



MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT



THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

“...The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof.”

– Article IV, Section 53 of the Michigan Constitution

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Michigan
Office of the Auditor General
REPORT SUMMARY

Performance Audit
Interdepartmental Billings and Selected
Service Delivery Evaluation Efforts
Department of Information Technology

Report Number:
 50-505-04

Released:
 May 2005

The Department of Information Technology (DIT) was created in October 2001 by Executive Order No. 2001-3 to achieve a unified and more cost-effective approach for managing information technology (IT) among all executive branch agencies. As a State agency, DIT is empowered to enact an enterprise solution for IT and provide consistent professional management of the State's IT resources.

Audit Objective:

To assess DIT's effectiveness and efficiency in billing State agencies for the actual costs of its services.

Audit Conclusion:

We concluded that DIT was generally effective and efficient in billing State agencies for the actual costs of its services. However, our audit disclosed reportable conditions related to physical inventories and Internet portal and desktop services costs (Findings 1 and 2).

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Audit Objective:

To assess the effectiveness of DIT's efforts in evaluating the quality of services delivered to State agencies.

Audit Conclusion:

We concluded that DIT was moderately effective in its efforts to evaluate the quality of services delivered to State

agencies. Our audit disclosed a reportable condition related to continuous quality improvement activities (Finding 3).

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Audit Objective:

To determine whether information technology related charges billed by DIT to other State agencies are in compliance with U.S. Office of Management and Budget Circular A-87, *Cost Principles for State, Local, and Indian Tribal Governments*.

Audit Conclusion:

We concluded that IT related charges billed by DIT to other State agencies were in material compliance with U.S. Office of Management and Budget Circular A-87, *Cost Principles for State, Local, and Indian Tribal Governments*. Our report does not include any reportable conditions related to this audit objective.

Noteworthy Accomplishments:

The DIT financial management implementation team was awarded the Government Financial Manager of the Year award by the Association of Government Accountants for fiscal year 2003-04. The award was given to this team because DIT and the Department of Management and Budget formed an administrative partnership to design and implement a financial management structure for the newly created DIT that served State agencies' fund sourcing needs; served the needs of DIT management; developed entity financial statements; established a cost accounting process that provided for fair and reliable distribution of costs to satisfy federal and restricted funding

requirements; created monthly billings; provided budget analysis and projections for DIT management; provided rationale and a plan for implementing billing rates for all services; controlled expenses to ensure that appropriations in each department and in DIT were not exceeded; and implemented an activity-based accounting system for payroll.

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Agency Response:

Our report contains 3 findings and 3 corresponding recommendations. The agency preliminary response indicated that DIT agreed with all of our recommendations.

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A copy of the full report can be obtained by calling 517.334.8050 or by visiting our Web site at: <http://audgen.michigan.gov>



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AUDITOR GENERAL

May 12, 2005

Ms. Teresa M. Takai, Director
Department of Information Technology
Landmark Building
Lansing, Michigan

Dear Ms. Takai:

This is our report on the performance audit of Interdepartmental Billings and Selected Service Delivery Evaluation Efforts, Department of Information Technology.

This report contains our report summary; description of agency; audit objectives, scope, and methodology and agency responses; comments, findings, recommendations, and agency preliminary responses; and a glossary of acronyms and terms.

Our comments, findings, and recommendations are organized by audit objective. The agency preliminary responses were taken from the agency's responses subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after the release of the audit report.

We appreciate the courtesy and cooperation extended to us during the audit.

AUDITOR GENERAL

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Description of Agency

The Department of Information Technology (DIT) was created in October 2001 by Executive Order No. 2001-3 to achieve a unified and more cost-effective approach for managing information technology (IT) among all executive branch agencies. DIT is empowered to enact an enterprise solution for IT and provide consistent professional management of the State's IT resources.

The Information Technology Fund, an internal service fund, was created to provide telecommunication and IT services for State agencies. DIT's financial activity is recorded in the Fund and user agencies are billed for the cost of services provided by DIT.

DIT issues monthly invoices to executive branch agencies for IT services through two methods: an invoice for telecommunications and data center operations, which is processed through a monthly interface with the Michigan Administrative Information Network*, and a monthly manually produced interdepartmental invoice for all other IT services, which is paid by agencies via interagency vouchers.

The monthly interdepartmental invoices are the focus of our audit and include all costs for the design, maintenance, and management of IT services, including:

- Direct agency charges (payments to vendors for IT costs incurred on behalf of an agency).
- Payroll costs of DIT first-line, supervisory, managerial, and administrative staff; support costs; and program administration for the areas of Agency Services, Contracts and Procurement, Distributed Processing, and Security Services.
- Desktop services (including help desk, field services, and desktop business management services).
- Internet portal* costs* of the State of Michigan's Web site <<http://www.michigan.gov>>.
- DIT enterprise administration costs (costs not charged through other rates, support costs, or direct charges).
- Center for Geographic Information.

* See glossary at end of report for definition.

- DIT 900 fee (funds IT standards and policy development and strategic planning).
- Early retirement leave payoffs.
- Project management fees.
- Limited specialized services.

Invoice amounts are calculated using a blend of actual costs, allocations of actual costs, and DIT-developed flat rates.

For the fiscal year ended September 30, 2003, DIT had operating expenses of \$516 million and operating revenues of \$507 million. As of August 2004, DIT employed approximately 1,760 employees.

Audit Objectives, Scope, and Methodology and Agency Responses

Audit Objectives

Our performance audit* of Interdepartmental Billings and Selected Service Delivery Evaluation Efforts, Department of Information Technology (DIT), had the following objectives:

1. To assess DIT's effectiveness* and efficiency* in billing State agencies for the actual costs of its services.
2. To assess the effectiveness of DIT's efforts in evaluating the quality of services delivered to State agencies.
3. To determine whether information technology related charges billed by DIT to other State agencies are in compliance with U.S. Office of Management and Budget Circular A-87, *Cost Principles for State, Local, and Indian Tribal Governments*.

Audit Scope

Our audit scope was to examine the program and other records related to the Department of Information Technology's interdepartmental billings and selected service delivery evaluation efforts. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Audit Methodology

Our audit procedures, performed between April and October 2004, included an examination of program records and activities primarily for the period October 1, 2002 through March 31, 2004.

To gain an understanding and plan our audit of DIT's activities related to interdepartmental billings and selected service delivery evaluation efforts, we conducted a preliminary review of associated operations. This included interviewing DIT and Department of Management and Budget management and staff; interviewing executive

* See glossary at end of report for definition.

branch agency staff; examining applicable policies, procedures, and methodologies; reviewing appropriations acts; reviewing billing processes; assessing selected service delivery evaluation efforts; and examining applicable records.

To accomplish our first objective, we analyzed and tested selected monthly interdepartmental billings. We examined invoicing methodologies, recalculated and tested billings, evaluated rate setting procedures for rated services, compared Information Technology Fund operating revenues and operating expenses, and assessed staffing levels associated with producing the monthly manual interagency invoices.

To accomplish our second objective, we interviewed DIT management, reviewed responses to and follow-up action on DIT surveys, and considered other DIT-implemented continuous quality improvement activities.

To accomplish our third objective, we reviewed U.S. Office of Management and Budget Circular A-87, *Cost Principles for State, Local, and Indian Tribal Governments*, and compared costs billed by DIT with the applicable principles.

Agency Responses

Our report contains 3 findings and 3 corresponding recommendations. The agency preliminary response indicated that DIT agreed with all of our recommendations.

The agency preliminary response that follows each recommendation in our report was taken from the agency's written comments and oral discussion subsequent to our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and Department of Management and Budget Administrative Guide procedure 1280.02 require DIT to develop a formal response to our audit findings and recommendations within 60 days after release of the audit report.

COMMENTS, FINDINGS, RECOMMENDATIONS,
AND AGENCY PRELIMINARY RESPONSES

EFFECTIVENESS AND EFFICIENCY IN BILLING STATE AGENCIES

COMMENT

Audit Objective: To assess the Department of Information Technology's (DIT's) effectiveness and efficiency in billing State agencies for the actual costs of its services.

Conclusion: We concluded that DIT was generally effective and efficient in billing State agencies for the actual costs of its services. However, our audit disclosed reportable conditions* related to physical inventories and Internet portal and desktop services costs (Findings 1 and 2).

FINDING

1. Physical Inventories

DIT had not completed a Statewide physical inventory or established complete and accurate records of desktop, laptop, or server computer equipment that State agencies transferred to DIT in October 2001. As a result, DIT did not have a validated count of desktop, laptop, and server computer equipment and may not have accurately billed State agencies for the use and maintenance of this equipment. A physical inventory of computer equipment is also important to help provide adequate safeguarding of assets, to help guard against possible misappropriation of assets, and to help ensure proper inventory valuation.

DIT used agency-submitted computer equipment inventory counts in its computations of information technology (IT) monthly billings to other State agencies. However, DIT did not validate the agency-submitted data used for the billings by completing a Statewide physical inventory.

Department of Management and Budget (DMB) Administrative Guide procedure 1270.05 requires all executive branch departments and subunits to implement and maintain an equipment inventory system that provides adequate internal control and necessary financial information used by the DMB Office of Financial Management in preparing the *State of Michigan Comprehensive Annual Financial Report*. Additionally, departments are required to perform an annual physical inventory of equipment in their possession.

* See glossary at end of report for definition.

At the time of our audit, DIT did not have a Statewide asset management system for tracking computer equipment inventories. DIT informed us that a contract was awarded in August 2004 to develop a comprehensive asset management system with full implementation planned for January 2006.

RECOMMENDATION

We recommend that DIT complete a Statewide physical inventory and establish complete and accurate records of desktop, laptop, and server computer equipment.

AGENCY PRELIMINARY RESPONSE

DIT agreed and will comply by January 2006. DIT informed us that it is implementing a comprehensive IT asset management system in order to more effectively control IT equipment, manage the IT equipment life cycle, and leverage State of Michigan IT assets. DIT also informed us that a contract was awarded in August 2004 and work is underway with a target of January 2006 for full implementation.

FINDING

2. Internet Portal and Desktop Services Costs

DIT did not accurately bill State agencies for Internet portal costs of the State of Michigan's Web site and did not ensure the accuracy of the amounts billed to State agencies for desktop services. As a result, State agencies were billed for Internet portal costs that were not directly attributable to their use. Also, DIT could not ensure the accuracy of the amounts billed to State agencies for desktop services.

Internet portal costs are billed to State agencies based on a weighted blend of content count and number of page views. Desktop services costs are for the operation of the help desk, field services, and desktop business management services and are charged to agencies on a per desktop computer basis.

Our review of billings for the Internet portal costs and desktop computer services costs disclosed:

a. Internet Portal Costs

For the fiscal years ended September 30, 2003 and September 30, 2004, DIT billed approximately \$600,000 (14.5%) and \$320,000 (8.0%), respectively, of

portal costs to State agencies for costs related to use of the portal by other Internet portal users.

Because DIT did not bill the other Internet portal users for their use of the portal, the portal costs attributable to those users were spread proportionately to the State agencies.

According to the service level agreement between DIT and each State agency, portal costs are to be allocated based on the number of times that pages are accessed. DIT did not maintain service level agreements with other user entities.

b. Desktop Computer Services Costs

DIT could not ensure that amounts billed to agencies for desktop services were appropriate. Our review noted:

- (1) Calculations for the desktop services rate used a lower total computer count than the count used for billings, and neither count was validated.

In August 2003, State agencies reported to DIT a total inventory of 52,522 desktop and laptop computers for billings. However, DIT developed its desktop services rate using 49,896 total computers to reflect a projected 5% turn-in factor. By decreasing the total number of computers used to calculate the desktop services rate, DIT increased the rate charged to State agencies for each computer. In August 2004, DIT determined that the 5% projected turn-in rate had not been realized; however, DIT did not adjust the fiscal year 2003-04 desktop services rate.

DIT performed electronic log-on discovery for networked desktop and laptop computers and applied other techniques to account for non-networked desktop and laptop computers. Using these methods, DIT arrived at a total of 57,554 desktop and laptop computers. However, this total did not agree with the agency-submitted count of 52,522. Therefore, in May 2004, DIT and the State agencies agreed that billings would be based on 50,693 total desktop and laptop computers.

- (2) DIT's projections to track desktop services rates and charges at March 31, 2004 and June 30, 2004 indicated that overcharges would

likely result for the fiscal year ended September 30, 2004. However, DIT did not adjust the fiscal year 2003-04 rate.

Prior to the beginning of fiscal year 2003-04 while developing the desktop services rate, DIT projected fiscal year 2003-04 desktop services charges to exceed expenses by approximately \$130,000 or less than 0.5% based on the calculated rate. At March 31, 2004, DIT's projections, based on actual expenses and charges through the second quarter, indicated that desktop services charges would likely exceed expenses by approximately \$663,000 or 1.7% by year-end. At June 30, 2004, projections indicated that desktop services charges would exceed expenses by approximately \$1.1 million or 2.5% by year-end.

Because DIT used differing and nonvalidated computer counts for desktop services rate development and billings and did not adjust its desktop services rate based on projections, DIT was unable to ensure the accuracy of amounts billed to State agencies for desktop services.

According to the service level agreement between DIT and each executive branch agency, services for which a rate has been calculated, such as desktop services, are to be charged based on usage of the specific service.

RECOMMENDATION

We recommend that DIT accurately bill State agencies for Internet portal costs of the State of Michigan's Web site and ensure the accuracy of amounts billed to State agencies for desktop services.

AGENCY PRELIMINARY RESPONSE

DIT agreed and will comply with the Internet portal costs portion of the recommendation in fiscal year 2004-05. DIT informed us that it agrees there is a need to have accurate baseline inventory counts for service rate development and chargeback purposes and that it is implementing a comprehensive asset management system to validate and maintain accurate inventory counts.

EFFECTIVENESS IN EVALUATING THE QUALITY OF SERVICES DELIVERED

COMMENT

Audit Objective: To assess the effectiveness of DIT's efforts in evaluating the quality of services delivered to State agencies.

Conclusion: We concluded that DIT was moderately effective in its efforts to evaluate the quality of services delivered to State agencies. Our audit disclosed a reportable condition related to continuous quality improvement activities (Finding 3).

FINDING

3. **Continuous Quality Improvement Activities**

DIT had not developed a comprehensive continuous quality improvement plan to identify and appropriately address customer needs and levels of customer satisfaction.

Because DIT is the IT service provider to all other executive branch agencies, a comprehensive continuous quality improvement plan is important to help ensure that the timeliness, quality, and level of services and information delivered by State agencies to Michigan's citizens and others is not impaired.

Although DIT performed some continuous quality improvement activities to identify levels of customer satisfaction, those activities were not always followed up with corrective action plans when appropriate. For example, DIT performed a monthly customer satisfaction survey of help desk users. This survey addressed 7 general service areas and levels of customer satisfaction with the service received from DIT. DIT began compiling the responses to this monthly survey in April 2003; however, as of August 2004, DIT had not developed a process to analyze the survey responses or to address the areas in which the survey identified below average customer satisfaction.

DIT also conducted other continuous quality improvement activities, including developing a Statewide Vision and Values document, holding town hall meetings*, establishing the Michigan Information Technology Executive Council (MITECH),

* See glossary at end of report for definition.

and implementing service level agreements with executive branch agencies. However, DIT had not implemented a comprehensive continuous quality improvement plan that included an evaluation process to improve effectiveness by assessing performance indicators* that measure outputs* and outcomes* related to objectives. The process should also provide a comparison of actual with desired outputs, a reporting of the comparison results to management, and proposals for changes to improve effectiveness.

In accordance with Executive Directive No. 2001-3 and industry best practices, DIT should have a Statewide IT continuous quality improvement plan based on the entity's business definition. Executive Directive No. 2001-3 requires all department directors and agency heads to ensure the implementation of quality and customer service management techniques. Additionally, the Control Objectives for Information and Related Technology (COBIT) framework* recommends that management establish a standard approach regarding quality assurance that includes both general and project-specific quality assurance activities. This approach should require specific quality assurance reviews and implement a quality assurance planning process.

RECOMMENDATION

We recommend that DIT develop a comprehensive continuous quality improvement plan to identify and appropriately address customer needs and levels of customer satisfaction.

AGENCY PRELIMINARY RESPONSE

DIT agreed in principle with the recommendation and the need to maintain quality management practices in efforts to identify customer needs and to improve customer satisfaction. DIT informed us that it will continue to implement multiple means of measuring customer needs and satisfaction, which may not be implemented within the formal process framework identified as continuous quality improvement.

* See glossary at end of report for definition.

COMPLIANCE WITH U.S. OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-87

COMMENT

Audit Objective: To determine whether IT related charges billed by DIT to other State agencies are in compliance with U.S. Office of Management and Budget Circular A-87, *Cost Principles for State, Local, and Indian Tribal Governments*.

Conclusion: **We concluded that IT related charges billed by DIT to other State agencies were in material compliance with U.S. Office of Management and Budget Circular A-87, *Cost Principles for State, Local, and Indian Tribal Governments*.** Our report does not include any reportable conditions related to this audit objective.

Noteworthy Accomplishments: The DIT financial management implementation team was awarded the Government Financial Manager of the Year award by the Lansing, Michigan, chapter of the Association of Government Accountants for fiscal year 2003-04. The award was given to this team because DIT and DMB formed an administrative partnership to design and implement a financial management structure for the newly created DIT that served State agencies' fund sourcing needs; served the needs of DIT management; developed entity financial statements; established a cost accounting process that provided for fair and reliable distribution of costs to satisfy federal and restricted funding requirements; created monthly billings; provided budget analysis and projections for DIT management; provided rationale and a plan for implementing billing rates for all services; controlled expenses to ensure that appropriations in each department and in DIT were not exceeded; and implemented an activity-based accounting system for payroll.

GLOSSARY

Glossary of Acronyms and Terms

Control Objectives for Information and Related Technology (COBIT) framework

In April 1996, the Information Systems Audit and Control Foundation (ISACF) developed an internal control framework to manage, use, and audit information technology. The framework (referred to as COBIT) consists of 34 high-level control objectives associated with primary information technology processes, grouped into four domains. The four domains are planning and organization, acquisition and implementation, delivery and support, and monitoring.

The basic philosophy of the COBIT framework is to center the need for internal controls over information technology processes according to a natural grouping of common information technology processes. The framework is based on the concept that management must first achieve a complete understanding of the department's business processes before it can effectively develop, manage, and audit the processes for implementing information and related technology solutions. The framework is based on the underlying assumption that a department's core business processes drive the need for implementing information and related technology. Control objectives define the criteria that must be met to ensure delivery of technology solutions that meet the department's business requirements.

DIT

Department of Information Technology.

DMB

Department of Management and Budget.

effectiveness

Program success in achieving mission and goals.

efficiency

Achieving the most outputs and outcomes practical with the minimum amount of resources.

Internet portal costs	Costs associated with the operation of and updates to the State of Michigan Internet web site.
IT	information technology.
Michigan Administrative Information Network (MAIN)	The State's fully integrated automated administrative management system that supports the accounting, payroll, purchasing, contracting, budgeting, personnel, and revenue management activities and requirements. MAIN consists of four major components: MAIN Enterprise Information System (EIS); MAIN Financial Administration and Control System (FACS); MAIN Human Resource System (HRS); and MAIN Management Information Database (MIDB).
outcomes	The actual impacts of the program.
outputs	The products or services produced by the program.
performance audit	An economy and efficiency audit or a program audit that is designed to provide an independent assessment of the performance of a governmental entity, program, activity, or function to improve public accountability and to facilitate decision making by parties responsible for overseeing or initiating corrective action.
performance indicators	Information of a quantitative or qualitative nature used to assess achievement of goals and/or objectives.
portal	A site featuring a suite of commonly used services, serving as a starting point and frequent gateway to the Web (Web portal) or a niche topic (vertical portal).
reportable condition	A matter that, in the auditor's judgment, represents either an opportunity for improvement or a significant deficiency in management's ability to operate a program in an effective and efficient manner.

town hall meetings

Meetings conducted by the DIT director that are open to all DIT employees. The purpose of the meetings is to keep DIT employees informed and to provide a direct avenue for information sharing.

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