

Summary of Request:

The Board approved an internal audit plan for 2015 which included an audit of agency contract management.

Historical Perspective:

The contract management audit was selected on the annual risk assessment update and on recent statewide interest in this area of public procurement practices. Governor Abbott issued a letter regarding agency contract oversight shortly after his inauguration outlining his position on proposed legislation already filed by Senator Nelson (SB 20). This emanated from news reports on mismanagement of state contract procurement and administration processes.

Pros: The Board of Nursing will be in compliance with the Texas Internal Audit Act, the plan approved by the Board for fiscal year 2015 and will provide the Texas Board of Nursing information on our current contract practices and any areas needing immediate attention.

Cons: None.

Staff Recommendation:

Board Action: Move to accept Internal Audit Report 2015-1, Contract Management Audit as prepared by E. Jaye Stepp, CPA for fiscal year 2015.



Texas Board of Nursing

Internal Audit Report #2015-1

Contract Management Audit

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Acronyms and Abbreviations

- CMBL Certified Master Bidders List
- CMG Contract Management Guide, State of Texas
- CPA Comptroller of Public Accounts, Texas
- ED Executive Director
- ESBD Electronic State Business Daily
- IA Internal Audit
- IIA Institute of Internal Auditors
- IPPF International Professional Practices Framework, IIA’s
- OAG Office of Attorney General
- SAO State Auditor’s Office
- TAC Texas Administrative Code
- TGC Texas Government Code
- TPASS Texas Procurement and Support Services
- TxCPA Texas Comptroller of Public Accounts

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Internal Audit Report

July 10, 2015

Texas Board of Nursing

The following report provides the results of the internal audit of the processes and controls around Legacy Fund activities. We conducted this audit in accordance with *Generally Accepted Government Auditing Standards* and the *International Standards for the Professional Practice of Internal Auditing*. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Overall, based on the results of our review and testing, controls provide reasonable assurance that the BON generally ensures compliance with requirements for contract management. However, some recommendations to improve processes are detailed in the attached report.

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Executive Summary

Audit Purpose

The contract management audit was selected based on the annual risk assessment update and on recent outside interest in this area of state procurement practices. There is a known risk to the agency in that this area is not well organized and has never been audited. There is also increased focus by the SAO this year on agency contracts. The Governor issued a letter regarding agency contracts oversight shortly after his election. Other agencies have been in the news lately for mismanagement of contract procurement and administration processes. This audit will also concurrently satisfy the IA Act's requirement to audit agency administrative processes periodically.

Our audit focused on ensuring that contracts engaged by the agency are supported by appropriate supporting documentation to evidence proper planning, procurement, formation, and oversight activities are in compliance with State guidance.

Overall Conclusion

For the contracts reviewed, the BON generally complies with State requirements for contract formation. However, the documentation supporting the performance of other contract planning and oversight activities was inconsistent, so we were unable to determine if all required activities were performed. The essential clauses recommended by the CMG were not always present in limited supporting documentation, and internal contract communication channels needs improvement. There are limited procedures in place to ensure consistency in activities. The agency has very few large contracts in place and none that exceed the threshold requiring the Copa's Procurement and Support Services (TPASS) review. Only 10% of contracts at the BON exceed the threshold that requires posting to the Electronic State Business Daily and bid solicitations. However, for those that do require going out for bid, the solicitation and selection documents are to be maintained at the agency for the life of the contract. BON did not have that documentation available for audit review and evaluation.

There were two recommendations resulting from this audit, both relating to enhancing contract management processes by utilizing the State's Contract Management Guide in addition to the State Procurement Manual. The agency should develop written contract management procedures to ensure consistent performance by all involved in the contracting process.

Acknowledgements

The BON staff was cooperative in providing requested audit information, documents, and responses to inquiries and surveys in a timely manner. We appreciate the input and assistance provided in the audit process.

Objectives, Scope, and Methodology

Audit Objectives: The following audit objectives were developed and agreed-upon by the auditor and the client:

Audit Objective A – Compliance: Determine if the agency’s written guidance for the contract management activity aligns with state guidance to ensure compliance with policies, plans, procedures, laws, and regulations. Evaluate for consistency in application and overall adherence to the Comptroller’s Contract Management Guide.

Audit Objective B – Processes & Controls: Review management processes and controls for accomplishment of established goals and objectives; for operational effectiveness and efficiency.

Audit Objective C – Reporting & Communication: Determine if reporting requirements and communication needs are being met. Are budgets adequately tracked, monitored, and reported?

Scope:

The scope of the audit was limited to FY-2014 and FY-2015 contracts. In some cases where a contract was entered into prior to that time frame, the original supporting documentation was reviewed since all contracting activities would not be repeated on a renewed contract.

Methodology:

Meetings were held with the Director of Operations and Accounting staff to discuss the processes and controls around the contracting activities and understand the flow of information. We requested and reviewed documents including written procedures, tracking documents, and contract administration files. We requested an inventory of all current contracts, and reviewed the content of all contract files to evaluate activities supported by documentation. The contracting activities at BON includes different types of contracts that are entered into by various divisions, primarily Legal and Operations.

Sources of Information & Criteria:

The Comptroller’s Contract Management Guide
The State of Texas Procurement Manual
Background materials and published reports from State Auditor’s Office

Audit Results and Recommendations

The results and recommendations presented in this section represent the conclusions of the internal audit program which was developed based on audit objectives established and agreed upon with the BON management.

Audit Objective A –Compliance: Determine if the agency’s written guidance for the contract management activity aligns with state guidance to ensure compliance with policies, plans, procedures, laws, and regulations. Evaluate for consistency in application and overall adherence to the Comptroller’s Contract Management Guide (CMG).

Compliance requirements for the contract management activities are contained in the Comptroller’s CMG and the State Procurement Manual. Contract manager responsibilities from the CMG were used to develop a questionnaire for management to determine what activities are being performed in relation to contracts, since there are several areas involved. Contract files at the agency were also reviewed to evaluate content and staff activities. The contract files are also maintained in several different areas of the agency.

The CMG recommends that agencies have a trained and certified Contract Manager. A contract manager’s duties are determined by the agency, but they usually have significant duties related to contract management. The BON does not have a trained or designated contract manager, but they do have a Certified Texas Purchaser (CTP) on staff who performs many contract management duties. The CTP certification is required for individuals to make purchases between \$25,000 and \$100,000 and most of BON’s contracts are less than \$100,000.

The Procurement manual’s section on Code of Ethics & Conflict of Interest states: “All purchasing staff of a state agency who have been delegated the authority to purchase must also sign a Conflict of Interest statement each year. One copy of the signed statement should be given to the employee, with a copy to the employee’s supervisor and other copies distributed according to individual agency requirements.” A sample Conflict of Interest form is provided in the procurement manual that complies with TGC §2155.003. The CMG refers to the procurement manual guidelines for Conflict of Interest for staff to follow, or their own internal agency guidelines.

Vendor Performance reporting is required for purchases over \$25,000 but the Comptroller recommends reporting on all purchases and contracts upon closure. The Vendor Performance Tracking System (VPTS) provides the state procurement community with a comprehensive tool for evaluating vendor performance to reduce risk in the contract award process. The VPTS tracks exceptional, satisfactory and unsatisfactory vendor performance.

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The Contract Management Guide provides comprehensive guidance on the various phases of contracting activities, including planning, procurement, formation and oversight, such as:

- Plan – identify contracting objectives and strategy
- Procurement – fairly and objectively select the most qualified contractors
- Contract formation / rate / price establishment – ensure the contract contains provisions that hold the contractor accountable for producing detailed results, including all relevant terms and conditions as well as establish processes that are cost-effective and aligned with the cost of providing the goods and services.
- Contract oversight – monitor and enforce the terms of the contract

BON has been delegated authority from the Comptroller for purchasing many items, such as a commodity or service with an estimated purchase price of \$5,000 or less; emergency purchases; commodity purchases of goods that do not exceed \$25,000; purchases of services the estimated cost of which does not exceed \$100,000, and more.

The CMG states that Contract Administration includes seven general processes:

1. Planning
2. Monitoring Performance
3. Change Management
4. Payment Approval
5. Dispute Resolution
6. Termination
7. Contract Closeout – Purchaser / Accounting

The Accounting division uses a spreadsheet for budgetary tracking on contracts and blanket PO's. However, this tracking spreadsheet does not include all contracts at the agency. The Accounting division indicated that they are not always aware of all contracts in place at BON. It would improve budget monitoring and payment tracking if accounting staff were to include all contracts in their monitoring tool. This would require that they be involved with / informed about all contracts that the agency enters into, preferably prior to execution.

The Director of Operations reviews and approves most invoices and monitors budgets. Some of the contracts found in the Operations contract folder were not included on the spreadsheet maintained by Accounting. The Director of Operations relies on program people to monitor performance of contracts and communicate concerns.

The Legal division also enters into contracts for expert witnesses and consultants. They use templates for their contract document, performance is monitored by the agency's GC and Legal Assistant Supervisor and invoices are reviewed and approved by them prior to submission to Accounting for payment. Legal does not monitor the overall costs of the contracts. The legal contracts that were reviewed showed some inconsistency in the templates being used. Templates should be monitored to ensure they remain current and staff are using the most current version of the templates.

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The CMG also recommends that the Contract Administration file includes:

- Copy of current contract and all modifications
- Reference list or list of prior contracts / experience
- Documents: solicitation; response; evaluation; notice of award

Contract files were reviewed for essential clauses, recommended clauses, payment terms, authority to contract, statements of work, etc. The contracts are generally good but they lack consistency in content. Critical items include:

- Operations contracts did not always state a limit or not-to-exceed amount, confidentiality clauses were not always included, indemnification clauses were often not included, and dispute resolution clauses were included most of the time, but not always.
- Legal contracts are using templates, which is a best practice, but the templates were inconsistent, possibly some older versions were used. Contracts were found to sometimes not include a not-to-exceed amount, and some contracts lacked a confidentiality clause.

The CMG recommends contract close out procedures that include the vendor performance report to the Comptroller's office on any contracts that exceed \$25,000 (required) and recommended for all contracts and other final steps to close a contract.

Overall consistency and completeness in contract performance procedures could be improved with a review of CMG requirements and developing procedures and tools to ensure CMG recommended activities are adhered to.

Recommendation #2015-1-01

BON should develop procedures and tools to ensure that the CMG recommendations are followed in agency contract administration performance and documentation.

Management Response #2015-1-01

The BON staff agree with this recommendation and will revise current policies and procedures that include general processes on contract management as provided in the Comptroller's Contract Management Guide.

Responsible party: Operations Director, Chief Accountant and Purchaser

Implementation date: September 1, 2015

Audit Objective B – Processes & Controls: Review management processes and controls for accomplishment of established goals and objectives; for operational effectiveness and efficiency of the contract management process.

Contracts are planned, formed and procured by various staff at the agency. Operational contracts are managed by operations and tracked by Director of Operations and Accounting staff. Legal contracts are managed by Legal division staff (General Counsel and Legal Assistant Supervisor) and are not included in tracking spreadsheet used by Accounting.

Operations contracts are often one-pagers that include the costs, time frames, payment terms and limits, as well as termination, extension, and dispute resolution processes. Legal division staff use templates for their contracts, which is a best practice, and their files were fairly consistent in content. However, both sets of contracts reviewed found some inconsistencies, such as lack of a not-to-exceed amount, or confidentiality clauses. Legal also does not run their contracts through the Purchasing for review prior to entering into a contract, as they recommended by the CMG. Purchasing can provide a review to ensure appropriate procurement processes are followed, essential clauses are included, appropriate approvals have been obtained, and budgetary impacts have been recorded for monitoring purposes.

A summary of results found at BON, based on common contract elements follows:

Contract planning expectations include documented planning efforts that could include performing a needs assessment, performing a risk assessment, and/or developing a communication plan. The CMG suggests that every contract management initiative should include an executive sponsor, a contract manager, purchasing staff and program staff to assist in the process. Purchasing staff should review all contracts to ensure that purchasing statutes are followed and that procurement is handled in a fair and competitive environment.

At the BON -

- Operations and Legal Directors serve as executive sponsors and provide oversight
- There are no designated or certified contract managers at BON,
- Purchasing's CTP has not been receiving all agency contracts for review

The CMG recommends these activities be included in contract planning:

- Risk assessments should be performed to include consideration of past performance, turnover in key positions, dollar amount of contract, etc.
- A communication plan to manage and control both internal and external communication. Identify stakeholders, type, content and frequency for reporting status. Determine who, what, when, where and how information will be communicated.

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- Employees involved in preparing a solicitation should sign and submit a non-disclosure statement and conflict of interest statement prior to beginning work on a solicitation.
- Contract terms must be established prior to solicitation and must be included in the solicitation document. All contracts must have a specific ending date. It is recommended that maximum time without reissuing a competitive solicitation is 4 years, including renewal periods.

Contract formation includes provisions required by the *State of Texas Contract Management Guide* (CMG). The CMG includes recommended terms and conditions that include administrative provisions, financial provisions, provisions to allocate risk, a statement of work, provisions relating to the contract term, termination and dispute resolution, and provisions related to rights and ownership of work product and intellectual property.

The contracts reviewed at BON had many of these provisions in most of their contracts, but some of the recommended clauses were not consistently found in all contracts. A best practice in contract formation is the use of customizable templates for contracts, and a documented review and approval process prior to execution. Legal and Operations both use templates; the templates should be periodically reviewed to ensure they remain complete and current.

Essential clauses that were found intermittently in contracts reviewed –

- Indemnification
- Funding out clause
- Confidential information
- Right to audit
- Ownership / intellectual property

Contract procurement – maintain documentation of the proposal evaluation process and/or document their determinations of best value, and documented conflict of interest statements. At BON, the contract files were lacking in support for bid evaluation and selection.

Contract monitoring – monitoring contractor performance and compliance with terms of the contract, implementing corrective actions, contract amendments, processing payments, and complying with reporting requirements. At BON, monitoring of contractor performance is done by the Operations Director and the General Counsel.

Contract management Policies and Procedures at BON are not adequately documented to ensure consistent performance of all activities related to contracts at BON.

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Contract files were limited in content. Generally available was a copy of the contract and solicitations. The CMG suggests that keeping one complete master contract administration file is critical. The file provides a basis for settling claims and disputes should they arise and should be maintained throughout the life of the contract and then in accordance with agency record retention requirements. The CMG also provides a list of suggested content for files.

Contract close out - In addition to monitoring performance, vendor performance should be reported to the Comptroller's office for inclusion in their vendor database. A contract close-out procedure is a simple but detailed administrative procedure. The purpose is to verify that both parties have fulfilled their contractual obligations and there are not responsibilities remaining. Close-out is also a good time to assess the success of the contract and determine if there are any lessons learned for future contracts.

Opportunities for improvement include those discussed above, and,

- Use checklists for approvals and expected file content,
- Document processes for contracts, and templates, to make a more efficient and consistently applied process.
- Train all staff involved in contracts, including purchasing staff.
- Ensure that Accounting / purchasing staff are communicated with in the contract planning and formation stages.
- Ensure conflict of interest and nondisclosure statements are in place.

Recommendation #2015-1-02:

Every contract management initiative should include an executive sponsor, a contract manager, purchasing staff and program staff to assist in the process. Contract planning and formation supporting documentation needs improvement. Contract administration files should include essential documents listed in the CMG and should be maintained in one complete master file, held by Accounting.

Management Response #2015-1-02

The BON staff agree with this recommendation and will revise current policies and procedures that include the Comptroller's Contract Management Guide provisions on contract planning, information, procurement, monitoring and close out.

Responsible party: Operations Director, Chief Accountant and Purchaser

Implementation date: September 1, 2015

Audit Objective C – Reporting & Communication: Determine if reporting requirements and communication needs are being met. Are budgets adequately tracked, monitored, and reported?

Reporting on contracts is primarily through the financial reporting process at BON. Contracts are monitored through budgets and deliverables. Adherence to budgets and timely, acceptable contract deliverables serve as assurance of satisfactory performance. Financial performance is monitored through the budgetary process; performance is monitored by the programs who requested the service / goods. The Director of Operations provides general oversight over BON's operational contracts.

Accounting staff mentioned that there had been times when they'd get an invoice for a contract they had no knowledge of, representing poor communications between staff involved in contracting. It should be required that all contracts be communicated to and routed through accounting staff for budgetary monitoring and reporting purposes.

Improved communications through a team of contract sponsors, managers, purchasers, and program staff would improve the completeness of periodic monitoring and reporting on contracts.

The implementation of the close out procedures would provide historical perspective for internal evaluations in the contracting process.

RECOMMENDATIONS: None specific to this objective

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Texas Board of Nursing

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