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An Audit Report on

Contract Management at the Texas Education Agency

August 2006
Report No. 06-064



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Overall Conclusion

The Texas Education Agency (Agency) should improve its contracting processes and ensure that it follows established contracting policies and procedures. The Agency does not have baseline expectations for contract monitoring, which results in a range of monitoring effectiveness across the divisions. For example, audit testing identified:

- Six contracts for which the Agency did not have documentation indicating it had received the goods and services for which it contracted. Those six contracts totaled \$32.7 million.
- Eleven contracts with monitoring documentation that ranged from minimal notes to detailed evaluations.

The Agency does not always construct clear payment terms in its contracts or follow established contracting policies and procedures. Testing identified instances in which payment terms in contracts were not specific. Although we did not identify any inappropriate expenditure of funds, strengthening contracting controls will provide greater assurance that Agency contract expenditures are accurate.

The Agency also should strengthen automated controls to protect information it uses to support contracting decisions. The Agency should review user accounts in its Integrated Statewide Administrative System (ISAS) more frequently for inactivity and reasonableness with job duties. It also should ensure that contract amounts in ISAS agree with actual contract terms.

Contracting Phases in the Texas Building and Procurement Commission's *State of Texas Contract Management Guide*

- Planning
- Procurement
- Contract Formation
- Rate/Price Establishment
- Contract Administration

Agency Contracting Information

As of February 2006, the Agency had 172 active contracts totaling \$460 million over multiple years.

The Agency made payments to contractors totaling about \$201 million from the beginning of fiscal year 2005 through February 2006.

Most of the Agency's contract dollar volume directly supports school districts throughout Texas. For example, its largest contract (for \$283.5 million) is for conducting student assessments over a five-year period. Approximately 100 Agency employees are involved in student assessment efforts. School districts contract only for their own needs.

The Agency has not established a database that documents specific information about vendor contracts entered into by all independent school districts. We surveyed 18 school districts to inquire about their contracting activity and contract expenditures. Information some districts provided indicated that their most significant contracts are for construction of school buildings, utilities, professional services, food service, transportation, copiers and printers. The majority of school districts' expenditures are for salaries and benefits.

Summary of Management's Response

The Agency concurs with the overall findings in this report. The Agency's responses to specific recommendations are included in the Detailed Results section of this report.

Summary of Information Technology Review

The Agency has sufficient controls over the input, processing, and output of contract-related financial transactions. However, as discussed above, the Agency should strengthen ISAS access controls to prevent unauthorized access. In addition, it should strengthen controls to ensure that contract amounts in ISAS agree with amounts in the actual contract.

Summary of Objective, Scope, and Methodology

The objective of the audit was to fulfill the requirements of Rider 83, page III-22, General Appropriations Act (79th Legislature), to assess controls over contract management and procedures on payments for purchasing contracts at the Agency. In the assessment, the State Auditor's Office was required to answer the following questions:

- Does the Agency effectively monitor and control contract payments?
- Does the Agency have the information necessary to support contract decision-making?
- Has the Agency established and maintained a database that documents specific information about vendor contracts at all independent school districts throughout the state of Texas?

The scope of this audit included an evaluation of the contract management process and an examination of selected contracts in place during fiscal years 2005 and 2006.

The audit methodology included interviewing Agency contract management personnel; reviewing contract management processes, policies, and procedures;

evaluating controls; and examining selected contracting practices and supporting documentation for compliance with state laws, Agency policy, and contract terms. We also surveyed 18 independent school districts to obtain information about their contracting practices.

Recent SAO Work		
Number	Product Name	Release Date
06-049	An Audit Report on State Agencies' Use of Criminal History Records	July 2006
06-036	An Audit Report on Financial Operations at the Texas Education Agency	May 2006

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Detailed Results

Chapter 1

The Agency Does Not Have Baseline Expectations for Contract Monitoring, Which Results in Inconsistencies in Monitoring Across Divisions

Because the Texas Education Agency (Agency) requires each division to monitor its own contracts, monitoring of the Agency's 172 active contracts varies from minimal monitoring to extensive monitoring that includes conducting status meetings and independently verifying contractor performance.

Auditors identified six contracts for which the Agency's monitoring was not adequate. These six contracts totaled \$32.7 million. For these six contracts, the Agency did not ensure that it received the quantity of services for which it was billed. For example:

Criminal Background Checks from the Department of Public Safety

The Agency has a contract with the Department of Public Safety to conduct national criminal history background checks on new teachers. That contract is for \$3.6 million over a two-year period.

About 43,000 background checks are conducted annually at a cost to the applicant of \$47 each. Of that amount:

- The Agency pays \$24 to the Department of Public Safety for the Federal Bureau of Investigation fee.
- The Agency pays \$15 for the Department of Public Safety for its fee.
- The Agency pays \$2 to Department of Information Resources.
- The Agency retains \$6.

- The Agency has a contract with the Department of Public Safety to conduct background checks for educator certifications. The Agency received a list of background checks to support the invoices it received from the Department of Public Safety; however, it did not verify the number of background checks actually conducted before it paid the Department of Public Safety.
- The Agency pays a contractor a portion of the advance placement testing fees when students take advance placement exams. However, it did not ensure that the number of students reported as having taken the advanced placement exams in 2004 and 2005 actually took them before it paid the contractor.
- The Agency does not appropriately monitor contracts for the Even Start and Adult Basic Education

programs. The Agency was not able to demonstrate how it ensured that these programs were being conducted in accordance with federal guidelines, and it approved and paid bills for these contracts without verification of the costs incurred.

Auditors also determined that the Agency does not verify service support and performance data supplied by a contractor that provides support for desktop computers, laptop computers, and the Agency's mainframe computer. The two contracts the Agency has with this contractor total \$35.4 million. In addition:

- The Agency did not perform an adequate “lease vs. purchase” analysis when it entered into the leasing arrangement for desktop and laptop computers.
- The Agency does not periodically perform updated “lease vs. purchase” analyses to demonstrate that leasing of 942 computers is the option that provides the best value.

Auditors also determined that the Agency conducted some type of monitoring of 11 other contracts tested. However, the extent of the effectiveness of monitoring varies across divisions. Monitoring was not consistently documented or applied. For example, one division maintained a tracking notebook for a contract to document each task assigned to the contractor. In addition, there was an assessment of completion of each task. Other divisions conducted regular meetings with the contractor and maintained minutes of those meetings; however there was no documented assessment of completion of contracted tasks.

Recommendations

The Agency should:

- Establish written policies and procedures regarding appropriate and necessary monitoring activities to evaluate the quality of contractor performance and timely delivery of all goods and services in compliance with the terms and conditions of the contract.
- When necessary, include specific monitoring guidance in individual contracts.
- Regularly conduct training for new contract monitors.

Management’s Response

The Agency concurs with the overall findings. The majority of the contracts audited were initiated prior to fiscal year 2004. Since that time, in a re-organization stemming from a reduction of work force in August 2003, the Agency has decentralized contract administration and is making significant efforts to ensure all contract administrators are provided training and a clear understanding of their role and responsibilities. The Agency recognizes the importance of contract development and administration and has also hired legal counsel to assist the agency divisions with contracting issues.

The Agency concurs with the recommendations. The Purchasing and Contracts Division will revise the current TEA Contracts Manual by December 1, 2006 to include an entire section on contract development and administration. The Purchasing and Contracts Division will develop

additional mandatory training requirements for all contract developers and administrators. Training for contract developers and administrators will be mandatory for all staff members involved in the process.

The Information Technology Division is currently conducting a "lease vs. purchase" analysis for desktop and laptop computers to determine the best value option to the Agency. The contract for desktop computer rentals will expire August 31, 2007.

The Agency Does Not Always Construct Clear Payment Terms in Contracts or Follow Established Contracting Policies and Procedures

The Agency did not always properly construct contract payment terms and did not always follow proper contracting procedures. Four (17 percent) of 24 contracts tested (which totaled \$ 42.2 million) did not properly specify payment terms. For example, one contract did not specifically identify the basis for the monthly billings the contractor submits to the Agency.

The Agency has established procedures to (1) ensure that it complies with law; (2) correctly solicit, form, and close out contracts; (3) ensure that funding is available for contracts; and (4) ensure that management is informed about Agency contracting activities. However, the Agency does not follow established policies and procedures for contract solicitation, formation, and close-out. For example:

- Two (13 percent) of eight winning proposals tested (which represented \$256.4 million in contracts), did not have time and date stamps indicating when they were received. The absence of time and date stamps prevented us from determining whether the proposals were properly controlled to help ensure objectivity in the Agency’s selection of contractors.
- Six (75 percent) of the eight proposals tested (which represented \$294.5 million in contracts) did not contain representations by the vendors that no gifts were given in connection with the solicitations.
- Contract documents did not have all required signatures:
 - ♦ For 21 (91 percent) of 23 contracts tested, at least one “Authorization to Contract” form lacked one or more required signatures. In addition, in two instances, the same individual signed off as division head and as having performed the fiscal review.
 - ♦ Two (33 percent) of six contracts tested did not have signed non-disclosure forms for all proposal evaluators. Evaluators are required to sign forms stating they have no conflict of interest or preconceived positions with the proposals. In addition, when signing non-disclosure forms, individuals affirm that they will not disclose any information related to the content, status, or ranking of proposals.
- The Agency did not follow formal contract close-out procedures on 3 contracts tested. Failure to follow formal close-out procedures increases the risk that there will not be an accurate accounting at the end of the contract term to ensure that the contractor has provided all required goods and services, all property inventory and ownership issues have been resolved, and a release of claims has been obtained to preclude further billings or contract claims.

Recommendations

The Agency should:

- Construct contract payment terms appropriately.
- Consistently follow established contracting policies and procedures.

Management's Response

The agency concurs with the recommendations. The receipt of all bid solicitations has been transferred to the Purchasing and Contracts Division to ensure compliance with all applicable statutes, rules, and policies. All current contracts include federal and state required general provisions and affirmations.

The Authorization to Contract is an internal form to document the contract budget and approval process. The chain of command differs for every agency division. All applicable signatures were designated on the form in accordance with the division's chain of command.

The Purchasing and Contracts Division has developed a contract file checklist to ensure all applicable documents are included in the master contract file and such records are housed in the Division. Contract close out procedures will be included in the mandatory training. In fiscal years 2005 and 2006 to date, TEA has received 100% audit compliance rating for contracts exceeding \$25,000 from the Texas Building and Procurement Commission which includes the solicitation and award procurement process.

The Agency Should Improve Certain Automated Controls for Contract-Related Financial Transactions

The Agency has sufficient controls over the input, processing, and output of contract-related financial transactions in its Integrated Statewide Administrative System (ISAS). Automated controls in ISAS include:

- Edit checks that prevent purchase order amounts from exceeding the contract amount.
- Edit checks that prevent payments from being made unless a valid purchase order exists.
- Controls that prevent prices from exceeding the product of quantity and unit prices.
- Account lockout controls that prevent repeated invalid access attempts to ISAS.
- Separation of duties that prevent a single user from being able to control transactions in the contracting process.

While automated controls exist over the input, processing, and output of contract-related financial transactions, opportunities exist to strengthen controls to protect automated information from unauthorized access and ensure the accuracy of information used to support contract decision making. We provided some details regarding these issues confidentially to the Agency for corrective action. Other less sensitive matters include the following:

- The Agency does not have a process to review user accounts in ISAS for stale/inactive accounts or for reasonableness with job duties. Thirty-six user accounts tested for ISAS access had never been used, and 66 accounts had not been accessed for at least five months. In addition, the Agency performed a review of access rights and determined that some employees have access to areas that conflict with their current job descriptions.
- Password requirements in ISAS do not agree with the Agency's password policies. The system requires users to change their passwords on a frequent basis; however, the system-required password length, password composition, and password history are not sufficient to comply with Agency policy.
- System administration personnel are notified of failed login attempts and account lockouts for ISAS. In addition, an event log is maintained on the server that runs ISAS. This event log provides an audit trail of security incidents that should be investigated; however, critical information from the event logs is not reviewed in a proactive manner.

- ISAS contains automated controls over the key contracting related types of transactions including the contracts, purchase orders, invoices, and payment vouchers. However, the Information in ISAS does not always agree with contract terms (this did not cause any incorrect payments):
 - For 8 (33 percent) of 24 contracts tested, dollar values stated on contracts and subsequent amendments do not agree with contract values in ISAS.
 - For 4 (13 percent) of 24 contracts tested, there were material differences between the contract amount and the purchase order amount.

Recommendations

The Agency should:

- Frequently and formally evaluate ISAS user accounts for reasonableness with job duties and remove stale accounts.
- Enforce the password requirements specified in its policies.
- Frequently review critical information from the event logs for ISAS, report any security incidents to appropriate management level, and take appropriate action to minimize the potential for future occurrence.
- Ensure that contract amounts recorded in ISAS are the same as the amounts actually specified in contracts.

Management's Response

The Agency concurs with the recommendations. A formal review has already begun of all ISAS accounts and will be completed by 9/30/06. This user audit will be repeated on a regular basis to ensure accounts are assigned accordingly. The password controls on the ISAS system will be upgraded to match the Agency policy by 12/15/06. The ISAS event logs will be regularly reviewed by authorized personnel and any anomalies reported to the Chief Financial Officer, the Chief Information Officer and the Information Security Officer for possible action.

The contract amounts recorded in the Integrated Statewide Administrative System (ISAS) designate the initial contract amount and do not currently capture contract budget amendments or purchase order change notices. The staff is working with the ISAS Support Team to enhance the contract module in ISAS to ensure the contract amount correctly reflects all adjustments to the original contract.

The Agency Should Make Specific Improvements to Contract-Related Documentation

The Agency does not always maintain copies of all contract-related documents for the time period that is required by state record retention policies. Therefore, auditors were not always able to determine whether the Agency received the best value for the State, received contracted goods or services, or followed established policies and procedures for all contracts. The following are examples of missing documents:

- For 3 (13 percent) of 23 contracts tested (which totaled \$20.8 million), the Agency could not demonstrate that it verified the availability of funding prior to issuing the requests for proposal.
- The Agency did not have copies of proposals received, evaluators' nondisclosure statements, and the formal termination of contract letter sent to one contract after the termination of the contract. The Agency entered into this contract in fiscal year 2003 and terminated the contract that same year after funding was terminated by the Legislature.
- The Agency did not have requests for proposals for 2 (8 percent) of 24 contracts tested. Without the request for proposals, auditors were unable to determine whether the Agency's solicitation contained all required information. In addition, we were unable to determine what the Agency requested from bidders and whether it adequately communicated its needs.

Recommendation

The Agency should maintain contract documents for the time period required by state record retention policies

Management's Response

The Agency has centralized the contract files in the Purchasing and Contracts Division to ensure the agency meets the required records retention policy and maintains complete and accurate files.

Agency division budgets are prepared in the summer of each year and must reflect all expected expenditures including contract amounts for the upcoming fiscal year. Justification must be provided to the budget office and approved by the Chief Operating Officer (COO). In addition, quarterly budget analysis and adjustments are performed and approved by the COO.

The Authorization to Contract document designates a signature block for fiscal review to ensure the division has sufficient funds to cover the contract. This process is required for each fiscal year the contract is active.

The Agency Does Not Maintain Information on School Districts' Contracts

Rider 83, page III-22, the General Appropriations Act (79th Legislature), required the State Auditor's Office to determine whether the Agency has established and maintained a database that documents specific information about vendor contracts at all independent school districts throughout the State of Texas. We found no statutes that require the Agency to collect such information.

Auditors surveyed 18 school districts to ask questions about contracting functions at these districts. Of the 18 surveyed, 15 responded:

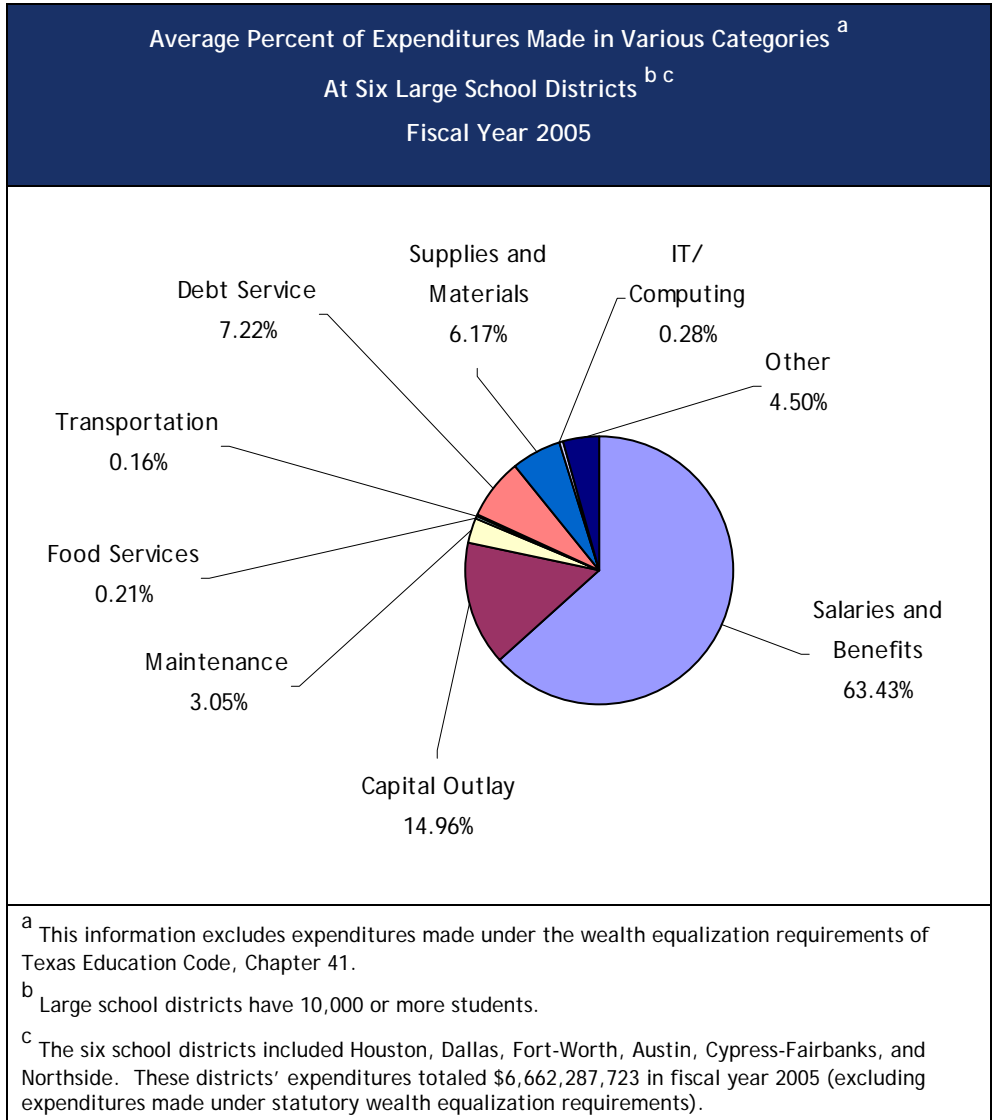
- Most districts that responded manage contracts from a central location, but only seven of the districts have a list of contracts in a central location. Methods used to track contracts ranged from electronic databases to manual files. Most contracting occurs at large districts, and smaller school districts reported having relatively few contracts.
- Regardless of their size, the districts that responded reported they use consolidated buying power to seek quantity discounts through regional Education Service Centers, cooperative purchasing agreements, and consolidating purchase orders with nearby school districts.
- Most of the school districts that responded do not have a process to preclude overlap of purchases with the Agency; however, our survey did not identify any actual overlap in contracting or payments. The most significant contracts at districts include contracts for construction of school buildings, utilities, professional services, food service, transportation, copiers and printers.
- The districts that responded specified that the contracting activities they conduct to significantly improve student performance included contracts for:
 - ♦ Online subscriptions
 - ♦ Consultants for staff development
 - ♦ Online student reports related to student assessments
 - ♦ Education technology service centers
 - ♦ Mass purchase of library books

A summary of the expenditures made by the 18 school districts that auditors surveyed is detailed in Figures 1, 2, and 3 on the following pages. As these

figure show, approximately 63 percent of these districts' funding is spent on salaries and benefits.

Figure 1 presents the average percent of expenditures that six large school districts made in various expenditures categories in fiscal year 2005.

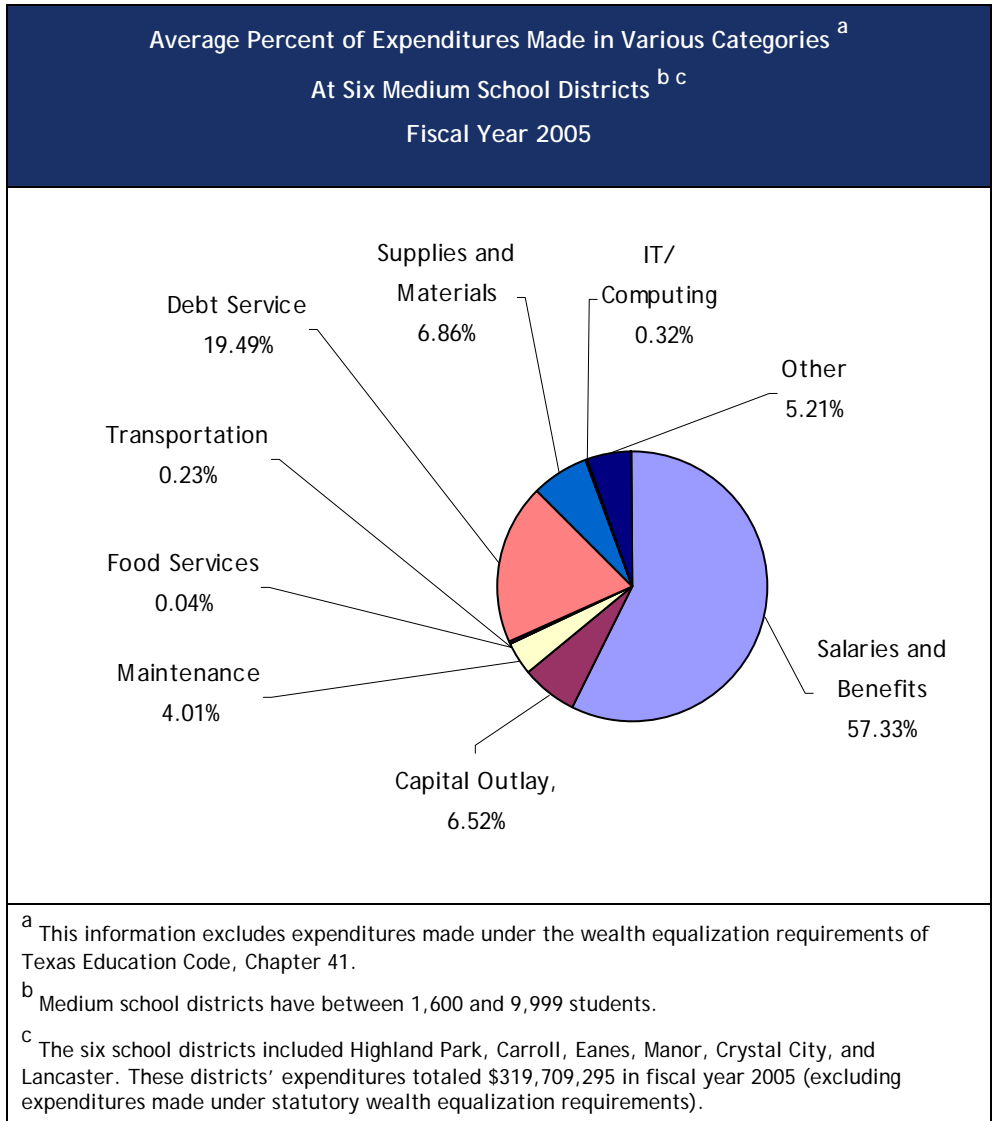
Figure 1



Source: Unaudited information from the Texas Education Agency's Public Education Information Management System (PEIMS).

Figure 2 presents the average percent of expenditures that six medium-sized school districts made in various expenditures categories in fiscal year 2005.

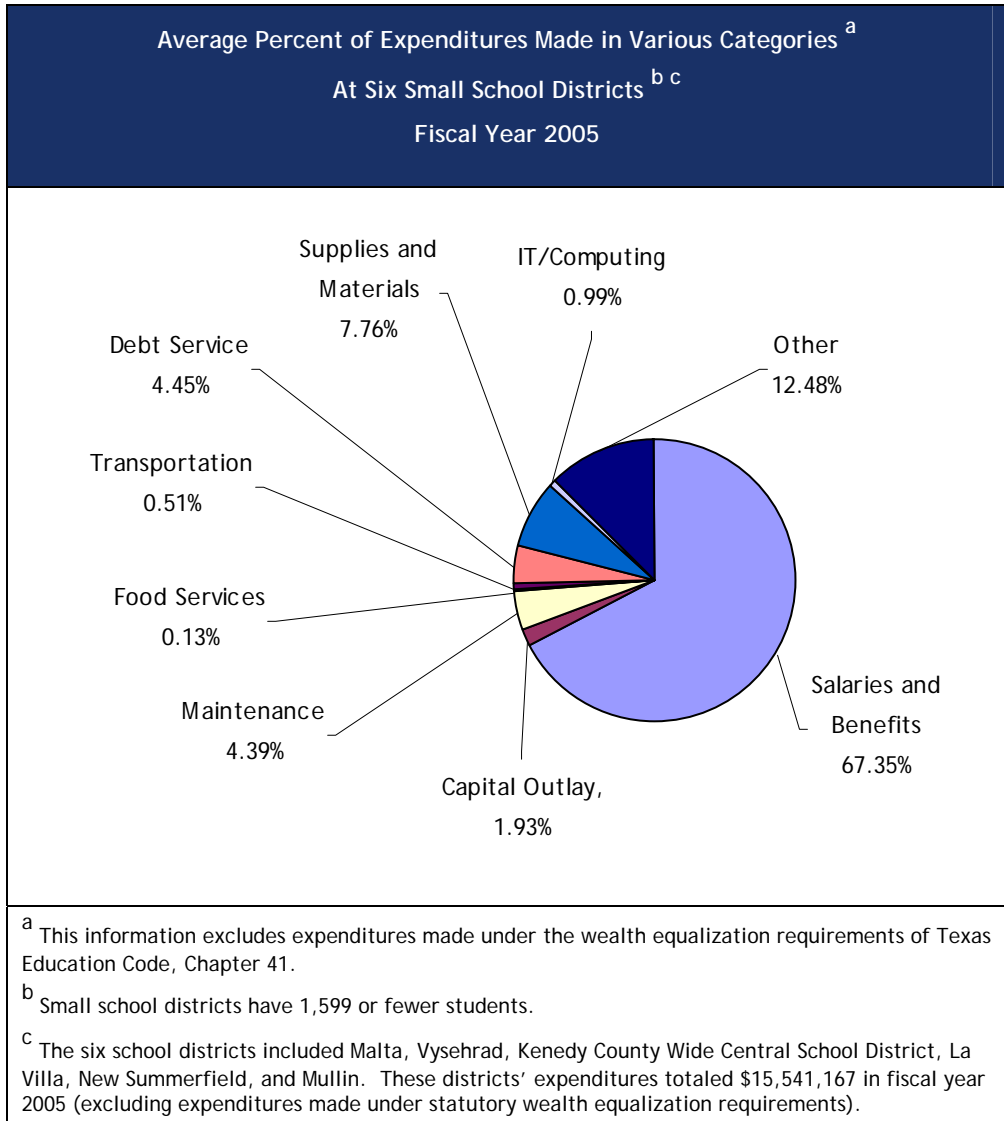
Figure 2



Source: Unaudited information from the Texas Education Agency's Public Education Information Management System (PEIMS).

Figure 3 presents the average percent of expenditures that six small school districts made in various expenditures categories in fiscal year 2005.

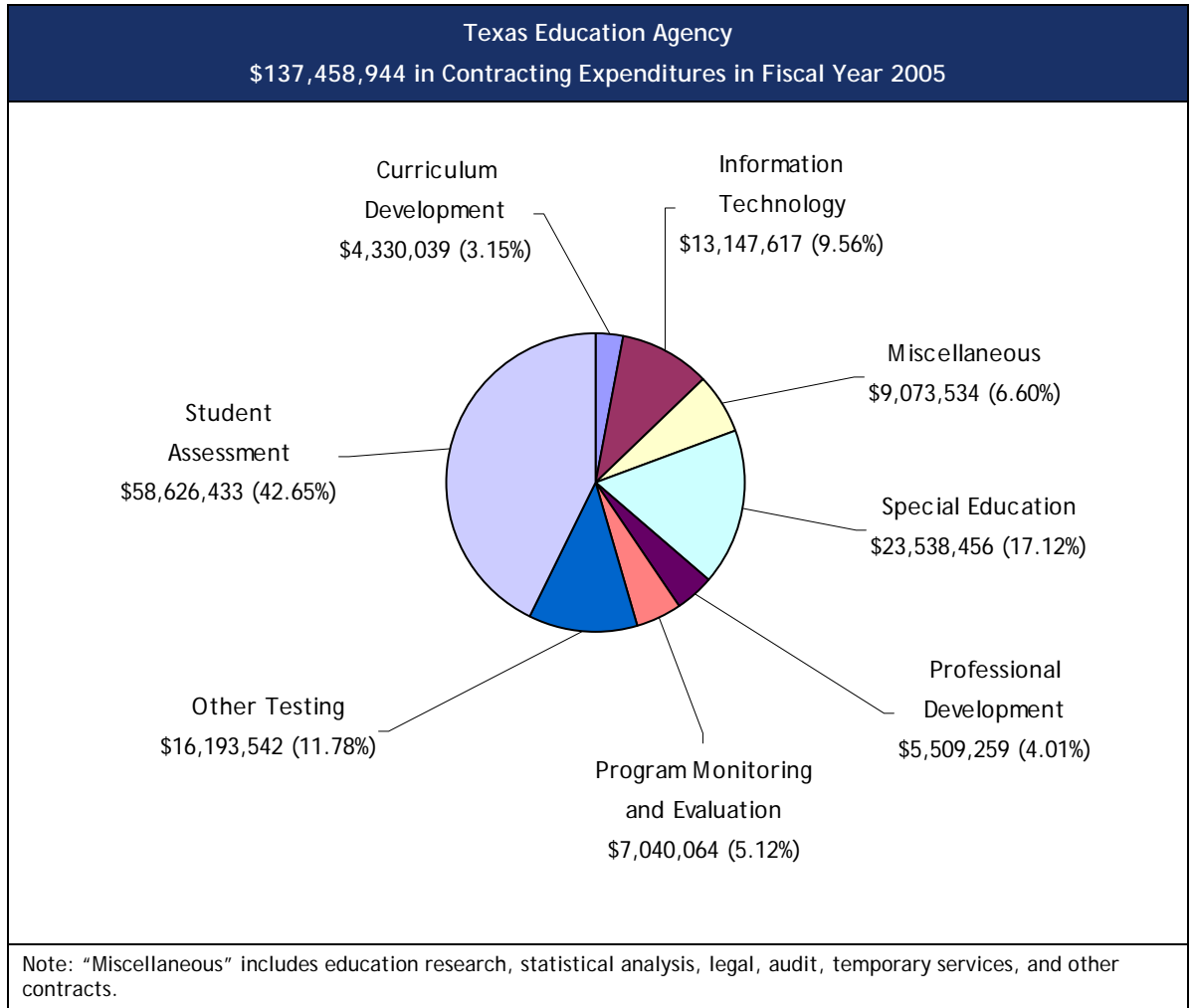
Figure 3



Source: Unaudited information from the Texas Education Agency's Public Education Information Management System (PEIMS).

Figure 4 below shows the types of contracting expenditures made at the Agency.

Figure 4

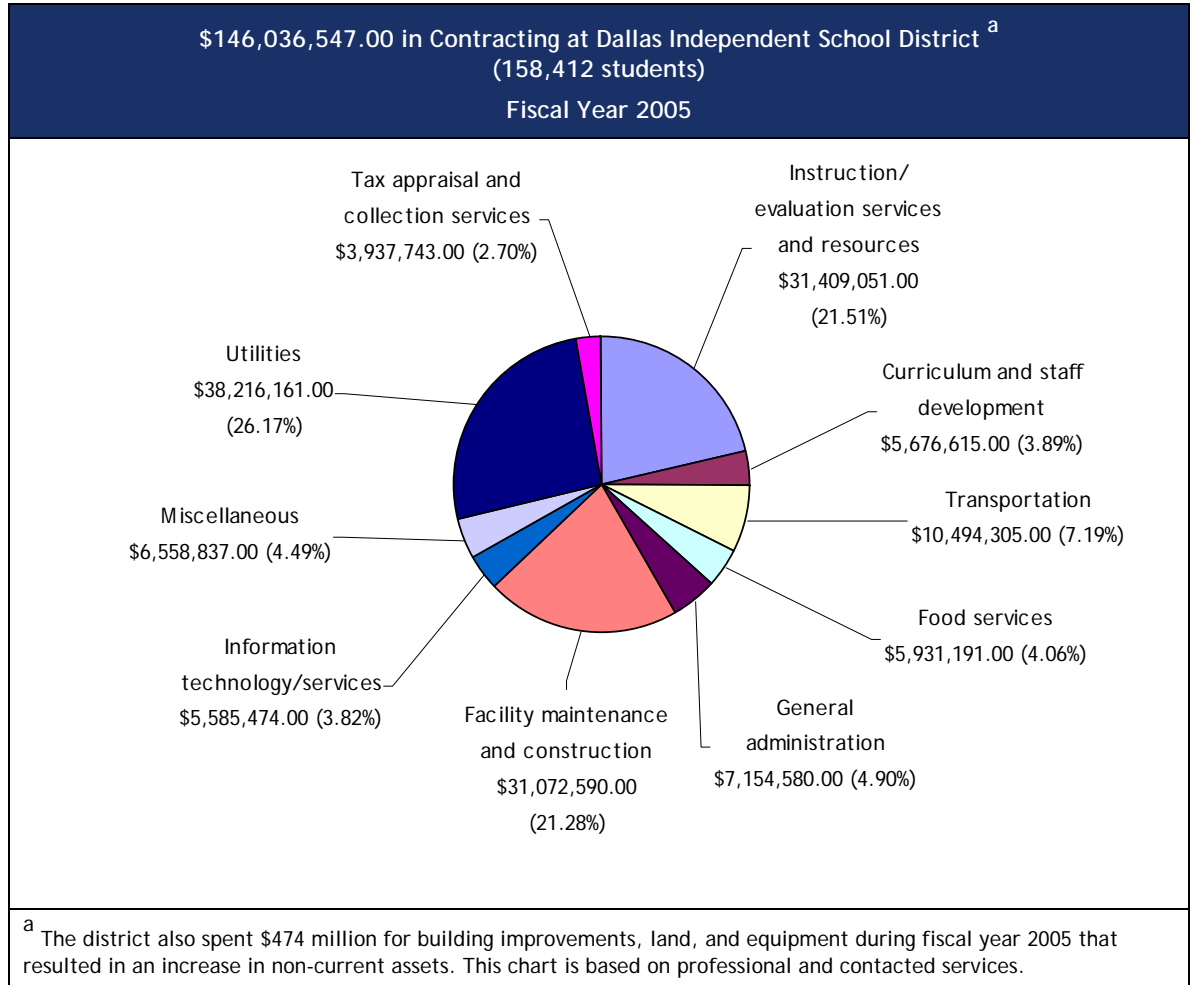


Source: Unaudited information self-reported by the Texas Education Agency.

This Agency information in Figure 4 and the school district information in Figures 5 through 7 below demonstrate the lack of overlap between Agency and school district contracting activity.

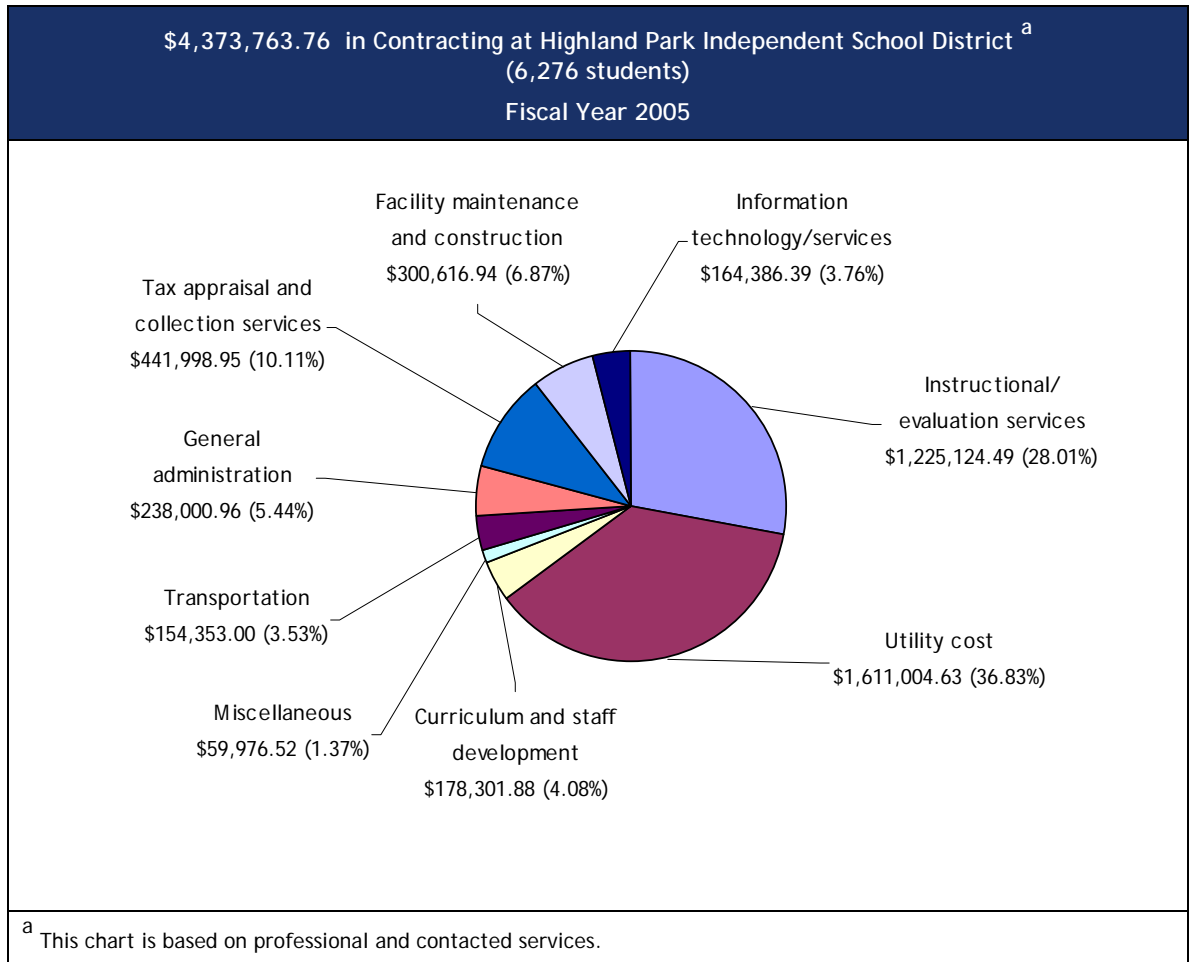
Figures 5 through 7 illustrate the range of contracting activities at one large, one medium, and one small school district, respectively, during fiscal year 2005. These illustrations show how the extent and categories of contracting activity vary by the size of school district (school district size is in terms of the student population; see Figures 1-3 for more information on school district size).

Figure 5



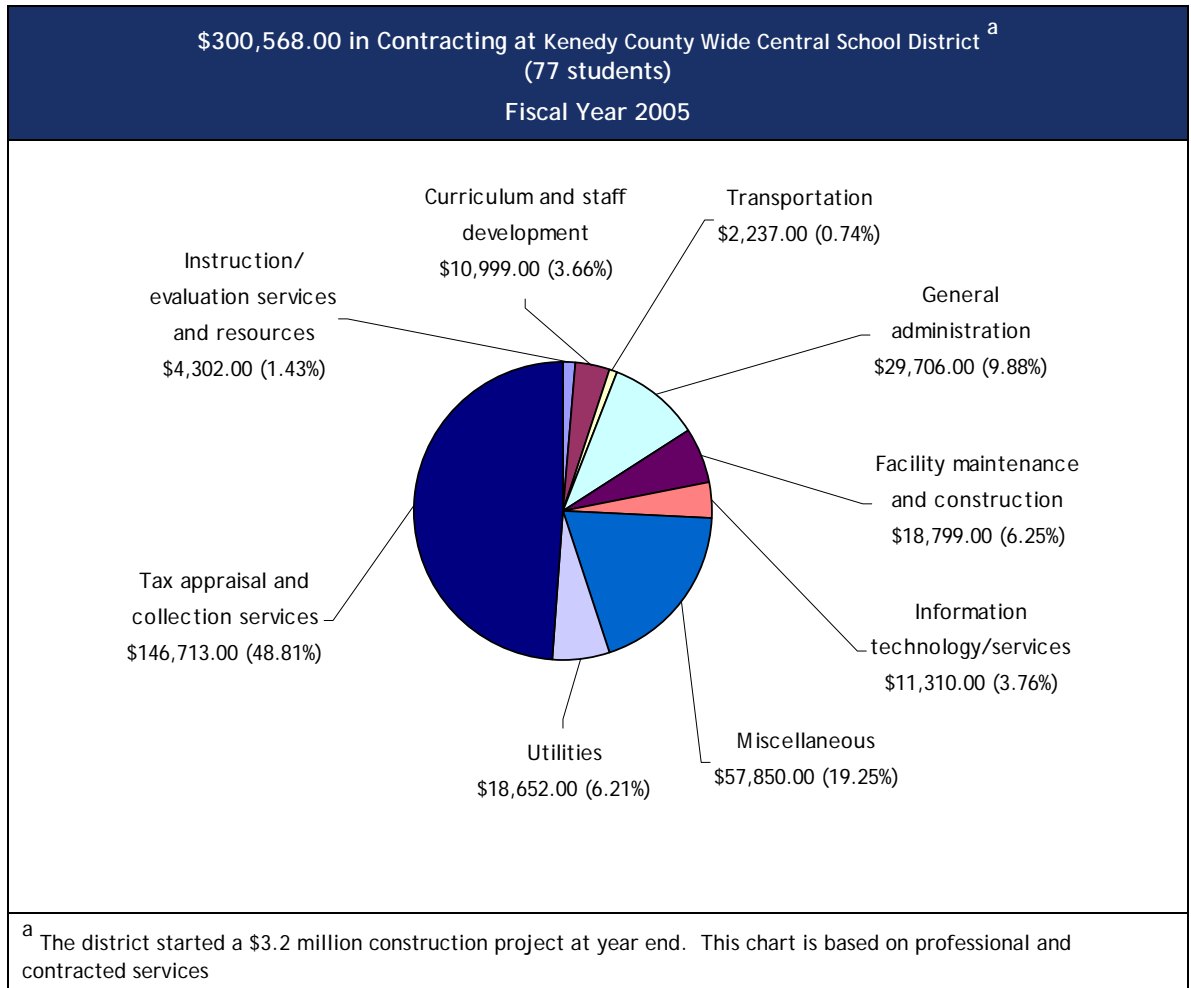
Source: Unaudited information self-reported by the district.

Figure 6



Source: Unaudited information self-reported by the district.

Figure 7



Source: Unaudited information self-reported by the district.

Management's Response

The scope of this audit included an evaluation of whether TEA has established and maintained a database that documents specific information about vendor contracts at all independent school districts throughout the State of Texas. TEA does not have any legal authority that allows the agency to collect such information. Texas school districts have been granted authority under the Local Government Code to be independent of the Agency in this area.

Appendix

Objective, Scope, and Methodology

Objective

The objective of the audit was to fulfill the requirements of Rider 83, page III-22, General Appropriations Act (79th Legislature), to assess controls over contract management and procedures on payments for purchasing contracts at the Agency. In the assessment, the State Auditor's Office was required to answer the following questions:

- Does the Agency effectively monitor and control contract payments?
- Does the Agency have the information necessary to support contract decision-making?
- Has the Agency established and maintained a database that documents specific information about vendor contracts at all independent school districts throughout the state of Texas?

Scope

The scope of this audit included an evaluation of the Agency's contract management controls and payment procedures and an examination of selected practices documented for contracts in place and applicable payments during fiscal years 2005 and 2006. We also surveyed independent school districts regarding their contracting practices. The following school districts provided detailed survey information:

- Austin Independent School District
- Carroll Independent School District
- Dallas Independent School District
- Fort Worth Independent School District
- Highland Park Independent School District
- Kenedy County Wide Central School District
- La Villa Independent School District
- Malta Independent School District
- Manor Independent School District

- Mullin Independent School District
- New Summerfield Independent School District
- Northside Independent School District
- Vysehrad Independent School District

The following districts advised us they could not respond to our survey request:

- Crystal City Independent School District
- Cypress-Fairbanks Independent School District
- Lancaster Independent School District

Methodology

The audit methodology included interviewing Agency contract and division management personnel; reviewing the contract management process and its controls; and examining selected practices documented in contract and payment files for compliance with state laws, Agency policy, and contract terms. We requested 18 school districts respond to specific questions regarding their contracting practices.

Information collected and reviewed included the following:

- Policies and procedures for the Agency’s contract management and payment processes
- The Texas Building and Procurement Commission’s *State of Texas Contract Management Guide*
- Selected contract payment files containing contracts, approval documents, negotiation documents, payment vouchers and evaluation information

Procedures and tests conducted included the following:

- Conducted interviews with Agency contract management personnel
- Reviewed Agency policy and procedures
- Evaluated the design of Agency processes using best practices criteria, state law, the Texas Building and Procurement Commission’s *State of Texas Contract Management Guide*, and Agency policies
- Tested actual Agency practices for selected contracts to determine compliance with Agency policy and procedures and state law

Criteria used included the following:

- Texas Government Code, Chapters 572, 2155 through 2157, and 2251
- Title 1, Texas Administrative Code, Chapter 113
- Texas State Record Retention Schedule (3rd Edition), Section 5.2
- The Texas Building and Procurement Commission's *State of Texas Contract Management Guide*
- Agency policies and procedures

Project Information

Audit fieldwork was conducted from April 2006 through July 2006. This audit was conducted in accordance with generally accepted government auditing standards.

The following members of the State Auditor's staff performed the audit:

- Ron Zinsitz, CPA, CIDA (Project Manager)
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- Brian Jones
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- Dean Duan, CISA (Information Systems Audit Team)
- Gary Leach, MBA, CQA, CISA (Information Systems Audit Team)
- Dennis Ray Bushnell, CPA (Quality Control Reviewer)
- Verma Elliot, MBA, CGAP (Audit Manager)

Copies of this report have been distributed to the following:

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The Honorable David Dewhurst, Lieutenant Governor, Joint Chair
The Honorable Tom Craddick, Speaker of the House, Joint Chair
The Honorable Steve Ogden, Senate Finance Committee
The Honorable Thomas “Tommy” Williams, Member, Texas Senate
The Honorable Jim Pitts, House Appropriations Committee
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Texas Education Agency

Members of the State Board of Education
Dr. Shirley J. Neeley, Commissioner of Education



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