

Ralph Campbell, Jr.
State Auditor

STATE OF NORTH CAROLINA
Office of the State Auditor

2 S. Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0601
Telephone: (919) 807-7500
Fax: (919) 807-7647
Internet <http://www.osa.state.nc.us>

INTERIM REPORT--PHASE 2

May 22, 2001

Governor Michael F. Easley
Senator Eric Reeves, Co-Chair
Representative Joe Tolson, Co-Chair
Representative Russell Tucker, Co-Chair
Members of the Joint Select Committee on Information Technology
Members of the General Assembly
Mr. Ron Hawley, Chief Information Officer

Ladies and Gentlemen:

Pursuant to Senate Bill 222 of the 1999 Session Laws as passed by the General Assembly, we are submitting this **second Interim Report**, covering the period January 1, 2000 through December 31, 2000, on the performance audit of the Office of Information Technology Services (ITS) procurement function. This interim report updates the data contained in the first interim report dated February 20, 2001 and identifies additional operational and procedural issues discussed with ITS management.

The legislation directed us to review the procurement process for information technology that was transferred in Senate Bill 222 from the Department of Administration, Division of Purchase and Contract (P&C) to ITS. The specific objectives as identified in the legislation along with ones identified by the State Auditor were:

- Determine whether the Office of Information Technology Services (ITS) established adequate rules and internal procedures to exercise the powers granted especially with regard to the additional powers contained in Senate Bill 222.
- Ascertain whether ITS complied with applicable statutes, rules, and regulations.
- Assess the efficiency and effectiveness of the procurement policies and operations of ITS and compare the procedures and operations of the IT procurement process at ITS to the process previously used at the Department of Administration, Division of Purchase and Contract (P&C).

Office of Information Technology Services Overview

The Office of Information Technology Services (ITS) was placed within the Department of Administration in 1983¹ when it was established, moved to the Office of the State Controller in 1987, and transferred to the Department of Commerce in 1997. Effective September 1, 2000, ITS became a separate agency within the Office of the Governor (House Bill 1578 of the 2000 Session). The State's Chief Information Officer (CIO), who heads ITS, was reporting to the Secretary of Commerce at the beginning of the review. The CIO now reports to the Governor's Chief of Staff.

The Statewide IT Procurement Office is located within the ITS Financial and Facilities Services section. The Chief IT Procurement Officer reports to the ITS Chief Financial Officer. As of December 31, 2000, the Procurement Office contained 16 positions as shown in Table 1, at an estimated annual total cost (salary and benefits) of \$1,078,675. Of these 16

TABLE 1 OFFICE OF INFORMATION TECHNOLOGY SERVICES STATEWIDE IT PROCUREMENT OFFICE STAFFING AS OF DECEMBER 31, 2000				
Position Title	Prior Organizational Placement / Funding Date	Salary	Estimated Benefits ⁽¹⁾	Annual Personnel Cost
Chief IT Procurement Officer	ITS Computing Services	\$ 68,147	\$ 29,303	\$ 97,450
Program Assistant V	Funded 10/1/99	30,645	13,177	43,822
State Purchasing Administrator (Statewide)	Funded 4/1/00	59,306	25,502	84,808
State Procurement Specialist III	Funded 5/1/00	50,808	21,847	72,655
State Procurement Specialist III	Funded 10/1/99	44,926	19,318	64,244
State Procurement Specialist III	Funded 9/1/99	44,074	18,952	63,026
State Procurement Specialist III	Funded 9/1/99	51,572	22,176	73,748
State Procurement Specialist III ⁽²⁾	Funded 12/1/00	49,428	21,254	70,682
State Procurement Specialist III ⁽²⁾	Funded 12/1/00	49,428	21,254	70,682
Departmental Purchasing Agent III	ITS Business Technology Services	45,736	19,666	65,402
Contract Compliance Specialist	ITS Telecommunications Services	68,652	29,520	98,172
State Purchasing Administrator (ITS Agency)	ITS Purchasing	44,502	19,136	63,638
Departmental Purchasing Agent III ⁽²⁾	Funded 10/1/00	43,117	18,540	61,657
Departmental Purchasing Agent II (ITS Agency)	ITS Purchasing	36,202	15,567	51,769
Departmental Purchasing Agent II (ITS Agency) ⁽²⁾	Funded 10/1/99	36,126	15,534	51,660
Departmental Purchasing Agent I (ITS Agency) ⁽²⁾	ITS Purchasing	31,650	13,610	45,260
TOTAL		\$754,319	\$324,356	\$1,078,675
Source: Office of State Personnel Position Histories.				
⁽¹⁾ Benefits estimated at 43% of salary				
⁽²⁾ Position vacant at 12/31/2000, salary estimated at: mid-point of salary range				

positions, 12 positions are responsible for statewide IT procurement (annual estimated cost of \$866,348) and the remaining four handle ITS internal agency purchasing (annual estimated cost of \$212,327). Three new positions were added during the period July 1, 2000 through December 31, 2000 but were not filled as of December 31, 2000.

¹ ITS was originally called the State Information Processing Services (SIPS). House Bill 253 of the 1999 Session of the General Assembly formally changed the name to ITS.

Total expenditures for the Office from July 1, 2000 to December 31, 2000 were \$246,096, while total revenues were \$491,678.

TABLE 2 STATEWIDE IT PROCUREMENT OFFICE EXPENDITURES AND REVENUES JANUARY 1, THROUGH DECEMBER 31, 2000	
EXPENDITURES	AMOUNT
Personal Services	\$ 355,210
Purchased Services	61,598
Supplies	4,769
Property, Plant, and Equipment	2,247
Other Expenses	849
Intragovernmental Transfers	215
TOTAL EXPENDITURES	\$ 424,888
REVENUES	1,186,264
EXCESS REVENUES (EXPENDITURES)	\$ 761,376

Source: ITS Budget Reports

Comparatively, from January 1, 2000 to June 30, 2000, the period of the first interim report, total expenditures were \$178,793 and total revenues \$694,586. Table 2 contains revenue and expenditure data for calendar year 2000. As can be seen, ITS generated \$761,376 more in revenue than it expended for calendar year 2000. Revenues are generated from administrative fees paid by vendors that are awarded technical services or convenience contracts. The vendors pay a percentage of the contract award to ITS to cover the costs of processing and maintaining these contracts.

Audit Progress

Senate Bill 222 directs that this audit be conducted in three phases with an interim report on operations from January 1, 2000 through June 30, 2000, a second interim report on operations from January 1, 2000 through December 31, 2000, and a final report on operations from January 1, 2000 through June 30, 2001. This **second interim report** covers operations for the Statewide IT Procurement Office for the period January 1, 2000 through December 31, 2000, and **updates data contained in the first interim report**. Office of the State Auditor staff conducted the on-site fieldwork for this interim report during the period February through March 2001. The following pages contain our conclusions on the IT Procurement Office operations, categorized under the three operational objectives previously identified.

Rules and Internal Procedures

We conducted in-depth interviews, observed operations, reviewed policies and procedures manuals, and viewed information contained on the ITS web site to determine whether adequate rules and internal procedures had been developed. Analysis of Senate Bill 222 indicated which areas were required for development of new rules and procedures. Further, we compared the rules and policies and procedures of ITS to those utilized by the Department of Administration, Division of Purchase and Contract.

Conclusion: ITS established adequate rules and internal procedures to exercise the powers granted by Senate Bill 222 for the IT procurement process. Temporary rules were developed and became effective January 1, 2000. ITS held a public hearing February 15, 2000 and permanent rules were adopted effective August 1, 2000. ITS created information technology procurement policies and procedures and posted these policies on the ITS web site. In addition, ITS established internal policies and procedures governing the operations of the Statewide IT Procurement Office. Table 3, page 5, summarizes the requirements contained in Senate Bill 222 and ITS' progress toward implementing the powers granted.

ITS management addressed the following issues reported during the first phase of the audit:

Issue The Statewide IT Procurement Office did not have a formal monitoring process to evaluate the progress and accomplishments of the program.

Response This issue was discussed with ITS management during the first phase of the mandated audit work. ITS management included criteria for goals and objectives in the performance evaluations of the procurement specialists.

Issue There were weaknesses in the Statewide IT Procurement Office's computerized tracking system.

Response This issue was discussed with ITS management during the first phase of the mandated audit work. ITS management has corrected these deficiencies and is closely monitoring the database.

Issue ITS' internal procedures manual for statewide procurement contained some inconsistencies.

Response This issue was discussed with ITS management during the first phase of the mandated audit work. ITS management made a number of changes to the procedures but as of March 2001 has not resolved all the inconsistencies noted. Management is continuing to address the inconsistencies.

Concerns noted during the second phase were discussed with ITS management. ITS has taken, or plans to take steps to address:

Issue References to the "Department of Commerce" and "Secretary of Commerce" within the North Carolina Administrative Code were not changed timely to reflect the transfer to the Office of the Governor.

Response These changes have now been approved by the Rules Review Commission of the Office of Administrative Hearings in March 2001.

Issue The Statewide IT Procurement Office has not conducted compliance reviews as required within the North Carolina Administrative Code.

Response ITS is awaiting approval from the Office of State Personnel for a position to process rules revisions, conduct agency training, and perform compliance reviews.

Compliance with Regulations

We reviewed ITS' policies and procedures, as well as the General Statutes and North Carolina Administrative Code pertaining to ITS and procurement operations. To assess compliance with regulations regarding contracts for this second interim report, we analyzed a sample of contracts approved and awarded by ITS during the period July 1, 2000 through December 31, 2000. In addition, we performed tests of a sample of expenditures incurred during the same period.

**TABLE 3
 STATUS OF REQUIREMENTS OF SENATE BILL 222**

Cite	Requirement	Status	Explanation
143B-472.50(a)	Establish Office of ITS as a division of Department of Commerce.	Implemented	
143B-472.50(b)	ITS shall be administered by the State Chief Information Officer (CIO)	Implemented	
143B-472.50(b)	The CIO shall be appointed by and report to the Secretary of Commerce.	Implemented	
143B-472.51(a)(1)	Procure all information technology (IT) for State agencies, except the University of NC and its constituent institutions.	Implemented	
143B-472.51(a)(2)	Obtain IRMC approval for all rates and fees for common, shared State government technology services.	Implemented	
143B-472.51(a)(3)	Recommend State government-wide, enterprise-level policies for information technology	Implemented	
143B-472.51(a)(4)	Develop standards, procedures and processes for implementing policies approved by IRMC.	Partially Implemented	ITS developed standards, procedures & processes for implementing policies approved by IRMC. ITS is working to improve the consistency between existing procedures for different types of IT procurement contracts.
143B-472.51(a)(6)	Develop a plan for managing IT assets to minimize total life cycle costs of assets and have this plan approved by IRMC.	Partially Implemented	ITS is developing an inventory system including total life cycle cost. Estimated completion 2 years. <i>Budgetary constraints may delay this action.</i>
143B-472.51(b)	Other state agencies and local governmental entities may use the IT programs, services or contracts offered by ITS	Implemented	
143B-472.52(c)	Conduct and maintain a continuous inventory of each State agency's current and planned investments in IT assets. Including the development and implementation of standards, processes and procedures for the inventory.	Partially Implemented	ITS is developing an inventory system including total life cycle cost. Estimated completion 2 years. <i>Budgetary constraints may delay this action.</i>
143B-472.53(b)	ITS shall develop a plan for the State government-wide management of distributed IT assets. The plan shall prescribe the State government-wide infrastructure and services for managing these assets. The plan must be submitted to the IRMC.	Implemented	
143B-472.54	The office shall procure all IT for State agencies except the UNC System. ITS shall integrate technological review, cost analysis, and procurement for all information technology needs of those state agencies in order to make procurement and implementation of technology more responsive, efficient, and cost effective.	Implemented	
143B-472.55(1)	ITS can authorize any department, institution, or agency to purchase or contract IT assets/services	Implemented	
143B-472.55(2)	Establish processes, specifications and standards that apply to all IT to be purchased licensed or leased in the State government.	Implemented	
143B-472.55(3)	Comply with the state government-wide technical architecture, as required by the IRMC	Implemented	
143B472.56	All State agencies covered by this part shall use contracts for IT acquired by ITS for any IT required by the State agency that is provide by these contracts.	Implemented	
143B-472.58(a)	ITS encourage state agencies to use small, minority, physically handicapped and women contracts.	Implemented	
143B472.58(b)	Every State agency required by this part to use the services of ITS in the procurement of IT which purchases IT directly shall report to ITS the information required by G.S. 143-48(b). ITS will report to the DOA this information.	Repealed by HB1578	
143B-472.60	The Secretary of Commerce and CIO shall not have a financial or personal beneficial interest in the purchase of or contract for IT.	Implemented	
143B-472.60	ITS employees can not accept or receive rebate, gifts or otherwise any money or anything of value from persons, firms or corporation.	Implemented	
143B-472.63(a)	The Secretary will establish a benchmark for contract approval by the Board of Awards.	Implemented	
143B-472.63(b)	The Director of Budget will approve all contracts for IT being acquired by ITS	Implemented	
143B-472.64	Develop a system for budgeting and accounting of expenditures for IT operations, services, projects, infrastructure and assets. This is a joint effort with ITS, OSBM, and OSC	Partially Implemented	ITS, OSC, and OSBM are continuing to develop a uniform reporting system for budgeting and accounting of IT assets and services.
143-135.9(c)	Acquisition of information technology by the State shall be conducted using the "Best Value" procurement method	Implemented	
150B-21.1(a)(4)	The Secretary may adopt temporary IT procurement rules. 30 days prior to adopting temporary rules the Secretary must notify appropriate persons, accept oral and written comments and hold a public hearing	Implemented	
Section 18	The Secretary shall develop policies and procedures to ensure the use of "Best Value" procurement no later then December 31, 1999.	Implemented	
Section 19	The Secretary will provide training to agencies and vendors on "Best Value" procurement.	Implemented	

Section 20	The Secretary will report to the Joint Select Committee on IT on the results of the implementation of this act on or before April 1, 2000.	Implemented
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Conclusion: ITS complied with statutes, rules, and regulations for calendar year 2000. The Statewide IT Procurement Office contract files included necessary documentation and the expenditures were adequately supported and recorded. However, we noted that the Statewide IT Procurement Office needs to formally track the receipt of administrative fees charged to vendors for handling technical services contracts. This issue has been discussed with ITS management and ITS is taking steps to address the concern.

Efficiency and Effectiveness; Comparison to Prior Process

We calculated the turnaround times for purchase requests processed by the Statewide IT Procurement Office from July 1, 2000 through December 31, 2000 and compared those to times for the corresponding period a year earlier at the Department of Administration, Division of Purchase and Contract. We also compared these turnaround times to ITS turnaround times calculated in our first audit phase covering January 1, 2000 to June 30, 2000. In addition, we conducted a user survey of agency purchasing agents who had used either ITS and/or P&C for their IT purchases since July 1, 2000. The user survey provided

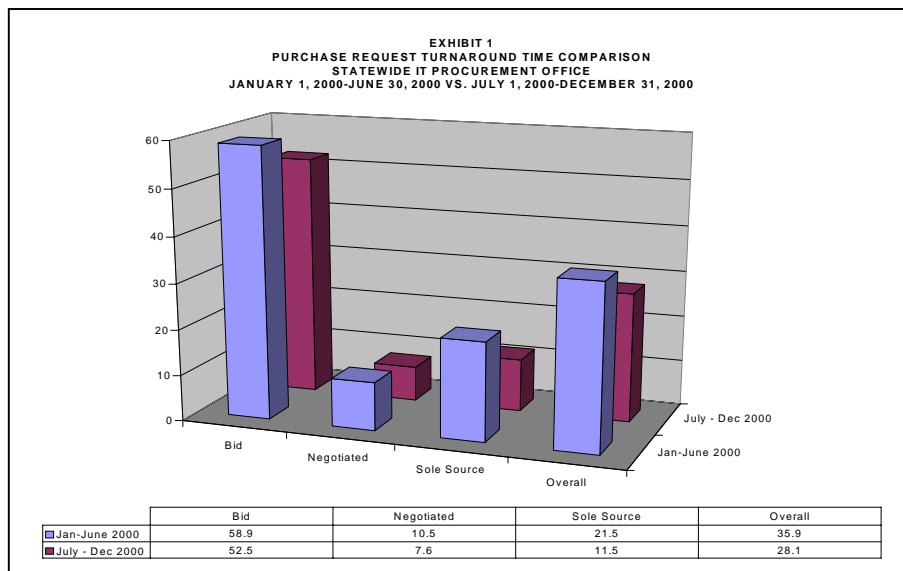
further information regarding the quality of service provided by each agency. Finally, we analyzed the organizational structure in place at ITS to handle the IT procurement process.

**TABLE 4
 PURCHASE REQUEST TURNAROUND TIMES
 (in days)
 COMPARISON OF ITS TO P&C
 (Highlighted items show faster time.)**

PURCHASE TYPE	ITS	P&C
	7/1/2000- 12/31/2000	7/1/1999-- 12/31/1999
IT Goods	30	35
IT Services	25	45
Bids	53	63
Emergency Purchases	N/A	15
Negotiated Contracts	8	7
Sole Source Contracts	12	20
Overall	28	40

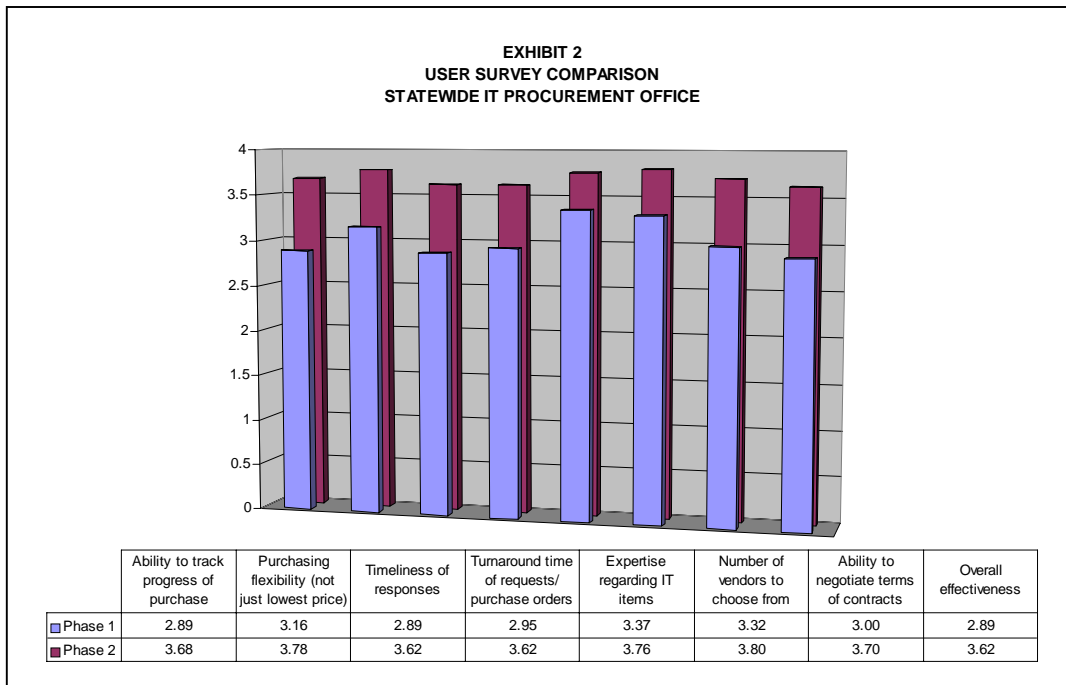
Source: ITS and P&C contract files

Conclusion: The Statewide IT Procurement Office had a faster overall turnaround time than did P&C. In fact, the Statewide IT Procurement Office approved all purchase types except negotiated contracts faster than P&C, as detailed in Table 4. In addition, the ITS turnaround time improved over that calculated in the first phase. Exhibit 1 shows that ITS has improved its turnaround times for all categories, with an overall reduction of 7.8 days.



At the end of ITS' first year handling the IT procurement process, survey respondents believed that ITS is more responsive, has a higher level of expertise, and is less problematic (see Table 5). This shows a marked improvement over the results from the first phase of the audit, as illustrated in Exhibit 2.

TABLE 5 USER SURVEY RESULTS COMPARISON (Table shows percentage of respondents choosing each entity.)		
FACTOR	ITS	P&C
Experienced problems with service	25%	50%
Personnel Expertise		
Excellent	32%	25%
Good	54%	35%
Fair	11%	20%
Poor	4%	0%
Don't Know	0%	20%
Responsiveness		
Excellent	36%	25%
Good	43%	25%
Fair	21%	35%
Poor	0%	0%
Don't Know	0%	15%
Rating Scale: 5--Excellent, 4--Very Good, 3--Good, 2--Fair, 1--Poor		
Ability to track progress of purchase request/order	3.68	3.75
Purchasing flexibility (not just lowest price)	3.78	3.22
Timeliness of responses	3.62	3.47
Turn-around time of requests/purchase orders	3.62	3.32
Expertise regarding IT items	3.76	3.37
Number of vendors to choose from	3.80	3.63
Ability to negotiate terms of contracts	3.70	3.67
Overall effectiveness	3.62	3.58
Source: Compiled by OSA from Survey Results		



The State incurred an additional \$274,173 in salaries and benefits from January to December 2000, which was supported by receipts, resulting from the creation of new positions to staff the Statewide IT Procurement Office (See Table 6).

TABLE 6 STATEWIDE IT PROCUREMENT OFFICE ADDITIONAL STAFFING COSTS INCURRED JANUARY 1, 2000 THROUGH DECEMBER 31, 2000							
POSITION TITLE	JANUARY--JUNE 2000 (Phase 1)			JULY--DECEMBER 2000 (Phase 2)			JAN-DEC 2000
	ACTUAL SALARY COSTS	ESTIMATED BENEFITS *	TOTAL COSTS	ACTUAL SALARY COSTS	ESTIMATED BENEFITS *	TOTAL COSTS	TOTAL ADDITIONAL COSTS
Program Assistant V	\$ 14,705	\$ 6,323	\$ 21,028	\$ 15,323	\$ 6,589	\$ 21,911	\$ 42,939
State Purchasing Administrator (Statewide)	-	-	-	23,228	9,988	33,216	33,216
State Procurement Specialist III	-	-	-	11,474	4,934	16,408	16,408
State Procurement Specialist III	19,598	8,427	28,025	22,463	9,659	32,122	60,147
State Procurement Specialist III	24,747	10,641	35,387	9,660	4,154	13,813	49,201
State Procurement Specialist III	24,747	10,641	35,387	25,786	11,088	36,874	72,261
TOTAL	\$ 83,796	\$ 36,032	\$ 119,828	\$ 107,933	\$ 46,411	\$ 154,345	\$ 274,173
Source: Office of State Personnel Position Histories							
* Benefits estimated at 43% of salary							

TABLE 7 STATEWIDE IT PROCUREMENT OFFICE REPORTED COST SAVINGS JANUARY 1, 2000 TO DECEMBER 31, 2000	
Contract Type	Savings Calculated
Term Contract Price Renegotiations	\$ 1,443,528
Lease/Buyouts	797,426
Bid Renegotiations	362,317
Maintenance Renegotiations	3,910
Total	\$ 2,607,181
Source: Statewide IT Procurement Office Cost Savings Reports	

However, ITS documented \$2,607,181 in State contract cost savings during this same period. Most of the reported savings were derived from negotiating better prices than those stated in term contracts. (See Table 7)

Finally, as previously discussed with ITS management, the organizational structure could be adjusted to improve operations.

Issue The State's purchasing authority is split between two agencies leading to confusion and concern by state agencies and vendors.

Response This issue was discussed with ITS and P&C management during the first phase of the audit, but is beyond the control of ITS management. This is an issue that will need to be addressed by the General Assembly.

Issue Universities, community colleges, and local government agencies may choose to utilize ITS or P&C which could potentially limit economies of scale that could be achieved through bulk-buying discounts.

Response This issue is beyond the control of ITS management. It will need to be addressed by the General Assembly.

Issue ITS Agency Purchasing remained inter-mingled with the Statewide IT Procurement Office.

Response This issue was discussed with ITS management during the first phase of the audit. No changes had been made to the organizational structure during on-site work for the second phase. However, subsequent to the audit fieldwork, ITS management changed the reporting structure so that the ITS Agency Purchasing function reports directly to the Chief Fiscal Officer instead of the Chief Procurement Officer.

Next Steps

As directed by the legislation, we will assess the effectiveness and efficiency of the ITS operational procedures for the procurement process again for the period January 1 to June 30, 2001 and prepare a final report covering the period January 1, 2000 through June 30, 2001.

We have shared a draft copy of this interim report with Mr. Ron Hawley, the State's Chief Information Officer. After discussions of our initial points of concern with Mr. Hawley and his staff, ITS has made changes based on those discussions. We will continue to work with ITS staff to complete the final report as directed in the legislation.

We wish to thank the State's Chief Information Officer and the staff at ITS for their cooperation thus far in the audit. As always, we stand ready to discuss this interim report with the Joint Select Committee on Information Technology.

Respectfully submitted,



Ralph Campbell, Jr.
State Auditor