

Technology Sourcing Office  
Contracts and Vendor Management

# **Follow-up Audit on the SAO Report 14-007**

## **Internal Audit Report 15-301.1**

June 2015



Texas Department of Information Resources  
Internal Audit

Internal Audit is DIR's independent, objective assurance and consulting activity designed to add value and improve the agency's operations. It helps the agency accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

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## Executive Summary

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This report presents the results of the Internal Audit's follow-up audit on the Department of Information Resources (DIR) Information and Communications Technology Cooperative Contracts Program (#14-007) report issued by the Texas State Auditor's Office (SAO) in October 2013. The SAO audit report included 23 recommendations DIR management agreed to implement.

To provide assurance improvements were made in the operational areas addressed by the SAO, this follow-up audit was included in the approved Fiscal Year 2015 Internal Audit Annual Plan. The objective of the follow-up audit was to verify the implementation status of the corrective action plans developed to address 19 of 23 recommendations DIR management reported as "Fully Implemented." Internal Audit did not perform follow-up work on 4 recommendations DIR management reported as "Incomplete/Ongoing."

The following is a summary of the results on the implementation status of the 19 recommendations verified by Internal Audit.

Fully Implemented	Substantially Implemented	Incomplete/Ongoing	Not Implemented	Total
13	4	2	0	19

Overall, DIR improved its operating controls over the contract procurement processes, provisions and execution of cooperative contracts, vendors' compliance, volume discounts, training and certification requirements of the DIR contract staff, and the strategy to identify customers' information technology needs. Additional controls were implemented over the vendor sales reports, remittance of administrative fees, and customer discounts. Furthermore, DIR strengthened its operating controls over the processes and documentation of cost savings provided through the DIR cooperative contracts, and the review and update of contract data.

DIR management agreed with the results presented in this report.

Internal Audit thanks the DIR staff from the Technology Sourcing Office and Information Technology Services divisions for their time, cooperation, and assistance provided during this follow-up audit.

## Background

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Texas Government Code, Section 2157.068, mandates the Department of Information Resources (DIR) procures commercial software, hardware, or technology services other than telecommunication services that are generally available to business or the public and for which DIR determines that a reasonable demand exists in two or more state agencies. Through its Cooperative Contracts Program DIR establishes contracts for information resources technology products and related services. In addition to state agencies and higher education institutions, Texas Government Code, Section 2054.0565, authorizes local governments, school districts, assistance organizations, and out-of-state governmental entities to purchase from DIR cooperative contracts. For the first quarter of Fiscal Year 2015, DIR reported total sales of approximately \$555.4 million through its Cooperative Contracts Program.

In Fiscal Year 2014 the State Auditor's Office (SAO) conducted an audit of the DIR Information and Communications Technology Cooperative Contracts Program and issued an audit report (#14-007) that included 23 recommendations DIR management agreed to implement. The audit objective was to determine whether DIR designed and implemented effective processes and related controls for the Cooperative Contracts Program to help ensure that the agency procure contracts in accordance with applicable state laws, rules and agency policies and procedures, and that the State's interests were protected.

To provide assurance improvements were made in the operational areas addressed by the SAO, this follow-up audit was included in the approved Fiscal Year 2015 Internal Audit Annual Plan. The objective of the follow-up audit was to verify the implementation status of the corrective action plans developed to address 19 of 23 recommendations DIR management reported as "Fully Implemented." Internal Audit did not perform follow-up work on 4 recommendations DIR management reported as "Incomplete/Ongoing."

To accomplish the objective, Internal Audit interviewed DIR staff from the Technology Sourcing Office and the Information Technology Services divisions, reviewed procurement documentation and contracts, statutes, rules, policies and procedures, training and certification documentation, DIR Board materials, and other relevant documentation. In addition, Internal Audit selected contracts to review the cost-savings performance measure process, and compliance with established policies and procedures. Internal Audit also assessed the adequacy and effectiveness of the controls implemented to determine whether the controls mitigated the risks associated to the audit recommendations.

The follow-up audit was conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing* and the *Generally Accepted Government Auditing Standards*. These standards require audits to be planned and performed to obtain sufficient and appropriate evidence to provide reasonable support for the results and conclusions

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included in the report. Internal Audit states that the evidence obtained provides reasonable support for the results and conclusions included in this report.

## Detailed Results

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In summary, Internal Audit verified the implementation status of the corrective action plans developed to address 17 of 19 recommendations was “Fully Implemented” or “Substantially Implemented.” The implementation status of the corrective action plans for the remaining two recommendations was verified as Incomplete/Ongoing.” The implementation status categories and their definitions include:

- Fully Implemented – successful development and use of a process, system, or policy to implement a recommendation
- Substantially Implemented – successful development but inconsistent use of a process, system, or policy to implement a recommendation
- Incomplete/ Ongoing – ongoing development of a process, system, or policy to address a recommendation
- Not Implemented – lack of a formal process, system, or policy to address a recommendation

Fully Implemented	Substantially Implemented	Incomplete/ Ongoing	Not Implemented	Total
13	4	2	0	19

## Chapter 1: Procurement Process, Program Contracts, and State’s Interests

Management from the DIR Technology Sourcing Office (TSO) fully or substantially implemented all the corrective action plans developed to address the recommendations included in Chapter 1 of the SAO report. TSO management asserted the corrective action plan for recommendation 1-D-2 was “Fully Implemented.” However, due to additional controls needed to fully implement the recommendation, Internal Audit determined the recommendation was “Substantially Implemented.”

TSO management made significant progress in implementing the corrective action plans developed to address the recommendations included in Chapter 1 of the SAO report. Additional operating controls are in place to strengthen the processes over 1) contract procurement and vendor proposal documentation, 2) volume discounts, 3) training and certification requirements of the DIR contract staff, 4) strategy to identify customers’ information technology needs, 5) contract provisions for vendor price changes and non-compliance, and 6) contract execution.

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Reference	Recommendation	Status, as Verified by Internal Audit	Internal Audit Status Comments
1-A-1	Ensure that its review of vendor proposal scoring documentation is complete and accurate prior to approval.	Fully Implemented	DIR developed procedures to ensure vendor proposal scoring documentation is complete and accurate prior to approval and before negotiation starts.
1-A-2	Require program vendors to specify Manufacturer Suggested Retail Price (MSRP) at the time of negotiation and include in its contracts either MSRP amount or a not-to-exceed price.	Fully Implemented	Vendors are required to specify the MSRP at the time of negotiation. DIR includes in its Request for Offers (RFOs) and contracts the requirement for inclusion of the MSRP amount and approval request for price changes.
1-A-3	Include in Program contracts volume discounts that increase as total statewide purchases in the aggregate increase.	Substantially Implemented	DIR revised its contract templates to include volume discounts. However, for two of five contracts reviewed, volume discounts did not increase, as total statewide purchases increased in the aggregate for all the services included in the contracts.
1-B-1	Develop and implement internal policies and procedures that clearly identify the employees involved in contract establishment and contract management who need to attend training and obtain certifications, and the types of certification the Department requires.	Fully Implemented	DIR developed internal policies and procedures that clearly identify the employees involved in contract establishment and contract management who need to attend training and obtain certifications, including the types of certification required.
1-B-2	Specify the time frame in which an employee involved in contract establishment and contract management is required to complete training and obtain the required certification.	Fully Implemented	DIR policies and procedures specify all contract managers must obtain the required training and certification within one year of employment, if not already certified.
1-B-3	Implement a process to track employees' training hours to	Fully Implemented	DIR implemented a process to track employees' training hours to ensure they comply with statutory

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	ensure they comply with statutory requirements.		requirements. The training documentation for each employee includes a spreadsheet that documents course related information and the training certificates.
1-C-1	Ensure that the primary customer groups are represented on the customer advisory committee.	Fully Implemented	DIR revised its Customer Advisory Committee (CAC) Charter to include all primary customer groups. The revised Charter was approved by the DIR Board in October 2013.
1-C-2	Evaluate its new product and/or service form and determine whether the information on that form is valuable in identifying information technology needs, educate its customers on using that form, and encourage them to communicate their needs through that form.	Fully Implemented	DIR evaluated the New Product or Service Request (NPSR) Form to include valuable information to identify the information technology needs of the customers. DIR also educates its customers in using the Form and encourages them to communicate their needs through the Form. The revised NPSR is in electronic format and available to DIR customers on the DIR website.
1-C-3	Establish a process to collect input from all Program customers in a manner that allows the Department to consolidate that information and establish new Program contracts; review its exemption request log and determine whether requesting more specific information would enable the Department to identify the need to establish new Program contracts; determine whether implementing an electronic exemption request process would be beneficial; require state agencies to prepare and submit procurement schedules	Fully Implemented	DIR developed policies and procedures that describe the process for collecting input from customers.  DIR reviewed and implemented an electronic "Exemption Request Form" that allows the customers to submit exemption requests online. The form collects valuable information to identify the need to establish new Program contracts. DIR reviews the exemption request forms, previous sales history for goods or services and engages the customers (who utilize or may utilize the goods or services) being considered for solicitation. Customer engagements may

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	for information technology commodities they are planning to purchase in a prescribed format that the Department can use to identify statewide needs and establish new Program Contracts; review biennial operating plans to identify proposed information technology projects for which the Department could establish new Program contracts.		include: on-site meetings, surveys or other methods that actively allow the customers to provide input on their needs.
1-D-1	Fully implement prior audit recommendations regarding terms for corrective action and late fees in its Program contracts.	Fully Implemented	<p>DIR revised its contract templates to describe that a vendor may change the price of any product or service at any time (based upon changes to the MSRP, and with the acceptance and approval of DIR) and to indicate that prices may not be increased for at least ninety (90) days after the contract start date.</p> <p>The revised contract templates include consequences to address situations in which vendors do not submit monthly vendor sales reports or remit administrative fees on time.</p> <p>The revised contract templates also include recommended late fee penalties DIR can impose on vendors when they do not comply with the reporting and administrative fee payment requirements.</p>
1-D-2	Ensure that all contracts are reviewed and approved by required staff prior to vendor signature, and include required signatures in accordance with	Substantially Implemented	DIR ensures all contracts include the required signatures of the Executive Director and the Contracts Attorney. All contracts reviewed during this follow-up work included the corresponding

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	Department policies and procedures.		Business Issues Memorandum and Approval Routing Slips. However, 10 of the 14 contracts reviewed, were not reviewed and approved by the required DIR staff prior to the vendor's signature, as stated in the DIR policies and procedures.
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## Chapter 2: Vendor Sales Reports, Administrative Fees, and Customer Discounts

Management from the DIR Technology Sourcing Office (TSO) has not fully implemented the corrective action plans developed to address the three recommendations included in Chapter 2 of the SAO report. TSO management asserted the corrective action plan to address recommendation 2-A-3 was "Fully Implemented." However, due to additional controls needed to fully implement the recommendation, Internal Audit determined the recommendation was "Incomplete/Ongoing." The corrective action plans developed to address the remaining two recommendations were not verified by Internal Audit because TSO management asserted the recommendations were "Incomplete/Ongoing."

TSO management made progress in implementing the corrective action plans developed to address the recommendations included in Chapter 2 of the SAO report. Additional operating controls are in place to strengthen the processes over the reporting of vendor sales reports, vendor remittance of administrative fees, customer discounts, and vendor compliance with contract requirements.

Reference	Recommendation	Status, as Verified by Internal Audit	Internal Audit Status Comments
2-A-1	Develop and implement a process for regularly verifying the completeness and accuracy of monthly sales reports that Program vendors submit and the administrative fees that Program vendors pay.	Incomplete/ Ongoing	Not verified by Internal Audit.
2-A-2	Revise the monthly sales reports that program vendors submit to require vendors to report the discounts they agreed to in their contracts and the	Incomplete/ Ongoing	Not verified by Internal Audit.

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	<p>actual discounts the vendors provided to their customers, and any other information the Department determines would enable its contract managers to monitor whether vendors provided the discounts specified on their Program contracts.</p>		
<p>2-A-3</p>	<p>Restore its policies and procedures that require contract managers to review Program vendors' monthly sales reports and monitor whether vendors provide customers the discounts specified in their Program contracts; comply with its policy requiring contract managers to fully document their review of vendors' compliance with requirements for the submission of monthly sales reports and payment of administrative fees in a timely manner, and follow-up on those reviews as necessary; clearly define in its policies and procedures how contract managers should determine vendor's compliance with reporting requirements and how to proceed when they identify non-compliance; include in all Program contracts a provision for a late fee penalty that the Department can impose when vendors do not comply with requirements regarding administrative fee payment and monthly sales reporting.</p>	<p>Incomplete/ Ongoing</p>	<p>DIR restored its policies and procedures that require contract managers to review Program vendors' monthly sales reports and monitor whether vendors provide customers the discounts specified in their Program contracts.</p> <p>Contract managers are required to fully document their review of vendors' compliance with the requirements for the submission of monthly sales reports and remittance of administrative fees in a timely manner, and follow-up on reviews when non-compliance issues are identified.</p> <p>Contract managers' review of vendor sales reports is conducted periodically and timely. However, the contract managers' review of the vendors' remittance of administrative fees is conducted on an ad hoc basis and not conducted timely, as required by DIR's policies and procedures.</p> <p>The policies and procedures clearly define how contract managers should determine vendor's compliance with reporting requirements and how to proceed when non-compliance is identified.</p>

			All Program contracts include a provision for a late fee penalty that DIR can impose when vendors do not comply with requirements regarding monthly sales reporting and remittance of administrative fees.
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### Chapter 3: Program Cost Savings Methodology, Performance Measure Guidance, and Cost Savings Calculations

Management from the DIR Technology Sourcing Office (TSO) fully or substantially implemented all the corrective action plans developed to address the recommendations included in Chapter 3 of the SAO report. TSO management asserted the corrective action plans for two of the recommendations (3-B-2 and 3-C-2) were "Fully Implemented." However, due to additional controls needed to fully implement the recommendations, Internal Audit determined the recommendations were "Substantially Implemented."

TSO management made significant progress in implementing the corrective action plans developed to address the recommendations included in Chapter 3 of the SAO report. Additional operating controls are in place to strengthen the processes over the alignment, calculation, review, and documentation of the cost savings provided through the DIR Cooperative Contracts Program.

Reference	Recommendation	Status, as Verified by Internal Audit	Internal Audit Status Comments
3-A	The Department should seek guidance and work with the Legislative Budget Board (LBB) to update, implement, and follow an agreed-upon methodology for calculating Program cost savings for all contracts.	Fully Implemented	DIR worked with the Legislative Budget Board (LBB) and obtained guidance to revise the language of its performance measure on the Total Contract Savings and Cost Avoidance Provided through DIR Contracts. The revised language was accepted and approved by the LBB and includes additional detail describing the process for calculating cost savings using the vendors' top selling items (for new contracts) or using the most frequently sold products, per DIR's

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			historical data (for contract renewals).
3-B-1	The Department should obtain formal approval for all Program cost savings calculation procedures and formally incorporate the approved procedures into its policies and procedures.	Fully Implemented	DIR obtained approval for the revised language on the cost savings calculations procedures and incorporated the revised language into its policies and procedures.
3-B-2	Ensure that contract managers follow established policies and procedures to calculate Program cost savings.	Substantially Implemented	<p>DIR established policies and procedures to ensure contract managers properly calculate Program cost savings. However, for two of 14 contracts reviewed, DIR staff selected less than 10 top selling products/ services for benchmarking purposes during the cost savings calculations. DIR policies and procedures required a minimum selection of 10 top selling products/ services during the benchmark process.</p> <p>All 14 contracts included evidence of review by a Certified Texas Procurement Manager (CTPM) or Certified Texas Contract Manager (CTCM) and supporting documentation, as required by DIR's policies and procedures.</p>
3-B-3	After seeking performance measure clarification and guidance from the LBB, update its policies and procedures to align with the cost savings performance measure definition, methodology, and data source guidance in ABEST, and ensure that its procedures are detailed enough to enable the Department to perform calculations consistently. This should include establishing	Fully Implemented	<p>DIR revised its policies and procedures to align them with the cost savings performance measure definition, methodology, and data source guidance included in ABEST.</p> <p>DIR procedures are detailed enough to enable its staff to perform calculations consistently. The procedures provide clear guidance on how to use the cost savings calculation tool and</p>

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	<p>clear guidance on how to use the cost-savings calculation template and clarification of the purpose of all formulas.</p>		<p>indicate that cost avoidance is calculated by product or service using the benchmark comparison price. If no benchmark data is available, DIR uses the negotiated price discount.</p> <p>DIR creates a Cost Benchmarking Justification Memo for the Deliverables Based Information Technology Services (DBITS) contracts because no benchmark data is available. The memo is retained in the contract file.</p>
3-C-1	<p>Develop and implement a process that includes a full review of supporting documentation for Program cost savings calculations, including a review of the mathematical accuracy of the calculations, before obtaining management approval.</p>	Fully Implemented	<p>DIR developed and implemented a process that includes a full review of supporting documentation for Program cost savings calculations. The procedures include a review of the mathematical accuracy of the cost savings calculations before obtaining management approval. The process helps ensure the cost savings calculations are supported, performed consistently, and free of errors.</p>
3-C-2	<p>Ensure that contract managers followed established policies and procedures to calculate Program cost savings, including verifying and documenting all information the Department uses to calculate cost savings rates.</p>	Substantially Implemented	<p>DIR established policies and procedures to ensure contract managers calculate Program cost savings consistently, including verifying and documenting all information DIR uses to calculate cost savings rates. DIR staff documents supporting evidence for its benchmarks against other cooperative contracts and verifies with process with other cooperative contracts such as: the General Services Administration (GSA), The Interposal Purchasing System (TIPS), The Cooperative Purchasing Network (TCPN), or the Western States Contracting</p>

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			<p>Alliance (WSCA). However, for four of 14 contracts reviewed, the supporting documentation was not retained for the prices used during the cost avoidance calculations.</p> <p>In instances where no benchmark information was available, the DIR discounted price was used and a Cost Benchmarking Memo was added to the contract file. However, in one case the Cost Benchmarking Memo was not prepared or available for review.</p>
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## Chapter 4: Information Technology Controls

Management from the DIR Information Technology Services (ITS) has not fully implemented the corrective action plans developed to address the three recommendations included in Chapter 4 of the SAO report. ITS management asserted the corrective action plan to address recommendation 4-C was “Fully Implemented.” However, due to additional controls needed to fully implement the recommendation, Internal Audit determined the recommendation was “Incomplete/Ongoing.” The corrective action plans developed to address the remaining two recommendations were not verified by Internal Audit because ITS management asserted the recommendations were “Incomplete/Ongoing.”

TSO management made progress in implementing the corrective action plans to address the recommendations included in Chapter 4 of the SAO report. Additional operating controls are in place to strengthen the processes over the review and update of contract data.

Reference	Recommendation	Status, as Verified by Internal Audit	Internal Audit Status Comments
4-A	The Department should regularly review access to Program contract data to help ensure that 1) it limits access only to current employees whose job duties necessitate access, and 2) only required user accounts are active on servers, databases, applications, and shared drives.	Incomplete/ Ongoing	Not verified by Internal Audit.

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4-B	Ensure that its password policies and procedures comply with Texas Administrative Code (TAC) requirements and the password guidelines for state agencies available on the Department's Web site; implement its updates password policy on all environments where Program data resides.	Incomplete/ Ongoing	Not verified by Internal Audit.
4-C	Require staff to document their reviews of contract data completeness and accuracy; document a process to help ensure that it updates and reviews Salesforce data when a Program contract is renewed or amended; implement a quality review process to help ensure that Salesforce data is free of manual data entry errors; add automation controls and edit checks to Salesforce to assist in minimizing errors.	Incomplete/ Ongoing	<p>DIR requires its staff to document their reviews of contract data completeness and accuracy and documented a process to ensure the Salesforce data is updated and reviewed when a Program contract is renewed or amended.</p> <p>In addition, DIR requires its contract managers to review information entered into the Salesforce system by another Contract Manager. However, the review is not documented in the Salesforce system, as required by the agency procedures.</p> <p>No automation controls or edit checks have been added to the Salesforce system to assist in minimizing data entry errors.</p>

## Appendix A

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### Objective, Scope, and Methodology

The objective of this follow-up audit was to verify the implementation status of the corrective action plans developed to address 19 of 23 recommendations from the Texas State Auditor's Office (SAO) audit report 14-007 that DIR management reported as "Fully Implemented."

To accomplish the objective, Internal Audit interviewed DIR staff from the Technology Sourcing Office and the Information Technology Services divisions, reviewed procurement documentation and contracts, statutes, rules, policies and procedures, training and certification documentation, DIR Board materials, and other relevant documentation. In addition, Internal Audit selected contracts to review the cost-savings performance measure process, and compliance with established policies and procedures. Internal Audit also assessed the adequacy and effectiveness of the controls implemented to determine whether the controls mitigated the risks associated to the audit recommendations.

## Appendix B

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### Internal Report Distribution

Department of Information Resources (DIR) Board  
DIR Interim Executive Director  
DIR Chief Operations Officer  
DIR Digital Government / Information Resources Manager  
DIR Information Technology Services Director  
DIR Technology Sourcing Office Director  
DIR Contracts and Vendor Management Manager

### External Report Distribution

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