.....	4
Findings and Recommendations.....	5
Finding 1: Dollar Rounding on Fee Reports .....	5
Finding 2: Outdated Procedures .....	5
Finding 3: Substandard Documentation of Vendor Sales Reports .....	6
Finding 4: Reporting or Payment of Admin Fees Not Enforced.....	7
Finding 5: Right to Audit Clause.....	8
Finding 6: “Materially” Not Defined in Contract .....	9
Finding 7: Sales Reporting.....	10
Finding 8: Renewal of Contracts with Delinquent Sales Reports .....	11
Finding 9: Critical Application Stored on Single PC Hard Drive .....	12
Finding 10: Concentration of Duties in Managing ICT Contracts.....	13

## Executive Summary

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This report discusses the details of the audit of the Contract Establishment and Monitoring Process in the Information and Communication Technology Cooperative Contracts (ICT) Division. This report combines two scheduled FY2011 audits—the ICT Contract Establishment and Monitoring Process audit and the Vendor Reporting and Fee Process audit—into one report. The purpose of the audits was to determine if contracts are objectively established and if vendor activity is effectively monitored.

The objective of the audits was to determine if written policies and procedures are documented, current, followed, and in compliance with state guidelines. Additionally, the appropriateness of the methodology used for establishing a contract and the effectiveness of the vendor selection during the contract negotiation process were examined. The audits also examined the reasonableness of the contract negotiation process with selected vendors and looked at vendor sales to determine if they were monitored and accurately reported.

The scope of the audits included a review of the ICT Division's policies and procedures and the contracts established or amended from September 2009 through January 2011. Also, vendor sales reports and checks received from September 2007 to January 2011. The methodology used consisted of reviewing policies and procedures, interviewing staff, and analyzing data from the ICT Division and the Accounting Section of the Finance Division.

The review revealed that DIR should strengthen its controls in the ICT division. Internal Audit made the following recommendations:

- ICT Division Management should reformat sales reports to show actual amounts reported by vendors and not the rounded totals.
- ICT Division Management should keep procedures current and ensure that all procedures are complete and approved by management.
- ICT Division Management should require vendors to submit a remittance summary with the sales report.
- ICT Division Management should require that Contract Managers follow procedures and contact vendors monthly if the administrative fee is not timely submitted. Management should establish an effective way for Contract Managers to monitor vendor performance.
- DIR should require standard wording in the *Right to Audit* clause in all agency contracts and not allow vendors to negotiate and change wording.
- ICT Division Management should enforce program procedures, establish standards for obtaining sales reports from delinquent and non-reporting vendors, ensure vendors

submit monthly sales reports to DIR, and require that all vendor communications be documented in the contract file and on Salesforce.com.

- ICT Division Management should establish an effective contract monitoring process that ensures vendors who do not report activity are notified of their contractual obligations to report monthly even if they had no sales. In addition, contract monitoring should ensure that DIR is receiving all administrative fees due, and ensure that a contract is not renewed if the contract terms have not been met.
- ICT Division Management should follow existing procedures for obtaining approval for application development from the information resources manager and cross-train employees to create and run management reports.
- ICT Division Management should separate the duties of employees so that there is a clear line of independence between the establishment and the performance monitoring of ICT contracts. Also, the ICT Division Director should assign contract amendments and renewals duties only to the Contract Establishment Managers.

The ICT Division agreed with the majority of the recommendations and indicated that they have begun to implement the recommendations.

## Introduction

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The audit of the Contract Establishment and Monitoring Process of the Information and Communications Technology Cooperative Contracts (ICT) Division was part of 2001 Internal Audit Plan. In addition, the audit of the ICT Division's Vendor Reporting and Fee Process was also included in the 2011 Internal Audit Plan. These two audits were conducted at the same time due to the similar subject area. In addition, the State Auditor's Office (SAO) announced an audit of the Fee Methodology for the ICT Division. Since the SAO was conducting an audit of this area, Internal Audit did not conduct any test work involving the Fee Methodology for the ICT Division.

## Objective, Scope, and Methodology of Work

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The objective of the audit is to determine if the ICT Division's contracts are objectively established and how vendor activity is monitored. The objective of the audit is to answer the following questions:

- Determine if policies and procedures are current, documented, followed and adhere to State guidelines.
- Determine the appropriateness of the methodology used for contract establishment.
- Determine the appropriateness and effectiveness of vendor selection for the contract negotiation process.
- Determine the reasonableness of the contract negotiation process with selected vendors.
- Determine whether vendor sales are monitored and accurately reported.

The scope of the audit includes a review of the ICT Division's contracts established or amended from September 2009 through January 2011. Also, vendor sales reports and checks received were reconciled from September 2007 through January 2011.

The audit methodology consists of reviewing the policies and procedures, interviewing ICT Division staff involved in the establishment and monitoring of contracts, collecting and reviewing documents, and documenting the processes. It also included reviewing contracts, recalculating the reported fees, and reconciling vendor sales reports in the ICT Division with associated fees received in the Accounting Division.

## Background

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In FY2010, the Contracting and Procurement Services Division was divided into the Enterprise Contract Division and the Information Communications Technology Cooperative Contracts (ICT) Division. In response to a Sunset Commission recommendation to have

separate procedural manuals for the sections, DIR decided to divide the sections in order to ensure the appropriate level of management emphasis.

## The ICT Program

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The purpose of the ICT program is to save money for the State of Texas by leveraging the state's purchasing power for information and communications technology goods and services, while streamlining the procurement process for state agencies. The goal of the program is to save public sector customers money through purchase discounts, allowing them to apply these savings towards other critical needs. State agencies are required to use this service, but can request a waiver if the products or services on contract do not meet their needs. Other public sector entities, like higher education, or independent school districts, can also use the contracts, but are not required to do so. Their use of these contracts contributes to the leverage the ICT program has in negotiating with vendors for a lower cost for the goods and services. A fee not to exceed 2% of the vendor sales is used to recover cost for the program.

The ICT Division's Establishment Section competitively awards contracts by soliciting bids posted on the State Comptroller's Electric State Business Daily website. The section then negotiates with vendors for rates that are generally much lower than the manufacturer's suggested retail price (MSRP). The ICT Division then awards one or multiple vendors a contract. The contracts are based on an indefinite demand/indefinite quantity model. Prices for products and services are not to exceed the negotiated price. The "quantity of one" price negotiated by DIR is based on the state's volume buying power, and according to the program, represents a significantly discounted price based on benchmarks with other purchasing cooperatives and government entities. However, customers have the authority to negotiate with the vendor for additional discounts that would further lower the cost than what the Establishment Section originally negotiated.

After a contract has been established, the ICT Division's Contract Performance Section monitors the activity of the vendor. Vendors are required to self-report all or no sales activity from qualified customers using ICT contracts to purchase goods or services. The vendors are also required to submit the fees associated with those ICT contract sales. It is the Contract Performance Section's responsibility to monitor vendor compliance with the terms of the contract including ensuring that vendors are reporting and remitting fee payments.

## Findings and Recommendations

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### Finding 1: Dollar Rounding on Fee Reports

The Detail Fee Report, prepared by the Contract Performance Data Analytics Team, does not present the same amounts as the actual sales reports submitted by vendors. Actual dollar amounts reported by vendors on their sales reports should equal the Detail Fee Reports used by ITC Division Management and anyone who asks for a copy. The Data Analytics Team has formatted the Detail Fee Report to round sales dollar amounts reported by vendors.

The administrative fee percentages on the Detail Fee Reports do not reconcile with the amounts reported by vendors, causing other users such as DIR Internal Audit and the Texas State Auditor's Office to question amounts. The rounded amounts could be material when taken in the aggregate for all reports, and they make it difficult to reconcile fee amounts.

#### Recommendation

Reformat the report to show actual amounts in dollars and cents reported by vendors.

#### Management Response

Management agrees with this finding and has modified the Detail Fee Report to provide exact dollars and cents for each amount.

### Finding 2: Outdated Procedures

Internal Audit reviewed the May 2006 ICT contracts program procedures it received from ITC Division Management in February 2011. IA determined that the procedures were outdated. For example, the document contained references to an obsolete division name, Services Delivery Division, which is currently the Information and Communications Technology Cooperative Contracting Division. Subsequently, ICT Division Management created more up-to-date procedures in March 2011; however, procedures were incomplete in that there was no section for the Monthly Administrative Fee Reconciliation procedure. The draft purpose of this procedure was "to ensure that the GoDirect Administrative Fees due from vendors are accounted." ICT Division Management did not update the program procedures between May 2006 and March 2011.

Complete and up-to-date procedures are required for effective management of the ICT contracts program. Current and approved procedures allow staff to effectively and consistently discharge their responsibilities.

ICT Division Management, before March 2011, did not modify the procedures to reflect changes in processes and terminology. The management of the program will be inconsistent if incomplete procedures are used. This could result in inefficient contract monitoring.

## Recommendation

Continue to work to keep program procedures current by setting a schedule to review procedures so there is a firm date for completion of the revisions. In addition, ensure that all procedures are complete and approved by management.

## Management Response

Management agrees with this finding. Management completed a comprehensive update of division procedures in March 2011, and will conduct an annual review of all procedures in accordance with the recommendations of the Contract Advisory Team.

## Finding 3: Substandard Documentation of Vendor Sales Reports

Internal Audit examined the CDI Payment Summary Report used by ITC Division Management. IA determined that in November 2010, 44.14% of administrative fee payments received by DIR had no or substandard documentation attached to assist with identifying which contract is associated with a payment.

The Standard Terms and Conditions for Product and Related Services Contract terms (4) DIR Administrative Fee (b) specifies the “Vendor shall reference the DIR Contract number on any remittance instruments.”

There is no enforcement of contract terms regarding remittances since the responsibility for this is not established.

Contract remittances may not be applied to the correct contract. In addition, State resources are not used efficiently when a DIR Accounting Division employee's time is used to research which contract to apply administrative fee payments.

## Recommendation

Require the vendor to submit a remittance summary with the sales report that includes the total amount of the check to be remitted and the vendor check number. The remittance summary should also include line items that show the contract number, the total sales for the contract, the administrative fee percentage used, and the total administrative fee amount for the contract. The remittance summary should be reviewed and approved by the ICT Division and forwarded to the Accounting Division for processing. (Note: The standard DIR contract indicates that monthly reports shall include any information required by DIR.)

## Management Response

Management agrees with this finding. Management will implement a new process that requires vendors to submit documentation which provides detailed information along with administrative fee payments. **Estimated Implementation: September 2011.** Please see the response to Finding 10 for additional information regarding the division's plan to address this issue.

## Finding 4: Reporting or Payment of Administrative Fees Not Enforced

Some vendors do not pay the administrative fees due to DIR. Some contract files do not show documentation indicating that Contract Managers ask vendors to pay delinquent fees owed to DIR. There is no evidence that Contract Managers take a proactive approach to ask vendors on a monthly basis to report and pay the correct administrative fees. ITC Division Management has explained that Contract Managers do not contact vendors until the contract is up for renewal amendment.

Internal Audit reviewed procedures from May 2006, procedures (draft) from August 2009, and finalized, but incomplete (see Finding 2), procedures from March 2011. The March 2011 procedures state that Contract Managers are to contact vendors more frequently than just at the renewal of the contract.

In addition, the Admin Fee Reconciliation procedure (March 2011) states that “ICT publishes the reconciliation reports for the current vendor sales month.... Contract Managers contracts (sic) vendor and informs them of non-compliance issue and requests immediate payment...” However, there is little evidence—either on the drive used by ICT (T:/Busops), on Salesforce.com, or in the contract files reviewed by IA—that vendors were contacted on a monthly basis to request payment of the past due administrative fees. Some contracts are renewed with past due Administrative Fees still owed to DIR.

Between 2008 and 2011, ICT Division Management had not reconciled \$2.4 million dollars in Administrative Fees. After IA brought this matter to the attention of division management, 94% of the accounts were reconciled as of April 19, 2011. The division is in the process of reconciling the remaining 6%, or \$595,392, of overdue Administrative Fees.

ICT Division procedures explain that Contract Managers will document in the contract file and on Salesforce.com that they informed vendors of past due Administrative Fees and that they will develop and maintain a system for follow-up to ensure that the Administrative Fees are received by DIR before contracts are renewed.

There is no requirement in program procedures for Contract Managers to document their requests to vendors to pay past due administrative fees. Also, ICT Division Management does not have an effective way to alert the contract managers that a vendor’s administrative fees are past due.

Vendors make sales through ICT Contracts, and then do not pay the administrative fees in a timely manner. This results in DIR having uncollected revenue from sales off the DIR contracts.

### Recommendation

ICT Division Management should require that Contract Managers follow procedures and contact vendors monthly if the administrative fee is not timely submitted or paid correctly, and document those contacts in the contract file and Salesforce.com. ICT Division

Management should establish an effective and consistent way for contract managers to monitor vendor performance, which includes monitoring past due administrative fees.

### **Management Response**

Management agrees with this finding and has implemented a new monthly review process for Contract Managers to follow to ensure enforcement of timely vendor submissions of administrative fees. Contract Managers review the new monthly Administrative Fee Reconciliation Report to track administrative fee payments. **Implementation: July 2011.** Please see the response to Finding 10 for additional information regarding the division's plan to address this issue.

### **Finding 5: Right to Audit Clause**

In ICT contracts, Amendment 4 states that Appendix A, Section 3, Definitions, H. Compliance Check, is amended as follows: "an audit of Vendor's compliance with the contract performed either by a third party auditor or DIR contract management staff in accordance with Appendix A, Records and Audit." This clause can be interpreted to exclude DIR Internal Audit from auditing contract performance.

Also, ICT contract number DIR-SDD-633, Subsection C. "Records and Audit," Paragraph 5(b), states that "...the parties shall mutually agree to what documents and records the State or any third-party shall gain access to, whether it is the State or any third-party accessing such records and/or data." This clause is a scope limitation on audits.

Language in contracts referring to audits should be consistent to prevent any misunderstanding and to ensure consistency with scope and objectives. Internal Audit has access to all records and has the right to audit vendor contract compliance.

The vendors for these contracts were allowed to negotiate the language in the *Records and Audit* clause. ITC Division Management did not consult with IA on the amended wording of the contract clause.

Inconsistent language may cause disputes with vendors over audit coverage. In addition, by altering the audit clause uniquely for each vendor, the preparation and conduction of audits will become inefficient and lengthy, requiring use of additional resources. IA has the right to audit all aspects of DIR operations. The wording of the contract may cause vendors to challenge IA's right to audit.

### **Recommendation**

All ICT Cooperative Contracts should attempt to use consistent wording in the Records and Audit clause. However, whatever wording is used to define who will do an audit, the wording in the clause should indicate either DIR's Internal Audit or DIR's representative has a right to audit.

## Management Response

Management agrees with this finding and will work with Internal Audit to develop a process to review and make recommendations regarding any future changes to the audit clause. In addition, management will work with Internal Audit and Legal to revise the audit clause to include the right for Internal Audit to conduct vendor audits. **Estimated Implementation: September 2011.**

## Finding 6: “Materially” Not Defined in Contract

During contract negotiation, the wording of Subsection C. Records and Audit of an ICT contract was changed to include the word “materially.”

“If Vendor is found to be responsible for **materially** inaccurate reports, DIR may invoice for the reasonable costs of the audit, which Vendor must pay within thirty (30) days of receipt.”

“Materially” is not defined and is left to interpretation. The vendor was allowed to negotiate the wording of the *Records and Audit* clause in a DIR contract.

The definition of the word “materially” is established by statistical methods. Vendors are allowed to negotiate the wording of the Records and Audit clause. With no definition for the word “materially,” there could be unresolved disagreements over what is material, leading to lost employee productivity and increased costs to the state. The Records and Audit clause might be weakened by this wording.

## Recommendation

Require standard wording in the Records and Audit clause in all DIR contracts and do not allow vendors to negotiate and change the wording.

## Management Response

Management believes that negotiating standard clauses is a business decision that allows for program staff to potentially obtain better value for the state and its customers. The flexibility to modify wording while still achieving the objective and intent of the standard terms and conditions (as validated by Legal review) allows the program staff to negotiate the best value while still ensuring the contract includes all of the necessary and appropriate requirements to protect the state’s interests.

## Finding 7: Sales Reporting

Some vendors do not report ICT Contract Sales to DIR in a timely manner. Other vendors do not submit sales reports at all. During the audit period, IA reviewed files that did not contain documentation that vendors were contacted on a monthly basis for past due sales reports. There is a policy that directs Contract Managers to contact vendors for late reports or contact vendors who have not sent reports to DIR. IA reviewed many files that did not have evidence that the Contract Manager followed up to see that the vendor adhered to the reporting policy before renewing the contract.

Vendors are required to submit a monthly sales report to DIR by the 15th of the month whether they have sales to report or not. The ICT program procedures include requirements that Contract Managers contact delinquent or non-reporting Vendors and document those contacts in the contract file.

ICT Contract Managers are not adhering to the procedures requiring them to contact delinquent or non-reporting vendors and obtain past due reports even though they were aware of the past due vendors.

Since administrative fee amounts are determined as a percentage of sales reported for the ICT contracts, without sales report amounts DIR cannot establish how much the Vendor owes to the State.

### Recommendation

ICT Division Management

- should enforce program procedures,
- establish standards for obtaining sales reports from delinquent and non-reporting vendors,
- should ensure vendors submit monthly sales reports to DIR, and
- require that all vendor communications be documented in the contract file and on Salesforce.com.

Additionally, during a customer survey, the ICT Division should make a request to customers to voluntarily provide a list of ICT-related purchases they placed for the year, including the date, vendor name, product, and cost. The ICT Division can then compare the customer-reported data against vendor reporting and note any discrepancies.

## Management Response

Management agrees with this finding and will enforce program procedures; establish standards for obtaining sales reports from delinquent and non-reporting vendors; ensure vendors submit monthly sales reports to DIR; and require that all vendor communications be documented in the contract file and on Salesforce.com. Please see the response to Finding 10 for additional information regarding the division's plan to address this issue. In addition, management will develop a process to provide customers with sales reports for verification. **Estimated Implementation: September 2011.**

## Finding 8: Renewal of Contracts with Delinquent Sales Reports

Internal Audit obtained from ICT Division Management a list of vendors who sent sales reports to DIR from September 2009 to April 2011. During the review, IA used an automated software package to extract the names of 155 vendors who had not sent sales reports for at least one month since September 2009. IA analyzed documentation in the contract files and on Salesforce.com for nine vendors who had not reported between eight and thirteen times. Even though some of these vendors had been contacted by the Contract Manager to send in the delinquent reports, four of the nine vendors were still delinquent when their contracts were amended to extend the term.

ICT contracts should be renewed only when vendors are in compliance with contract terms. The Contract Managers monitor the contracts for compliance by reviewing the vendor websites and monitoring HUB compliance. The contract marketing plan and sales reporting compliance are also reviewed. Annually, the Contract Managers check the CPA tax standing, HUB status, commodity class item codes, and the excluded parties list. All contracts state that, whether vendors have sales or not, they are to send to DIR a monthly sales report due by the 15th of the month. If a vendor has sales, the vendor is to pay administrative fees to DIR based on the sales report.

The insufficient monitoring of some contracts allowed for the contracts to be amended without the vendors complying with contract provisions concerning reporting or payment of administrative fees. The ICT Division did not enforce the terms of some contracts in a timely manner and only attempted to obtain late sales reports when the contract was up for renewal. When vendors were contacted to send late reports at time of renewal, there was no additional follow-up to ensure adherence to contract terms. Without proper monitoring of contracts, DIR cannot be assured that vendors are meeting their contractual obligations stated in the contracts.

## Recommendation

ICT Division Management should establish an effective contract monitoring process that ensures vendors who do not report activity are notified of their contractual obligations to

report monthly even if they had no sales. In addition, contract monitoring should ensure that DIR is receiving all administrative fees due, and ensure that the vendor's contract is not renewed when the contract terms have not been met.

### **Management Response**

Management agrees that it must ensure that contract terms are enforced. However, the range of penalties for non-compliance are not a "one size fits all." In some instances, it is appropriate to delay renewal of a contract for failure to submit administrative fees timely. However, in some cases the inability to consider contract specific issues in determining the appropriate penalty could result in increased costs to the state. Please see the response to Finding 10 for additional information regarding the division's plan to address this issue.

## **Finding 9: Critical Application Stored on Single PC Hard Drive**

During an interview with an ICT Performance Analytics manager, IA was informed that critical data analytics Oracle tables and Business Objects applications are stored on his personal computer. IA was also informed that if the manager left the agency, there would not be a backup person to handle the creation of management reports and thus information and institutional knowledge may be lost.

All agency applications and data should be stored and backed-up on shared drives and employees are cross-trained to create management reports.

ITC Division Management allowed the ICT Contract Reconciliation Application to be built without requesting the involvement of DIR's Technical Services Delivery Section or the approval of the agency's Information Resources Manager. Also, ICT Contracts Management has not cross-trained employees to develop reports and critical programming tasks.

With the application residing on a single PC hard drive, DIR is at risk of losing critical data and the ability to create management reports. Without proper cross-training, DIR is susceptible to losing critical institutional knowledge.

### **Recommendation**

DIR can reduce this risk by putting in place policies stating that all critical data and programs are stored on shared drives and employees are cross-trained to create and run management reports. Procedures should be developed to ensure that other employees will be able to create or recreate these reports. Additionally, ICT Division Management should follow existing procedures for obtaining approval for application development from the Information Resources Manager.

## Management Response

Management agrees with this finding and is currently in the process of moving all reports and scheduled events to a shared drive. However, the Information Resources Manager was aware of the application development activities of the division. Management also agrees that employees should be cross-trained on report development and other critical tasks and is currently working to do so. **Implementation: July 2011.**

## Finding 10: Concentration of Duties in Managing ICT Contracts

During the audit process, IA interviewed several ICT Contract Establishment employees. During those interviews, some of these employees said that they handle the establishment of the contracts during the RFO process, and those same individuals handle the contract performance duties of those same contracts. Also, Contract Performance Managers are assigned to amend or renew the same contracts that they monitor for performance. This assignment of responsibilities is a concentration of duties by having the same person who negotiates the contract also monitor for performance. This concentration of duties creates a risk to the agency since errors or omissions may not be discovered in a timely manner.

One important internal control over contracting is the concept of *separation of duties*, where two different people handle key components of a process so that one person does not have duties which give the appearance that the contracting might not be a fair process.

ICT Division Management has assigned individual employees to handle both the establishment and the performance monitoring of some contracts. Contract Managers monitor contract performance as well as amend and renew the same contracts.

DIR is at risk of the public perception of the lack of independence.

## Recommendation

For good internal control, IA recommends that ICT Division Management separate the duties of employees so that there is a clear line of independence between the establishment and the performance of an contract. Also, the division director should assign contract amendments and renewals duties only to the Contract Establishment Managers.

## Management Response

Management believes that it can accomplish the intended objectives and benefits of this recommendation by segregating the administration of reporting and administrative fee payments to a newly dedicated full-time employee. This position will be filled with an existing FTE position with repurposed responsibilities. **Estimated Implementation: September 2011.** The responsibilities will include the following:

- Work with Accounting and Sourcing Analytics to ensure the administrative fee payments and monthly sales reports and administrative fees are received accurately and timely with appropriate documentation.
- Make recommendations to management regarding administrative fee reconciliation and vendor reporting processes.
- Work with Accounting and Sourcing Analytics departments to complete, modify and improve the administrative fee reconciliation report.
- Monitor and analyze monthly sales report and administrative fee submissions.
- Work with Accounting and Contract Managers to post adjustments to the administrative fee reconciliation report
- Communicate late sales report submissions to contract managers and vendors; document in Salesforce.com.
- Communicate late administrative fee submissions to contract managers and vendors; document in Salesforce.com
- Monitor vendor compliance with late payment and reporting penalty clauses.
- Work with vendors to reconcile administrative fee and monthly sales reports.
- Document all findings in Salesforce.com.