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AUDITOR GENERAL

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December 20, 2011

John E. Nixon, C.P.A., Director
Department of Technology, Management, and Budget
George W. Romney Building
Lansing, Michigan

Dear Mr. Nixon:

This is our report on our follow-up of the 4 material conditions (Findings 1 through 4) and 4 corresponding recommendations reported in the performance audit of Statewide Information Technology Contracting Practices, Department of Management and Budget and Department of Information Technology (DIT). That audit report was issued and distributed in August 2006. Additional copies are available on request or at <<http://www.audgen.michigan.gov>>. Executive Order No. 2009-55 renamed the Department of Management and Budget as the Department of Technology, Management, and Budget (DTMB). It also transferred all of the authority, powers, duties, functions, responsibilities, records, personnel, property, equipment, and appropriations of DIT to DTMB and abolished DIT.

Our follow-up disclosed that DTMB had partially complied with 3 recommendations and had not complied with 1 recommendation. A material condition still exists relating to information technology (IT) contract monitoring and audit (Finding 3). Reportable conditions exist relating to the IT contract control environment (Finding 1), IT contract award practices (Finding 2), and statements of work (SOWs) (Finding 4).

If you have any questions, please call me or Scott M. Strong, C.P.A., C.I.A., Deputy Auditor General.

Sincerely,

A handwritten signature in black ink that reads "Thomas H. McTavish".

Thomas H. McTavish, C.P.A.
Auditor General

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**STATEWIDE INFORMATION TECHNOLOGY
CONTRACTING PRACTICES
DEPARTMENT OF TECHNOLOGY,
MANAGEMENT, AND BUDGET
FOLLOW-UP REPORT**

INTRODUCTION

This report contains the results of our follow-up of the material conditions and corresponding recommendations and the agencies' preliminary responses as reported in our performance audit of Statewide Information Technology Contracting Practices, Department of Management and Budget (DMB) and Department of Information Technology (DIT) (50-510-05), which was issued and distributed in August 2006. That audit report included 4 material conditions (Findings 1 through 4) and 3 other reportable conditions.

PURPOSE OF FOLLOW-UP

The purpose of this follow-up was to determine whether the Department of Technology, Management, and Budget (DTMB) has taken appropriate corrective measures in response to the 4 material conditions and 4 corresponding recommendations.

BACKGROUND

In March 2010, Executive Order No. 2009-55 renamed the Department of Management and Budget as the Department of Technology, Management, and Budget. It also transferred all of the authority, powers, duties, functions, responsibilities, records, personnel, property, equipment, and appropriations of DIT to DTMB by a Type III transfer and abolished DIT.

Act 431, P.A. 1984, as amended, established DTMB's authority to provide for the procurement of information technology (IT) commodities and services. DTMB's Purchasing Operations (formerly known as Acquisition Services) is responsible for managing the contract bid process, providing advice and consultation on State agency bids, offering training by certified instructors, and providing the forms and tools needed to effectively procure goods and services for State agencies.

In addition to Purchasing Operations, the State Administrative Board, based on recommendations from its Finance and Claims Committee, is responsible for approving all contracts and contract amendments over \$25,000.

SCOPE

Our fieldwork was performed from August through mid-October 2011. We interviewed DTMB Purchasing Operations staff to determine the status of compliance with our audit recommendations. We examined a sample of IT contracts that were active during the period January 1, 2008 through September 7, 2011. We reviewed and tested compliance with policies, procedures, laws, rules, and regulations related to IT contracts.

FOLLOW-UP RESULTS

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

RECOMMENDATION AND RESPONSE AS REPORTED IN AUGUST 2006:

1. IT Contract Control Environment

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 (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.

FOLLOW-UP CONCLUSION

DTMB did not fully address 2 of the 5 parts of our finding. Therefore, DTMB had partially complied with our recommendation and a reportable condition exists. Specifically, our follow-up disclosed:

- a. DTMB had complied with part a. of the finding. DTMB established ethics training and made it available for Purchasing Operations staff on the DTMB Intranet and in periodic in-class training sessions. Purchasing Operations' Knowledge Management Team communicates the process for reporting suspected purchasing improprieties by including Michigan Civil Service Commission Rules 2-8.6, "Reporting Alleged Violations," and 2-10, "Whistleblower Protection," in its ethics training. DTMB informed us that it was not aware of any improprieties reported since the 2006 audit.
- b. DTMB had complied with part b. of the finding. Executive Directive No. 2005-3 prohibits no-bid or sole source contracts with the exception of emergency criteria outlined in the directive. Beginning in January 2009, DTMB began to track proprietary solicitations where there may be only a limited number of vendors that are able to provide the requested services. These proprietary solicitations follow the same Act 124, P.A. 1999, bidding procedures as other contracts, which require all requests over \$50,000 to be posted to an Internet Web site for a minimum of 14 days. Our review of selected contracts and interviews with Purchasing Operations staff did not identify any sole source contracts during our follow-up period.
- c. DTMB had partially complied with part c. of the finding by establishing periodic contract inspections. However, we noted that DTMB did not consistently

perform these inspections. As of October 2011, the most recent documented inspections that DTMB had performed occurred in June 2010. In addition, our review of contract files identified inadequate documentation related to contract performance monitoring procedures (see follow-up conclusion for Finding 3, part d. and part e.).

- d. DTMB had partially complied with part d. of the finding. As part of DTMB's process for completing the purchase request form (PRF), DTMB established a risk assessment process. However, we found that DTMB's risk assessments did not always address all of the useful factors for identifying risks, such as the complexity and subject matter of the procurement, the dollar amount of the procurement, 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.

DTMB informed us that a new risk assessment process, utilizing the project assessment report (PAR), was implemented in April 2010 as a required part of completing the PRF. We found that the PAR substantially addresses useful risk factors. However, our review of 5 contracts with an effective date subsequent to April 2010 disclosed that DTMB did not utilize the PAR for 2 of the 5 contracts.

- e. DTMB had complied with part e. of the finding by establishing an updated desk manual that outlines policies and procedures for IT procurement and contract administration. This manual provides detailed instructions to improve the consistency and quality of contract documents. In addition, the desk manual includes various process diagrams, narratives, and legal and regulatory requirements, as well as identification of DTMB templates available on the DTMB Intranet.

RECOMMENDATION AND RESPONSE AS REPORTED IN AUGUST 2006:

2. IT Contract Award Practices

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 joint evaluation committee (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 tabulation 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.

FOLLOW-UP CONCLUSION

DTMB did not fully address 2 of the 3 parts of our finding. Therefore, DTMB had partially complied with the recommendation and a reportable condition exists. Specifically, our follow-up disclosed:

- a. DTMB had complied with part a. of the finding. Executive Directive No. 2005-3 prohibits no-bid or sole source contracts with the exception of emergency criteria outlined in the directive. Beginning in January 2009, DTMB began to track proprietary solicitations where there may be only a limited number of vendors that are able to provide the requested services. These proprietary solicitations follow the same Act 124, P.A. 1999, bidding procedures as other contracts, which require all requests over \$50,000 to be posted to an Internet Web site for a minimum of 14 days. Our review of selected contracts and interviews with Purchasing Operations staff did not identify any sole source contracts during our follow-up period.

- b. DTMB had partially complied with part b. of the finding. For all 3 contract files that we sampled, DTMB used a JEC and documented and maintained adequate support for the JEC recommendation in the contract file. DTMB completed a vendor score sheet for each vendor selection based on objective and measurable evaluation criteria. We evaluated the JEC committee members for each sampled contract and concluded that the JEC consisted of relevant DTMB staff and end-user specialists.

However, we noted that confidentiality and disclosure statements were not signed by all JEC members for 2 of the 3 contracts tested. As a result, DTMB cannot ensure that all JEC members represented that they did not have a personal interest in the contract award.

- c. DTMB had partially complied with part c. of the finding. We selected 5 contracts with change notices of \$1 million or more and determined that 3 of the 5 change notices increased the amount of the original contract by 100% or more and did not extend the life of the contract. In addition, 2 of the 5 change notices did not appear to provide the State Administrative Board with an estimate of the total cost of system development and ownership at the time the original contract was evaluated. For example, the original contract for software maintenance and support of the License 2000/MyLicense System software was for \$1.24 million, effective October 2010. In January 2011, DTMB issued a change notice for \$1.58 million to upgrade legacy technology in order to continue receiving maintenance and support for License 2000/MyLicense System software. Although the original contract allowed for enhancements, this future cost of maintenance and support, identified shortly after the original contract, could have been included in the original contract.

Also, we reviewed 5 contracts' bid tabulation documents and found that improvements have been made since the prior audit in providing sufficient information about the contract. We found that the contracts we sampled all provided a reasonable explanation of what was being purchased.

RECOMMENDATION AND RESPONSE AS REPORTED IN AUGUST 2006:

3. IT Contract Monitoring and Audit

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.

FOLLOW-UP CONCLUSION

DTMB did not fully address 6 of the 6 parts of our finding. Therefore, DTMB had not complied with the recommendation and a material condition still exists. Specifically, our follow-up disclosed:

- a. DTMB had partially complied with part a. of the finding. DTMB established Administrative Guide procedure 0610.03 (Vendor Performance - *Post-Award*) to include mandatory procedures for documenting positive and negative vendor performance. The Vendor Performance module in the Advanced Purchasing and Inventory Control System (ADPICS) is a mechanism for DTMB to document vendor performance. However, we reviewed 5 contracts and determined that DTMB had not documented vendor performance evaluations for any of the 5 contracts either within ADPICS or the contract files.

We also tested 3 additional contracts and determined that DTMB did not clearly document that past vendor performance was used in the vendor selection process for any of the 3 contracts. We found that DTMB considered

past experience of the vendor; however, the performance was not clearly tied to the past experience. Management informed us that it will update the necessary templates to clearly document the consideration of vendor performance in the selection process.

- b. DTMB had partially complied with part b. of the finding. DTMB did not always sufficiently document the monitoring of the propriety and reasonableness of large change notices. Our review of 5 contracts with change notices disclosed that 1 contract did not have sufficient documentation to justify that the contract modification was necessary and relevant to the scope of the original contract. Specifically, DTMB processed a change notice for Unemployment Insurance Agency (UIA) mainframe maintenance and support (\$6,472,751), Corrections Management Information System (CMIS) maintenance and support (\$3,712,391), and Michigan Business One Stop enhancements (\$673,911). The original contract against which this change order was processed was for maintenance, support, and web-hosting services for Michigan.gov, Michigan.org, and State Courts e-ticket web portals. The original contract also allowed for application development and maintenance services; however, DTMB did not include clear documentation within the change notice to show how the enhancements for UIA, CMIS, and One Stop were relevant to the scope of the original contract. DTMB informed us that it had many discussions regarding the approval of the change notice; however, it did not always formally document the discussions.

- c. DTMB had partially complied with part c. of the finding. DTMB established procedures within DTMB Administrative Guide procedure 0510.37 (Agency Contract Compliance Inspectors and Administrators - *Pre-Award & Post-Award*) to monitor compliance with contract provisions. However, our testing of 5 contract files disclosed that DTMB did not have documentation to support that it performed an audit of any of the 5 contract files to ensure compliance with contract provisions. DTMB informed us that it would like to establish a contract management group to improve contract monitoring and auditing; however, it did not have the resources to perform such monitoring and auditing.

- d. DTMB had partially complied with part d. of the finding. DTMB established procedures to track and monitor contract requirements and deliverables in Administrative Guide procedure 0510.37. However, our testing of 5 contract files disclosed that DTMB did not maintain monitoring documentation or compliance reports in the contract file for any of the 5 contracts, as required by this procedure.
- e. DTMB had partially complied with part e. of the finding. DTMB established procedures for contract closeout in Administrative Guide procedure 0510.37. However, our review of 3 contracts expiring during our follow-up period disclosed that DTMB did not maintain documentation that the closeout procedures had been performed for any of the 3 contract files.
- f. DTMB had partially complied with part f. of the finding. DTMB informed us that it established the PAR to assess the appropriateness of long-term contracts. The PAR specifically includes risk assessment for the length of the contract. However, our review of 5 contracts disclosed that DTMB did not utilize the PAR for 2 of the 5 contracts (see follow-up conclusion for Finding 1, part d.). In addition, we reviewed 5 contract files and determined that none of the 5 files contained documentation that DTMB performed an analysis and considered other alternatives to the current contract, such as other vendors that may be more cost-efficient.

RECOMMENDATION AND RESPONSE AS REPORTED IN AUGUST 2006:

4. Statements of Work (SOWs)

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.

FOLLOW-UP CONCLUSION

DTMB had partially complied with the recommendation; however, a reportable condition exists. Specifically, our follow-up disclosed:

- a. DTMB had complied with part a. of the finding. DTMB established SOW templates that identify standard items to include when writing effective SOWs. Also, DTMB provided annual training to staff to learn how to write effective SOWs. We reviewed SOWs for 3 contracts that became effective during our audit period and found that DTMB has improved the consistency and sufficiency of the information contained in the SOWs for the 3 contracts.
- b. DTMB had partially complied with part b. of the finding. DTMB established procedures for reviewing SOWs. DTMB also established templates (see part a.) to help ensure that essential elements are included in the SOWs. However, establishing a formal approval for the SOWs after review and acceptance by the business owner would further ensure that the SOWs contain the essential elements. The 3 SOWs that we reviewed did not contain formal approval by the business owners. Management informed us that business owner approval is sometimes done through e-mail or at other times in the contracting process. However, DTMB did not maintain these e-mails in the contract files and the other approvals did not directly approve the SOWs.

