



# 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*

*Statewide Information Technology*

*Contracting Practices*

*Department of Management and Budget and*

*Department of Information Technology*

Report Number:  
50-510-05

Released:  
August 2006

*Acquisition Services, within the Department of Management and Budget (DMB), and the Contract Office (formerly known as Contracts and Procurement Services), within the Department of Information Technology (DIT), share responsibilities for the management of information technology (IT) contracts. The current value of the State's active IT contracts during the period September 30, 2003 through April 1, 2005 was approximately \$4.8 billion. The active IT contracts originated from February 1, 1988 through February 18, 2005.*

***Audit Objective:***

To assess the effectiveness of DMB's and DIT's efforts to administer the IT contracting process.

***Audit Conclusion:***

DMB's and DIT's efforts to administer the IT contracting process were ineffective. In January 2003, the Governor appointed a new director of DMB and a new director of DIT. The new directors initiated projects to improve the IT contracting process. Although DMB and DIT have made improvements in IT procurement and contract administration, significant control weaknesses persist that diminish DMB's and DIT's efforts to manage IT contracts.

***Material Conditions:***

DMB and DIT had not established an effective control environment for managing IT contracts (Finding 1).

DMB's practices for competitively awarding IT contracts were not effective (Finding 2).

DMB and DIT did not perform critical contract monitoring and audit activities (Finding 3).

DMB and DIT need to improve the statements of work for the procurement of IT commodities and services (Finding 4).

***Reportable Conditions:***

DMB and DIT should request the Legislature to update current procurement laws (Finding 5).

DMB and DIT had not fully developed a work force planning strategy to support the State's IT acquisition work force (Finding 6).

***Noteworthy Accomplishments:***

DMB was awarded the National Purchasing Institute's Excellence in Procurement Award for 2005.

In response to Executive Directive No. 2003-1, which established standards of

ethical conduct for the executive branch, DMB developed an on-line tutorial entitled *Ethics for Procurement in State Government*. Over 2,200 State employees responsible for purchasing and contract administration completed the tutorial.

In addition, the director of DMB's Acquisition Services was awarded the Association of Government Accountants' William R. Snodgrass Distinguished Leadership Award. The purpose of the award is to formally recognize State government professionals who exemplify and promote excellence in government financial management and who have demonstrated outstanding leadership in enhancing sound financial management legislation, regulations, practices, policies, and systems.

In 2005, DIT was awarded a National Association of State Chief Information Officers (NASCIO) Recognition Award for Best Practices in the Use of Information Technology in State Government. The award is given each year to technology programs and systems that have created cost-effective, innovative solutions in the operation of State government. DIT won the award for State IT Management Initiatives for its implementation of consolidated IT services. DIT's consolidation approach placed a premium on change and risk management; customer, cross-boundary, and service relationships; and outreach processes. The IT contracting optimization project is an example of DIT's management initiative. DIT worked with DMB to define roles and

responsibilities and to establish a more efficient and effective IT contract administration process.

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**Audit Objective:**

To assess the effectiveness of DIT's efforts to assess the State's need for contracted IT services.

**Audit Conclusion:**

DIT's efforts to assess the State's need for contracted IT services were moderately effective.

**Reportable Condition:**

DIT had not fully developed a formal strategy to govern the State's utilization of IT contractors (Finding 7).

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**Agency Response:**

Our audit report contains 7 findings and 7 corresponding recommendations. DMB's and DIT's preliminary responses indicate that they agree with all of the recommendations and have complied or will comply with them.

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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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August 23, 2006

Ms. Lisa Webb Sharpe, Director  
Department of Management and Budget  
Lewis Cass Building  
Lansing, Michigan  
and  
Ms. Teresa M. Takai, Director  
Department of Information Technology  
Romney Building  
Lansing, Michigan

Dear Ms. Webb Sharpe and Ms. Takai:

This is our report on the performance audit of Statewide Information Technology Contracting Practices, Department of Management and Budget and Department of Information Technology.

This report contains our report summary; description of Statewide information technology contracting practices; audit objectives, scope, and methodology and agency responses; comments, findings, recommendations, and agency preliminary responses; two exhibits, presented as supplemental information; 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 agencies' 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 release of the audit report.

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

AUDITOR GENERAL



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## Description of Statewide Information Technology (IT) Contracting Practices

Acquisition Services, within the Department of Management and Budget (DMB), and the Contract Office (formerly known as Contracts and Procurement Services [CPS]), within the Department of Information Technology (DIT), share responsibilities for the management of IT contracts\*.

Act 431, P.A. 1984, as amended, established Acquisition Services' authority to provide for the procurement of IT commodities and services\*. Acquisition Services strives to maintain operations in line with the three main goals of integrity, quality service, and responsible spending. Acquisition Services' procurement responsibilities include seeking competitive bids\* and negotiating contracts to recognize cost savings in volume purchases and to create more competition in the procurement process to lower vendor\* prices.

Effective October 14, 2001, Executive Order No. 2001-3 created DIT. The Executive Order made DIT responsible for the management of IT contracts and projects and the coordination of IT purchases by State agencies. The Executive Order requires DIT to oversee the expanded use and implementation of project management and contract management principles as they relate to IT projects within the executive branch. In response to the Executive Order, DIT established CPS. In October 2002, CPS published an IT procurement user's guide to document new IT purchasing procedures and to assist in the coordination of IT purchases between DIT and the State agencies. During our audit fieldwork, CPS reorganized and CPS became the DIT Contract Office.

DIT's Contract Office works collaboratively with DMB on IT procurement. The Contract Office's goals include providing access to high quality vendors with proven delivery capabilities and managing contracts and vendors to ensure the best use of limited budget resources.

In addition to DMB's Acquisition Services and DIT's Contract Office, the State Administrative Board, based on the recommendation from its Finance and Claims Committee, is responsible for approving all contracts and contract amendments over \$25,000. For the time period when most of the IT contracts reviewed during our audit originated, the State Administrative Board reviewed and approved all contracts

\* See glossary at end of report for definition.

exceeding \$250,000 and all contract amendments exceeding \$125,000. The Finance and Claims Committee members are the Governor, Attorney General, and State Treasurer.

In November 2004, DMB and DIT collaborated on the IT contracting optimization project. The purpose of the project is to establish a more efficient IT procurement process. DMB and DIT are in the process of restructuring the IT procurement process to eliminate duplication of effort and further define DMB and DIT roles and responsibilities.

The current value of the State's active IT contracts\* during the period September 30, 2003 through April 1, 2005 was approximately \$4.8 billion (see Exhibit 1, presented as supplemental information). The active IT contracts originated from February 1, 1988 through February 18, 2005. During our audit, we reviewed 39 IT contracts representing \$3.0 billion of the \$4.8 billion. DMB awarded 26 (67%) of these contracts before January 2003 (see Exhibit 2, presented as supplemental information).

\* See glossary at end of report for definition.

## Audit Objectives, Scope, and Methodology and Agency Responses

### Audit Objectives

Our performance audit\* of Statewide Information Technology (IT) Contracting Practices, Department of Management and Budget (DMB) and Department of Information Technology (DIT), had the following objectives:

1. To assess the effectiveness\* of DMB's and DIT's efforts to administer the IT contracting process.
2. To assess the effectiveness of DIT's efforts to assess the State's need for contracted IT services.

### Audit Scope

Our audit scope was to examine the program and other records related to information technology commodity and service contracts. 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 from March through December 2005, included an examination of DMB's and DIT's activities and records for IT commodity and service contracts that were active during the period September 30, 2003 through April 1, 2005.

Our criteria used in the audit included management policies and procedures and control guidelines outlined in the Control Objectives for Information and Related Technology\* (COBIT), as issued by the Information Systems Audit and Control Foundation (ISACF) in July 2000, as well as other procurement and contract management best practices.

To accomplish our audit objectives, our audit methodology included a preliminary review of policies, procedures, laws, rules, and regulations related to IT contracts. Our preliminary review included interviews with personnel from DMB's Acquisition Services and DIT's Contract Office to determine their roles and responsibilities for IT contract

\* See glossary at end of report for definition.

management and to obtain an understanding of controls over the IT procurement process. In addition, we identified best practices for IT procurement and contract management. Further, we performed a data analysis to identify IT commodity and service contracts.

To assess the effectiveness of DMB's and DIT's efforts to administer the IT contracting process, we selected a sample of IT commodity and service contracts. For our sample contracts, we reviewed DMB's and DIT's contract bidding and award process, contract provisions, and contract change notices. In addition, we reviewed DMB's and DIT's contract monitoring and audit activities. Finally, we reviewed DMB's and DIT's acquisition work force development and training efforts.

To assess the effectiveness of DIT's efforts to assess the State's need for contracted IT services, we obtained an understanding of DIT's strategic planning process for selecting IT projects. We evaluated DIT's processes for forecasting current and future employee skill sets needed to support State business activities. We met with DIT human resource personnel and assessed DIT's activities for tracking employee skill sets and training needs. We inquired about DIT's activities to monitor contractor\* utilization and to determine the most cost-effective mix of contractors and State employees. In addition, for a sample of IT contracts, we assessed contract provisions to ensure effective knowledge transfer between contractors and State employees.

### Agency Responses

Our audit report contains 7 findings and 7 corresponding recommendations. DMB's and DIT's preliminary responses indicate that they agree with all of the recommendations and have complied or will comply with them.

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

\* See glossary at end of report for definition.

COMMENTS, FINDINGS, RECOMMENDATIONS,  
AND AGENCY PRELIMINARY RESPONSES

# EFFECTIVENESS OF EFFORTS TO ADMINISTER THE INFORMATION TECHNOLOGY (IT) CONTRACTING PROCESS

## COMMENT

**Audit Objective:** To assess the effectiveness of the Department of Management and Budget's (DMB's) and the Department of Information Technology's (DIT's) efforts to administer the IT contracting process.

**Conclusion: DMB's and DIT's efforts to administer the IT contracting process were ineffective.** Our assessment disclosed four material conditions\*. DMB and DIT had not established an effective control environment for managing IT contracts (Finding 1). Also, DMB's practices for competitively awarding IT contracts were not effective (Finding 2). In addition, DMB and DIT did not perform critical contract monitoring and audit activities (Finding 3). Finally, DMB and DIT need to improve the statements of work (SOWs) for the procurement of IT commodities and services (Finding 4). Our assessment also disclosed reportable conditions\* related to legislation and an IT acquisition work force planning strategy (Findings 5 and 6).

In January 2003, the Governor appointed a new director of DMB and a new director of DIT. The new directors initiated projects to improve the IT contracting process. Although DMB and DIT have made improvements in IT procurement and contract administration, significant control weaknesses persist that diminish DMB's and DIT's efforts to manage IT contracts.

**Agency Preliminary Response:** DMB and DIT management believe that the material weaknesses identified in this audit represent an independent validation of the concerns identified in the 2003 Contract and Procurement Task Force Report, which resulted from Executive Directive No. 2003-8. The task force report identified four critical areas of focus for Michigan's procurement environment:

1. Integrity and Ethics in Procurement
2. Full and Open Competition
3. Contract Administration
4. E-Procurement

\* See glossary at end of report for definition.

DMB and DIT believe that the task force report and this independent audit are evidence that the direction of procurement prior to 2003 was not a direction that would consistently provide the best value for Michigan taxpayers. DMB and DIT noted that the majority of the deficiencies related to DMB's and DIT's contract award practices were associated with 26 contracts that were awarded prior to 2003, including many that were awarded prior to the creation of DIT in 2001.

DMB and DIT believe that this audit also illustrates that significant reforms and improvement in IT procurement controls have been achieved by the departments since 2003, particularly with regard to the competitive award of IT contracts. DMB and DIT noted that they have worked together to initially limit sole source\* awards and subsequently eliminate them entirely. DMB and DIT also informed us that they have been working together to ensure that expiring IT contracts are competitively bid in cases where there is a continuing need for services and the services cannot be provided by State employees. In addition, DMB and DIT informed us that they recently hired a consultant to help identify additional improvements in their contract management practices. DMB and DIT believe that these changes represent a dramatic departure from the previous IT procurement environment, when sole source awards and other noncompetitive contracting decisions were commonplace.

**Noteworthy Accomplishments:** DMB was awarded the National Purchasing Institute's Excellence in Procurement Award for 2005. The award is earned by those organizations that demonstrate excellence by obtaining a high score on a rating of standardized criteria. The program is designed to measure innovation, professionalism, e-procurement, productivity, and leadership attributes of the procurement function.

In response to Executive Directive No. 2003-1, which established standards of ethical conduct for the executive branch, DMB developed an on-line tutorial entitled *Ethics for Procurement in State Government*. Over 2,200 State employees responsible for purchasing and contract administration completed the tutorial.

In addition, the director of DMB's Acquisition Services was awarded the Association of Government Accountants' William R. Snodgrass Distinguished Leadership Award. The purpose of the award is to formally recognize State government professionals who exemplify and promote excellence in government financial management and who have demonstrated outstanding leadership in enhancing sound financial management legislation, regulations, practices, policies, and systems.

\* See glossary at end of report for definition.

In 2005, DIT was awarded a National Association of State Chief Information Officers (NASCIO) Recognition Award for Best Practices in the Use of Information Technology in State Government. The award is given each year to technology programs and systems that have created cost-effective, innovative solutions in the operation of State government. DIT won the award for State IT Management Initiatives for its implementation of consolidated IT services. DIT's consolidation approach placed a premium on change and risk management; customer, cross-boundary, and service relationships; and outreach processes. The IT contracting optimization project is an example of DIT's management initiative. DIT worked with DMB to define roles and responsibilities and to establish a more efficient and effective IT contract administration process.

## **FINDING**

### **1. IT Contract Control Environment**

DMB and DIT had not established an effective control environment for managing IT contracts. Collectively, many of the control weaknesses found during our review indicated an increased risk for potential improprieties in the contracting process. Our review of the IT contracting process disclosed:

- a. DMB had not established a process for purchasing employees to report possible improprieties in the contracting process. Sections 2-8 and 2-10 of the *Michigan Civil Service Commission Rules\**, the State Ethics Act\*, and Executive Directive No. 2003-1\* establish rules for ethical standards and guidelines for reporting suspected improprieties. DMB's *Evaluation of Internal Controls - A General Framework and System of Reporting* states that agencies should establish comprehensive written policies or codes of conduct, including procedures to report illegal or improper activities. Establishing a confidential reporting process in which employees could report their concerns without fear of retribution would improve the integrity of the contracting process.

We noted that DMB had not consistently followed its own purchasing policies, procedures, and best practices. For example, in December 2000, DMB canceled the joint evaluation committee\* (JEC) for the development of the Michigan Child Support Enforcement System (MiCSES) and awarded a sole source contract to Policy Studies, Inc. (PSI) without sufficient justification. The

\* See glossary at end of report for definition.

sole source justification indicated that the vendor was uniquely qualified to meet the State's procurement objective. However, the DMB buyer indicated that there were other vendors qualified to perform the work. Act 431, P.A. 1984, as amended, requires DMB to first determine that competitive solicitation of bids is not appropriate before using any other procurement method for an acquisition. In addition, in March 2002, DMB processed a 10-year extension on the State's contract with the IBM Corporation for the Michigan Administrative Information Network\* (MAIN) hosting, contrary to recommendations from the DMB buyer and a consultant to renew the contract for a shorter time period.

DMB informed us that the contracts were processed at the direction of management. However, we could not determine the rationale for management's decisions because the contract files did not contain documentation to support the decisions. Management override of established controls compromises the integrity of the entire procurement process.

Our review did not identify any instances of the current management overriding established controls.

- b. DMB and DIT had not always utilized effective competitive bidding practices and had awarded some sole source contracts to vendors without proper justification (see Finding 2). DMB Administrative Guide procedure 510.13 specifies the conditions for which a sole source contract may be issued. The procedure requires the requesting State agency to prepare a sole source justification that documents one or more of the conditions. The existence of unbiased competitive bidding practices is necessary to help ensure an arm's length relationship between a particular vendor and the State.
- c. DMB and DIT did not have an effective quality assurance process for IT contract administration. According to the Control Objectives for Information and Related Technology (COBIT), organizations should define, plan, and implement measures to monitor compliance with established best practices for critical processes. Our review identified inconsistent and inadequate documentation in the contract files, especially related to JEC conclusions (see Finding 2). Further, DMB and DIT did not prepare SOWs that contained

\* See glossary at end of report for definition.

specific objectives and vendor tasks and how employees would tie those tasks to the expected outcomes of the project (see Finding 4). A well-functioning quality assurance process would help DMB and DIT ensure that employees comply with established policies and procedures and ensure the proper documentation of all relevant activities and decisions.

- d. DMB and DIT had not established a risk assessment process for managing IT contracts. An effective risk assessment process would help DMB and DIT focus their limited resources on contracts with the greatest exposure to project or contract failure, noncompliance, fraud, or abuse. Factors that may be useful in identifying the level of risk include: the complexity and subject matter of the procurement, the dollar amount of the procurement and whether the procurement will result in a major contract, whether the procurement will impact the public, and the availability and experience of staff resources required to implement the objectives of the procurement. COBIT suggests that an IT procurement policy differentiate purchases depending on the risk involved. DMB and DIT can determine this risk by reviewing aspects such as the contract's cost and criticality to an agency.
- e. DMB and DIT had not fully developed policies and procedures for IT procurement and contract administration. Without documented policies and procedures, DMB and DIT management cannot be assured that their directives will be properly communicated to their employees. We noted:
  - (1) DMB and DIT had not fully developed their operational procedures to provide employees with guidance and examples of best practices for implementing established policies. Providing guidance and examples of best practices may help employees improve the consistency and quality of contract documents.
  - (2) DMB and DIT had not updated the DMB Administrative Guide procedures to reflect the current IT procurement environment from an enterprisewide perspective. The Administrative Guide procedures should be updated to reflect the changes in IT contracting procedures since the establishment of DIT's Contract Office.
  - (3) DMB and DIT had not fully established policies and procedures to manage the IT procurement and contracting administration function. For

example, DIT had not defined when the use of certain IT contract terms and conditions, such as liquidated damages, software escrow, IT security, and audit requirements, would be mandatory. Also, DMB and DIT had not established policies and procedures for assessing and monitoring contractor performance. In addition, DMB and DIT had not established a process for identifying external legal and regulatory requirements and their impact on the IT contracts.

The National Association of State Procurement Officials recommends that State governments have a clear and enforced set of procurement ethics, standards, and policies to optimize the procurement function.

DMB and DIT have made efforts to improve the controls over IT contracts. For example, DMB established a knowledge management function to improve purchasing operations, including revising purchasing policies and procedures, updating invitation-to-bid\* and request-for-proposal\* templates, developing training, establishing checklists, and conducting independent reviews of vendor protests. Likewise, DIT informed us that it has drafted new policies and procedures and established templates and checklists for developing SOWs and contract terms. Also, DMB and DIT informed us that they have established IT procurement goals for streamlining the procurement process to make the IT procurement process more effective and efficient. In addition, DMB and DIT informed us that they took proactive steps to reduce the number of sole source contracts awarded by the State.

### **RECOMMENDATION**

We recommend that DMB and DIT continue their efforts to establish an effective control environment for managing IT contracts.

### **AGENCY PRELIMINARY RESPONSE**

DMB and DIT agree and informed us that they have complied or will comply with the recommendation.

With regard to item a., DMB informed us that it is developing an internal procedure to provide guidance to employees on the applicability of existing legal requirements

\* See glossary at end of report for definition.

(Sections 2-8 and 2-10 of the *Michigan Civil Service Commission Rules*, the State Ethics Act, and Executive Directive No. 2003-1) to the contracting function and to establish a process for employees to report possible improprieties.

With regard to item b., DMB and DIT agree that the justifications and approvals for sole source awards were not appropriately documented, primarily for contracts issued prior to 2003. DMB informed us that with the implementation of Executive Directive No. 2005-3, the previous procurement culture that allowed frequent sole source contracting has been eliminated and competitive bidding is now mandated.

With regard to items c. and d., in addition to the improvements identified in the finding, DMB and DIT have recently developed a risk assessment process and implemented project control offices for large IT systems development contracts. These project control offices now serve as a critical control over contractor performance.

With regard to item e., DMB and DIT informed us that they are developing and implementing comprehensive policies and procedures for procurement and contract administration and monitoring. DMB informed us that, in addition to the improvements identified in the finding, it had created an on-line desk manual, which guides procurement staff through all required elements of an IT or other procurement. DMB and DIT will work to achieve full compliance with the recommendation by December 31, 2006.

## **FINDING**

### **2. IT Contract Award Practices**

DMB's practices for competitively awarding IT contracts were not effective. As a result, DMB could not demonstrate that it obtained the best value\* for IT commodities and services.

According to COBIT, agencies should develop an effective competitive bid process to purchase IT commodities and services before awarding IT contracts. An effective and comprehensive competitive bid process, which includes a thorough selection and evaluation of vendor bids, would help to ensure that the State realizes the best value on IT purchases.

\* See glossary at end of report for definition.

We reviewed 39 IT contracts that were active during the period September 30, 2003 through April 1, 2005. The current value of these 39 IT contracts was \$3.0 billion. DMB awarded 26 (67%) of these contracts before January 2003 (see Exhibit 2 for detailed listing of contracts).

Our review of contract documentation disclosed:

- a. DMB had not always awarded sole source IT contracts in accordance with sole source eligibility criteria. DMB Administrative Guide procedure 510.13 states that a sole source award can be issued for one or more of the following documented conditions: (1) the service or commodity is available from only one source, (2) the service or commodity must be compatible with current services or equipment, (3) it would not be economically feasible for another vendor to perform the service, or (4) a single vendor is uniquely qualified to meet the agency's procurement objective.

We reviewed 11 sole source IT contracts awarded from December 8, 1994 through October 1, 2004. DMB awarded 7 (64%) of 11 sole source contracts before January 2003 (see Exhibit 2 for detailed listing of contracts). The original award value of the 11 contracts was \$229.9 million. However, at the time of our review, the contracts' value had increased to \$534.2 million. Our review disclosed:

- (1) Five (45%) of 11 sole source contract files did not contain sole source justification forms. Without proper documentation, DMB cannot attest to the validity of sole source procurements.
- (2) Four (36%) of 11 sole source contract files did not contain all required approvals for the procurement. DMB's internal policy specifies the approvals required based on the initial contract value. The sole source justification forms for these contracts did not include approvals from buyers, buyers' managers, or the director of Acquisition Services as required. Without appropriate approvals, DMB cannot ensure the integrity of the IT procurement process.
- (3) DMB did not obtain sufficient documentation from State agencies to support its decisions to award the sole source contracts. At a minimum, contract documentation should include the agency's justification for the

sole source contract, the agency's efforts to identify other suitable vendors, and the agency's efforts to limit the sole source contract to commodities and services that are only available from one source.

Executive Directive No. 2005-3, issued on April 30, 2005, prohibited sole source contracts except for specific circumstances. This Executive Directive indicates that it is in the State's best interest to utilize a competitive procurement process. DMB informed us that it has performed an analysis showing that the State pays 10% to 12% more for commodities and services when only one vendor responds to a contract proposal.

- b. DMB did not always demonstrate effective competitive bidding practices for IT contracts. DMB utilizes JECs to review contract bids from vendors and to make a vendor recommendation based on their analysis. An effective JEC process is necessary to ensure that DMB conducts the contract bid process in a fair, consistent, and unbiased manner.

Of the 39 IT contracts reviewed, 28 were competitively bid by DMB. DMB utilized a JEC to recommend a vendor for 22 of 28 IT contracts.

Our review of the 22 contract files identified the following deficiencies in the JEC process (see Exhibit 2 for detailed listing of contracts):

- (1) Seven (32%) contract files did not contain documentation to support the JEC's vendor recommendation. Without documentation, DMB and DIT cannot ensure that the JEC process was conducted in accordance with DMB policies and procedures. In addition, poor documentation decreases the likelihood that DMB and DIT can successfully defend the JEC's recommendations if the contract award is appealed.
- (2) Five (23%) contract files did not contain objective and measurable evaluation criteria for the JEC to use in evaluating vendor proposals. For example, some of the JEC's established general evaluation criteria and indicated the maximum points that could be awarded. However, the interpretation of the criteria and how to award points was determined by each JEC member. Without objective evaluation criteria, DMB and DIT cannot ensure vendor proposals were evaluated in a fair, consistent, and unbiased manner.

- (3) Eighteen (82%) contract files did not contain evidence that DMB assigned staff to JECs with the technical knowledge necessary to evaluate the feasibility of vendor proposals. A JEC composed of members representing purchasing, technical, and business functions would increase the JEC's ability to make knowledgeable decisions and allow the JEC to evaluate more effectively the technical merits of vendor proposals.
  - (4) Sixteen (73%) contract files did not contain conflict of interest disclosures for JEC members. As a result, DMB cannot provide evidence that all JEC members were unbiased and did not have a personal interest in the contract award. DMB Administrative Guide procedure 0510.07 requires JEC members to complete conflict of interest disclosure forms after reviewing the list of bidding vendors.
- c. DMB did not always provide complete and accurate contract information to the State Administrative Board for its review and approval. DMB communicates information about IT contracts and award recommendations to the State Administrative Board on a bid tabulation\* (bid tab) form.

Our review of the bid tab documentation for 34 IT contracts and related change orders disclosed:

- (1) DMB did not always provide the State Administrative Board with the total cost of system development and ownership. The costs documented on the bid tab represented primarily the project development costs, but often did not include costs for future system maintenance, operational support, and software upgrades. As a result, DMB subsequently processed change orders to pay for these items. When practical, DMB should include estimates of these additional costs to provide the State Administrative Board with a more accurate assessment of the total cost of a system.
- (2) DMB did not ensure that bid tab documents always contained sufficient, accurate, and relevant information about the contract or change order. Bid tabs amending the State's contract with Electronic Data Systems (EDS) for end-user computing and network services for \$240 million

\* See glossary at end of report for definition.

and \$40 million did not provide a reasonable explanation or sufficient detail on what IT commodities and services were being purchased or how the amendment amounts were derived.

Including meaningful information about an IT system or project would improve the State Administrative Board's ability to provide effective oversight.

DMB informed us that, during our audit fieldwork, it had implemented improvements in the IT contract award process. We observed improvements in the sufficiency and organization of the contract award documentation for more recent contracts in our sample. DMB also used DIT technical advisors on the JECs for these contracts. In addition, DMB informed us that it had revised its bid tab to include information justifying the purchase, as well as the basis for the cost estimate and any identified savings.

### **RECOMMENDATION**

We recommend that DMB continue its efforts to develop effective practices for competitively awarding IT contracts.

### **AGENCY PRELIMINARY RESPONSE**

DMB and DIT agree and informed us that they have complied or will comply with the recommendation.

In response to item a., with the implementation of Executive Directive No. 2005-3, competitive bidding is now mandated. DMB and DIT informed us that they have eliminated sole source awards for IT contracts. Between 2003 and the issuance of the Executive Directive, DMB had significantly reduced the number and value of sole source contracts. In addition, DIT informed us that it has implemented new processes to ensure that all requests from agencies for IT commodities and services are competitively bid or are covered within an existing competitively bid contract.

In response to item b., DMB and DIT informed us that they have implemented policy changes and restructured the JEC process to address these past deficiencies. In addition, DMB and DIT will continue working to ensure that JEC recommendations are based on objective and measurable criteria and that contract

files contain sufficient documentation to support such recommendations. DMB and DIT believe that they have made significant progress to ensure that JEC members possess the appropriate mix of business and IT knowledge necessary to evaluate vendor proposals. DMB and DIT will continue to identify and assign to future JECs appropriately qualified individuals representing purchasing, technical, and business functions. Finally, with regard to the portion of the finding related to the lack of conflict of interest disclosures, DMB informed us that it now requires such disclosure forms for all JEC members.

In response to item c., as noted in the finding, DMB made improvements to the information presented on the bid tab to support its contracting decisions and provide better information to the State Administrative Board. In addition, DIT informed us that controls over IT procurements now include the bid information sheet. This document requires that agencies provide more detailed information on projected costs, project feasibility and a thorough business case analysis. DMB and DIT will continue to work together to obtain and provide such information to the State Administrative Board for large future IT procurements and to ensure that information provided in bid tabs is complete and accurate.

## **FINDING**

### **3. IT Contract Monitoring and Audit**

DMB and DIT did not perform critical contract monitoring and audit activities. As a result, DMB and DIT did not meet the minimum standards of due diligence necessary to ensure that contractors were performing duties in accordance with contract terms.

Our review disclosed the following weaknesses:

- a. DIT did not proactively evaluate and document vendor performance information. In addition, DMB did not use past vendor performance information in its vendor selection process. Therefore, DMB and DIT could not fully ensure the selection of the most qualified vendor.

The Office of Federal Procurement Policy's (OFPP's) *Best Practices for Collecting and Using Current and Past Performance Information* states that current performance assessment is a basic "best practice" for good contract

administration and is one of the most important tools available for ensuring good contractor performance. Also, the evaluation and use of past performance is instrumental in making "best value" selections in the contract award process. The OFPP guide recommends that vendors regularly be evaluated in four areas: quality, cost, timeliness, and business relations.

State agencies can document vendor performance problems in the Advanced Purchasing and Inventory Control System\* (ADPICS). However, we found very limited documentation of vendors' performance in ADPICS.

To improve the usefulness of vendor performance information, DMB and DIT should establish standards governing the collection and use of vendor performance data.

- b. DMB and DIT did not monitor the propriety and reasonableness of large dollar change orders. Failure to manage and control contract changes can result in unintended increases to the time, scope, and cost of the contract; circumvent management controls; and diminish contractor accountability. By monitoring change orders, DMB and DIT would help to ensure that all contract modifications are necessary and relevant to the original contract or project.

We identified 17 contracts with change orders that increased the original contract value by more than 100%. The current value of the 17 contracts is approximately \$1.8 billion (see Exhibit 2 for detailed listing of contracts).

Our review disclosed a large number of change notices to the scope of the IBM Corporation's MAIN hosting contract. The original contract was to provide for the development and operation of MAIN processing, the Internet work, and the MAIN Management Information Database\* (MIDB). For example:

- (1) DMB processed approximately \$29 million of change notices for goods\* and services that appeared to be outside the scope of the original contract. For many of the change orders, DMB did not have sufficient documentation to justify the necessity of the change notices or to explain why the items or services requested were related to the scope of the original contract. For example, DMB processed a \$447,630 change

\* See glossary at end of report for definition.

notice to provide software assistance to develop the Data Collection and Distribution System\* (DCDS)/Human Resources Management Network\* (HRMN) interface; a \$255,800 change notice to provide consulting services to assist with the DIT asset management project; and change notices totaling \$204,680 for a Lawson/HRMN system administrator. In 2002, when DMB negotiated the latest contract extension with the IBM Corporation, it revised the contract to help clarify and specify which vendor responsibilities were within the scope of the contract.

- (2) DMB did not ensure that all change notices included basic information, such as project plans, expected deliverables\*, or work breakdown structures\*. Without such information, contract administrators\* may find it difficult to hold the vendor accountable and ensure that the intended results are achieved.
- c. DMB and DIT did not perform audits of IT contracts. Therefore, DMB and DIT could not ensure that vendors were complying with contract terms and provisions. Auditing contract provisions would improve contract oversight and help DMB and DIT ensure that the State obtains the best value on its IT contracts.

For example, the State's contract with the IBM Corporation for MAIN hosting and operational support allows the State to audit the basis and accuracy of the IBM Corporation's billings for operations and services. In the 12 years of contracting with the IBM Corporation, neither DMB nor DIT had performed periodic audits of the accuracy of its billings.

Likewise, DMB and DIT did not validate vendor pricing assertions. Contracts such as the IBM Corporation's MAIN hosting contract and EDS's contract for end-user computing and network services and its Michigan Master Computing Contract have most favored customer clauses. A most favored customer clause requires the vendor to give the State its best pricing available on the goods or services purchased. DMB and DIT informed us that they did not perform periodic audits to ensure that the State received the best pricing.

\* See glossary at end of report for definition.

- d. DIT had not established a standard process to track and monitor contract requirements and deliverables.

DIT contract administrators informed us that they primarily relied on the project managers to determine whether the contractors were complying with the contract requirements, meeting deadlines, and producing acceptable deliverables.

While project managers have an important role in contract monitoring, the responsibility for contract monitoring should remain with the contract administrators to ensure a proper separation of duties. DMB Administrative Guide procedure 0510.08 indicates that it is the contract administrator's duty to review vendor progress and ascertain whether all terms and conditions of the contract have been met. Therefore, DIT should establish standard procedures and templates to track and monitor the acceptance of significant contract deliverables.

- e. DMB and DIT had not established contract closeout audit procedures. The purpose of a closeout audit is to verify that both the contractor and the State have fulfilled their contractual obligations.

Performing contract closeout audits would help ensure that the State pays no more than a fair amount for IT goods and services and that the State receives the complete goods or services that it paid for. In addition, a closeout audit would provide DMB and DIT with the opportunity to assess vendor performance and ensure that all relevant documentation is maintained in the contract file.

- f. DIT had not established a plan for assessing the appropriateness of long-term IT contracts. DIT had 24 IT contracts with contract periods and extensions lasting five years or longer. Without periodic review, DIT cannot be assured that the contracts continue to provide the best value. As such, DIT should establish time frames and procedures for performing cost-benefit analyses to determine whether the State should continue an existing contract, rebid the contract, or replace and upgrade to new technology.

## **RECOMMENDATION**

We recommend that DMB and DIT perform critical contract monitoring and audit activities.

## **AGENCY PRELIMINARY RESPONSE**

DMB and DIT agree and informed us that they have complied or will comply with the recommendation. DMB and DIT noted that the finding is consistent with the 2003 Contract and Procurement Task Force Report, which recommended several specific contract management improvements.

With regard to item a., DIT informed us that, for all major projects, it is now evaluating and documenting vendor performance through an improved project control office monitoring process. Also, DMB informed us that it now incorporates past vendor performance into the standard invitation-to-bid template and considers such information in the formal proposal evaluation process conducted by JECs.

With regard to the remainder of the finding, DMB and DIT indicated that they will continue to jointly improve contract monitoring and audit activities. DIT informed us that it has implemented new policies and procedures that require DIT's Agency Services staff to complete technical reviews of agency requests for new systems and system enhancements, as well as significant change orders to existing contracts, prior to such requests being submitted to DIT's Contract Office. In addition, DIT, in consultation with DMB, is developing improved contract monitoring and audit processes, including procedures designed to: ensure compliance with contract terms; track contract requirements and acceptance of deliverables; complete contract closeout audits, and ensure that contract files have all required documentation. Also, DIT informed us that it provided training on its new policies and procedures to all of its contract administrators. DMB and DIT will work to achieve full compliance with the recommendation by December 31, 2006.

## **FINDING**

### **4. Statements of Work (SOWs)**

DMB and DIT need to improve the SOWs for the procurement of IT commodities and services. Poorly written SOWs may result in the procurement of poor quality commodities and services, unfavorable vendor pricing, and diminished control over project costs over the life of the contract.

Our review of SOWs for 39 IT contracts disclosed:

a. DIT had not developed standards for writing effective SOWs. Without appropriate standards, DIT could not ensure that its SOWs consistently contained the essential elements. Federal government procurement guidelines suggest that SOWs should clearly document vendor performance requirements, establish time frames and completion dates, as well as identify results, performance measures, and acceptance criteria. Our review disclosed the following examples of SOWs with poor vendor performance requirements:

- (1) The SOW for the contract between Compuware Corporation and the Unemployment Insurance Agency, now part of the Department of Labor and Economic Growth (DLEG), contained a general list of tasks that DLEG expected Compuware Corporation to perform under the contract. However, the SOW did not identify the outcomes or desired results and acceptance criteria. This may have impacted DMB's and DLEG's ability to assess the effectiveness of the vendor's performance. DMB processed approximately \$3 million in contract amendments for the Compuware Corporation contract.
- (2) The SOW for the contract between EDS and the MiCSES project control office did not contain detailed tasks and deliverables, sufficient vendor performance requirements, or suitable agency acceptance criteria for work performed under the contract.
- (3) The PSI contract to provide transition planning and program management for MiCSES did not utilize an SOW. Our review of contract documentation indicated that DMB and the Department of Human Services (DHS), formerly known as the Family Independence Agency, accepted the PSI's project proposal in lieu of an SOW. The absence of an SOW may have negatively affected DHS's ability to manage the project effectively and may have resulted in the significant growth of this contract. The PSI contract was awarded in December 2000 for \$5.5 million dollars and by March 2004 had increased to \$200.3 million dollars.

DMB Administrative Guide procedure 0510.01 requires State agencies to complete an SOW that details the work that the agency expects the vendor to perform, the time frames for performance, and the specific outcomes and

deliverables. In addition, the State's project management methodology requires SOWs for development projects and indicates that vendors should not develop the SOW.

- b. DMB and DIT had not implemented a quality assurance process over SOWs for IT contracts. A quality assurance process would help DMB and DIT ensure that the SOWs contain the essential elements, specifically address each IT project's unique requirements, and are formally approved by the business owners.

During our audit fieldwork, DMB enhanced the invitation-to-bid template and DIT developed SOW checklists to help ensure that SOWs for IT contracts contained the required elements. Continued improvements to address the quality of the SOWs would help DMB and DIT in their efforts to contract for timely, high quality IT commodities and services.

### **RECOMMENDATION**

We recommend that DMB and DIT improve the SOWs for the procurement of IT commodities and services.

### **AGENCY PRELIMINARY RESPONSE**

DMB and DIT agree and informed us that they have complied or will comply with the recommendation. DMB and DIT believe that deficiencies in the SOWs identified in the finding may have contributed to the many problems related to these contracts. DMB noted that while it generally defers to end-user agencies for expertise in drafting SOWs, it is now DMB's practice to intercede, when necessary, to promote full and open competition.

DMB and DIT informed us that they now require prospective vendors for all IT solicitations to identify if they have had any role in creating the SOW. In addition, DIT informed us that its new SOW templates require agencies to invest more time in analyzing potential costs and thoroughly developing business requirements. DIT also informed us that it implemented new policies and procedures that require DIT's Agency Services group to review all requests for new systems and systems enhancements in order to ensure that SOWs contain well-defined business requirements (developed in conjunction with the user agency). DIT will continue its ongoing initiative to train staff on the new SOW templates and the development of

business requirements. DMB and DIT will work to achieve full compliance with the recommendation by December 31, 2006.

## **FINDING**

### 5. Legislation

DMB and DIT should request changes in legislation to update current procurement laws. Updating current State procurement laws would clarify and strengthen DMB's and DIT's authority over IT procurement and contract management and would help to ensure that policies and procedures are consistently enforced.

The National Association of State Procurement Officials recommends that state governments establish a clear and enforced set of procurement ethics, standards, and policies that apply to both the executive and legislative branches and are codified in law. Our research identified other states' legislation and federal legislation that, if implemented in Michigan, would improve controls over IT procurement and contract management.

For example:

- a. State law does not sufficiently specify the circumstances when it is appropriate for DMB to award no-bid (sole source) IT contracts. In addition, State law does not require DMB to periodically review no-bid contracts and contract amendments to make a determination as to whether the no-bid award continues to be justified.

Act 431, P.A. 1984, as amended, requires DMB to first determine that competitive solicitation of bids in the private sector is not appropriate before using any other procurement method for an acquisition. In addition, Executive Directive No. 2005-3, effective April 30, 2005, prohibits the use of no-bid contracts except for in emergencies. However, an executive directive does not have the permanence of a State law. A State law governing the award of no-bid contracts may have prevented DMB's awarding of no-bid contracts that were not well justified (see Finding 2).

- b. State law does not prohibit the disclosure of procurement information. For example, State law does not protect vendor proprietary financial information

from Freedom of Information Act (FOIA) requests. DMB informed us that vendors are reluctant to provide proprietary financial information that could be used by its competition. DMB informed us that its inability to protect this information puts the State at a disadvantage when negotiating with vendors. Protecting vendors' proprietary financial information from FOIA disclosure would enable DMB to more effectively negotiate a fair and reasonable price for the State.

- c. State law does not prohibit vendors involved in creating technical proposals and requirements from bidding on resulting projects. Allowing vendors to bid on contracts in which the vendor assisted in developing the project requirements may give the vendor an unfair advantage.
- d. DMB should strengthen the State's code of ethics to protect the State against the improprieties in the contracting process.

Act 196, P.A. 1973, as amended, establishes a code of ethics for State of Michigan employees and officers. However, the Act does not establish time frames prohibiting State employees involved in the contractor selection or award process or that have acted as project manager, program manager, or contract administrator from accepting compensation from the contractors after separating from State service. Title 41, Section 423 of the *United States Code* establishes a one-year prohibition from accepting compensation from a contractor for former federal employees when contracts exceed a certain dollar threshold and the employee is involved in the selection of the contractor or administration of the contract. In addition, the federal law establishes penalties for both the contractor and former employee who violate the law.

During our review, we became aware of senior State executives who accepted employment from IT contractors subsequent to separating from the State. Although we did not determine that the weaknesses identified in this audit report were related to the executives obtaining employment from IT contractors, strengthening the State's code of ethics would help protect the State from even the appearance of improprieties.

## **RECOMMENDATION**

We recommend that DMB and DIT request changes in legislation to update current procurement laws.

## **AGENCY PRELIMINARY RESPONSE**

DMB and DIT agree and will comply with the recommendation. DMB and DIT believe that several important legislative changes are necessary to clarify and strengthen their authority over IT procurement and contract management and to improve controls over these critical activities.

With regard to item a., DMB informed us that the Michigan Senate passed Senate Bill 662 of 2005 to codify the Governor's Executive Directive No. 2005-3, which essentially prohibited the use of no-bid contracts. DMB indicated that this bill has remained with the House Committee on Government Operations since October 2005.

With regard to item b., DMB will pursue legislation to protect prospective vendors' proprietary financial information from FOIA requests, which would enable DMB to more effectively negotiate fair and reasonable pricing on IT contracts.

With regard to item c., DMB informed us that it has already added a new requirement to current IT solicitations for prospective vendors to identify in their proposals if they have had any role in creating the SOW. To further strengthen IT procurement controls, DMB will pursue specific legislation to prohibit vendors involved in creating technical proposals and requirements from bidding on resulting projects.

With regard to item d., DMB agrees that changes to the State's code of ethics are necessary to protect the State against the appearance of improprieties in the contracting process. DMB and DIT also agree that situations in which senior State employees accept employment with IT contractors after separating from State service can present the appearance of improprieties in the contracting process. DMB informed us that the Governor has already proposed legislation (House Bill 5980 and Senate Bill 1217, both introduced in April 2006) that would establish comprehensive standards of ethical conduct and conflict of interest standards for current and former employees and officials in the executive branch, including employees with contracting responsibilities. This proposed legislation also would

prohibit an employee or official in the executive branch with responsibility for the management of a contract from (1) acting on any matter that may result in a conflict of interest or a violation of the proposed new ethics law; (2) soliciting or accepting political contributions from a contractor; and (3) engaging in discussions or negotiations with a contractor regarding direct or indirect employment of the official or employee by the contractor. DMB and DIT responded that "all seven senior State employees who accepted employment from IT contractors after separating from the State did so prior to or shortly after January 1, 2003. These individuals included: former Governor John Engler, two former department directors (Douglas E. Howard - Family Independence Agency, Janet E. Phipps - DMB), three former deputy directors (Theodore J. Benca - Civil Service, David C. Viele - Community Health, and John M. Kost - DMB), and the former director of the Office of Child Support (Wallace N. Dutkowski)."

## **FINDING**

### **6. IT Acquisition Work Force Planning Strategy**

DMB and DIT had not fully developed a work force planning strategy to support the State's IT acquisition work force. A work force planning strategy is necessary to ensure that the State's IT acquisition work force has the skills necessary to secure best value IT commodities and services. According to COBIT, employees should be provided with an appropriate orientation when hired and ongoing training to maintain their knowledge, skills, abilities, and internal control\* and security awareness at the level required to achieve organizational goals.

Our review disclosed:

- a. DMB and DIT had not formally defined their respective roles and responsibilities with regard to IT procurement. The roles and responsibilities for certain IT procurement and contracting functions have, at various times, fluctuated between DMB's Acquisition Services and DIT's Contract Office. As a result, DMB and DIT could not ensure that all significant IT acquisition activities were assigned to a responsible party. COBIT states that management should define and communicate roles and responsibilities for all personnel in the organization.

\* See glossary at end of report for definition.

During our audit fieldwork, DMB and DIT initiated an IT contracting optimization project to define and clarify their roles and responsibilities. In addition, DMB and DIT drafted a memorandum of understanding to describe the functional work conditions, circumstances, and procedures under which both agencies will operate.

- b. DIT had not collaborated with the Department of Civil Service to establish formal job classifications and career paths for its contract administrators. Establishing a job classification and career path for contract administrators will help DIT facilitate efficient recruitment of appropriately skilled and experienced staff.

Our review disclosed that DIT's IT contract administrators held a variety of job classifications and position descriptions. Some of the IT contract administrators' position descriptions did not include all necessary or desired knowledge, skills, and abilities that would be required to successfully perform contract administrator duties. The Department of Civil Service informed us that it had not established a contract administration job classification because, historically, contract administration was not an employee's primary job function. Rather, it was just one of many job responsibilities. However, with the creation of DIT, its Contract Office assumed the full-time responsibility for administering the State's IT contracts.

- c. DIT had not established a training and certification program for its IT contract administrators. In addition, DMB had not allocated resources to provide continuing education for IT buyers. Our research indicated that the federal government and states such as Texas are establishing certification programs for their contracting professionals. The goal of the certification programs is to standardize the education, training, and experience requirements for contracting professionals.

DMB and DIT informed us that recent budget constraints have restricted their ability to provide training opportunities for staff. However, the quality and effectiveness of the State's IT procurement process depends on the development of a capable and competent work force. Establishing a training and certification program for IT contract administrators and buyers would help DMB and DIT strengthen the IT procurement and contract management functions.

During our audit, DMB was in the process of developing training courses for various procurement and contract administration topics.

- d. The IT contracting optimization project did not fully identify the appropriate staffing resources necessary to perform all critical IT procurement and contract management functions. The IT contracting optimization project included a study to identify and baseline the staffing resources necessary to create and modify various types of IT contracts. However, the study did not include all of the critical procurement and contract management functions, such as ongoing oversight of contract amendments and contract closeout audits.

Recent executive directives and the appropriations acts for fiscal years 2002-03 through 2004-05 placed restrictions on the creation of new positions and hiring of State employees. However, the executive directives allow exceptions to be granted if the creation of the new position or filling of the vacancy will produce more efficient and timely performance by the State department or agency or if failure to create the new position will result in rendering a State department or agency unable to deliver basic services or result in the loss of revenue to the State. Therefore, DMB and DIT should complete a staffing study to address all critical functions and develop a corresponding budget strategy that reflects the agencies' acquisition work force staffing and development needs. This strategy might include identifying funding sources, establishing a methodology for prioritizing funding needs, and establishing a process for developing a sufficient acquisition work force training budget.

### **RECOMMENDATION**

We recommend that DMB and DIT fully develop a work force planning strategy to support the State's IT acquisition work force.

### **AGENCY PRELIMINARY RESPONSE**

DMB and DIT agree and will comply with the recommendation to continue to define the roles and responsibilities for their respective procurement staff and establish appropriate staffing levels. DMB and DIT informed us that recent innovations in procurement practices will allow them to focus more attention on managing contractor performance and other contract administration activities. One such innovation currently being pursued by DMB is a new e-procurement system. This

system will result in significant efficiencies within several phases of the contracting process, both for state procurement and contracting staff and prospective vendors. DMB and DIT will continue their efforts to establish formal job classifications, career paths, and an effective training and certification program for contract administrators. DMB will identify and allocate resources to provide the necessary continuing education for its IT buyers. DMB and DIT will work to achieve full compliance with the recommendation by September 30, 2007.

## **EFFECTIVENESS OF EFFORTS TO ASSESS THE NEED FOR CONTRACTED SERVICES**

### **COMMENT**

**Background:** Contracts for IT services represent a significant amount of the State's IT expenditures. The current value of the State's active IT service contracts during the period September 30, 2003 through April 1, 2005 was approximately \$1.2 billion. Therefore, it is in the State's and the taxpayers' best interest for DIT to determine whether State employees or external expertise can most effectively meet the State's IT and business needs. DIT's strategy for obtaining IT services should provide timely, reliable information about how dollars are spent for IT services and whether the services provided are meeting the State's needs. In addition, DIT's strategy should ensure the competitiveness of State employees by providing adequate training and technical support to assist in the development of a high performing IT work force.

**Audit Objective:** To assess the effectiveness of DIT's efforts to assess the State's need for contracted IT services.

**Conclusion:** **DIT's efforts to assess the State's need for contracted IT services were moderately effective.** Our audit identified a reportable condition related to IT contractor utilization (Finding 7).

### **FINDING**

#### **7. IT Contractor Utilization**

DIT had not fully developed a formal strategy to govern the State's utilization of IT contractors. Without a strategy, DIT cannot ensure that its use of contractors is

cost-effective and aligned with the State's IT and business strategies. Our review disclosed:

- a. DIT had not established a process for determining the appropriate mix of contractors and State employees for IT development and operations. According to COBIT, at least annually or upon major changes to the business, operational, or IT environment, management should perform a staffing evaluation to ensure that the IT function has a sufficient number of competent IT staff now and in the future.

The use of contractors may provide DIT with the opportunity to more effectively and efficiently address the State's IT needs. For example, DIT can use contractors to fill shortages of State employees or to gain access to new technology and high demand skills. However, using contractors as long-term employee replacements may be more expensive than establishing additional positions or training employees.

DIT informed us that it had reviewed and transferred long-term contractor positions to State employees. DIT indicated that it had realized over \$10 million in savings by transferring these positions to State employees.

- b. DIT had not created an accurate Statewide inventory of employee skill sets and a method of tracking employee availability. Without such an inventory, DIT does not have a formal process to match employee skill sets with IT projects. As a result, IT projects are staffed primarily from DIT's Agency Services for the requesting department without consideration of the knowledge and skills of all available DIT employees. This may result in the overutilization of contractors. COBIT suggests that organizations establish a skills database. A database inventorying employee skill sets may help DIT more effectively utilize its personnel.
- c. DIT had not developed a strategy to ensure effective knowledge transfer between contractors and State employees upon completion of a project. Failure to provide for knowledge transfer between contractors and State employees may result in an overdependence on contractors to provide information system maintenance services. For example, after the implementation of MAIN, the IBM Corporation's MAIN hosting contract had several change notices totaling approximately \$12 million for vendor

assistance in the development, execution, and documentation of MAIN application programs. The State may have avoided the \$12 million in change notices if the vendor's knowledge had been transferred to State employees.

The process for determining the most cost-effective mix of contractors and State employees is complex and difficult. There are significant and interdependent issues that DIT must review and address, for example, DIT's funding model, employee classification, compensation levels, and training. Therefore, DIT will need to involve other functional areas in developing its strategy.

### **RECOMMENDATION**

We recommend that DIT fully develop a formal strategy to govern the State's utilization of IT contractors.

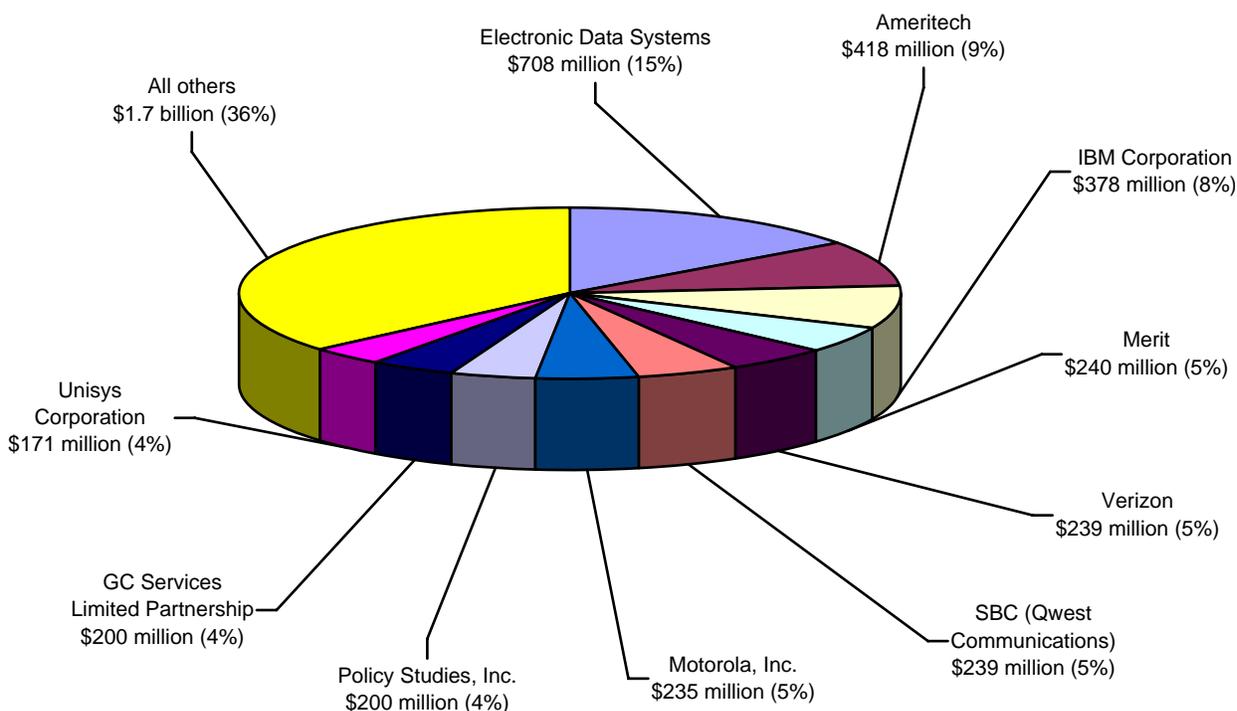
### **AGENCY PRELIMINARY RESPONSE**

DIT agrees and will comply with the recommendation by further developing its strategy for governing the State's utilization of IT contractors. DIT will continue its efforts to forecast staffing needs and to ensure proper use of contractors. Also, DIT will continue to identify and develop methods to inventory employees' skills and to more effectively match skills with IT projects. Finally, DIT is now using new SOW templates that require, as a standard deliverable, knowledge transfer between IT contractors and State employees. DIT will work to achieve full compliance with the recommendation by September 30, 2007.

## SUPPLEMENTAL INFORMATION



STATEWIDE INFORMATION TECHNOLOGY CONTRACTING PRACTICES  
Department of Management and Budget and Department of Information Technology  
Top Information Technology Vendors  
September 30, 2003 through April 1, 2005



Vendor	Total Contract Amounts	Percentage
Electronic Data Systems	\$ 707,514,292	15%
Ameritech	418,352,325	9%
IBM Corporation	377,533,202	8%
Merit	240,288,019	5%
Verizon	239,391,041	5%
SBC (Qwest Communications)	238,530,541	5%
Motorola, Inc.	235,493,393	5%
Policy Studies, Inc.	200,284,950	4%
GC Services Limited Partnership	199,808,251	4%
Unisys Corporation	170,528,382	4%
All others	1,725,495,877	36%
<b>Total</b>	<b>\$ 4,753,220,277</b>	<b>100%</b>

STATEWIDE INFORMATION TECHNOLOGY CONTRACTING PRACTICES  
 Department of Management and Budget (DMB) and Department of Information Technology (DIT)  
 Contracts Sampled for Information Technology (IT) Commodities and Services \*  
From September 30, 2003 through April 1, 2005

Contract Number	BPO** Number	Vendor	BPO** Effective Date	BPO** Expiration Date	Description of IT Services Procured Through Contract	Sole Source
1	88000002	NEC Solutions (America), Inc.	02/01/1988	09/30/2005	Automated Fingerprint Identification System	N
2	B4000144	IBM Corporation	12/01/1993	12/31/2011	Michigan Administrative Information Network (MAIN) technology services for DMB	N
3	B4100052	Ameritech	02/01/1994	02/01/2004	Master Contract - voice and data communications network services	N
4	B5000240	Motorola, Inc.	12/08/1994	06/08/2009	800 MHz radio system for the Michigan Department of State Police (MSP)	Y
5	B5001021	Electronic Data Systems	02/01/1995	02/09/2004	End-user computing hardware, software, and services for agencies Statewide, DMB	N
6	B5000692	Unisys Corporation	05/08/1995	12/31/2008	Mainframe hardware and software for the Michigan Information Processing Center	N
7	B5000929	Data Control Technologies, Inc.	09/01/1995	03/02/2004	Cellular telephone instruments and service for all State agencies	N
8	B6000116	IBM Corporation	10/18/1995	10/17/2005	Mainframe operations and support for the Michigan Employment Security Commission (MESCC)	N
9	B6000094	Integrus Inc.	11/06/1995	03/05/2004	Bull Mainframe consolidation for DMB Michigan Information Processing Center	N
10	B6000081	Oracle Corporation	11/15/1995	12/31/2008	Oracle software and support for all State agencies	N
11	B6000606	Compuware Corporation	04/01/1996	09/30/2004	Develop, implement, and maintain the Michigan Child Support Enforcement System (MiCSES) Program for the Department of Human Services (DHS)	N
12	B7000106	Ergometrics & Applied Personnel Research	10/01/1996	09/30/2004	Computer scoring service for the corrections officer examination	N
13	B7000417	GC Services Limited Partnership	07/01/1997	11/15/2008	MARCS for the Department of Treasury	N
14	B8000856	Graybar Electric Co	06/15/1998	06/14/2004	DHS computer and data patch cables	N
15	B9000378	Nextel West Corp	02/16/1999	08/10/2007	Nextel Communication Units/Training/Service for all State agencies	Y
16	B9000492	IBM Corporation	04/15/1999	12/14/2006	Lawson Implementation (HRMN)	Y
17	B8000667	Citicorp Service, Inc.	11/16/1998	05/31/2006	Electronic transfer services for DHS and the Department of Community Health (DCH)	N
18	B9000845	Affiliated Computer Services, Inc.	08/30/1999	04/30/2005	MiCSES centralized collections for DHS	N
19	B0000240	Compuware Corporation	11/22/1999	10/01/2005	Programming and consulting services for Unemployment Insurance Agency (DLEG)	Y
20	B0000509	First Health Services Corporation	04/01/2000	10/01/2005	Pharmacy benefits management services for DCH	N
21	B1001103	Albin Industries, Inc.	11/01/2000	09/30/2005	Analog and digital photocopying equipment	N

*This schedule continued on next page.*

Initial Contract Value	As of May 31, 2005		Number of Change Orders	Percentage Increase Initial to Current Value	Finding Reference
	Current Contract Value	Date of Contract or Last Change Order			
\$ 18,265,007	\$ 27,026,330	06/22/2004	26	48%	2b, 2b(3), 2b(4), 3f
69,213,188	230,453,294	09/17/2004	89	233%	1a, 2b, 2b(2), 2b(3), 2b(4), 3b, 3b(1), 3b(2), 3c, 3f, 7c
17,198,640	128,991,909			650%	2b, 2b(2), 2b(3), 2b(4), 3b, 3f
187,275,915	228,442,720	05/10/2005	30	22%	2a, 2a(1), 3f
57,639,222	555,089,402	12/12/2002	22	863%	2b, 2b(2), 2b(3), 2c(2)(a), 3b, 3c, 3f
28,663,778	92,169,104	01/22/2004	38	222%	2b, 2b(1), 2b(3), 2b(4), 3b, 3f
240,000	380,000	09/02/2003	25	58%	2b, 3f
68,736,193	74,453,520	12/14/2004	53	8%	2b, 2b(4), 3f
32,608,691	72,777,744	10/17/2003	20	123%	2b, 3b, 3f
2,000,000	144,055,000	03/25/2005	23	7,103%	2b, 3b, 3f
	142,628,836				2b, 2b(1), 2b(2), 2b(3), 2b(4), 3f
3,780	17,105	10/09/2002	6	353%	2b, 3b, 3f
63,927,140	189,878,143	05/02/2003	6	197%	2b, 3b, 3f
95,880	95,880	02/13/2001	2	0%	2b, 2b(3), 2b(4), 3f
963,584	3,963,584	09/13/2004	21	311%	2a, 2a(1), 3b, 3f
16,027,433	32,935,736		13	106%	2a, 2a(1), 3b, 3f
84,405,175	84,781,639	03/02/2004	4	0%	2b, 2b(3), 2b(4), 3f
107,759,000	127,249,000	03/21/2005	7	18%	2b, 2b(3), 2b(4), 3f
5,616,000	8,633,636	07/14/2004	7	54%	2a, 2a(1), 3f, 4a(1)
8,404,385	47,660,252	05/18/2005	8	467%	2b, 2b(1), 2b(3), 2b(4), 3b, 3f
6,000,000	6,000,000	07/29/2003	4	0%	2b, 2b(1), 2b(3), 2b(4)

STATEWIDE INFORMATION TECHNOLOGY CONTRACTING PRACTICES  
 Department of Management and Budget (DMB) and Department of Information Technology (DIT)  
 Contracts Sampled for Information Technology (IT) Commodities and Services \*  
From September 30, 2003 through April 1, 2005

<u>Contract Number</u>	<u>BPO** Number</u>	<u>Vendor</u>	<u>BPO** Effective Date</u>	<u>BPO** Expiration Date</u>	<u>Description of IT Services Procured Through Contract</u>	<u>Sole Source</u>
22	B1001316	Policy Studies, Inc.	12/11/2000	03/31/2004	Project management services providing assistance in transition planning and program management for MiCSES	Y
23	B1001258	Unisys Corporation	01/01/2001	12/31/2005	Computer consultants to provide maintenance, technical services, and support for the ASSIST project for DHS	Y
24	B1001568	Sprint Payphone Services, Inc.	07/07/2001	07/06/2006	Inmate telephones for the Department of Corrections (DOC)	N
25	B1001740	Enfotech & Consulting Inc.	08/27/2001	09/30/2009	Consulting services for an electronic wastewater discharge reporting system for the Department of Environmental Quality	Y
26	B3001101	Motorola, Inc.	12/01/2002	12/01/2005	Two-way radios for all State agencies	N
27	B3001363	Novell Inc.	06/04/2003	09/30/2004	MSP Enterprise Application Integration	Y
28	B3001389	Cross Currant Corporation	08/18/2003	01/31/2006	ccCAD (computer aided dispatch) maintenance and support services for MSP	Y
29	B4200023	Kunz Leigh & Associates, Inc.	10/01/2003	10/01/2006	RPS/ARS and MIRS maintenance and support services	Y
30	B4200157	Accenture	01/01/2004	03/31/2007	Computer maintenance and support for MiCSES	N
31	B4200147	Electronic Data Systems	02/10/2004	02/10/2007	Michigan Master Computing Contract for commodities and limited services	N
32	B4200180	SBC (Qwest Communications)	03/10/2004	10/31/2009	LINK MI for DIT Telecom - all State agencies	N
33	B4200190	Everest Solutions, Inc.	03/24/2004	02/18/2005	Temporary employee services to assist in customer financial integration with legacy systems for the Department of Treasury	N
34	B4200233	Diebold Election Systems, Inc.	04/23/2004	04/26/2007	Voting systems for the Department of State	N
35	B4200234	Election Systems & Software, Inc.	04/23/2004	04/26/2007	Voting systems for the Department of State	N
36	B4200297	Koch Financial Corp.	06/01/2004	06/01/2007	Server hardware, software, and support	N
37	B4200323	Electronic Data Systems	07/12/2004	09/30/2005	Phase II Business Application Modernization	N
38	B4200381	Electronic Data Systems	09/01/2004	09/30/2007	Project control office for MiCSES for DIT and DHS	N
39	B5200105	ISA Information System Services	09/30/2004	09/30/2006	Annual maintenance for the CAD (computer aided dispatch) system for MSP	Y

Total Value of BPOs

\* The information in this schedule represents unaudited IT contract information. The schedule is intended to provide the report reader with background information regarding the IT contracts in our sample. Some of the data in the schedule is missing because the data was unavailable.

\*\* BPO is defined as "blanket purchase order," which is an alternate term for "contract" used in the Michigan Administrative Information Network.

Initial Contract Value	As of May 31, 2005			Percentage Increase Initial to Current Value	Finding Reference
	Current Contract Value	Date of Contract or Last Change Order	Number of Change Orders		
\$ 5,548,205	\$ 200,284,950	05/08/2002	6	3,510%	1a, 2a, 2a(2), 3b, 4a(3)
13,123,792	53,431,398	12/14/2004	4	307%	2a, 2a(2), 3b, 3f
67,500,000	67,500,000	01/11/2005	3	0%	2b, 2b(3), 3f
472,580	4,411,773	11/29/2004	10	834%	2a, 2a(1), 3b, 3f
3,050,604	8,050,604	05/10/2005	4	164%	2b, 2b(1), 2b(3), 2b(4), 3b
123,000	491,000	12/19/2003	2	299%	2a, 2a(2), 3b
375,000	375,000	N/A	0	0%	2a
286,000	1,163,430	05/24/2005	8	307%	2a, 3b
67,884,846	67,884,846	N/A	0	0%	2b, 2b(1), 2b(2), 2b(3), 2b(4)
57,894,512	57,894,512	10/20/2004	4	0%	2b, 2b(1), 2b(3), 2b(4), 3c
238,530,541	238,530,541	05/26/2005	1	0%	2b, 2b(2), 2b(3), 3f
93,366	93,366	01/19/2005	2	0%	2b
32,000,000	32,000,000	N/A	0	0%	2b, 2b(3)
32,000,000	32,000,000	N/A	0	0%	2b, 2b(3)
5,918,879	5,918,879	N/A	0	0%	2b
1,526,517	1,826,149	05/17/2005	2	20%	2b, 2b(4)
21,886,020	21,886,020	04/07/2005	1	0%	2b, 2b(4), 4a(2)
67,260	67,260	N/A	0	0%	2a, 2a(2)
<u>\$ 1,323,324,134</u>	<u>\$ 2,991,492,563</u>				

# GLOSSARY

## Glossary of Acronyms and Terms

active IT contract	A contract that is in force and has not expired.
Advanced Purchasing and Inventory Control System (ADPICS)	The State's procurement and materials management system that is fully integrated with the Relational Standard Accounting and Reporting System (R*STARS) in supporting the purchasing, receiving, payment process, and inventory management within State agencies.
ASSIST	Automated Social Services Information and Support System.
best value	According to the National Association of State Procurement Officials, the term commonly used to refer to a process of contractor selection in which the selection criteria includes subjective considerations and not just a low bid price. Best value procurements should result in an award that will give the State the greatest or best value for its money. To be effective, evaluation factors should be developed based on requirements and relate directly to the goods or services being procured. Examples of factors relevant to best value information technology procurements include: total cost of ownership, vendor performance history, quality of goods and services, timeliness of delivery, proposed technical performance, financial stability of vendor, cost of necessary training, qualifications of individuals proposed for a project, realistic risk assessment of the proposed solution, availability and cost of technical support, and testing and quality assurance program.
bid	An offer to contract with the State, submitted in response to an invitation to bid.
bid tabulation (bid tab)	A summary of bids and bid information. In Michigan, DMB's Acquisition Services submits the bid tab with its award recommendation to the State Administrative Board.

BPO	blanket purchase order.
contract	An agreement between two or more competent parties or persons that creates an obligation to do or not to do a particular thing. Two meanings are incorporated within this definition: the first is the concept of the <i>relationship</i> between the agreeing parties and the second refers to the written <i>document</i> describing the particulars of this relationship.
contract administrator	A person designated by a State agency, and delegated the authority by DMB's Acquisition Services, to manage day-to-day operations under a contract.
contractor	A business entity or individual that has a contract to provide goods or services. Used interchangeably with the term "vendor."
Control Objectives for Information and Related Technology (COBIT)	A framework, control objectives, and audit guidelines developed by the Information Systems Audit and Control Foundation (ISACF) as a generally applicable and accepted standard for good practices for controls over information technology.
CPS	Contracts and Procurement Services.
Data Collection and Distribution System (DCDS)	The State's client/server system that records, allocates, and distributes payroll costs within the accounting system for the MAIN Human Resource System (HRS).
DCH	Department of Community Health.
DLEG	Department of Labor and Economic Growth.
deliverable	A discrete type or increment of work. The work may involve the delivery of goods or services.

DHS	Department of Human Services, formerly known as the Family Independence Agency.
DIT	Department of Information Technology.
DMB	Department of Management and Budget.
EDS	Electronic Data Systems.
effectiveness	Program success in achieving mission and goals.
Executive Directive No. 2003-1	The directive establishing the basic policy of the executive branch regarding standards of ethical conduct for department directors, appointees of the Governor, and employees within the executive branch.
FOIA	Freedom of Information Act.
goods	A transportable article of trade or commerce that can be bartered or sold.
Human Resources Management Network (HRMN)	The State's integrated human resources system that processes personnel, payroll, and employee benefits data for the MAIN Human Resource System (HRS).
internal control	The organization, policies, and procedures adopted by agency management and other personnel to provide reasonable assurance that operations, including the use of agency resources, are effective and efficient; financial reporting and other reports for internal and external use are reliable; and laws and regulations are followed. Internal control also includes the safeguarding of agency assets against unauthorized acquisition, use, or disposition.
invitation to bid	A document containing the specifications designed to meet a well-defined State need. The invitation to bid informs the bidder of requirements for submitting a price quotation based

on the specifications. The award is based on an evaluation of price meeting those specifications.

IT	information technology.
joint evaluation committee (JEC)	A committee chaired by DMB's Acquisition Services that may be established to develop evaluation criteria, to conduct pre-proposal conferences, to schedule oral presentations by prospective contractors, and to evaluate proposals in response to an invitation to bid.
MAIN Management Information Database (MIDB)	The database component of MAIN designed to allow managers to develop ad hoc queries and reports for needed information. Data is extracted from the Relational Standard Accounting and Reporting System (R*STARS), ADPICS, and the MAIN Human Resource System (HRS).
MARCS	Michigan Accounts Receivable Collection System.
material condition	A reportable condition that could impair the ability of management to operate a program in an effective and efficient manner and/or could adversely affect the judgment of an interested person concerning the effectiveness and efficiency of the program.
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).
MiCSES	Michigan Child Support Enforcement System.
MIRS	MIDB Inquiry & Reporting System.

MSP	Michigan Department of State Police.
OFPP	Office of Federal Procurement Policy.
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.
PSI	Policy Studies, Inc.
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.
request for proposal	A more complex invitation to bid that contains more general specifications designed to outline the minimum State requirements. Bidders must submit proposals in accordance with the requirements of the request for proposal.
RPS/ARS	Revenue Processing System/Accounts Receivable System.
Sections 2-8 and 2-10 of the <i>Michigan Civil Service Commission Rules</i>	Section 2-8 establishes rules for ethical standards and conduct for State classified employees. Section 2-10 provides classified employees with protection against reprisals for disclosing a violation or suspected violation of State or federal laws, rules, and regulations.
service	The furnishing of labor by a contractor that does not include the delivery of a tangible end product.
sole source	A procurement process in which only one vendor possesses the unique and singularly available capability to meet the requirement of the solicitation.

SOW	statement of work.
State Ethics Act	An act that applies to State government employees and public officers appointed by the Governor and other executive department officials of the executive branch of State government. The State Ethics Act defines unethical conduct as a violation of one or more of the seven standards set forth in Section 2 of the Act.
vendor	A business entity or individual that has a contract to provide goods or services. Used interchangeably with the term "contractor."
work breakdown structure	A deliverable-oriented grouping of project elements that organizes and defines the total scope of the project.



