

SPECIAL REVIEW

**DEPARTMENT OF REVENUE
INTEGRATED TAX ADMINISTRATION
SYSTEM PROJECT CONTRACT**

DECEMBER 1994

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December 14, 1994

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December 14, 1994

The Honorable James B. Hunt, Jr., Governor
Secretary Janice H. Faulkner
North Carolina Department of Revenue
Members of the General Assembly of North Carolina

Ladies and Gentlemen:

Pursuant to General Statute §147-64.6(c)(16), we have completed our special review into allegations concerning the Department of Revenue's Integrated Tax Administration System Project Contract. The results of our review, along with recommendations for corrective actions are contained in this report. The Secretary of the Department of Revenue has reviewed this report and her written comments are included in Exhibit A.

We would like to express our appreciation to management and staff of the Department of Revenue for their cooperation during this review.

Ralph Campbell, Jr.
State Auditor

OVERVIEW

The Department of Revenue (Department) serves the role of collecting and accounting for the State's tax funds, insuring uniformity in the administration of the tax laws and regulations, conducting research on revenue matters, and exercising general and specific supervision over the valuation and taxation of property throughout the State. Currently there are 1,154 employees within the Department.

For the fiscal year ending June 30, 1994, the Department had total revenues of \$65.4 million and total expenditures of \$65.4 million in the general fund.

On August 18, 1993, the Department entered into a \$7.9 million contract with a Contractor to implement an Integrated Tax Administration System (ITAS) which would fully support all of the essential functions of tax administration for which the Department is responsible. The period of the contract is 26 months. In order to implement the system, the Contractor has assigned employees from across the United States to work on the ITAS Project in Raleigh. The Department currently has twenty (20) employees, including a Project Director, assigned to the project full-time. In addition, the Department established a steering committee made up of Department officials to oversee the ITAS Project. As of April 30, 1994, the ITAS Project had total receipts of \$4.1 million and total expenditures of \$2.7 million.

INTRODUCTION

The Office of the State Auditor received an allegation through the State Auditor's Hotline that the Department of Revenue (Department) was reimbursing the Integrated Tax Administration System (ITAS) Project Contractor for expenses in violation of the contract.

We used the following procedures to conduct our review of the above allegation:

1. Interviews with employees of the Department.
2. Interviews with individuals external to the Department.
3. Examination of records pertaining to the ITAS Project from August 1993 through April 1994.

This report represents the findings and recommendations from our review. We examined financial records but did not conduct a financial audit of the Department. The Office of the State Auditor reviews the Department's financial activities through its annual audit of the State's Comprehensive Annual Financial Report.

FINDINGS AND RECOMMENDATIONS

1. The Department of Revenue Has Made Payments to the ITAS Contractor Without Proper Review of the Documentation Supporting the Invoices.

During our special review, we determined that the ITAS Contractor's (Contractor) employees prepare a bi-weekly timesheet and expense report for the ITAS project. These documents are used by the Contractor to determine what fees and expenses to bill the Department of Revenue (Department) for work done on the project. When we started our special review, the Department had made invoice payments to the Contractor totaling \$1,970,634 for fees through April 30, 1994 and expenses through April 15, 1994. The Department had paid the Contractor the above monies without reviewing the documentation which supported the invoice amounts.

According to the January 21, 1994 ITAS Steering Committee Meeting Minutes, the invoice approval process was outlined by the Deputy Secretary in the following manner:

“...once an ITAS invoice had been received and approved by the Project Director, it will come to her” (Deputy Secretary) “to approve as the Chairman of the ITAS Steering Committee.”

The Contractor's invoices were approved in the above manner without reviewing the supporting documentation necessary to determine if the amounts were correct and in accordance with the ITAS contract which stated that the Contractor's travel expenses would be reimbursed at established state rates.

According to the Contractor, their employees have used their own internal policies to determine what expenses are allowed for reimbursement by the Contractor. Since allowable expenses according to the Contractor's policies and procedures differ from the State Budget Manual, disallowable expenses have been reimbursed as outlined in

the following findings. If the Department of Revenue had properly reviewed supporting documentation, these discrepancies could have been discovered and reconciled in the early stages of the project.

Recommendation

We recommend that Management take the necessary action to ensure that supporting documentation is properly reviewed prior to the payment of the Contractor's invoice.

2. The ITAS Contractor Received Reimbursement From the Department for Meals Not Authorized by the Contract.

According to Section 5.2.9 of the Request for Proposal, the Contractor's reimbursement for per diem was not to exceed established State rates. According to Section 5 of the North Carolina State Budget Manual, allowable reimbursement for subsistence expenses incurred while traveling on official state business during the period we examined was as follows:

Breakfast	\$	4.00
Lunch		6.00
Dinner		11.00
		<hr/>
Total	\$	<u>21.00</u>

These rates remained effective through June 30, 1994.

The State has reimbursed the Contractor at the rate of \$21 per day per employee for subsistence. We determined that the Contractor has been reimbursed \$6,415.91 in additional costs for meals above the subsistence allowance. There were at least forty-five instances where the Contractor's employees received reimbursement for meals totaling \$290 in addition to receiving subsistence. In these instances, the Contractor billed the Department for the employee's daily subsistence and actual meals. Also, at

least one of the meals, a Christmas dinner party, included alcoholic beverages at a cost of \$370.89. Section 5 of the State Budget Manual provides that “Payment or reimbursement for alcoholic beverages or “set-ups” may not be made from state funds. Such cost must be borne entirely by individuals.”

The Contractor has also billed the Department for unallowable overtime meals totaling \$2,028. The Contractor’s internal Project Orientation Guide allows in-town project personnel to receive an overtime meal allowance of up to \$13 for dinner if the individual works ten or more hours on any workday. Such an allowance is not provided for in the State Budget Manual.

Finally, the Contractor has billed the Department daily subsistence rates for some of their employees in excess of the allowed \$21 per day. One contract employee, working on this project from a foreign country, has received subsistence at a rate of \$43 per day. Other employees have received subsistence at the daily out-of-state rate of \$26 although they were working in North Carolina. The total excessive charges by the Contractor for daily subsistence rates amount to \$603.

According to management within the Department, they did not know that they were reimbursing the Contractor for these expenses.

Recommendation

We recommend that Departmental management implement controls to ensure that they are not reimbursing the Contractor for meals in violation of the contract and State Budget Manual and that they are not reimbursing the Contractor twice for the same expense. Finally, we recommend that Departmental management seek reimbursement from the Contractor for the amount of unauthorized meals and excessive subsistence they have been paid.

3. The Contractor Has Provided Meals For Department Employees at the Department's Expense.

The Contractor and Departmental officials have dined together on at least seven occasions at the Department's expense. Contractor's employees paid the total cost of these meals and later listed these meals as an expense on their bi-weekly expense report. The Department then reimbursed the Contractor for these meals. The cost of these seven meals totaled \$264.

Department officials stated that they knew the Contractor's employees paid for their meals. However, they stated they did not know that, in addition, the cost of the meals were reimbursed to the Contractor by the Department.

Recommendation

We recommend that the Department take appropriate action to ensure that unauthorized reimbursement of meals are not made for Departmental employees through payments to the Contractor.

4. The ITAS Contractor Has Received Reimbursement From the Department for Questionable Miscellaneous and Entertainment Expenses.

During our special review, we determined that the ITAS Contractor has billed and been reimbursed by the Department for unauthorized miscellaneous and entertainment expenses totaling \$4,723.34. This amount includes \$842.94 for parking which, according to Department officials, is the Contractor's responsibility. Other expenses appear to be personal in nature. These expenses include entertainment for the Contractor's employees such as attending a play and a sporting event. Also included are rental cars for employees during weekend visits home.

These personal expenses are inappropriate expenses for reimbursement by the Department.

According to the Departmental management, they did not know that they were reimbursing the Contractor for these expenses.

Recommendation

We recommend that the Department take appropriate action to ensure they are not reimbursing the Contractor for unauthorized expenses. Additionally, the Department should seek reimbursement for the \$4,723.34 of unauthorized miscellaneous and entertainment expenses paid to the Contractor.

5. The Contractor Has Been Reimbursed for Lodging Expense Not Authorized by the Contract.

Section 5.2.9 of the Request for Proposal states that lodging reimbursement shall not exceed established State rates. The State Budget Manual provides allowable lodging expense to be actual, up to \$34 per night. In addition, the Budget Manual states that excess lodging may be allowed if authorization is obtained from the department head in advance.

Since the start of the ITAS Project until February 2, 1994, contractor employees have incurred excess lodging expenses of \$1,594 without prior authorization.

On February 3, 1994, the Secretary of the Department approved excess lodging for the Contractor. The daily lodging expense approved by the Secretary was \$97. However, from February 3 through April 15, 1994, the Contractor employees still incurred excess lodging expenses totaling \$136 above the new approved rate of \$97 per night. Once again the excess lodging was reimbursed by the Department.

According to management of the Department, they did not know they were reimbursing the Contractor for these excess lodging expenses.

Recommendation

We recommend that procedures be implemented to ensure that lodging expenses incurred are in accordance with the contract.

6. The Department Reimbursed the Contractor For The Expense of Obtaining a Performance Bond.

The Revenue Department reimbursed the Contractor \$29,000 for the expense of obtaining a performance bond for the ITAS Project. Section 7.29 of the contract's Request For Proposal states the following:

A Performance Bond or other financial sureties acceptable to the State shall be required by the State to assure the Contractor's faithful performance to the specifications and conditions of the Contract. The amount of the Performance Bond shall be eighty percent (80%) of the total Contract amount. This bond shall remain in force until the completion and formal written acceptance by the State of all tasks related to this Contract. The successful Contractor shall furnish the Bond to the Project Director no later than ten (10) calendar days after Contract execution.

The Contractor shall obtain the performance bond with a surety company admitted to do business in the State and which is acceptable to the State. The Bond shall refer to this Contract, and shall bind the surety to all of the terms and conditions of this Contract, whether or not the particular term or condition is performed by the Contractor or by a Subcontractor.

The Performance Bond shall be forfeited and paid to the extent of damage suffered by the State, in the following circumstances:

- ◆ if the Contractor shall cease conducting business in the normal course, become insolvent, make a general assignment for the benefit of creditors, suffer or permit the appointment of a receiver for their business or assets, or avail themselves or become subject as debtors to any proceeding under the Federal Bankruptcy Act or any other statute of any State relating insolvency or the protection of rights of creditors; or if the contract is breached.

In the event that the State exercises an option to extend the Contract for any additional period(s), the Contractor shall extend the validity and enforcement of the bond for said period.

According to the Purchasing Manager for the North Carolina Department of Administration, Division of Purchase and Contract, the cost of a performance bond should be borne by the Contractor not by the state. The agreement signed by the parties, however, does not clearly specify who is to pay for the bond.

Recommendation

We recommend that future contracts of this nature be specific as to which party pays the cost associated with the purchase of the performance bond. In addition, we recommend that the Department take those steps which may be available to gain reimbursement of the cost of the performance bond.

7. The Department is Reimbursing the Contractor Excessive Amounts For the Rent and Subsistence for One of the Contractor's Employees.

Many of the Contractor's employees are renting apartments while working on the ITAS Project. During the initial stages of the project, the Department and the Contractor determined that due to the length of the project, apartments would be more

economical than staying in motels. The Department is reimbursing the Contractor \$1,800 per month for one of the Contractor's employees to rent a house. Apartment rent for the other Contractor's employees ranges from \$700-\$800 per month and, in most cases, includes two employees per apartment. According to the employee, he rents a nicer home since he does not incur as much travel expense on weekends as some of the other employees.

In addition, the Department reimbursed the Contractor daily subsistence of \$21 for this same employee for days he did not actually work on the ITAS Project as listed below:

Month	Days Charged to Project During the Month	Days Received Subsistence During the Month	Difference
September 1993	17	26	9
October 1993	16	26	10
November 1993	14.5	24	9.5
December 1993	12	22	10
January 1994	15	29	14
February 1994	15	21	6
March 1994	16	28	12
April 15, 1994	6	15	9
Total	111.5	191	79.5

While weekend days account for sixty days of the difference, excess subsistence paid for the remaining nineteen work days totals \$399. According to management of the Department, they did not know they were making these excess reimbursements.

Recommendation

We recommend that the Department seek reimbursement of \$8,000 in excessive rent and \$399 in excessive subsistence paid to the Contractor for this employee.

8. The Department Has Not Developed Procedures to Track Equipment Purchases and Security Deposits Made by the Contractor.

During our special review, we determined that through April 15, 1994, the Department had reimbursed the Contractor \$964 for a fax machine and \$1,009 for miscellaneous computer software and computer supplies. According to Departmental officials, they had no knowledge prior to our review that the Contractor had been reimbursed for these purchases. In addition, the Department had not developed procedures to track such asset purchases and include them on the fixed asset system when necessary.

We also determined that the Department had reimbursed the Contractor for security deposits made on apartments, furniture, and a leased car totaling \$4,729 through April 15, 1994. These security deposits should be tracked and refunded to the Department at the end of the project.

Recommendation

We recommend that the Department develop procedures to track these types of purchases and record any type of security deposits reimbursed to the Contractor. We also recommend that all equipment purchases paid for by the Department for the contractor be handled in accordance with the Department's normal purchasing procedures to ensure accountability.

9. It Appears That the Contractor Has Underbilled the Department For Professional Services Through April 1994.

During our review, we were provided the number of hours that each of the Contractor's employees had spent working on the ITAS Project through April 30, 1994. We multiplied these hours by the employee's hourly billing rate to determine if the Department had been billed appropriately by the Contractor. Based on our calculation, as compared to the Contractor's invoices, it appears that the

Contractor has underbilled the Department \$49,222 for the time its employees have spent working on the ITAS Project.

According to a representative for the Contractor, this discrepancy may be due to a computer programming error.

Recommendation

We recommend that the Department take the appropriate action to ensure that this problem is resolved and the hours spent on the project by the Contractor agree to the number of hours billed.

CONCLUSION

The ITAS project is a \$7.9 million undertaking. During the first eight months of the project, the Department has paid the Contractor \$1,970,634 for fees and expenses. Payments were made after receipt of invoices that lacked supporting detail. The Department did not verify the accuracy of the billings or whether they were in accordance with terms of the contract. The failure to review the supporting detail has led to discrepancies between what was due and what was paid. The Contractor has apparently not yet billed the Department for \$49,222 for services that have been performed. On the other hand, the Contractor has billed the Department for \$59,527.25 of expenses over and above what is allowed under the contract.

The significance of the findings exceeds their net financial impact. Sound management practices would have required the Department to obtain some assurance that the billings were consistent with the terms of the contract before making the payments. The Department did not do so for the ITAS project prior to being briefed on our preliminary findings.

During the course of our special review, we met with representatives of the Department of Revenue to discuss the procedures that needed to be followed in monitoring expenditures for the ITAS project. The Department already had procedures for monitoring the work done by the Contractor. The issues addressed by this special review centered on the monitoring of the expenditures. The Department has informed us that their latter responsibility has been assigned and procedures have been developed.

STATEMENT OF FINANCIAL IMPACT

The following schedule represents a quantification of the items examined during our special review. We cannot completely quantify the tangible benefits or detriment, if any, to the taxpayer resulting from the findings of our review. We are simply noting those areas where the system of internal controls should be enhanced.

1. Meals reimbursed in addition to allowed subsistence.	\$ 6,415.91
2. Reimbursed overtime meals.	2,028.00
3. Reimbursement for excess meal allowance.	603.00
4. Reimbursement for questionable miscellaneous and entertainment expenses.	4,723.34
5. Reimbursement for excess lodging.	1,730.00
6. Reimbursement for performance bond.	29,000.00
7. Reimbursement for excess rent.	8,000.00
8. Reimbursement for subsistence on days not charged to the project.	399.00
9. Purchases and security deposits made by the Contractor without the knowledge of the Department.	6,702.00
10. Underbilled professional fees. (Due to Contractor)	<u>49,222.00</u>
Total	<u><u>\$ 108,823.25</u></u>

