

# SUNSET ADVISORY COMMISSION

## FINAL REPORT

*Department of  
Information Resources*

July 2011



# *Sunset Advisory Commission*



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In 1977, the Texas Legislature created the Sunset Advisory Commission to identify and eliminate waste, duplication, and inefficiency in government agencies. The 12-member Commission is a legislative body that reviews the policies and programs of more than 130 government agencies every 12 years. The Commission questions the need for each agency, looks for potential duplication of other public services or programs, and considers new and innovative changes to improve each agency’s operations and activities. The Commission seeks public input through hearings on every agency under Sunset review and recommends actions on each agency to the full Legislature. In most cases, agencies under Sunset review are automatically abolished unless legislation is enacted to continue them.

*Department of  
Information Resources*

SUNSET FINAL REPORT  
JULY 2011

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This document is intended to compile all recommendations and action taken by the Sunset Advisory Commission for an agency under Sunset review. The following explains how the document is expanded and reissued to include responses from agency staff and the public.

- *Sunset Staff Report, September 2010* – Contains all Sunset staff recommendations on an agency, including both statutory and management changes, developed after extensive evaluation of the agency.
  - *Hearing Material, November 2010* – Summarizes all responses from agency staff and the public to Sunset staff recommendations, as well as new policy issues raised for consideration by the Sunset Commission at its public hearing.
  - *Decision Material, December 2010* – Includes additional responses, testimony, or new policy issues raised during and after the public hearing for consideration by the Sunset Commission at its decision meeting.
  - *Commission Decisions, December 2010* – Contains the decisions of the Sunset Commission on staff recommendations and new policy issues. Statutory changes adopted by the Commission are presented to the Legislature in the agency's Sunset bill.
  - *Final Report, July 2011* – Summarizes action taken by the Legislature on Sunset Commission recommendations and new provisions added by the Legislature to the agency's Sunset bill.
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# *Summary*

# Summary

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The Department of Information Resources (DIR) provides critical services needed by all state agencies, yet has not received adequate attention or oversight, given the more than \$1.5 billion that flows through its increasingly complex programs. DIR is a very different agency today than the one the Sunset Commission last reviewed in 1996. During the last 10 years, DIR has evolved from a primarily General Revenue-funded information technology (IT) policy and standards-setting agency, to one responsible for delivering IT and telecommunications services to thousands of state and local government customers on a cost-recovery basis. DIR's responsibilities now include procuring and managing major outsourced contracts for the State, including data center services, the Texas Agency Network (TEX-AN), and Texas.gov, the State's official website. All three of these contracts are currently in critical transition periods.

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*More than \$1.5 billion flows through DIR's programs, yet the Department does not receive adequate attention or oversight.*

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The Sunset review identified serious concerns with DIR's ability to effectively manage its internal operations as well as the services on which the State depends. DIR has struggled to efficiently manage its broad authority over its cost-recovery funding structure, resulting in large fund balances, and has also faced serious challenges with all three of its major outsourced contracts in recent years. The recommendations in this report aim to eliminate the reverse incentives created by DIR's flexible funding structure, and to increase the attention and oversight of DIR and its important programs by the Legislature, and by DIR's Board and internal auditor. One recommendation, that the Legislature transfer DIR's significant surplus fund balances to the General Revenue Fund, would result in an estimated \$9.7 million gain to that fund.

DIR's challenges managing and enforcing the data center services contract with IBM and the resulting frustration of participating state agencies have been widely publicized, but less well known are the problems with its telecommunications program. Transferred from the troubled General Services Commission (GSC) to DIR in 2001, the program and many of the critical management problems identified in previous audits and reviews have largely remained unchanged in the 10 years since DIR assumed responsibility. Though several key findings in this report stem from problems identified in DIR's telecommunications program, the recommendations would more broadly standardize DIR's management approach, and encourage DIR to move away from its current, program-driven "silo" mentality.

This report recommends a short, six-year Sunset date to allow the Legislature to consider whether proposed changes have improved the Department's oversight and accountability, and whether DIR has adequately resolved the identified challenges to its programs, particularly the data center services and telecommunications programs. Although DIR has a primarily new executive management team in place that appears focused on quickly implementing

necessary solutions, the short date would allow the Legislature to re-evaluate DIR and the status of its major contracts currently in transition sooner than the standard 12-year period.

Though not within the scope of Sunset staff's specific evaluation of DIR, further discussion regarding the State's oversight and controls over major contracts at all state agencies is warranted. Clearly, problems with major contracts, particularly for outsourced services or IT-related projects, are not unique to DIR. Though members of the Legislature, the Comptroller of Public Accounts, and the Legislative Budget Board have all recommended improvements to how agencies enter into and manage major contracts for many years, these efforts have not yet resulted in a consistent approach to oversight and management of these contracts, and agencies such as DIR continue to struggle, putting the State at risk.

The following material summarizes staff recommendations on the Department of Information Resources.

## Issues and Recommendations

### Issue 1

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#### ***DIR Lacks Needed Incentives and Oversight to Reduce Its Costs and Spend Taxpayer Funds More Efficiently.***

As a cost-recovery agency, DIR has broad authority to collect and spend fees for its administration, yet lacks consistent procedures and incentives needed to ensure it operates efficiently and delivers the savings customers and the Legislature expect. The Department's growing fund balances, which totaled \$29 million at the end of fiscal year 2009, indicate DIR is collecting profit beyond amounts necessary to operate its programs. DIR is not held accountable to a carefully planned budget, and has not sufficiently controlled its administrative spending, particularly on professional services. Though problems with DIR's financial management of its telecommunications program are most critical, the recommendations would provide increased oversight of all DIR's cost-recovery programs. These changes would help DIR minimize the cost of its services and control its own spending, while providing its customers and the State more cost-effective IT and telecommunications services.

#### **Key Recommendations**

- The Legislature, through the appropriations process, should transfer a portion of DIR's surplus fund balances to General Revenue, and require DIR to adhere to a "not to exceed" level of appropriations.
- Require DIR to establish clear procedures for setting, adjusting, and approving administrative fees for each of its cost-recovery programs and report the fees and methodology to LBB annually as part of the Department's budget process.
- Establish each of DIR's accounts in statute and limit expenditures to program purposes.
- Require DIR to develop a clear policy governing the appropriate use of staff augmentation contractors and outside consultants.

## Issue 2

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### ***DIR's Management and Enforcement of Major Statewide Contracts Have Increased Costs and Risks to the State.***

Although chosen by the Legislature to help other state agencies mitigate risks inherent in major IT contracts, DIR has not yet effectively filled this role. Two of DIR's major statewide contracts for data center and telecommunications services currently face significant, unresolved challenges. DIR recently restructured a third major contract for the State's website, Texas.gov, after serious problems with the previous contract, but these changes are still in transition. DIR's responsibility for these major statewide contracts, and the Department's demonstrated difficulty in effectively managing contractor performance, require an increased level of attention and oversight by DIR's Board than currently exists, and a more strategic, best-practices approach to contract management from DIR's staff. In addition, DIR has not effectively tracked and reported the costs and progress of the data center services consolidation project. A more consistent process for tracking and reporting this information for any future consolidation projects is needed. These changes would ensure DIR's major contracts with statewide impact receive adequate attention and oversight, and would provide DIR a clear, consistent approach for managing these critical programs.

#### **Key Recommendations**

- Require DIR to create a contract management guide to provide an overall approach to administering its major contracts, and detailed management plans specific to each of these contracts.
- Strengthen oversight of DIR's contracts by requiring more direct involvement by the Board and customers, and by establishing stronger conflict of interest provisions.
- Require DIR to consistently measure and report cost savings and project status for IT consolidation projects.

## Issue 3

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### ***DIR Has Failed to Prioritize and Provide Adequate Resources to Its Internal Audit Function, Putting Both the Department and the State at Risk.***

DIR's significant responsibility to the State and the \$1.5 billion in public funds flowing through the programs it manages require a high degree of scrutiny. However, despite a clear pattern of increasing risk associated with its functions, the resources DIR has dedicated to its internal audit function are insufficient. Without an adequate internal audit program, the critical programs DIR manages on behalf of the State have not received enough oversight or attention, allowing serious problems to go undetected and uncorrected for years. Providing additional resources and direction for DIR's internal audit function would help the Department identify and make the improvements necessary to manage its programs more effectively.

## Key Recommendations

- Require DIR to establish an Internal Audit Department, and require the Board to maintain an audit subcommittee to oversee the Internal Audit Department.
- DIR should dedicate at least three additional full-time staff to its Internal Audit Department.
- DIR should immediately evaluate its contract monitoring procedures and its telecommunications program.

## Issue 4

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### ***Texas Has a Continuing Need for the Department of Information Resources, but the Department Lacks Needed Focus and Oversight.***

The State has a continuing need to coordinate its IT and telecommunications resources to maximize their cost effectiveness and use. Though DIR is the most appropriate agency to carry out these functions, DIR's mission has become unclear as its duties have greatly expanded during the last 10 years. As a result, DIR has lost focus on effectively meeting the needs of state agencies, the primary customers it was created to serve. Additional oversight of DIR in six years is necessary to ensure the serious problems identified in this report are ultimately corrected, and to re-evaluate the status of several major programs currently in transition sooner than the standard 12-year period would allow.

## Key Recommendations

- Continue the Department of Information Resources for six years.
- Direct DIR's Board and executive management to refocus on its original mission and purpose, serving state agencies.

## Fiscal Implication Summary

Issue 1 of this report could result in an immediate gain to the General Revenue Fund.

- **Issue 1** – If the Legislature chooses to transfer a portion of DIR's surplus fund balances through the appropriations process, it would result in an estimated gain to the General Revenue Fund of \$9.7 million in 2011, based on balances at the end of fiscal year 2010. The estimate could change based on the actual amount of cash available in DIR's accounts at the time it is transferred.

## ***Summary of Legislative Action***

***H.B. 2499 Cook (Nichols), Regular Session***

***H.B. 1 Pitts (Ogden), Regular Session***

***H.B. 4 Pitts (Ogden), Regular Session***

***S. B. 1 Duncan (Pitts), 1st Called Session***

The Legislature adopted most of the Sunset Commission's recommendations in House Bill 2499, Regular Session, but the bill was ultimately vetoed by the Governor. However, the Legislature adopted several of the Sunset Commission's recommendations and additional legislative provisions relating to the Sunset review of DIR in other legislation. The list below summarizes the major provisions, and more detailed discussion is located in each issue.

### **Sunset Provisions Adopted in Other Legislation**

1. Continue the Department of Information Resources until 2013, and direct the Sunset Commission to re-examine the agency and make recommendations to the 83rd Legislature.
2. Transfer a portion of DIR's surplus fund balances to General Revenue.
3. Increase monitoring and oversight of DIR's appropriations.
4. Improve oversight of DIR's contracts and clarify revolving door provisions.
5. Keep the ICT cooperative contracts program at DIR, but require DIR to obtain best value and consider using strategic sourcing.

### **Fiscal Implication Summary**

The Sunset Commission provision to transfer a portion of DIR's surplus fund balances in the Telecommunications Revolving Fund and Clearing Fund to the General Revenue Fund, which was adopted in H.B. 4, Regular Session, resulted in a gain of \$4.3 million to the General Revenue Fund in fiscal year 2011.



*Agency at a Glance*  
*(September 2010)*

# Agency at a Glance

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The Department of Information Resources (DIR) is the State's information technology (IT) and telecommunications agency. The Legislature created DIR in 1989 to set the overall strategic direction for state agencies' use and management of IT. Since then, DIR's responsibilities have expanded significantly. DIR now provides a range of IT and telecommunications products and services to state agencies and eligible voluntary customers, including local governments and universities, primarily by procuring and administering contracts on behalf of the State.

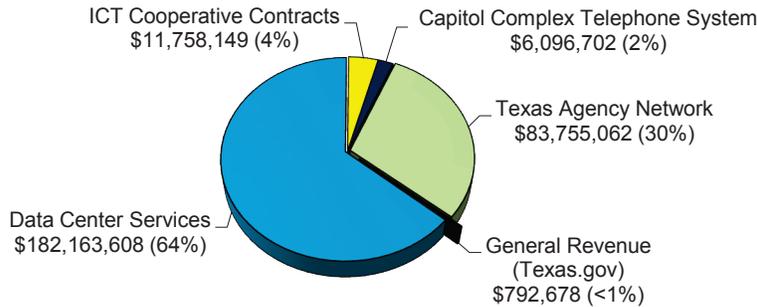
DIR's purpose is to coordinate and support the IT and telecommunications needs of the State by carrying out the following key activities.

- Procures and manages statewide cooperative contracts for information and communications technology services and products (ICT cooperative contracts).
- Provides telecommunications services, including the Texas Agency Network (TEX-AN) and Capitol Complex Telephone System (CCTS).
- Manages consolidated data center services.
- Manages Texas.gov, the official website of Texas.
- Provides guidance and oversight of state information security.
- Provides statewide IT strategic planning, reporting, and standards setting.

## Key Facts

- **Board.** DIR's Board consists of seven Governor-appointed members and three ex officio members. One of the seven Governor-appointed members must be employed by an institution of higher education. The three ex officio members rotate among the Commissioners of Insurance, Health and Human Services, and Education; and the Executive Directors of the Departments of Transportation, Criminal Justice, and Parks and Wildlife.
- **Revenues.** DIR is primarily funded with fees collected from its cost-recovery programs, including data center services, TEX-AN, CCTS, and ICT cooperative contracts. In fiscal year 2009, the Department received an appropriation of about \$209 million to fund its various appropriations strategies. This amount included \$189 million in interagency contracts, \$19 million in appropriated receipts, and approximately \$800,000 in General Revenue to support administration of Texas.gov. Historically, riders in the General Appropriations Act have allowed the Department to carry forward its unexpended balances and to keep all revenues generated by its programs, providing DIR with additional funds above the amounts specified in its bill pattern. In 2009, these riders provided DIR with an additional \$76 million, mostly from interagency contracts, for a total of \$285 million. The pie chart on the following page, *DIR Revenues*, provides more detail on DIR's sources of revenue by program.

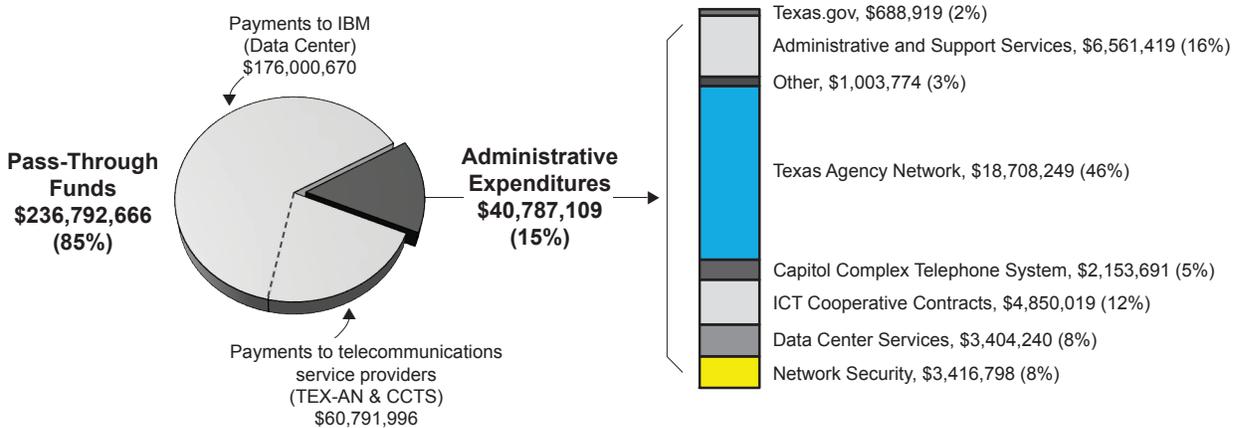
### DIR Revenues FY 2009



**Total Revenues: \$285 Million**

- Expenditures.** The Department’s expenditures for fiscal year 2009 totaled almost \$278 million. Of this amount, 85 percent, or \$237 million, represented pass-through payments to International Business Machines, Inc. (IBM) for the data center services contract, and service providers for TEX-AN and CCTS, primarily AT&T. The Department’s administrative expenditures for fiscal year 2009 totaled about \$41 million. The Department spent about half of this amount to administer its telecommunications program, as shown in the chart, *DIR Expenditures*.

### DIR Expenditures FY 2009



**Total Expenditures: \$277.6 Million\***

\* DIR’s revenues exceeded its expenditures. Excess revenues are kept in DIR’s fund accounts, discussed in Issue 1.

- Staffing.** DIR had approximately 235 authorized staff in fiscal year 2009, all located in Austin. DIR’s telecommunications division, which administers TEX-AN and CCTS, has the largest number of employees.
- Telecommunications.** DIR operates CCTS, the phone system for the Capitol Complex, and oversees the management of the State’s consolidated voice and data network, TEX-AN. The Legislature transferred both of these to DIR when it abolished the General Services Commission in 2001. DIR is the turnkey provider for CCTS, while AT&T is the main service provider for TEX-AN. Although 75 percent of TEX-AN’s 660 customers are voluntary, 78 percent of the

program's revenues are from state agencies, which are statutorily required to use the program. In fiscal year 2009, TEX-AN and CCTS generated more than \$87 million in sales.

- **ICT Cooperative Contracts.** DIR negotiates and administers about 850 cooperative contracts for products such as computer hardware and software, telecommunications services, and IT staffing services. In 2005, the Legislature authorized DIR to require state agencies to purchase all IT commodity items through these contracts.<sup>1</sup> Local governments, K-12 and higher education entities, and nonprofit organizations can voluntarily purchase from these contracts as well. In fiscal year 2009, approximately 3,000 entities purchased through the program, with \$1.3 billion in total sales. That year, higher education and K-12 combined represented 50 percent of total sales; state agencies represented 26 percent; and local governments represented 24 percent. According to DIR, its customers saved \$171 million in fiscal year 2009 by purchasing through DIR's contracts instead of other comparable group purchasing alternatives.
- **Data Center Services.** DIR manages the delivery of consolidated data center services to 27 state agencies and one university through a seven-year, estimated \$863 million contract with IBM. The contract includes consolidation of server and mainframe computer processing, print/mail functions, disaster recovery, security, and data center facility management. In fiscal year 2009, agencies paid DIR \$182 million for services under the contract, including \$6 million in cost-recovery fees and \$176 million in pass-through payments to IBM.
- **Texas.gov.** Formerly known as TexasOnline, Texas.gov is the official website for the State of Texas. More than 100 state agency, local government, and university participants offer nearly 1,000 online services through the website, such as driver license renewals, vehicle registration, property and sales tax payments, and utility bill payments. Texas.gov operates as a self-funded, public-private partnership, whereby a contractor, currently National Information Consortium USA (NICUSA), manages the daily operation of the website while DIR provides program management and serves as a liaison between the clients and the contractor. DIR receives approximately \$800,000 per year in General Revenue to fund its administrative costs, and the contractor and the State share the transaction fees collected from citizens and businesses using the online services. Since the creation of TexasOnline in 2000, these fees have contributed about \$62 million to the General Revenue Fund.
- **Information Security.** DIR provides information security services, best practices, and training to state agencies and other eligible entities. Services include controlled penetration tests, web application scans, perimeter security, and wireless network assessments. AT&T provides many of these services through the current TEX-AN contract, while DIR staff provide program management and support. DIR performed about 200 security assessments in fiscal year 2009.
- **IT Policy and Leadership.** Since its creation in 1989, DIR has been designated as the State's lead agency for coordinating the planning and use of IT. In addition to statewide strategic planning and reporting, DIR instructs other agencies on how to complete the information resources component of their agency strategic plans. The Department is responsible for developing best practices and standards related to web accessibility, IT project management, and information security. DIR staff also serve on two statewide committees, the Contract Advisory Team and Quality Assurance Team, which provide input and monitoring of major contracts and IT projects.

<sup>1</sup> Texas Government Code, sec. 2157.068(f); and Texas Administrative Code, Title 1, part 10, rule 212.10.



*Issues*

# Issue 1

## ***DIR Lacks Needed Incentives and Oversight to Reduce Its Costs and Spend Taxpayer Funds More Efficiently.***

### **Background**

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DIR recovers 99 percent of its operational costs through administrative fees for most of the programs it administers, including data center services; telecommunications services such as the Texas Agency Network (TEX-AN) and the Capitol Complex Telephone System (CCTS); information technology security services; and information and communications technology (ICT) cooperative contracts. The textbox, *DIR Cost-Recovery Programs*, briefly describes each of these programs and their associated accounts. In addition to the actual cost of services, DIR charges customers administrative fees to recover its operational costs for these programs as well as its indirect costs such as finance and human resources.

#### ***DIR Cost-Recovery Programs***

<b>Program</b>	<b>Service Provided</b>	<b>Account</b>
Telecommunications (CCTS & TEX-AN)	CCTS provides telephone services to agencies within the Capitol Complex. TEX-AN includes voice, data, shared internet, and security services provided to agencies and other public entities.	Telecommunications Revolving Fund
ICT Cooperative Contracts	Procures contracts for information technology commodities and services which state agencies must use, and other public entities may purchase from.	Clearing Fund
Data Center Services	Consolidates the servers and mainframe computers of 27 state agencies and one university. Other services include bulk printing and mailing, disaster recovery, and facility management.	Statewide Technology Account

### **Findings**

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**DIR is not operating its telecommunications and ICT cooperative contracts programs as true cost recovery, collecting profit beyond amounts necessary to cover program costs.**

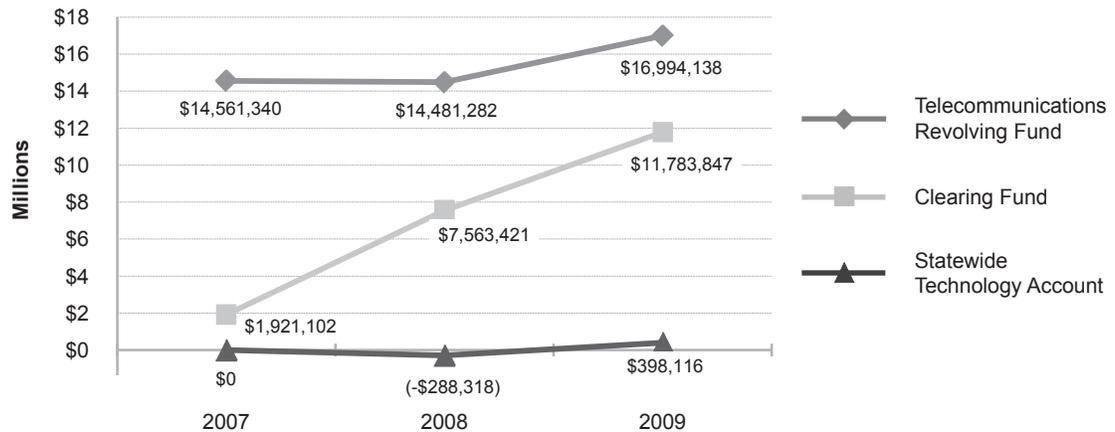
Cost-recovery programs are intended to break even. Growing fund balances indicate customers are paying more than necessary to recover DIR's operating costs for its telecommunications and ICT cooperative contracts programs. At the end of fiscal year 2009, the Department had accumulated fund balances totaling about \$29 million. Revenues from the telecommunications program account for 58 percent, or \$17 million of the surplus, while revenues from the ICT cooperative contracts program account for 41 percent, or \$12 million, as shown in the chart on the following page, *DIR Fund Balances*.

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*DIR accumulated fund balances totaling \$29 million at the end of fiscal year 2009.*

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**DIR Fund Balances  
FYs 2007 – 2009**



Concerns regarding high balances associated with these programs are not new, particularly in the telecommunications program. Before the program was transferred from the General Services Commission (GSC) to DIR in 2001, multiple reports from the State Auditor’s Office (SAO) found poor fee-setting practices had resulted in customer overcharges and high fund balances.<sup>1</sup> The Sunset review found DIR has not corrected longstanding, underlying problems that have once again led to a high balance in the Telecommunications Revolving Fund.

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*Fee revenues continue to exceed DIR’s operational costs for two of its programs.*

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In 2004, SAO also reported concerns about the growing balance in the Clearing Fund.<sup>2</sup> In recent years, DIR has made efforts to reduce its fees for the ICT cooperative contracts program, but sales growth has outpaced these fee reductions. Consequently, fee revenues continue to exceed the amount needed to operate the program, creating a need for a way to handle the surplus funds. In the past, surplus funds have been transferred from DIR’s accounts to the General Revenue Fund, including \$5 million from the Telecommunications Revolving Fund in 1995 and \$3 million from the Clearing Fund in 2003.<sup>3</sup>

**DIR has not established the procedures necessary to ensure its programs charge appropriate cost-recovery fees and deliver expected cost savings to customers.**

- Lack of formal and accountable fee setting.** DIR does not have a consistent, agencywide approach to setting, reviewing, and approving its administrative fees. DIR staff in each program area, particularly telecommunications, have broad authority to determine and manage the administrative fees without adequate oversight from DIR management or the Board. The process for setting and adjusting fees has evolved very differently for each program, as shown in the chart on the following page, *DIR Cost-Recovery Fees*.

### **DIR Cost-Recovery Fees**

Program	Cost-Recovery Fees
Telecommunications (TEX-AN & CCTS)	Uncapped. For services that DIR provides directly, such as CCTS and shared internet services, fees are included in the prices. Five fee levels exist for other telecommunications services: <ul style="list-style-type: none"> <li>• 0% on surcharges from telecom companies</li> <li>• 2% on equipment, such as routers</li> <li>• 8% for managed services mainly provided to the Health and Human Services Commission</li> <li>• 4% and 17% for a variety of goods and services provided through the current TEX-AN contract</li> </ul>
ICT Cooperative Contracts	Capped at 2% by appropriations rider. The actual fees vary by contract and the average fee amount is currently 0.92%. Fees are included in the purchase price of commodities and services.
Data Center Services	Uncapped. Set at 2.95% at inception of the contract based on initial assumptions. DIR must get approval from the Legislative Budget Board and the Governor's Office before changing the fee.

- **Poor management of telecommunications fees.** The lack of a consistent and accountable approach to setting and reviewing fees has allowed chronic problems with telecommunications fees to go unnoticed and uncorrected by the Department for many years.

*Failure to comply with state law.* Telecommunications fees do not meet certain statutory requirements created to ensure proper financial management of cost-recovery programs. Statute requires state agencies that charge administrative fees to review the fee amounts biennially and to make necessary adjustments through the appropriations process.<sup>4</sup> Statute also requires these agencies to reduce the fee amounts if they are set at a level that exceeds the agency's operational costs.<sup>5</sup> DIR has not complied with these requirements and lacks procedures for reviewing and adjusting its telecommunications fees. In the 10 years since DIR assumed responsibility for TEX-AN and CCTS, it has formally reviewed and adjusted the pricing for each only once.

*Outdated pricing and customer overcharges.* Many of the current fees are based on those established by GSC more than a decade ago. DIR conducted its first pricing analysis for TEX-AN in 2010, which resulted in the Department dramatically reducing prices and giving \$5.4 million in credits to state agency customers. The analysis also revealed DIR is unaware when infrastructure costs have been fully recovered and associated fees should be reduced or eliminated. As a result of this deficiency, DIR overcharged the Health and Human Services Commission (HHSC) \$2.5 million for infrastructure costs the Department had already recovered through previous billings.<sup>6</sup> DIR credited HHSC for these overcharges, but the analysis leading to this discovery and the other credits to state agency customers were years overdue.

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*DIR has formally reviewed TEX-AN fees only once in 10 years.*

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*DIR negotiated lower rates for TEX-AN services but did not pass all of the savings on to its customers.*

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***Lack of transparency and accountability.*** Fees for telecommunications are not sufficiently visible or understandable to DIR management, LBB, or the customers who pay them, inhibiting meaningful oversight of their use. At least five different fee levels exist for TEX-AN alone, and DIR was not able to articulate a reason for this myriad of fees. Some fees are built into the price of the service or commodity, while others are added as a separate fee. In one case, DIR negotiated lower rates with AT&T for TEX-AN services, but did not pass all of these lower rates along to its customers, and instead used the excess funds to pay for infrastructure maintenance, upgrades, and expenses relating to its new information security program. Although cost-recovery fees may occasionally be needed for these types of program-related expenditures, these expenditures should be planned for and approved in advance. DIR should inform telecommunications customers when contract amendments or other actions result in pricing changes, and provide justification if DIR chooses to use the funds for other expenses.

- **Failure to provide expected cost savings.** Statute requires state agencies to use DIR's telecommunications services, but the Department has neglected to ensure the program delivers the cost savings that customers and the Legislature expect. DIR has not adequately monitored its telecommunications pricing and does not benchmark rates against similar services in the private sector. Until the recent 2010 TEX-AN pricing study, the Department charged the same prices for its shared internet services for six years, while at the same time the commercial price of internet dropped significantly, resulting in customer complaints.

In addition, DIR uses a best value approach for all of the commodities and services it procures and may be missing opportunities to obtain better pricing using a low bid or strategic sourcing method for certain products. In survey responses and interviews with Sunset staff, some customers of DIR's ICT cooperative contracts program indicated dissatisfaction with some of the prices DIR negotiates. Customers rely on DIR's contracts to provide the best prices, but the Department assumes customers will use the contract prices as a starting point for their own negotiations with vendors. DIR provides limited assistance and information on how to do this, and many agencies and their staffs simply do not have the skill, knowledge, or time necessary to conduct successful negotiations every time they purchase off DIR's contracts. Customers that have negotiated additional discounts off the DIR contracted rate suggest room exists for additional cost savings in the contracted price for some commodities.

**DIR operates under reverse incentives that encourage the Department to maximize revenue to cover costs, instead of controlling costs and improving efficiency.**

Due to the Department's flexible funding structure and its ability to pass operational costs on to the customers that pay for its services, DIR lacks

incentives to control its costs and improve the efficiency of its services. Currently, most state agencies are being asked to reduce their General Revenue expenditures by 5 to 10 percent to compensate for a reported \$18 billion budget shortfall, but DIR is not significantly affected by this budget reduction and instead continues to increase expenditures. The Department's administrative budget increased 13 percent from fiscal year 2009 to 2010, including substantial amounts spent on contractors and consultants.

- **Lax funding structure.** DIR has much more budget flexibility than most state agencies. The Legislature, in riders to the General Appropriations Act (GAA), has authorized DIR to carry its fund balances forward every biennium and allows DIR to expend excess revenues generated by its programs. This authority provides the Department access to large fund balances, lessening its need to adhere to a planned budget.

This broad authority also allows DIR to be less precise when developing and proposing its Legislative Appropriations Request (LAR). The administrative budget approved by DIR's Board for fiscal year 2010 contained \$11.2 million of mostly professional services costs not included in the Department's LAR for that same year. Until fiscal year 2008, DIR did not have a budget amendment policy and the Department simply reported budget variances to its Board instead of requesting approval.

Access to large amounts of unrestricted and less scrutinized funds has led to their questionable use. In fiscal year 2010, DIR transferred money from the Telecommunications Revolving Fund to pay a \$1 million data center services expense. LBB staff indicate that DIR did not have authority for this transfer.

- **Inefficient spending on professional services.** The Department has a history of spending significant amounts of its administrative budget on professional services, including staff augmentation contractors and outside consultants. In fiscal year 2009, the Department spent approximately \$17 million, or 43 percent of its budget, on professional services. Although DIR may need to employ external contractors and consultants for special purposes, the Department often relies on outside help automatically, instead of carefully examining the most cost-efficient options, including using its own staff. DIR's expenditures on professional services almost doubled in the last three years, increasing from \$11.5 million in 2008 to a budgeted amount of \$22.4 million in 2010.

DIR lacks incentives to better control its use of and expenditures on professional services, since it can charge these expenses to its customers. For example, the Department uses staff augmentation contractors to support HHSC's call centers for Integrated Eligibility Enrollment and the Texas Information and Referral Network. Staff augmentation is intended to be used for temporary staffing needs, but DIR has been using this arrangement for three years. During this time, DIR has not

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*DIR has excessive budget flexibility and spending authority.*

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*DIR's expenditures on professional services almost doubled in the last three years.*

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performed a cost-benefit analysis of this arrangement or established a more permanent solution since it can charge HHSC for the \$3.5 million cost, including its own administrative fee, for managing these services. Although DIR is preparing to discontinue this arrangement, the costly use of staff augmentation shows the lack of incentive to control overall expenditures.

## Recommendations

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### ***Change in Appropriations***

**1.1 The Sunset Commission should recommend that the Legislature require a portion of the surplus fund balances in DIR's accounts be transferred to General Revenue.**

This recommendation would express the will of the Sunset Commission that the Legislature transfer a portion of the surplus balances in DIR's accounts, including the Telecommunications Revolving Fund and Clearing Fund, to the General Revenue Fund. Under this recommendation, the Legislature should adopt an appropriations rider prohibiting DIR from carrying forward the entirety of its surplus fund balances every year. Instead, the Department should be given authority to keep two months of working capital and additional amounts as determined by the Legislature necessary to cover budgeted capital expenditures. Any remaining unobligated and unencumbered balances should be transferred to the General Revenue Fund.

This recommendation is intended to remove incentives for DIR to collect funds in excess of its costs and to help reduce the fees DIR charges its publicly funded customers, not to produce a new and ongoing source of General Revenue for the State. In future years, the Legislature, with assistance from LBB staff, should continue to monitor all of DIR's account balances and could consider transferring surplus fund balances at the end of each fiscal year, or providing rebates to customers.

**1.2 The Sunset Commission should recommend that the Legislature require DIR to adhere to a "not to exceed" level of appropriations.**

This recommendation would express the will of the Sunset Commission that the Legislature require DIR to limit its spending to the amounts specified in the General Appropriations Act to fund the Department's various appropriations strategies. As part of this recommendation, DIR's riders would need to be reviewed and adjusted to limit the Department's spending authority. If the Department has any unforeseen costs and needs access to additional funds, it could request approval from LBB to expend funds from the appropriate revenue source. DIR would also retain its current authority to borrow and repay \$4 million from the Comptroller as needed for cash flow purposes.<sup>7</sup>

### ***Change in Statute***

**1.3 Require DIR to establish clear procedures for setting, adjusting, and approving administrative fees for each of its cost-recovery programs as part of its annual budget process.**

Under this recommendation, DIR would adopt a process for calculating the administrative fees for each of its cost-recovery programs. Fees must be directly related to the amount the Department needs to

collect to recover the cost of its operations, as determined by the Department's annual budget process. DIR should develop clear procedures directing how staff in each of DIR's programs and the finance division would work together to determine fees, including review and approval of fees by DIR's Chief Financial Officer, Executive Director, and Board.

**1.4 Require DIR to report its administrative fees and the methodology used to set them to the Legislative Budget Board annually, and post all fee information on its website.**

After reviewing and adjusting its fees as part of its annual budget process, the Department would report its fees for the new fiscal year to LBB, along with the underlying analysis and methodology which determined the fee amounts. DIR would also post information about the fees for its cost-recovery programs, including a description of how they are derived, on its website. As part of this recommendation, DIR should provide updates anytime a contract amendment or other action results in major pricing changes.

The Department would also report the cost allocation charged to its telecommunications customers, similar to existing reporting requirements for its ICT cooperative contracts and data center services customers. These changes would introduce needed transparency and accountability into DIR's fee-setting practices.

**1.5 Establish each of DIR's accounts in statute and limit expenditures to program purposes.**

This recommendation would add DIR's Clearing Fund Account and the Statewide Technology Account to statute, along with a description of their intended use to benefit each program, similar to what already exists for the Telecommunications Revolving Fund. DIR should not use funds in these accounts for purposes other than those specifically authorized by the Legislature.

**1.6 Require DIR to develop a clear policy governing the appropriate use of staff augmentation contractors and outside consultants.**

Under this recommendation, DIR would develop clear criteria for the appropriate use of staff augmentation contractors and outside consultants by the Department. DIR staff would prepare, and the Board would approve, an annual analysis of staffing needs and proposed use of contractors and consultants in conjunction with its budget process. The analysis should include the need for and cost-effectiveness of using staff augmentation contractors or outside consultants, and should consider the possibilities for DIR to use its own workforce to accomplish tasks proposed for contractors or consultants, and any training or additional resources that may be needed.

## ***Management Action***

**1.7 DIR should take steps to ensure it offers the most competitive pricing possible.**

For telecommunications services that DIR provides directly, such as shared internet and CCTS, the Department's annual analysis should include benchmarking its prices against the private sector to ensure it provides the expected cost savings to customers. As part of this recommendation, DIR should also evaluate whether other methods of procuring contracts for ICT commodities such as low bid or strategic sourcing could produce lower prices for some commodities.

## Fiscal Implication Summary

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Recommendation 1.1 to transfer a portion of the Department's fund balances would result in an estimated gain of \$9.7 million to the General Revenue Fund in 2011, based on balances at the end of fiscal year 2010. This estimate could change based on the actual amount of cash available in DIR's accounts at the time it is transferred. The fiscal impact of Recommendation 1.1 would not be reflected in the fiscal note for the DIR Sunset bill. Instead, if the Legislature adopts this recommendation, its fiscal impact would ultimately be reflected in the General Appropriations Act passed by the 82nd Legislature in 2011.

The other recommendations to limit DIR's spending authority and reduce its administrative costs should result in reduced fund balances and savings to DIR's customers, but these amounts cannot be estimated at this time.

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<sup>1</sup> State Auditor's Office, *An Audit Report on Management Controls at the General Services Commission*, report no. 97-080 (Austin, Texas, August 1997); and *A Follow-Up Audit Report on Management Controls at the General Services Commission*, report no. 99-029 (Austin, Texas, February 1999).

<sup>2</sup> State Auditor's Office, *Two Cost-Recovery Programs at the Department of Information Resources*, report no. 05-001 (Austin, Texas, September 2004).

<sup>3</sup> Ibid, cover page; and State Auditor's Office, *A Follow-Up Audit Report on Management Controls at the General Services Commission*, p. 12.

<sup>4</sup> Texas Government Code, sec. 316.045.

<sup>5</sup> Ibid.

<sup>6</sup> Department of Information Resources, *CTS TEX-AN Price Change Project*, (Austin, Texas, March 2010).

<sup>7</sup> Rider 5, p. I-69, Chapter 1424, (S.B. 1), Acts of the 81st Legislature, Regular Session, 2009, General Appropriations Act.

# *Responses to Issue 1*

## **Overall Agency Response to Issue 1**

The Texas Department of Information Resources (DIR) disagrees with the conclusion that “DIR lacks needed incentives and oversight to reduce its costs and spend taxpayer funds more efficiently.” Of particular concern is the implication that the current funding structure has incited DIR to deliberately overcharge its customers. The conclusion and underlying analysis for this issue indicates a lack of understanding regarding how customer and business-driven variables impact DIR’s fund balances and fee adjustments. As a result, some of the findings and statements included in this section of the report are inaccurate.

DIR supports and agrees with the objective of ensuring oversight, accountability, and transparency over the efficient use of taxpayer funds. DIR has implemented a number of improvements in the management of its cost-recovery business practices over the last few years, but acknowledges that practices used to establish and adjust cost-recovery fees should be more formalized and thoroughly documented. DIR also agrees that prior to fiscal 2010, the formal adjustment of fees for the Tex-AN program should have been handled in a more timely manner and that the current fee structure should be simplified. While not justified, this situation predominantly resulted from a division management issue, which has been appropriately resolved. (Karen Robinson, Executive Director – Department of Information Resources)

*Note:* DIR’s formal response, available at [www.sunset.state.tx.us](http://www.sunset.state.tx.us) or upon request, includes additional detail regarding the agency’s overall response to Issue 1.

## **Recommendation 1.1**

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*The Sunset Commission should recommend that the Legislature require a portion of the surplus fund balances in DIR’s accounts be transferred to General Revenue.*

### **Agency Response to 1.1**

DIR disagrees with this recommendation. The conclusion and underlying analysis for this recommendation is incorrect. The ability to sustain fee decreases, which have already been implemented, is dependent upon the availability of the current fund balances. If existing fund balances are swept at the end of fiscal 2011, DIR will be required to raise fees or decrease services, which seems to be contrary to the intent of this recommendation. Factors impacting the implementation of this recommendation include the following.

- Cost-recovery fee decreases implemented in fiscal years 2010 and 2011, and those included in DIR’s fiscal 2012/2013 Legislative Appropriation Request (LAR) significantly reduce the fiscal 2009 accumulated fund balances stated in the Sunset Report from \$29 million to \$6.3 million by the end of fiscal 2013. The Sunset report recommendation and fiscal impact is based on fund balances available at the end of fiscal 2009. The \$29 million accumulated fund balance figure stated in the Sunset report ignores the impact of fee

decreases implemented in fiscal 2010 prior to the commencement of the Sunset review, fee decreases implemented in fiscal 2011, and those approved in the fiscal 2012/13 LAR. The impact of the fiscal year 2011 to 2013 fee decreases on the accumulated fund balances was initially provided to Sunset staff on August 5, 2010. This data was then updated and provided to Sunset again after DIR Board approval of the fee decreases on August 27, 2010.

If the fund balance is swept in fiscal 2011 as recommended by Sunset, the fee reductions which have already been implemented will be unsustainable in future years, thus requiring DIR to either increase fees or reduce services. The accumulated fund balances for each of DIR's programs were included in the calculation of the fee decreases already implemented. As a result, the sustainability of the implemented fee decreases is dependent upon the current fund balance. According to generally accepted accounting principles, internal services funds such as those managed by DIR should operate on a breakeven basis over time. Fund balances should reflect a level that is anticipated to assure continued delivery of the services, with consideration of factors such as future revenue projections and expenditure needs. Fund balances can also be impacted by changes in costs or sales volume at rates different than what was projected, leading to surpluses or deficits.

**Staff Comment:** The fund balance figure stated in the fiscal impact of the report is based on projections DIR provided in August 2010 regarding the expected fund balances for the end of fiscal year 2010. This figure takes into account the fee decreases DIR implemented in fiscal year 2010. Additionally, Sunset staff is aware of the additional fee reductions proposed by DIR in its fiscal 2012/2013 LAR and notes that while the LAR has been approved by the DIR Board, it has not been approved by the Legislature.

- The determination of appropriate fund balances for each of DIR's cost-recovery funds requires consideration of a number of customer and business-driven variables. Recommendation 1.1 assumes that DIR's cost-recovery accounts have stable revenues and expenditures which allow a break-even calculation on an annual basis. The unique nature of each of DIR's cost-recovery services and management of the associated variables is quite different and considerably more challenging than a standard cost-recovery activity with stable costs and units to be processed. Examples of variables driven by DIR's customers include consumption of services, new initiatives, budgets, and buying patterns. DIR business variables include periodic investments in technology infrastructure upgrades and other cyclical expenses.

The Sunset report did not include an evaluation of the impact of the customer and business driven variables on the amounts of the fund balances. For example, based on an analysis of customer purchasing trends and the corresponding increase in revenue/fund balance in fiscal 2008, DIR implemented fee decreases in the Information and Communication Technology (ICT) Cooperative Contract Program effective in fiscal 2009. Based on the sales projected at that time, DIR expected the fund balance to be decreased accordingly. However, in fiscal 2009, again due to customer purchases from the contracts, which exceeded DIR projections, the fund balance grew despite the fee decreases. As a result, DIR implemented additional fee reductions in fiscal 2010. DIR based its fiscal 2010 projections on a lower estimated growth in sales due to uncertainty in future contract purchases given the current economic trends.

**Staff Comment:** Staff Recommendation 1.1 recognizes the need for some flexibility in determining the necessary fund balances and suggests allowing DIR to maintain two months of working capital and additional amounts as determined necessary by the Legislature to cover certain expenditures.

- Transfer of fund balances to general revenue would require a pro-rata share of the funds to be refunded to the Federal Government. Because state agencies and other state entities pay for DIR services with federal funds, sweeping fund balances into General Revenue will most likely result in a request from the federal government for a refund of the federal portion of the funds swept in General Revenue. If DIR's fund balances are swept as proposed by the Sunset report, an unintended consequence could be that the State would have to incur additional costs in order to refund the federal portion. Generally accepted accounting principles also suggest that any excess or deficiency should be charged back/refunded to the participating customers through rebates or lower fees. The actions taken by DIR to reduce cost-recovery fees are in alignment with these principles.

**Staff Comment:** In the past, excess funds have been transferred from DIR's accounts to the General Revenue Fund, including \$5 million from the Telecommunications Revolving Fund in 1995, and \$3 million from the Clearing Fund in 2003, without incurring a federal refund. In addition, DIR recommended that the Legislature transfer \$1 million from the Clearing Fund to General Revenue in 2008, and did not raise the potential need to refund a portion to the federal government at that time. DIR does not track the amount of federal funds in the Telecommunications Revolving Fund or Clearing Fund.

(Karen Robinson, Executive Director – Department of Information Resources; and Charles Bacarisse, Chairman – DIR Board of Directors)

**Note:** DIR's formal response, available at [www.sunset.state.tx.us](http://www.sunset.state.tx.us) or upon request, includes additional detail regarding the agency's response to Recommendation 1.1.

#### **For 1.1**

Andy Wilson, Researcher/Organizer – Public Citizen Texas, Austin

#### **Against 1.1**

None received.

## **Recommendation 1.2**

*The Sunset Commission should recommend that the Legislature require DIR to adhere to a “not to exceed” level of appropriations.*

#### **Agency Response to 1.2**

DIR disagrees with this recommendation. DIR's current spending is currently limited to the amount of appropriations authorized in the General Appropriations Act (GAA). While the GAA does provide DIR with the authority to carry forward and spend fund balances, the amount is approved by the DIR Board and the Legislature through the approval of the biennial

Legislative Appropriation Request (LAR). In addition, expenditures made pursuant to the GAA fund balance carry forward authority must be approved by the DIR Board and are subject to LBB reporting and oversight requirements. Implementation of this recommendation would significantly limit DIR's ability to address customer needs in a timely manner. The majority of expenditures DIR makes pursuant to the GAA carry-forward authority are directly related to service delivery and customer-requested items that are not known to DIR at the time the LAR is prepared.

DIR works closely with customers to understand, predict, and solution their needs. However, DIR customer needs are not always defined or visible at the time DIR prepares its LAR. For example, with the onset of Health Care Reform the Health and Human Services Commission (HHSC) is currently beginning the analysis of future seat requirements for call center support services provided by DIR. HHSC's preliminary data suggest a need for DIR to increase the services from supporting 3,000 seats to 8,000 seats over the next year. The expenditures for the additional services are not included in DIR's fiscal 2012/2013 LAR, and without the ability to fund these services through the GAA fund balance carry forward authority, DIR would not be able to provide the requested services to HHSC. (Karen Robinson, Executive Director – Department of Information Resources; and Charles Bacarisse, Chairman – DIR Board of Directors)

#### **For 1.2**

Andy Wilson, Researcher/Organizer – Public Citizen Texas, Austin

#### **Against 1.2**

None received.

### **Recommendation 1.3**

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*Require DIR to establish clear procedures for setting, adjusting, and approving administrative fees for each of its cost-recovery programs as part of its annual budget process.*

#### **Agency Response to 1.3**

DIR agrees with the recommendation to establish clear procedures for setting, adjusting, and approving administrative fees for its cost-recovery programs as part of its annual budget process with the modifications presented below.

#### **Agency Modifications**

1. The recommendation should be required as a management action as opposed to a statutory requirement.
2. Clarify that the intent of this recommendation is that the DIR Board would provide the final approval for all administrative cost-recovery fees including the fee for the Data Center Services program. Assuming this is the intent, Rider 9 in the GAA would need to be deleted if this modified recommendation is approved in DIR's final Sunset bill.

**Staff Comment:** Deleting Rider 9 from the GAA would eliminate several requirements and authority relating to the statewide technology center account, the account associated with DIR's data center services program. Without this rider, DIR would no longer be required to submit proposed changes to the administrative rate it charges data center services customers to LBB and the Governor's Office, or to receive written approval from LBB and the Governor's Office to expend funds associated with the account. In addition, DIR would no longer be required to report all administrative costs charged and collected from data center services customers to LBB and the Governor's Office. DIR's carry forward authority between fiscal years and biennia for any ending balances in the account would also be eliminated.

(Karen Robinson, Executive Director – Department of Information Resources)

**For 1.3**

Andy Wilson, Researcher/Organizer – Public Citizen Texas, Austin

**Against 1.3**

None received.

**Recommendation 1.4**

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*Require DIR to report its administrative fees and the methodology used to set them to the Legislative Budget Board annually, and post all fee information on its website.*

**Agency Response to 1.4**

DIR agrees with the recommendation to require DIR to report its administrative fees and their methodology to the Legislative Budget Board and to post the fee information on its website with the modification presented below.

Agency Modification

3. The recommendation should be required as a management action as opposed to a statutory requirement.

(Karen Robinson, Executive Director – Department of Information Resources)

**For 1.4**

Andy Wilson, Researcher/Organizer – Public Citizen Texas, Austin

**Against 1.4**

None received.

## **Recommendation 1.5**

*Establish each of DIR's accounts in statute and limit expenditures to program purposes.*

### **Agency Response to 1.5**

DIR agrees with the requirement that all funds should be used for their original purpose, but believes that transferability limits provided in Article 9, Section 14.01 of the General Appropriations Act should also apply to cost-recovery programs. (Karen Robinson, Executive Director – Department of Information Resources)

*Staff Comment:* According to LBB staff, Article IX, Section 14.01 of the General Appropriations Act allows agencies to transfer appropriation authority from one appropriation item to another, subject to certain restrictions, but does not provide authority to transfer funds from one account to another. Regardless of this transfer authority, funds should only be used for their statutorily required purposes.

### **For 1.5**

Andy Wilson, Researcher/Organizer – Public Citizen Texas, Austin

### **Against 1.5**

None received.

## **Recommendation 1.6**

*Require DIR to develop a clear policy governing the appropriate use of staff augmentation contractors and outside consultants.*

### **Agency Response to 1.6**

DIR agrees with the recommendation to require DIR to develop a clear policy governing the appropriate use of staff augmentation contractors and outside consultants with the modification presented below.

DIR management identified the need to review about the use of staff augmentation contractors in October 2009. Prior to the commencement of the Sunset review, DIR management requested the DIR Internal Auditor to review and make recommendations for improvement in practices related to DIR's use of staffing augmentation vendors. The review requested by management is nearing completion and will be used to develop policies which ensure the appropriate and cost-effective use of state funds.

The primary driver in DIR's use of staff augmentation contractors and outside consultants has been the need for specialized areas of expertise dictated by the highly technical and complex nature of DIR's business operations. The majority of services included in this category have been for outsourcing support for the Data Center Services, Tex-AN, and TexasOnline procurements, external legal services associated with the procurements, and staff augmentation services for the Health and Human Services Commission IEE project mentioned previously.

DIR's professional services expenditures, including staff augmentation expenditures, are comparable to other agencies expenditures in these categories.

#### Agency Modification

4. The recommendation should be required as a management action as opposed to a statutory requirement.

(Karen Robinson, Executive Director – Department of Information Resources)

#### **For 1.6**

Andy Wilson, Researcher/Organizer – Public Citizen Texas, Austin

#### **Against 1.6**

None received.

### **Recommendation 1.7**

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*DIR should take steps to ensure it offers the most competitive pricing possible.*

#### **Agency Response to 1.7**

DIR agrees with the recommendation. (Karen Robinson, Executive Director – Department of Information Resources)

#### **For 1.7**

Andy Wilson, Researcher/Organizer – Public Citizen Texas, Austin

#### **Against 1.7**

None received.

## ***Commission Decision***

Adopted Recommendations 1.1 through 1.7.

## ***Legislative Action***

In its review of DIR, the Sunset Commission recommended that the Legislature transfer a portion of DIR's surplus fund balances in the Telecommunications Revolving Fund and Clearing Fund to the General Revenue Fund. This recommendation was made to the Legislature and the relevant appropriative committees, and was included in House Bill 4, 82nd Legislature, Regular Session, the supplemental appropriations bill for fiscal year 2011. The provision makes a one-time transfer of \$4.3 million in fiscal year 2011 from DIR's accounts to the General Revenue Fund, including \$1.75 million from the Clearing Fund and \$2.55 million from the Telecommunications Revolving Fund. (Recommendation 1.1)

The Sunset Commission made several recommendations to limit DIR's spending authority and increase oversight of DIR's appropriations and fund balances. These recommendations were made to the Legislature and the relevant appropriative committees, and were included in House Bill 1, 82nd Legislature, Regular Session, the 2012-13 General Appropriations Act. House Bill 1 includes provisions to increase oversight and accountability of DIR's appropriations and fund accounts, and limits appropriations from revenue generated by DIR's cost-recovery programs to specified not-to-exceed amounts for each of DIR's funds. The bill requires DIR to submit annual reports regarding the amount of unexpended and unobligated balances carried forward in the funds to the Governor, Legislative Budget Board, and Comptroller. House Bill 1 also requires DIR to obtain written approval from the Legislative Budget Board before it may expend funds in excess of appropriated amounts, and requires DIR to return money collected in excess of its operating expenses to customers. (Recommendations 1.1 and 1.2)

The 82nd Legislature also adopted Recommendations 1.3 through 1.6 in H.B. 2499, Regular Session, but the bill was vetoed by the Governor.

As a management recommendation not needing statutory change, Recommendation 1.7 did not result in legislative action.

# Issue 2

## ***DIR's Management and Enforcement of Major Statewide Contracts Have Increased Costs and Risks to the State.***

### **Background**

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DIR manages three major statewide contracts and the information and communications technology (ICT) cooperative contracts program on behalf of the State. These contracts provide a range of information technology (IT) and telecommunications products and services to state agencies, local governments, school districts, universities, and other publicly funded entities. The Legislature has identified major contracts and IT projects as areas of risk for the State, and has directed DIR to help other agencies mitigate these risks. DIR is one of four members of the State's Contract Advisory Team, which reviews major contract solicitations, and provides general statewide contract management guidance.<sup>1</sup> DIR is also one of three agency members of the State's Quality Assurance Team, which approves, reviews, and monitors major IT projects undertaken by state agencies.<sup>2</sup>

Although chosen by the Legislature to help other state agencies mitigate risks inherent in these types of projects and contracts, DIR has demonstrated significant difficulty in successfully managing its own IT and telecommunications contracts, as described in the textbox, *Key Challenges of DIR's Major Contracts*.

#### ***Key Challenges of DIR's Major Contracts***

##### **Data Center Services Contract with IBM (Team for Texas)**

- Frustrated state agency customers and worsening customer satisfaction.
- Stalled progress resulting in failure to achieve promises of updated technology and projected cost savings.
- Increasing risks to the State due to aging of critical technology infrastructure and lack of consistent data backup.
- Significant vendor service delivery problems resulting in two Notices to Cure, and possible rebid of all or part of the services included in the current contract.

##### **Texas Agency Network (TEX-AN) Contract with AT&T**

- Long-delayed rebid, resulting in outdated services, lack of consistent or meaningful customer involvement, and uncompetitive prices.

##### **Previous TexasOnline Contract with Bearing Point**

- Inadequate protection of the State's financial interest.\*
- Ineffective contract monitoring process and inability to enforce certain contract terms.\*
- Inadequate customer involvement.
- New contract signed in July 2009 with NICUSA, and new Texas.gov website launched in June 2010.

\* **Source:** State Auditor's Office, *An Audit of the Department of Information Resources' TexasOnline Contract*, report no. 02-031 (Austin, Texas, March 2002), pp. 1-3; and *An Audit Report on the Department of Information Resources' Administration of the TexasOnline Contract*, report no. 06-011 (Austin, Texas, November 2005), pp. 1-2.

## Findings

**Unresolved challenges with two of DIR's major outsourced contracts have resulted in unrealized cost savings, increased risks to critical agency IT systems, and delays in much needed improvements.**

### Data Center Services

In November 2006, DIR entered into a seven-year contract with International Business Machines, Inc. (IBM) to consolidate state agency mainframes, servers, and print/mail operations through a consortium of providers led by IBM, called Team for Texas. DIR proposed data center services consolidation as a way for the State to save \$176 million over the seven years, and to improve and upgrade the State's IT infrastructure.<sup>3</sup> However, to date, the project has not delivered on these objectives for the 27 agencies and one university

required to participate in the consolidation, listed in the textbox, *Data Center Services Participants*. Service delivery problems evident from the beginning of the contract have not improved, and participating agencies are increasingly frustrated. The textbox on the following page, *Data Center Agencies' Customer Satisfaction*, describes results of a regular customer service survey IBM conducts under the terms of the contract. While all mainframe and print/mail functions have been consolidated, only 7 percent of server transformation, the most complex element of data center consolidation, had been completed as of June 2010, though originally scheduled to be completed by April 2009. Transformation, which includes preparing and upgrading agencies' server applications to enable the transfer to the consolidated data centers, is a critical component to the success of this project and to achieving projected cost savings.<sup>4</sup>

A variety of reasons account for the extensive delays in transformation and other service delivery problems under the contract. However, the Sunset review focused on DIR's role in managing the contract, and did not evaluate specific contract terms, contractor performance, or the role of state agencies involved in consolidation. Sunset staff found DIR has been slow and unsuccessful in enforcing IBM's performance under the contract, only recently taking more decisive action in its July 16, 2010 Notice to Cure and subsequent letter to IBM on August 16, 2010 expressing DIR's intent to rebid all or parts of the current contract.<sup>5,6</sup> Unfortunately, Sunset staff believes several critical problems with this contract are

#### **Data Center Services Participants**

Department of Aging and Disability Services  
Department of Agriculture  
Alcoholic Beverage Commission  
Angelo State University  
Department of Assistive and Rehabilitative Services  
Office of the Attorney General  
Department of Criminal Justice  
Texas Education Agency  
Commission on Environmental Quality  
Facilities Commission  
Department of Family and Protective Services  
Health and Human Services Commission  
Department of State Health Services  
Higher Education Coordinating Board  
Department of Information Resources  
Department of Insurance  
State Library and Archives Commission  
Department of Licensing and Regulation  
Department of Motor Vehicles  
Parks and Wildlife Department  
Public Utility Commission  
Railroad Commission  
Secretary of State  
Department of Transportation  
Veterans Commission  
Water Development Board  
Workforce Commission  
Youth Commission

far from resolved. The delays in transformation and other service delivery problems continue to result in serious consequences, including unrealized cost savings and deterioration of critical agency IT systems.

- **Inadequately Tracked and Reported Costs.** When the Legislature authorized DIR to consolidate data centers in 2005, the purpose of promoting efficiency and effectiveness and providing the best value for the State was clear.<sup>7</sup> After conducting a business case analysis, DIR determined one university and 26 state agencies, now 27 with the creation of the Department of Motor Vehicles in 2009, should be required to participate in data center consolidation. DIR estimated the potential \$176 million in cost savings on a statewide rather than an individual agency level, and 10 of the agencies were never projected to save money on an individual basis. The Legislature appropriated the additional funds necessary for those agencies to participate in the consolidation to help achieve cost savings at the statewide level. DIR staff recently testified the contract has attained its cost savings goals to date.<sup>8</sup> However, DIR has not evaluated data center costs since May 2009, and Sunset staff could not verify this assertion for the following reasons.

#### **Data Center Agencies' Customer Satisfaction**

**IBM Performance:** Customer satisfaction with IBM's performance has deteriorated over time, from 88 percent of participating agencies dissatisfied in April 2009, to 90 percent dissatisfied in November 2009, and 97 percent dissatisfied in May 2010.

**DIR Performance:** May 2010 survey results show 40 percent of the agencies rated DIR's performance as "fair" and 37 percent rated it "poor."

**Source:** Periodic customer satisfaction surveys conducted by ViaNovo for IBM.

**Conflicting and incomplete cost data.** Most of the agencies report having substantially higher data center costs now than before implementation of the contract. These costs include payments for IBM's services, and additional costs agencies report they have incurred to prevent the contract's service delivery problems from impacting operations, either by performing IBM's work themselves or closely monitoring to ensure critical work is completed. For example, a comparison of DIR's 2007 baseline costs for each agency before implementation of the contract, to the projected expenditures for fiscal year 2010, provided in Appendix A, shows substantial cost increases for 17 of the 24 agencies for which baseline data are available.<sup>9</sup> This comparison shows some agencies have experienced a more than 100 percent increase in data center costs during this time period. DIR attributes a substantial portion of the increase in costs to growth in agencies' use of services, but many agencies feel this simple explanation is unfair, and does not take into account the difference between how agencies previously handled growth in-house versus the contract's consumption-based pricing structure. Further, baseline cost data provided by several agencies to Sunset staff do not match baseline data provided by DIR, indicating a lack of shared, verified data for analyzing project costs. DIR relied on agencies to submit accurate baseline cost information, but this data varied in quality depending on the agency, and DIR never verified the data.

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*Sunset staff could not verify DIR's claim that the data center contract has attained its cost savings goals.*

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DIR also has not consistently made attempts to track additional resources agencies have dedicated to data center support and monitoring activities, or to functions that should be provided by IBM within the scope of the contract. In 2009, the State Auditor's Office (SAO) found 22 of the 27 data center agencies reported they were still performing some in-scope responsibilities.<sup>10</sup> DIR has a process to allow agencies to be reimbursed by IBM if they perform in-scope work, but as SAO found, several agencies do not report this information to request reimbursement because the process is too time-consuming, and DIR and IBM have denied previous requests.<sup>11</sup> As a result, DIR lacks reliable information to include these additional costs in its cost assessments. The costs of performing these activities, in addition to significant staff time spent monitoring IBM's work to ensure it is done correctly, appear substantial, given anecdotal information provided by several agencies, shown in the textbox, *Examples of Agency Data Center Support Costs*.

**Examples of Agency Data Center Support Costs (self-reported)**

- **Texas Education Agency** spent \$196,205 in fiscal years 2009 and 2010 for assistance with data backup support, database support, and software installation, costs incurred because the contractor did not perform this work.
- **Higher Education Coordinating Board** dedicates approximately three full-time staff to data center monitoring and support.
- **Department of Insurance** uses at least six full-time staff to support and monitor data center activities.
- **Parks and Wildlife Department** uses approximately 2.5 full-time equivalent staff to monitor the contractor's work.
- **Workforce Commission** staff spends approximately 1,150 hours per month to support and monitor data center activities.

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*The State could pay significantly more for consolidated data center services than the \$863 million originally reported.*

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Though the data center services contract is frequently described as an \$863 million contract, DIR calculated this amount based on the assumption that agencies' resource needs would not increase during the seven years of the contract. DIR did not estimate the cost of increased consumption as part of its business case analysis, but payments under the contract are based on consumption of services, and are not capped. Therefore, the amount the State ultimately pays may be significantly more than the \$863 million originally estimated. Only three years into the seven-year contract, the State has already paid \$486 million, 56 percent of the originally projected amount.

**Increasing prices and administrative costs.** DIR based its initial cost savings projections on the concept that volume purchasing would save the State money, but now projects the prices of some services will increase substantially in fiscal years 2012-2013. For example, the price of disk storage for applications that have not yet been transformed is projected to increase by 25 percent due to the significant delays in transformation. Also, DIR estimates an increase in its administrative fee from the current rate of 2.95 percent to 3.51 percent, if approved by the Legislative Budget Board (LBB) and the Governor's Office. By the end of fiscal year 2010, DIR will also have spent \$4.2 million on other consulting and legal fees to evaluate and fix the many ongoing problems with implementation of the contract, and Sunset staff expects these costs will continue until critical problems with the contract are resolved. In its August 16, 2010 letter to IBM, DIR indicated its intent to rebid all or part of the contracted

services, and has budgeted an additional \$3.25 million in consulting fees in fiscal year 2011 for assistance with this possible procurement. While these costs could not have been anticipated, DIR should include them in any future cost savings analysis.

- **Increasing Risk to State IT Systems.** DIR has not consistently or adequately reported on the effect of delayed transformation on the age of the State's IT systems. Agency servers have aged considerably as agencies wait for long-delayed transformation to occur, increasing the risk of equipment failures that could significantly impair agencies' ability to serve their clients. Many of the participating agencies' servers are more than five years old, beyond the typical industry standard for useful life of this equipment. Some information produced by DIR on statewide server age does not match information provided by agencies, indicating a lack of common, consistent data to evaluate the full extent of the problem. The table, *Server Age at Four Data Center Agencies*, shows information provided by four participating agencies.

In addition to aging server infrastructure, ongoing concerns with the adequacy of data backup under the contract have been well publicized, and is one of the key reasons behind DIR's two Notice to Cure letters sent to IBM on November 6, 2008 and July 16, 2010. For example, with the approval of the Governor and DIR, the Secretary of State pulled the Texas Elections Administration Management (TEAM) system from IBM control due to concerns about IBM's ability to recover lost data.<sup>12</sup> TEAM is a critical IT system that helps state and county officials manage voter registration information, and collect and report elections results, among other important functions.

**Server Age at Four Data Center Agencies**

Agency	Number of Servers	Number of Servers 5 Years of Age or Older	Number of Servers 7 Years of Age or Older
Texas Education Agency	357	202 (57%)	199 (56%)
Parks and Wildlife Department	116	71 (61%)	29 (25%)
Department of Transportation	768	636 (83%)	386 (50%)
Water Development Board	55	44 (80%)	18 (33%)

**TEX-AN Services**

DIR's inability to rebid the TEX-AN contract on time has resulted in significant delays in making needed improvements, including offering new services, transitioning customers to updated technologies, and offering more competitive pricing. As a result of the extensive delays, the TEX-AN program has become outdated and is not delivering the value it should to state agencies and other customers. The current contract was originally negotiated by the

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*Delays under the data center contract have led to aging agency equipment with increased risk of failure.*

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*DIR's customers continue to wait for updated telecom services and pricing.*

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General Services Commission in 1999. All contract extensions expired on August 31, 2009, and DIR is currently operating TEX-AN under a sole source contract with AT&T through the end of fiscal year 2011. In fiscal year 2009, DIR attempted and failed to rebid TEX-AN, spending almost \$5 million on consulting services and systems development, and \$1.3 million on staff augmentation contractors to work on the project, with no publishable request for offer (RFO) resulting from this effort. Also, due to its focus on rebidding TEX-AN, DIR has allowed critical management problems to persist, including outdated fees that have led to rising fund balances, and inappropriate use of contractors, as described in Issues 1 and 3.

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*DIR needs an effective way for customers to have input into changes to its programs.*

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DIR finally issued an RFO for a new TEX-AN contract on August 11, 2010, which will substantially change the way DIR operates the program once a vendor is selected. However, because of the strict timeframes caused by previous delays and gaps in leadership of the telecommunications division, DIR prepared and released this RFO very quickly, significantly limiting the amount of input from customers and vendors regarding this RFO. With this new contract, DIR plans to move from an essentially one-vendor model to multiple vendors, and to offer updated technology with an expanded range of services. Such significant changes are long overdue, but will be challenging for DIR to implement. For example, to successfully implement the new model, DIR must fully automate its ordering and billing processes, train staff to operate the new systems, and ensure customers are informed and able to easily access services under the new contract. DIR will also need to establish an effective way for customers to provide regular, coordinated, and effective input into decision making regarding these changes to the program.

**DIR's overall approach to managing its complex contracts is ad hoc and lacks appropriate oversight.**

- **Poor Oversight.** DIR's contracts lack proper oversight from its Board, its internal auditing program, and its customers. The Board has not been sufficiently involved and engaged in overseeing DIR's contracting

***Insufficient Board Oversight of Major DIR Contracts***

- The Board delegates approval of major contracts to DIR staff. For example, the Board did not approve the data center services contract with IBM.
- The Board has no consistent approach to actively monitor major contracts. For example, the Board is not engaged in the TEX-AN rebid, and has asked few questions of staff about this critical procurement. The Board also did not form a subcommittee to monitor the data center services contract until November 2009, over two years into the troubled contract.
- DIR's Board does not set the strategic direction for the ICT cooperative contracts program, and does not approve new initiatives to determine whether expansions in scope are in line with DIR's overall mission.

functions, as described in the textbox, *Insufficient Board Oversight of Major DIR Contracts*. DIR also has a history of under-resourcing its internal audit function, despite a clear pattern of increasing risk due to DIR's expanded contracting functions, as described in Issue 3. Finally, DIR does not always effectively engage its customers to involve them in decision making. Some programs have governance structures that include customers in direct program oversight, but historically, DIR has not applied this concept consistently to all its

outsourced contracts. For example, the TEX-AN program currently has no functioning governance structure to involve customers in decision making during this critical transition period, when customer input is most important.

- **Inconsistent Approach to Contract Management.** DIR lacks an overall, documented, best practices approach for managing its major outsourced contracts, resulting in individual programs implementing and managing these complex and high-risk contracts differently. Instead, staff uses applicable sections of the ICT cooperative contracts management manual and the State of Texas Contract Management Guide. This ad hoc approach is inadequate. Without a comprehensive contract management guide developed specifically for its major contracts, DIR has no way to document and apply lessons learned across programs, adjust its procedures as needed, ensure retention of institutional knowledge, or promote a clear and shared understanding of DIR's approach to contract management.

DIR has also failed to consistently plan for actions needed to effectively monitor contractor performance and enforce contract requirements. While DIR has guidelines in place for some of its contracts, these vary in quality and level of detail. DIR does not require consistent or comprehensive documented management plans, including detailed policies and procedures, for each of its major contracts. As a result, DIR may not adequately anticipate and mitigate the risks inherent to these contracts. For example, DIR did not conduct contingency planning to evaluate alternative solutions for the high-risk data center services contract until March 2009, more than two years after DIR and IBM signed that contract. DIR also does not clearly define the roles and responsibilities of staff responsible for contracting activities, resulting in contract management teams with no clear contract owner or division of responsibilities.

- **Inadequate conflict of interest standards.** DIR's statute lacks sufficient conflict of interest provisions limiting high-level DIR employees from accepting employment with vendors immediately upon departure from the Department, and prohibiting gifts from vendors. Adhering to the strictest standards is especially important for DIR due to its extensive interaction with the private sector, the \$1.5 billion of funds involved in DIR's contracts, and the statewide impact of its programs. Another agency that manages a cooperative contracting program, the Comptroller of Public Accounts, has statutory requirements and agency policies that include much stricter conflict of interest language, including a complete prohibition on accepting gifts, which DIR should follow.<sup>13</sup>
- **Inadequate training.** DIR does not provide enough training to all individuals involved in managing the agency's complex contracting programs. Contract managers, program staff, Board members, and executive management all participate in managing DIR's contracts in

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*DIR lacks a consistent approach to monitoring contractor performance.*

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*DIR's statute lacks sufficient conflict of interest provisions.*

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different ways, but only staff designated as contract managers receive a consistent level of training. All DIR staff who participate in managing DIR's contracts, and Board members responsible for oversight, should be trained on DIR's overall contracting approach as well as contract-specific management plans for each program area.

## Recommendations

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### ***Change in Statute***

#### **2.1 Require DIR to consistently measure and report cost savings and project status for IT consolidation projects.**

This recommendation would require DIR to develop a consistent and clear way to measure the costs and progress of any of its IT consolidation initiatives. DIR should work with the entities involved in the consolidation to develop an agreed upon methodology to first collect and validate data for a baseline assessment of costs, for use in both initial projections and subsequent cost comparisons. DIR would be required to use this methodology to evaluate and annually report information on actual costs and cost savings to the DIR Board, LBB, and DIR customers. In addition to reporting information about the current status of costs associated with these initiatives, DIR would also report on the progress of the projects compared to the initially projected timelines for implementation. DIR would report this information on both a statewide and individual agency level. DIR should coordinate with its Internal Audit Department for guidance on how to ensure the methodology provides an objective assessment of costs and project status. DIR would post these status reports on its website. This recommendation would apply to existing data center services consolidation and any future consolidation initiatives DIR undertakes to help ensure consistent and readily available information to evaluate the progress of any future consolidation projects.

#### **2.2 Require DIR to create a contract management guide to provide a clear, overall approach to managing its major outsourced contracts.**

Under this recommendation, DIR must create a contract management guide specifically targeted toward providing an overall, consistent approach on how to procure and manage DIR's major outsourced contracts. Currently, these contracts include Texas.gov, TEX-AN, and data center services. DIR should update this manual regularly, using lessons learned and changing conditions to guide these updates. The manual would serve as a way for DIR to take a consistent approach to administering its most complex contracts, and establish an overarching contract management framework. The manual would be required to include, but not be limited to, the following subjects.

- Definition of DIR's general approach to business case analysis, procurement planning, solicitation, contract execution, and contract monitoring and oversight. While Recommendation 2.3 would require DIR to create customized management plans specific to each contract, the manual would document DIR's general approach.
- Establishment of clear lines of accountability, staff roles and responsibilities and decision-making authority, including program staff, contract management staff, executive management, customer governance structures, and the Board.
- Description of DIR's strict ethics standards and policies, including those required by Recommendation 2.7.

- Establishment of DIR's process for evaluating and managing risk during each stage of contract procurement, implementation, and management.
- Definition of DIR's transition approach when contemplating major changes to a program's internal structure at DIR, or its model for delivering services to customers.
- Description of expectations and standards for obtaining and using stakeholder input during all phases of initial analysis, solicitation development, contract award, and contract implementation.
- Coordination with DIR's Internal Audit Department as needed for assistance and guidance in developing procedures for monitoring contracts and individual contractors.

### **2.3 Require DIR to create management plans specific to each of its major outsourced contracts.**

This recommendation would require DIR to develop specific procedures for administering, monitoring, and overseeing each of its major contracts. The plans would define DIR's specific approach to managing and mitigating risks inherent in each contract. The plans would be required for Texas.gov, TEX-AN, and data center services, and any other major outsourced contract DIR enters into in the future. Contract administration and program staff would develop these plans jointly, with input from executive management and the Board, and approval by the Executive Director.

For each of its major contracts, DIR should tailor the plan to define its approach to transitioning from one contract to another, establishing lines of accountability and coordinating of contract activities, implementing the program, monitoring contractor performance, identifying and mitigating risks, and involving and communicating with customers. DIR should revise its management plans as necessary to keep current during the active contract phase, and as it reprocures its contracts to ensure the plans remain updated and incorporate any changes resulting from new contracts. While Recommendation 2.2 would provide DIR's overall approach to managing major contracts, these contract-specific plans would provide the detail and procedures for how DIR will manage each of its unique, outsourced programs.

### **2.4 Strengthen and improve the Board's oversight of DIR's contracting functions.**

This recommendation would require DIR's Board to take the following actions to improve its oversight of DIR's contracting functions.

- Require the Board to approve all major outsourced contracts and any significant amendments with statewide impact, such as data center services or other outsourced consolidation activities; TEX-AN; and Texas.gov.
- Require the Board to adopt a policy establishing criteria for approval of all other contracts, including a monetary threshold above which Board approval is required for contract execution.
- Require the Board to adopt a policy setting a strategic direction for the ICT cooperative contracts staff to follow when developing new initiatives. Require the Board to evaluate and approve new categories of contracts under the program.
- Require the Board to establish subcommittee(s) to monitor DIR's major outsourced contracts, including data center services, TEX-AN, and Texas.gov.

**2.5 Require DIR to develop and implement an agencywide training policy for all staff involved in contract management and Board members.**

This recommendation would require DIR to develop a policy establishing contract management training requirements for all staff involved in contract management, including contract managers, program staff, and executive management, as well as the members of DIR's Board. The training policy would include specific training on DIR's overall approach to procuring and managing contracts, as well as contract-specific procedures, as developed under Recommendations 2.2 and 2.3. Contract management training for Board members, while less specific, would be a part of the Board member training already required in statute.

**2.6 Require DIR to establish formal contract governance structures for each of its major contracts.**

Under this recommendation, DIR would be required to establish a formalized contract governance structure for each of its major contracts, including data center services, TEX-AN, and Texas.gov, to ensure customer involvement in decision making. This recommendation would require DIR to have a standard, coordinated approach to obtaining the feedback necessary to effectively manage its contracts to best meet customer needs.

**2.7 Establish stricter conflict of interest provisions in DIR's statute.**

This recommendation would add specific provisions to DIR's statute similar to those in the Comptroller of Public Account's statute. DIR employees involved in contracting and procurement would be prohibited from soliciting or accepting anything of value from a vendor or potential vendor.

The recommendation would also prohibit a former DIR employee at the deputy director level or above who leaves employment with DIR from accepting employment or receiving compensation from any vendor regarding a particular contract in which the former employee participated during the period of employment. This prohibition would last two years from the date the employee leaves DIR. DIR would be required to include these provisions in its internal policies, such as its employee and contract management manuals, and in staff training.

***Management Action***

**2.8 DIR's Board should immediately establish a subcommittee to monitor the TEX-AN procurement process and implementation of the new contract(s).**

This recommendation would direct DIR to immediately begin implementing Recommendation 2.4 to form a board subcommittee to monitor major contracts specifically for its current TEX-AN procurement effort. Board oversight of this critical procurement should begin immediately instead of waiting for statutory changes to be passed by the Legislature through DIR's Sunset bill in 2011. This subcommittee should closely monitor the staff's progress on reprocurring the TEX-AN contract and actively request information to stay informed about their progress. Once the contract is established, this subcommittee should continue to monitor the implementation and transition to the new TEX-AN contract(s).

## **2.9 DIR should immediately develop transition plans for upcoming changes to the TEX-AN and data center services contracts.**

DIR should immediately begin developing a transition plan to ensure a properly planned TEX-AN transition process. This plan should be finalized after DIR awards contract(s), but before implementation and conversion of customers to new services. The plan should define DIR's approach for ensuring a smooth transition, including educating and informing customers on changes, ensuring DIR staff is properly trained to administer new services, and defining how DIR plans to update its business model to accommodate the changes.

DIR should also immediately begin planning for upcoming changes to the data center services program resulting from DIR's recent notification to IBM of the likely rebid of portions of that contract. DIR should develop a transition plan to effectively implement changes and ensure customers are involved and informed throughout the transition process.

As part of this planning process, DIR should evaluate its administrative structure to ensure it can appropriately implement and monitor the likely multiple-vendor approach to delivering TEX-AN and data center services. DIR should involve stakeholders in developing these plans, and should make the plans publicly available when complete.

## **Fiscal Implication Summary**

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The recommendations to strengthen and improve DIR's contract management and Board oversight could be implemented using existing resources. Improved oversight of costs and enhanced contract management would yield savings to both DIR and its customers; however, projections of savings cannot be estimated.

- .....
- 1 Texas Government Code, sec. 2262.101 and sec. 2262.102.
  - 2 Texas Government Code, sec. 2054.1181.
  - 3 Department of Information Resources, *DIR Agency Business Case* (Austin, Texas, February 2007).
  - 4 Department of Information Resources, *Year 2: Data Center Services Program Contract-to-Date Cost Assessment Report*, p. 2. (Austin, Texas, May 19, 2009). Available. Online: [www2.dir.state.tx.us/SiteCollectionDocuments/DCS/GTCostAssessmentReport20090519.pdf](http://www2.dir.state.tx.us/SiteCollectionDocuments/DCS/GTCostAssessmentReport20090519.pdf). Accessed: August 25, 2010.
  - 5 Notice to Cure letter from the Department of Information Resources to IBM, July 16, 2010. Available. Online: [www2.dir.state.tx.us/about/pressroom/Pages/NoticetoCureDCSContract.aspx](http://www2.dir.state.tx.us/about/pressroom/Pages/NoticetoCureDCSContract.aspx). Accessed: August 31, 2010.
  - 6 Letter from Department of Information Resources to IBM, August 16, 2010.
  - 7 Texas Government Code, sec. 2054.383(b)(3).
  - 8 Edwin Swedberg, Deputy Executive Director, Data Center Services, Department of Information Resources, testimony to the House Appropriations Subcommittee on General Government (Austin, Texas, July 19, 2010).
  - 9 Similar baseline data are unavailable for the Department of Motor Vehicles, Facilities Commission, Veterans Commission, and Angelo State University.
  - 10 State Auditor's Office, *An Audit Report on the Department of Information Resources and State Data Center Consolidation*, report no. 09-051 (Austin, Texas, August 26, 2009), p. 25.
  - 11 *Ibid*, p. 26.
  - 12 Kate Alexander, "Elections System Pulled from IBM Data Center Contract" *Austin American Statesman* (November 4, 2009). Online. Available: [www.statesman.com/search/content/region/legislature/stories/2009/11/04/1104data.html](http://www.statesman.com/search/content/region/legislature/stories/2009/11/04/1104data.html). Accessed: August 25, 2010.
  - 13 Texas Government Code, sec. 2155.003; and Comptroller of Public Accounts, *The State of Texas Procurement Manual*, "Code of Ethics and Conflict of Interest," (Austin, Texas). Available. Online: [www.window.state.tx.us/procurement/pub/manual/1-2.pdf](http://www.window.state.tx.us/procurement/pub/manual/1-2.pdf). Accessed: August 16, 2010.

# *Responses to Issue 2*

## **Overall Agency Response to Issue 2**

DIR agrees that contract management is a critical and essential function given the nature of the agency's core functions, and has dedicated resources and management focus accordingly. DIR also agrees that there are always opportunities for improvement in this area, and routinely incorporates "lessons learned" into ongoing contract management activities. However, DIR disagrees with the conclusion that its management and enforcement of major statewide contracts have increased costs and risks to the State. Due to the limited scope of the Sunset review of DIR's contract management activities, the conclusions drawn in this section of the report do not accurately reflect the scope and breadth of DIR's contract management activities.

The recommendations in this section place a great deal of emphasis on documentation of contract management processes and procedures. DIR acknowledges that opportunities exist for improvement in documentation and intra-agency coordination of its contract management practices, and is already taking steps to implement improvements in this area.

The DIR Board does not agree with the proposed changes in the Board's role in relation to contract management activities. The DIR Board believes the recommendation fundamentally changes the responsibilities of the DIR Board from policy setting to operational management given the scope of DIR's contracting activities. State statute currently requires the Board to employ the employees necessary to implement the Board's duties and to develop and implement policies that clearly separate the policymaking responsibilities of the Board and the management responsibilities of the executive director and staff of DIR (Government Code, Sections 2054.021 and 2054.029). (Karen Robinson, Executive Director – Department of Information Resources)

*Note:* DIR's formal response, available at [www.sunset.state.tx.us](http://www.sunset.state.tx.us) or upon request, includes additional detail regarding the agency's contract management activities in response to Issue 2.

## **Recommendation 2.1**

*Require DIR to consistently measure and report cost savings and project status for IT consolidation projects.*

### **Agency Response to 2.1**

DIR agrees with the recommendation to establish a consistent methodology for reporting cost savings and project status. DIR will use the DCS Business Executive Leadership Committee (BELC), comprised of five executives from agency partners and two from DIR, to establish the methodology for measuring and reporting cost savings and project status. There are some enterprise-wide savings factors that are difficult to allocate at the agency level and the BELC will be used to determine the feasibility of reporting the agency-level savings.

DIR will review LBB performance measures to determine if they need to be adjusted based on the outcome of this effort. DIR will coordinate the methodology with the DIR Internal Auditor. DIR will provide this cost savings and project status information to the LBB, DIR Board and DIR Customers and post the reports on the DIR web site. (Karen Robinson, Executive Director – Department of Information Resources)

### **For 2.1**

Andy Wilson, Researcher/Organizer – Public Citizen Texas, Austin

### **Against 2.1**

None received.

## **Recommendation 2.2**

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*Require DIR to create a contract management guide to provide a clear, overall approach to managing its major outsourced contracts.*

### **Agency Response to 2.2**

DIR supports this recommendation, and agrees that DIR’s contract management activities could be improved through coordination between programs. DIR has already reallocated and dedicated resources to perform this task.

DIR does not agree with the Sunset implication that the existence of a documented policy and procedure manual will provide any greater assurance of contract success than DIR’s current documented practices. Most of the significant and critical decisions for these large contracts ultimately boil down to management decisions based on assessment of risks and consideration of other critical factors such as impacts on service delivery which cannot be contemplated and addressed through written policies and procedures.

The Sunset report also appears to place a great deal of reliance on ensuring the “consistency” of all of DIR’s contract management practices, and is critical of the fact that DIR has unique contract management practices for each of the major statewide contracts. DIR agrees that consistency is important from the perspective of ensuring that all of the key elements of contract management are appropriately addressed. However, DIR does not believe it is realistic to expect that the contract management procedures for each of the three major statewide contracts can be consistent. The nature of the business operations as well as the nature of the contractual obligations for each of these contracts are unique, and require contract management procedures and practices designed to address the specific risks associated with each.

This concept of risk based contract management processes is a core concept of the State of Texas Contract Management Guide. Specifically, the Guide states the following: “There is no single ‘right’ way to contract. Various types of purchases and contracts may require different practices, processes, and strategies for successful implementation.” (Karen Robinson, Executive Director – Department of Information Resources)

## **For 2.2**

Andy Wilson, Researcher/Organizer – Public Citizen Texas, Austin

## **Against 2.2**

None received.

## **Modification**

1. Instead of having separate guides, require the Contract Advisory Team to add to the Texas Contract Management Guide to cover shared services contracts. Additionally, improve the Texas Contract Management Guide to provide guidance on other types of contracts that agencies handle, such as medical services, professional services, grants, etc. Keeping the guidance all in one document provides several important state benefits.
  - Access by all state purchasing units for consistency in contracting, thereby controlling risk and increasing savings.
  - Instructive to state purchasing units that may be procuring in a new area and would benefit from education and guidance.
  - Transparency in state government contracting.

(The Honorable Susan Combs, Comptroller of Texas – Texas Comptroller of Public Accounts, Austin)

## **Recommendation 2.3**

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*Require DIR to create management plans specific to each of its major outsourced contracts.*

### **Agency Response to 2.3**

DIR agrees with the recommendation to require DIR to create management plans specific to each of its major outsourced contracts, with the modification presented below.

Contract specific management plans exist for three of DIR's four programs (Texas.gov, data center services, and information and communications technology cooperative contracts). DIR agrees that this type of documentation does not exist for the Tex-AN contract and will develop a plan for the new Tex-AN contract. The current plans appropriately reflect the differences in each of the businesses, but are based on assessment of risks for each of the key elements included in the State of Texas Contract Management Guide.

### **Agency Modification**

2. The recommendation should be required as a management action as opposed to a statutory requirement.

(Karen Robinson, Executive Director – Department of Information Resources)

**For 2.3**

Andy Wilson, Researcher/Organizer – Public Citizen Texas, Austin

**Against 2.3**

None received.

**Recommendation 2.4** 

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*Strengthen and improve the Board's oversight of DIR's contracting functions.*

**Agency Response to 2.4**

The DIR Board does not agree with this recommendation. The recommendation as currently written fundamentally changes the responsibilities of the DIR Board from policy setting to operational management, given the scope of DIR's contracting activities. Since procurement and contracting issues cannot be discussed in an executive session of the Board meeting, the Board would be required to approve the selection of vendors and contract amendments without discussion of confidential procurement and contract information. The implementation of this recommendation would require the Office of the Governor's appointments division to reassess the qualifications of the Board members. (Karen Robinson, Executive Director – Department of Information Resources; and Charles Bacarisse, Chairman – DIR Board of Directors)

*Staff Comment:* Recommendation 2.4 does not require the DIR Board members to discuss any confidential or sensitive procurement and contract information in an open meeting. The recommendation simply requires the Board to give final approval to all major outsourced contracts and any significant amendments with statewide impact.

**For 2.4**

Andy Wilson, Researcher/Organizer – Public Citizen Texas, Austin

**Against 2.4**

None received.

**Recommendation 2.5** 

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*Require DIR to develop and implement an agencywide training policy for all staff involved in contract management and Board members.*

**Agency Response to 2.5**

DIR agrees with the recommendation to develop and implement an agency-wide training policy for all staff involved in contract management and Board members with the following modification.

### Agency Modification

3. The recommendation should be required as a management action as opposed to a statutory requirement.

(Karen Robinson, Executive Director – Department of Information Resources)

#### **For 2.5**

Andy Wilson, Researcher/Organizer – Public Citizen Texas, Austin

#### **Against 2.5**

None received.

## **Recommendation 2.6**

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*Require DIR to establish formal contract governance structures for each of its major contracts.*

### **Agency Response to 2.6**

DIR agrees with the recommendation to require DIR to establish formal contract governance structures for each of its major contracts with the modification presented below. All of DIR's major contracts, with the exception of Tex-AN, currently include formal governance structures, which ensure customer involvement in decision making. A formal governance structure is contemplated in the new Tex-AN RFO, and will be implemented with the award of the new contract.

### Agency Modification

4. The recommendation should be required as a management action as opposed to a statutory requirement.

(Karen Robinson, Executive Director – Department of Information Resources)

#### **For 2.6**

Andy Wilson, Researcher/Organizer – Public Citizen Texas, Austin

#### **Against 2.6**

None received.

## **Recommendation 2.7**

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*Establish stricter conflict of interest provisions in DIR's statute.*

### **Agency Response to 2.7**

DIR agrees with the recommendation. DIR believes that the current revolving door statute applies to DIR deputy executive directors and that the Sunset recommendation would provide a duplicate requirement in statute. (Karen Robinson, Executive Director – Department of Information Resources)

*Staff Comment:* The State's current revolving door statute applies only to regulatory agencies. While the Texas Ethics Commission generally interprets the term "regulatory agency" to include most executive branch agencies, this recommendation would clarify the provisions apply to DIR. The recommendation also includes stricter conflict of interest provisions than provided by current general state law that would prohibit DIR employees involved in contracting and procurement from accepting anything of value from vendors or potential vendors.

### **For 2.7**

Andy Wilson, Researcher/Organizer – Public Citizen Texas, Austin

### **Against 2.7**

None received.

## **Recommendation 2.8**

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*DIR's Board should immediately establish a subcommittee to monitor the TEX-AN reprocurement process and implementation of the new contract(s).*

### **Agency Response to 2.8**

DIR agrees with the recommendation. (Karen Robinson, Executive Director – Department of Information Resources)

### **For 2.8**

Andy Wilson, Researcher/Organizer – Public Citizen Texas, Austin

### **Against 2.8**

None received.

## **Recommendation 2.9**

*DIR should immediately develop transition plans for upcoming changes to the TEX-AN and data center services contracts.*

### **Agency Response to 2.9**

DIR agrees with the recommendation. DIR is actively planning for all activities required to replace the service provider for the DCS program, including re-procurement, continuity of operations, risk mitigation, transition and termination. DIR is currently engaged in transition planning that includes guidance and feedback from our agency stakeholders; including regular meetings with the DCS Business Executive Leadership Committee (BELC) and Information Technology Leadership Committee (ITLC) and regular briefings with all DCS agencies. As part of this planning process, DIR is developing an initial organization model to align with the new multi-vendor environment.

In addition, the DCS re-procurement RFOs will require each service provider to submit transition plans. The final contracts with each of the new service providers will include a transition plan for their specific service component. These transition plans will be made available to the public when complete. DIR will immediately begin developing a transition plan to ensure a properly planned Tex-AN transition. (Karen Robinson, Executive Director – Department of Information Resources)

### **For 2.9**

Andy Wilson, Researcher/Organizer – Public Citizen Texas, Austin

### **Against 2.9**

None received.

## ***Commission Decision***

Adopted Recommendations 2.1, 2.2, 2.3, 2.5, 2.6, 2.7, 2.8, and 2.9.

Adopted Recommendation 2.4 to require DIR's Board to take the following actions.

- Require the Board to approve all major outsourced contracts and any significant amendments with statewide impact, such as data center services or other outsourced consolidation activities; TEX-AN; and Texas.gov.
- Require the Board to adopt a policy establishing criteria for approval of all other contracts, including a monetary threshold above which Board approval is required for contract execution.
- Require the Board to adopt a policy setting a strategic direction for the ICT cooperative contracts staff to follow when developing new initiatives. Require the Board to evaluate and approve new categories of contracts under the program.
- Require the Board to establish subcommittee(s) to monitor DIR's major outsourced contacts, including data center services, TEX-AN, and Texas.gov.

Also modified Recommendation 2.4 to require the Board to take the following additional actions to improve oversight of DIR.

- Require the Board to regularly evaluate the extent to which DIR meets its information technology mission by providing cost effective services and meeting customer needs.
- Require the Board to regularly evaluate the operations of the agency, including reviewing analytical data and trend information regarding the agency's revenues and expenses, as well as performance information.

## ***Legislative Action***

The 82nd Legislature adopted Recommendations 2.1 through 2.7 in H.B. 2499, Regular Session, but the bill was vetoed by the Governor.

Senate Bill 1, 82nd Legislature, 1st Called Session, includes aspects of two Sunset provisions to increase oversight and accountability of DIR's contracting practices. The bill requires the DIR Board to establish approval requirements for all contracts, including a monetary threshold above which Board approval is required before a contract may be executed. (Part of Recommendation 2.4) Senate Bill 1 also clarifies that standard revolving door provisions for regulatory agencies apply to DIR. (Part of Recommendation 2.7)

As management recommendations not needing statutory change, Recommendations 2.8 and 2.9 did not result in legislative action.

# Issue 3

## ***DIR Has Failed to Prioritize and Provide Adequate Resources to Its Internal Audit Function, Putting Both the Department and the State at Risk.***

### **Background**

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The Texas Internal Auditing Act (the Act) requires state agencies with annual operating budgets of more than \$10 million, more than 100 employees, or that receive and process more than \$10 million annually to have an internal auditing program.<sup>1</sup> DIR meets these criteria.

Internal auditing allows for regular, independent evaluation and scrutiny of an agency's financial, managerial, and compliance risks. This review provides agency management with accurate and consistent information to evaluate program operations and identify potential risks before they result in more serious problems. Internal auditing programs also typically coordinate all audit activity at an agency and serve as the primary point of contact for external auditing entities, such as the State Auditor's Office (SAO), federal auditors, and auditors from other state agencies. The textbox, *Types of Internal Audits*, shows the common types of internal audits described in the Act.

#### ***Types of Internal Audits***

- Financial
- Compliance
- Economy and Efficiency
- Effectiveness
- Investigations

The Act requires agency governing boards to ensure internal audit resources are sufficient to cover all identified risk areas within a reasonable period of time. Neither the Act nor the Institute of Internal Auditors describes how to adequately resource an agency's internal audit program. Rather, agency governing boards and management must make this determination based on the size and scope of programs, level of risk, and overall audit responsibilities.<sup>2</sup> DIR currently has one full-time internal auditor with a fiscal year 2010 budget of \$87,996, who reports to the Board's Finance and Audit Subcommittee.

### **Findings**

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#### **DIR has not adequately prioritized its internal audit function given its responsibility to the State, increasingly complex programs, and \$1.5 billion in transactions.**

Because the risks inherent to DIR's programs affect not only DIR, but many other governmental entities that rely on and pay for DIR's services, a high level of scrutiny is necessary to ensure DIR manages these complex programs effectively. The Sunset review found significant problems with DIR's management of several of its programs, yet the resources DIR has dedicated to its internal audit function are insufficient, exposing the Department and the State to an unacceptable level of risk.

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*DIR's programs  
require a high  
level of scrutiny.*

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- **Increasingly Complex and High-Risk Programs.** Since its last Sunset review in 1996, DIR has evolved from a primarily standards-setting agency into an agency whose core function is procuring and managing major contracts on behalf of the State. DIR is responsible for three highly

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*DIR only has one internal auditor to help oversee the \$1.5 billion of public funds flowing through its programs.*

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complex statewide outsourced programs, including data center services, Texas.gov, and the Texas Agency Network (TEX-AN), the State's telecommunications network. DIR also manages about 850 information and communications technology (ICT) cooperative contracts used by most state agencies, as well as many local governments, school districts, and universities. Because state agencies are generally required to use DIR's contracts, the State has placed a high degree of trust in DIR to manage these programs efficiently. However, the Sunset review identified significant concerns with DIR's ability to manage some of these major contracts, as described in more detail in Issue 2.

DIR's complex contracts involve considerable amounts of public funds, \$1.5 billion in fiscal year 2009, as shown in the table, *DIR Program Sales and Transactions*. The funds flowing through DIR's contracts are made up of General Revenue and other state funds; federal funds; licensing, registration, and other fees paid by citizens; local tax revenue; and other public funding sources. In addition to paying for the cost of the actual goods and services, DIR customers also pay administrative fees which DIR uses to recover the costs of administering these programs. Establishing appropriate fees and managing several different accounts adds additional complexity to DIR's management responsibilities. The Sunset review also identified concerns with DIR's ability to efficiently manage this cost-recovery structure, as discussed in more detail in Issue 1.

**DIR Program Sales and Transactions  
FY 2009**

Program	Sales or Transaction Totals
ICT Cooperative Contracts	\$1.2 billion
Data Center Services	\$183.2 million
Telecommunications Services (TEX-AN and CCTS)	\$87.2 million
Texas.gov	\$67.2 million
<b>Total</b>	<b>\$1.5 billion</b>

- Failure to Prioritize Internal Audit.** DIR's Board has not met the requirements of the Internal Auditing Act to ensure the Department's internal auditing function is prioritized and adequately resourced.<sup>3</sup> DIR currently oversees \$1.5 billion of risk with a single internal auditor. The table, *DIR Internal Auditing Budget*, shows DIR reduced its internal auditing expenditures by 55 percent between 2006 and 2009. The Board approved these decreases at the same time DIR's management responsibilities were growing in complexity and risk, particularly with implementation of the data center services contract.

**DIR Internal Auditing Budget**

Fiscal Year	Amount	Number of Audits
2006	\$53,193	3
2007	\$43,704	4
2008	\$35,989	3
2009	\$23,700	1
2010	\$87,996	0

As a result, DIR's internal audit function has not been able to provide the meaningful and comprehensive scrutiny DIR's increasingly complex responsibilities require. Dating back to at least 1996, DIR contracted with an outside firm for internal audit services. Overall, the audits did not provide adequate attention to DIR's areas of greatest risk, such as the implementation of the data center services contract, or DIR's overall administration of its telecommunications program.

For example, DIR has conducted only one internal audit of the data center services program, focused only on the contract's procurement. This audit yielded no findings and was only four pages long.<sup>4</sup> Also, DIR has not conducted an internal audit of its \$87 million telecommunications program since fiscal year 2003, even though the program is DIR's largest source of cost-recovery fee revenue, and involves complicated, mostly manual billing procedures.

DIR's Board has taken recent, positive steps to support a full-time, in-house internal auditor, but these newly dedicated resources are insufficient to adequately cover DIR's programs. In October 2009, DIR's Board, unsatisfied with the quality of the contracted audits, hired one full-time internal auditor, and created a Finance and Audit Subcommittee to manage the internal audit program. The internal auditor has set up the program and begun audit work, but without additional resources, has not yet been able to complete any of the projects the Subcommittee approved in the fiscal year 2010 audit plan.<sup>5</sup>

Internal auditing has simply not been a DIR priority. The Department is capable of reallocating resources to functions it deems critical to its operations. For example, in fiscal year 2008, DIR established a business development group to market the Department's ICT cooperative contracts and other programs. In fiscal year 2009, DIR spent \$260,000 on salaries for the group's three full-time staff, and provided more than \$600,000 in additional resources for special projects, including a redesign of the DIR website.

**Without an adequate internal audit program, critical DIR functions have not received needed oversight or attention, allowing problems to go undetected and uncorrected for years.**

- **Telecommunications Program.** The Sunset review identified serious concerns regarding DIR's management of its telecommunications program which warrant immediate attention. Concerns include DIR's ability to effectively manage the program on a cost-recovery basis given increasing fund balances, poorly documented procedures to govern complicated billing processes, and inappropriate use and oversight of contractors. These factors demand immediate attention to investigate accounting and management procedures in more detail than the Sunset review could provide, and to identify specific changes needed to restore accountability and transparency to the program.

***Continuing Failure to Appropriately Adjust Cost-Recovery Fees.*** DIR recovers more fees than necessary to operate the telecommunications program, as shown by the continual accumulation of balances in the Telecommunications Revolving Fund. This is not a new problem. Audits dating back to 1992 demonstrated the General Services Commission's (GSC) chronic difficulty in managing the telecommunications program's

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*DIR has not conducted an internal audit of its \$87 million telecom program since 2003.*

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*Serious concerns with DIR's management of the State's telecom program demand immediate attention.*

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*Problems with the State's telecom program have continued uncorrected since 1992.*

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*DIR spent more than \$6 million on a failed attempt to rebid the TEX-AN contract.*

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finances, ensuring the best possible prices for its state agency customers, and operating the program on a cost-recovery basis.<sup>6</sup> Though GSC no longer exists and DIR now administers this program, DIR has once again accumulated a large fund balance, \$17 million at the end of fiscal year 2009. Issue 1 of this report provides more detail on problems with DIR's cost-recovery structure, including the telecommunications program.

***Continuing Failure to Fully Document Billing Procedures.*** DIR's billing procedures lack automation, depend on several staff handling various spreadsheets, and have resulted in at least one serious billing error. Though DIR had already recovered network infrastructure costs incurred from a service provided to the Health and Human Services Commission (HHSC), it continued billing HHSC \$500,000 per month for five additional months. DIR staff was unaware of this error until DIR conducted a pricing analysis in 2010, the first such analysis since DIR acquired the program in 2001. As a result of this analysis, DIR credited the overpayments to HHSC.

DIR internal audits from fiscal years 2002 and 2003 identified several instances in which DIR lacked documented procedures and internal controls for the administration of its telecommunications program, including procedures for its customer billing process.<sup>7</sup> Though these audits identified this problem years ago, DIR was unable to produce sufficient evidence that documented billing procedures currently exist. DIR plans to make major changes to this process by fully automating it, in conjunction with the new TEX-AN contract(s) to be awarded in fiscal year 2011, but has not yet implemented these changes.

***Inappropriate Use and Lack of Oversight of Staff Augmentation Contractors.*** DIR has not provided adequate oversight of its telecommunications program in part because of its extensive and inappropriate use of staff augmentation contractors. Staff augmentation is intended for temporary use, yet DIR has routinely used contractors to fill ongoing staffing needs, including management roles, without conducting any analysis of the costs or benefits of this practice. In fiscal year 2009, DIR spent more than \$6 million to pay staff augmentation contractors, primarily for the telecommunications division.

DIR released its Request for Offer (RFO) to rebid the TEX-AN contract in August 2010 after extensive delays. DIR's previous attempt to release this RFO in fiscal years 2008-2009 failed. DIR had hired a staff augmentation contractor to manage the project, and several others to work on the RFO team, along with DIR staff. After reviewing the team's draft proposal, DIR executive management decided not to go forward with the RFO after spending almost \$5 million to pay for procurement assistance services from a consultant, and an additional \$1.3 million for the contractors working on the RFO team.

In 2007, HHSC contracted with DIR to provide telecommunications network support services for its call centers after cancelling its contract with Accenture. DIR hired staff augmentation contractors to provide the services, but failed to provide adequate oversight of these contractors for three years. Two contractors managed the contractor team, and reported to another contractor DIR employed in an ongoing management position. DIR also allowed the contracted managers to evaluate the performance of the contractors under their supervision. DIR billed HHSC more than \$3.5 million for these services in fiscal year 2009.

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*DIR hired contractors to manage and evaluate other contractors' work.*

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The Board's Finance and Audit Subcommittee has identified DIR's extensive use of staff augmentation as an area of risk, and the internal auditor is currently conducting an audit on the Department's use of these services.

- **Contract Management.** DIR's ability to effectively monitor its contracts has not been adequately evaluated due in part to its under-resourced internal audit program. Though the Board's new Finance and Audit Subcommittee identified contract management procedures as an area of high-risk for the Department, and directed an audit, the single internal auditor has not completed this project. DIR manages major contracts with statewide impact, and should pay special attention to ensuring it uses taxpayer funds efficiently and holds vendors accountable for fulfilling contract terms. The Sunset review identified several instances in which DIR has not adequately filled this role, indicating a need for an immediate evaluation of the Department's overall approach to contract management.

For example, in a 2009 audit, SAO found DIR did not have sufficient procedures for monitoring IBM's performance under the data center services contract, and that 83 percent of the service level data reported by IBM and tested by SAO contained errors.<sup>8</sup> The same pattern exists in DIR's ICT cooperative contracts program. DIR relies on vendors to remit the administrative fee customers pay as part of the price of goods back to DIR, along with the vendors' monthly sales reports. However, DIR performs little validation to ensure these reports and administrative fee amounts are correct, and has not considered regular audits of this process part of its core management responsibility until recently. In fiscal year 2009, DIR collected more than \$11 million in fees for this program. DIR should have a more consistent process to ensure the amounts collected are accurate.

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*DIR does not validate over \$11 million in fees for the ICT cooperative contracts program.*

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### **Other state agencies with high-risk, complex programs devote significantly greater resources to internal auditing than DIR.**

An analysis of other state agencies' internal audit programs shows DIR's program is comparatively under-resourced, though comparing DIR's structure and complicated programs with other agencies is difficult. The

agencies shown in the table, *Comparison of State Agency Internal Audit Programs*, have complex contracting and outsourcing functions, or manage large amounts of funds. Among the agencies, the Department of Housing and Community Affairs is closest in size to DIR and spends more than five times the amount DIR spends on internal audit. While none of these agencies' functions are very similar to DIR's, this comparison indicates DIR has a comparatively under-resourced internal auditing function given the critical, high-risk programs it manages on behalf of the State.

**Comparison of State Agency Internal Audit Programs  
FY 2010**

Agency	Internal Audit Budget	Internal Audit FTEs	Number of Annual Audits
Department of Information Resources	\$87,996	1	1
Department of Housing and Community Affairs	\$487,248	7	7
Department of Transportation	\$1.1 million	26	20
Commission on Environmental Quality	\$1.2 million	19	30
Department of Criminal Justice	\$1.2 million	25	20
Health and Human Services Commission	\$2.6 million	26	10

## Recommendations

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### *Change in Statute*

#### **3.1 Require DIR to establish an Internal Audit Department.**

#### **3.2 Require the DIR Board to maintain an audit subcommittee.**

These recommendations would solidify the Board's recent decision to establish an Internal Audit Department. This approach would ensure DIR maintains a full-time, in-house internal audit function, and that the Board continues to closely monitor the internal audit activities to improve oversight. The audit subcommittee would be required to determine if allocated resources are adequate to cover the areas of risk identified in the annual audit plan, as required by the Texas Internal Auditing Act. The subcommittee would make recommendations to the full Board regarding the adequacy of DIR's audit resources, and re-evaluate needed resources during DIR's annual budgeting process.

Under this recommendation, the Internal Audit Department would prepare an annual audit plan using risk assessment techniques to determine DIR's areas of greatest risk, for approval by the Board. The Internal Audit Department could bring issues outside the annual audit plan to the Board that require immediate attention. The Internal Audit Department would also coordinate all audit activity at DIR, including acting as DIR's liaison for external auditing entities, such as SAO, and providing consultation and guidance, but not approval, on the design of audit activities DIR program areas undertake, such as auditing vendors' reported performance information or payments.

## ***Management Action***

### **3.3 DIR should dedicate at least three additional full-time staff to its Internal Audit Department.**

This recommendation would serve as a starting point for improving the adequacy of DIR's internal auditing resources by providing one auditor to cover each of DIR's four main programs, including its three major contracts and the ICT cooperative contracts program. The intent of the recommendation is to provide DIR the capacity to more adequately evaluate each of its major programs, though the auditors would still conduct audits based on identified areas of greatest risk. Once DIR adds these staff, the Board should regularly evaluate whether these resources are adequate to cover DIR's significant areas of risk as defined in the annual risk assessment, and make any necessary adjustments to staffing and other audit resources as required by the Internal Auditing Act.

### **3.4 Direct DIR's Internal Audit Department to evaluate DIR's contract management policies and procedures.**

This recommendation would direct the internal auditor to conduct an immediate audit of DIR's procedures for monitoring vendor performance and financial information under its ICT cooperative contracts program and three major contracts for data center services, Texas.gov, and TEX-AN. This recommendation would provide an immediate, independent review of the Department's contract management functions, a critical DIR responsibility that has not received sufficient independent scrutiny.

### **3.5 DIR should contract for an independent and comprehensive audit of its telecommunications program.**

An independent, comprehensive audit of DIR's telecommunications program is critical. The program has not undergone a thorough audit since DIR began administering the program in 2001. An immediate and independent audit would provide qualified analysis and needed attention at a time when DIR is contemplating major changes to the program. The audit should be conducted after DIR awards the new TEX-AN contract(s), and should include an evaluation of the following areas of concern identified by Sunset staff:

- billing processes and systems;
- cost-recovery fee and price-setting practices;
- use of contractors in the telecommunications division, particularly DIR's financial and oversight controls of staff augmentation contractors; and
- overall administration and management, including organizational structure.

## **Fiscal Implication Summary**

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The recommendations to establish an Internal Audit Department and Board audit subcommittee would not have a fiscal impact, as DIR has already hired an internal auditor and the Board has an audit subcommittee. However, adding three internal audit staff would cost an estimated \$225,000 annually for salaries and benefits. The internal audit function is critical to the administration of DIR's programs, which are cost recovery. As such, DIR would fund these positions as administrative costs

from program revenues. If DIR requires additional full-time equivalent positions, it should request these positions through the appropriations process.

Based on the cost of previous contracted management audits by other state agencies, Sunset staff estimates the cost of auditing DIR's telecommunications program would be about \$500,000. DIR could pay for this audit with revenue from its telecommunications program, using current surplus amounts in the Telecommunications Revolving Fund. The results of this study are expected to result in savings by helping DIR set appropriate and cost-effective operational policies and better oversee contractors' performance. However, these types of savings cannot be estimated.

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<sup>1</sup> Texas Government Code, Chapter 2102.

<sup>2</sup> Institute of Internal Auditors, *The Role of Auditing in Public Sector Governance* (Alamonte Springs, Florida, November 2006), p. 4.

<sup>3</sup> Texas Government Code, sec. 2102.006(d).

<sup>4</sup> Department of Information Resources, *An Internal Audit Report of the Data Center Consolidation Procurement by the Department of Information Resources* (Austin, Texas, July 6, 2007).

<sup>5</sup> Department of Information Resources, *Internal Audit Plan Fiscal Year 2010* (Austin, Texas, 2010).

<sup>6</sup> State Auditor's Office, *A Follow-Up Audit Report on Management Controls at the General Services Commission*, report no. 99-029 (Austin, Texas, February 1999), p. 51.

<sup>7</sup> State Auditor's Office, *An Audit Report on the Department of Information Resources and State Data Center Consolidation*, report no. 09-051 (Austin, Texas, August 2009), p. 7.

<sup>8</sup> Department of Information Resources, *Internal Audit Annual Report for FY 2002* (Austin, Texas, October 28, 2002), pp. 10-26; and Department of Information Resources, *Internal Audit Annual Report for FY 2003* (Austin, Texas, September 29, 2003), pp. 8-13.

# Responses to Issue 3

## Overall Agency Response to Issue 3

Both the DIR Board and the DIR management team believe that the Internal Audit function is critical to the success of the organization and value the contributions provided by the current Internal Audit Director. The DIR Board and DIR management recognized that due to the increasing scope and complexity of DIR operations that a contracted internal audit function was inadequate, and hired the current DIR Internal Audit Director in October, 2009. At that point, a decision was made to allow the Internal Audit Director sufficient time to evaluate and assess the risks prior to determining the appropriate size of the internal audit function. The DIR Board also established a Finance and Audit subcommittee, whose members meet regularly with the Internal Auditor. (Karen Robinson, Executive Director – Department of Information Resources)

*Note:* DIR's formal response, available at [www.sunset.state.tx.us](http://www.sunset.state.tx.us) or upon request, includes additional detail regarding the agency's overall response to Issue 3.

## Recommendation 3.1

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*Require DIR to establish an Internal Audit Department.*

### Agency Response to 3.1

DIR agrees with the recommendation but believes that the Texas Internal Auditing Act already makes this a statutory requirement for DIR. (Karen Robinson, Executive Director – Department of Information Resources)

*Staff Comment:* The Texas Internal Auditing Act, Texas Government Code Chapter 2102, requires certain agencies to maintain an internal audit function but does not require the function to be maintained in-house as proposed in Recommendation 3.1.

### For 3.1

Andy Wilson, Researcher/Organizer – Public Citizen Texas, Austin

### Against 3.1

None received.

## Recommendation 3.2

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*Require the DIR Board to maintain an audit subcommittee.*

### Agency Response to 3.2

DIR agrees with the recommendation. (Karen Robinson, Executive Director – Department of Information Resources)

**For 3.2**

Andy Wilson, Researcher/Organizer – Public Citizen Texas, Austin

**Against 3.2**

None received.

**Recommendation 3.3** 

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*DIR should dedicate at least three additional full-time staff to its Internal Audit Department.*

**Agency Response to 3.3**

DIR agrees that the Internal Audit function needs additional resources and is currently assessing the appropriate level of resources. (Karen Robinson, Executive Director – Department of Information Resources)

**For 3.3**

Andy Wilson, Researcher/Organizer – Public Citizen Texas, Austin

**Against 3.3**

None received.

**Recommendation 3.4** 

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*Direct DIR's Internal Audit Department to evaluate DIR's contract management policies and procedures.*

**Agency Response to 3.4**

Based on the DIR Internal Audit Director's risk assessment, an evaluation of DIR's contract management practices is included in the draft fiscal 2011 Internal Audit Plan. The DIR Board will consider approval of the Internal Audit Plan in October 2010. (Karen Robinson, Executive Director – Department of Information Resources)

**For 3.4**

Andy Wilson, Researcher/Organizer – Public Citizen Texas, Austin

**Against 3.4**

None received.

## **Recommendation 3.5**

*DIR should contract for an independent and comprehensive audit of its telecommunications program.*

### **Agency Response to 3.5**

DIR agrees with the recommendation. Once the new contract is signed a decision will be made regarding the appropriate timing of the audit. (Karen Robinson, Executive Director – Department of Information Resources)

### **For 3.5**

Andy Wilson, Researcher/Organizer – Public Citizen Texas, Austin

### **Against 3.5**

None received.

## ***Commission Decision***

Adopted Recommendations 3.1 through 3.5.

## ***Legislative Action***

The 82nd Legislature adopted Recommendations 3.1 and 3.2 in H. B. 2499, Regular Session, but the bill was vetoed by the Governor.

As management recommendations not needing statutory change, Recommendations 3.3 through 3.5 did not result in legislative action.



# Issue 4

## ***Texas Has a Continuing Need for the Department of Information Resources, but the Department Lacks Needed Focus and Oversight.***

### **Background**

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The Legislature created the Department of Information Resources (DIR) in 1989 to oversee planning and management of information technology (IT) resources in Texas. Since that time, the Legislature has significantly expanded DIR's powers and duties, and has shifted the Department's funding sources from General Revenue to a cost-recovery structure. State agencies are generally required to use DIR's programs and services, while other entities such as K-12 education, local governments, and universities participate on a voluntary basis. Today, DIR serves its broad range of customers by managing the following key functions.

- Procures and manages statewide cooperative contracts for information and communications technology commodities and services (ICT cooperative contracts).
- Provides telecommunications services, including the Texas Agency Network (TEX-AN) and the Capitol Complex Telephone System.
- Manages consolidated data center services.
- Manages Texas.gov, the official website of Texas.
- Provides guidance and oversight of state information security.
- Provides statewide IT strategic planning, reporting, and standards setting.

### **Findings**

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#### **The State has a continuing need to coordinate its IT and telecommunications resources to maximize their cost-effectiveness and use.**

Because properly functioning IT and telecommunications systems are complex, costly, and increasingly critical to Texas' ability to serve its citizens, the State has a significant interest in coordinating these functions. State expenditures on technology have more than doubled over the last 15 years, increasing from \$950 million in fiscal year 1995 to \$2.4 billion in fiscal year 2008.<sup>1,2</sup> Providing standards and coordinating IT purchasing helps promote a uniform approach for the use of rapidly changing technology and maximizes the State's buying power.

State agencies increasingly rely on IT and telecommunications systems for many purposes, including processing payments for everything from driver's licenses to hunting permits; tracking and validating information for occupational licensing and other regulatory activities; managing complex highway projects; and determining eligibility for and delivering benefits such

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*State expenditures on technology totaled \$2.4 billion in fiscal year 2008.*

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as medical assistance and unemployment. Citizens expect an ever-growing level of technological sophistication and responsiveness from government to communicate and provide information in a straightforward and timely manner, especially over the Internet. The State needs to promote the greatest degree of consistency, timeliness, and sharing of information across its state agencies.

**DIR's mission and purpose have become unclear, and as a result, the Department has neglected state agencies, the primary customers it was created to serve.**

Originally created to support state agencies, DIR has lost focus on its most important constituency. During the last 10 years, the Legislature has expanded DIR's duties and required the Department to rely on cost-recovery fees rather than General Revenue to fund its operations. As a result, DIR has become more focused on generating revenue through its cost-recovery

programs, rather than directly serving the state agencies it was originally created to support. This focus on its voluntary customers such as local governments and universities, is evident as shown in the textbox, *DIR's Changing Mission Statements*. While increasing its voluntary customer base increases purchasing power for the State and drives IT prices down for all of DIR's customers, simply lowering costs should not be DIR's primary way to support state agencies.

***DIR's Changing Mission Statements***

**DIR's Mission Statement for 2009-2013:** To transform the delivery of technology to state agencies so they can better serve the citizens of Texas.

*Source: DIR Agency Strategic Plan, 2009-2013, p. 5.*

**DIR's Mission Statement for 2011-2015:** To provide technology leadership, solutions, and value to all levels of Texas government and education, to enable and facilitate the fulfillment of their core missions.

*Source: DIR Agency Strategic Plan, 2011-2015, p. 5.*

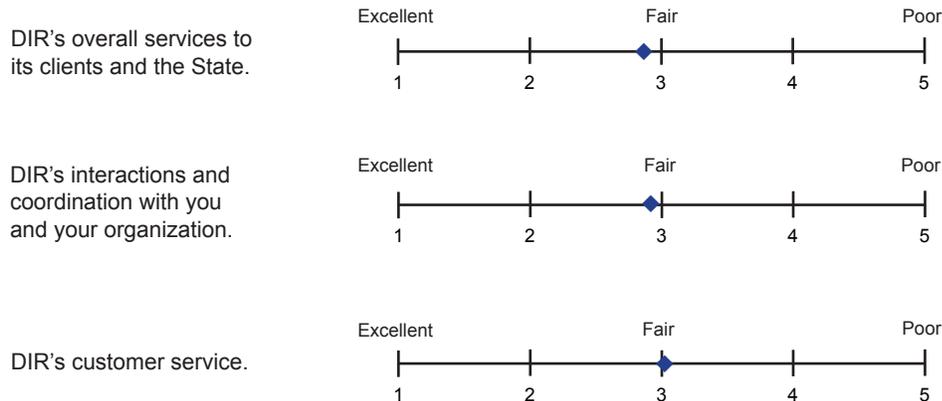
Also, while DIR is responsible for setting a coordinated, strategic direction for the planning and use of technology in the state, the Sunset review found a "silo" mentality within the Department where each individual program develops its own goals and objectives with little thought toward an agencywide purpose, and rarely coordinates efforts with other programs that serve the same constituency. Although specifically authorized to use a portion of its cost-recovery revenue to support its statewide planning, policy development, and technical assistance functions, DIR devotes limited resources to these important duties, and much of the guidance DIR is required to prepare for state agency use is outdated, some by 10 years.<sup>3</sup> In survey responses, meetings, and focus groups with Sunset staff, state agencies consistently indicated frustration with the lack of coordinated and up-to-date assistance they expect DIR to provide. The chart on the following page, *Summary of State Agency Survey Responses*, shows state agency executive directors, information resources managers, and IT staff only rated DIR's overall performance of its mission and customer service as fair. These ratings, when combined with hundreds of additional comments received from state agency staff, indicate DIR needs to greatly improve its relationship with state agencies.

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*State agencies consistently expressed frustration with DIR's assistance.*

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## Summary of State Agency Survey Responses



Based on 157 responses from state agency executive directors, information resources managers, and IT staff to a survey conducted by Sunset staff.

DIR also does not have an agencywide approach to customer management or a consistent way to track and report customer contacts, suggestions for improvement, or complaints. As a result, DIR's Board and executive management lack the overall picture necessary to make informed decisions about the services DIR's customers may need, or the quality of services provided. DIR plans to develop a system to better track this information agencywide, but this has not yet occurred.

### **Steps recently taken by the Department to better manage certain critical programs and services for the State do not provide enough assurance that problems will ultimately be corrected.**

As described in Issues 1, 2, and 3 of this report, the Sunset review identified serious concerns with DIR's ability to manage certain services the State depends on it to deliver. These concerns include the Department's difficulty managing its cost-recovery structure in a transparent manner; lack of adequate oversight and controls of DIR's essential statewide contracts; and a failure to adequately prioritize and provide resources for its own internal audit function.

DIR's relatively new executive management team recognizes some of these concerns and has taken initial steps to address them, including recent efforts to analyze and reduce some of DIR's administrative fees; more directly address identified problems with the data center services contract; reprocure the long-delayed TEX-AN contract; and improve the Department's internal auditing function. However, the pattern of frequent leadership and organizational changes in recent years necessitates clear direction and follow-up to ensure DIR continues to address these significant concerns regardless of staffing changes. For example, since 2003, DIR has had four different executive directors, and four different directors over its troubled

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*DIR has had four executive directors in seven years.*

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telecommunications division. DIR has also undergone significant, repeated organizational changes during this time, indicating the Department has been struggling with how best to organize and focus on its many responsibilities. Consequently, additional oversight of DIR is necessary.

**DIR is the most appropriate agency to coordinate Texas’ IT and telecommunications resources, but further analysis of the State’s purchasing structure is needed.**

As it currently exists, DIR has responsibility for functions consolidated from other agencies the Legislature has restructured or abolished, leaving few reasonable organizational alternatives for these functions. The textbox,

<b>Consolidation of Functions Into DIR</b>	
1989	DIR created, replacing the Automated Information Systems Advisory Council, and the Automated Interagency Services Division of the State Purchasing and General Services Commission
2001	General Services Commission abolished and telecommunications functions transferred to DIR
2005	TexasOnline Authority abolished and functions transferred to DIR
2009	Telecommunications Planning and Oversight Council abolished and functions transferred to DIR

*Consolidation of Functions Into DIR*, shows entities that previously performed some of DIR’s current duties but are no longer in existence.

Opportunities may exist to restructure or streamline the State’s two separate cooperative contracting programs currently housed at DIR and the Comptroller’s Office, and described in the table, *Comparison of the State’s Cooperative Contracting Programs*. However, several efforts to evaluate this structure are currently underway, including

the Comptroller’s analysis of statewide spending trends completed in June 2010, DIR’s planned 2011 analysis of opportunities for greater efficiency in IT purchasing, and the Select House Committee on Government Efficiency and Accountability’s charge to explore ways to reduce inefficiency in government, including looking for best practices in purchasing state goods and services.<sup>4</sup> Sunset staff concluded that any significant changes to these two cooperative contracting programs should be part of a broader analysis of the State’s overall purchasing structure, which is outside the scope of the Sunset review of DIR. However, the results of these efforts would help inform the upcoming Sunset review of the Comptroller’s cooperative contracting program, scheduled to occur in 2013.

**Comparison of the State’s Cooperative Contracting Programs  
FY 2009**

	<b>Staff</b>	<b>Budget</b>	<b>Funding Source</b>	<b>Purchase Volume</b>	<b>Predominant Contract Method</b>
DIR Contracting & Procurement Services Division	34	\$7.5 M	Fees (currently averages 0.92%)	\$1.3 billion (26% state agency)	best value
Comptroller-TPASS Statewide Procurement & Contract Management Division	32	\$4.5 M	General Revenue	\$573 million (92% state agency)	low bid

**While organizational structures vary, all 50 states coordinate government IT and telecommunications resources.**

All states have moved to consolidate and coordinate IT and telecommunications standards setting, planning, purchasing, and service provision in an office, department, or separate agency led by a state Chief Information Officer (CIO). In recent years, the national trend has been to create a separate, dedicated agency to perform these functions. Currently, 20 states have independent IT agencies, as shown in the textbox, *Organization of IT Functions in Other States*. This number has increased during the last five years, up from 16 in 2005, as reported in a national survey of CIOs.<sup>5</sup> While state structures vary as to whether IT and telecommunications functions are housed in the same agency, combining these activities in a single entity makes sense given their growing importance and interconnectedness, and the continuing need for strategic direction to improve their effectiveness and control costs.

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*The national trend has been to create a separate, dedicated agency to perform IT functions.*

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***Organization of IT Functions in Other States***

**Independent Agency: 20**

Arizona, Arkansas, Connecticut, Delaware, Georgia, Indiana, Maryland, Michigan, Minnesota, Mississippi, Nevada, New Hampshire, New Mexico, New York, North Dakota, South Dakota, Texas, Utah, Virginia, Washington

**Division Within Another Agency (usually a Department of Administration): 21**

Alabama, Alaska, Hawaii, Idaho, Iowa, Kansas, Kentucky, Louisiana, Maine, Massachusetts, Missouri, Montana, Nebraska, Ohio, Oklahoma, Rhode Island, South Carolina, Wisconsin, Oregon, Tennessee, Vermont

**Attached to the Office of Governor: 9**

California, Colorado, Florida, Illinois, New Jersey, North Carolina, Pennsylvania, West Virginia, Wyoming

*Source: National Association of State Chief Information Officers, State Profiles: [www.nascio.org/aboutNASCIO/profiles/](http://www.nascio.org/aboutNASCIO/profiles/)*

**The Department's statute does not reflect standard language typically applied across the board during Sunset reviews.**

DIR's governing statute does not include a standard provision relating to alternative rulemaking and dispute resolution that the Sunset Commission applies in across-the-board fashion to agencies under review. Without this provision, the Department could miss ways to improve rulemaking and dispute resolution through more open, inclusive, and conciliatory processes designed to solve problems by building consensus rather than through contested proceedings.

## Recommendations

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### ***Change in Statute***

#### **4.1 Continue the Department of Information Resources for six years.**

A shorter, six-year Sunset date would provide increased oversight of DIR by allowing the Legislature to evaluate DIR's implementation of major changes needed to improve the Department sooner than the standard 12-year period. The Sunset review in six years would be focused on evaluating whether DIR has implemented changes to address the significant problems identified in this report, specifically relating to DIR's funding structure, contract management, and internal audit functions. A shorter date would also allow the Legislature to review the status of DIR contracts currently in transition, such as the data center services contract, pending procurement of the TEX-AN contract, and the newly awarded contract for Texas.gov.

#### **4.2 Apply the standard Sunset across-the-board requirement for DIR to develop a policy regarding negotiated rulemaking and alternative dispute resolution.**

This recommendation would ensure that DIR develops and implements a policy to encourage alternative procedures for rulemaking and dispute resolution, conforming to the extent possible, to model guidelines by the State Office of Administrative Hearings. DIR would also provide training as needed and collect data concerning the effectiveness of these procedures. Because the recommendation only requires the Department to develop a policy for this alternative approach to solving problems, it would not require additional staffing or other expenses.

### ***Management Action***

#### **4.3 Direct DIR's Board and executive management to refocus the Department on its original mission and purpose, serving state agencies.**

This recommendation would direct DIR's Board and management to provide increased consideration of and attention to state agencies, the primary customers DIR was created to serve. DIR should ensure it has a consistent mission and focus that prioritizes providing technical assistance, policy development and guidance, and customer service to state agencies. DIR should also provide more coordinated services to state agencies, and increase communication and coordination among programs that serve the same state agency constituency. Additionally, DIR should provide sufficient resources to support these functions, funded by cost-recovery fees already authorized.

Under this recommendation, DIR should develop and regularly update the guidance it provides state agencies, including information on how best to access and use new DIR initiatives, and should reflect current industry-standard practices. Finally, DIR should develop an agencywide policy and system for consistently tracking and responding to customer contacts and complaints or less formal suggestions for improvement. Taking these actions will help transition DIR away from a "silo" mentality toward a more cohesive, customer service-focused organization that better meets state agencies' needs.

## Fiscal Implication Summary

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Notwithstanding other recommendations in this report, if the Legislature continues DIR for six years, its annual appropriation of \$256 million, including approximately \$800,000 of General Revenue, would continue to be needed for its operations.

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<sup>1</sup> Sunset Advisory Commission, *Sunset Staff Report on the Department of Information Resources* (Austin, Texas, 1996), p. 57.

<sup>2</sup> Department of Information Resources, *The Texas Transformation: Technology-Driven Value. 2008 Biennial Performance Report on the Use of Information Resources Technologies in State Government* (Austin, Texas, November 2008), p. 51.

<sup>3</sup> Department of Information Resources, Policy, Standards, Guidelines, and Procedures, [www2.dir.state.tx.us/pubs/pages/doclibrary.aspx#policy](http://www2.dir.state.tx.us/pubs/pages/doclibrary.aspx#policy). Accessed: August 16, 2010.

<sup>4</sup> House Select Committee on Government Efficiency and Accountability, interim charge two, public hearing (Austin, Texas, May 12, 2010).

<sup>5</sup> National Association of Chief Information Officers, *Compendium of Digital Government in the States* (Lexington, Kentucky, 2005), p. 18.



# *Responses to Issue 4*

## **Overall Agency Response to Issue 4**

DIR appreciates the Sunset staff's recognition of the continuing need to coordinate IT and telecommunications resources and the recommendation to continue the Department of Information Resources. However, DIR respectfully requests a four-year Sunset date instead of the six-year Sunset date recommended by Sunset staff. This should provide adequate time for the improvements implemented by the new management team to be institutionalized.

DIR strongly disagrees with the conclusion that DIR's mission and purpose have become unclear and that as a result the Department has neglected state agencies. DIR also disagrees that including voluntary customers in its mission statement is an indicator that DIR has lost focus on its state agency customers. DIR believes that it is appropriate for the voluntary customers to be included in DIR's mission statement given that DIR's enabling legislation includes other government entities as customers in the majority of DIR's core programs, that several of DIR's Legislative Budget Board (LBB) performance measures include the voluntary customers in the measurement, and that the additional sales volumes provided by these organizations enables DIR to negotiate at an enterprise level and pass reduced pricing on to state agencies.

DIR also takes exception to the statement that "DIR has become more focused on generating revenue...rather than directly serving state agencies..." It seems a weak argument to base such a conclusion solely on a slight modification to the DIR mission statement. In addition to the core shared services offerings that are primarily focused on supporting state agencies, DIR also demonstrates support to these agencies by leading activities such as the following:

- Providing training and support to state agency Information Resource Managers (IRMs). DIR's coordinator of this program recently received an award for her continued and exceptional work in providing quality educational events for state agencies.
- Providing statewide electronic information resources accessibility standards and practices.
- Providing guidance, tools, and training on the Statewide Project Delivery Framework to help state agencies improve the value of technology projects.
- Hosting an annual "Power to Purchase" conference/expo to provide education and training to state agency IT and purchasing professionals at no cost to state agency attendees.
- Providing training on cyber security standards and best practices.
- Working collaboratively with state agency personnel to identify needs for IT commodities and services and awarding contracts for these items through DIR's Information and Communication Technology (ICT) cooperative contracting program.

(Karen Robinson, Executive Director – Department of Information Resources)

## Recommendation 4.1

*Continue the Department of Information Resources for six years.*

### Agency Response to 4.1

DIR agrees with the recommendation to continue the agency with the modification presented below.

### Agency Modification

1. DIR respectfully requests that the next Sunset review take place in four years instead of six years.

(Karen Robinson, Executive Director – Department of Information Resources)

### For 4.1

Andy Wilson, Researcher/Organizer – Public Citizen Texas, Austin

### Against 4.1

None received.

### Modification

2. **Abolish DIR and replace it with a newly created agency, the Texas Department of Technology Services (DTS).** The new agency would be responsible for providing focused, strategic, and coordinated IT services to state agencies. Functions would be limited to managing data center services, the Texas Agency Network, the Capitol Complex Telephone system, and the Texas.gov website; and developing IT policy, strategic planning, and IT security services. The new agency should be given clear direction to help state agencies with advice and technical assistance in determining IT needs and solving problems.

**Establish a new board to govern the agency.** The Governor would appoint seven board members to staggered six-year terms. The members should represent specific areas of expertise such as business and financial management, information technology, telecommunications, or any other areas of expertise necessary to set policy for and successfully oversee the agency. One member would represent higher education. Three ex officio state agency members would serve on the Board, mirroring DIR's current Board structure, except one of the ex officio members would represent a state agency with less than 100 staff.

**Require the Board to establish a customer advisory committee.** The customer advisory committee would be comprised of customer representatives receiving services from each of DTS's key programs, including small agencies. The committee would report to and advise the Board on the status of the agency's delivery of critical statewide services such as data center services, telecommunications, and the Texas.gov website.

**Transfer the ICT cooperative purchasing function to the Comptroller's office.** DIR's current authority to manage the statewide cooperative contracting program for information and communications technology commodities and services would transfer to the Comptroller's office, which already administers the State's other statewide cooperative purchasing contracts. This would initially involve a transfer of about 25 staff.

**Fund DTS directly with General Revenue (Change in Appropriations).** Express the will of the Sunset Commission that the Legislature simplify the agency's complex cost-recovery fee structure by directly funding these functions with General Revenue. Further consideration would be necessary during the appropriations process to make this modification cost neutral by reducing and offsetting the overall costs to General Revenue. Initially, DIR's fund balances, totaling between \$24 and \$29 million at the end of fiscal year 2010, could be transferred to General Revenue.

**Adjust recommendations in Issues 1 through 4 to be consistent with the new structure in the items above.**

(Representative Byron Cook, Member – Sunset Advisory Commission)

## **Recommendation 4.2**

*Apply the standard Sunset across-the-board requirement for DIR to develop a policy regarding negotiated rulemaking and alternative dispute resolution.*

### **Agency Response to 4.2**

DIR agrees with the recommendation. (Karen Robinson, Executive Director – Department of Information Resources)

### **For 4.2**

Andy Wilson, Researcher/Organizer – Public Citizen Texas, Austin

### **Against 4.2**

None received.

## **Recommendation 4.3**

*Direct DIR's Board and executive management to refocus the Department on its original mission and purpose, serving state agencies.*

### **Agency Response to 4.3**

DIR agrees with the need to continue to serve state agencies and will continue to look for opportunities for improvement. (Karen Robinson, Executive Director – Department of Information Resources)

### **For 4.3**

Andy Wilson, Researcher/Organizer – Public Citizen Texas, Austin

### **Against 4.3**

None received.

## ***Commission Decision***

Adopted Recommendation 4.1 with Modification 2 as amended to continue DIR for six years, but to transfer DIR's ICT cooperative contracts program to the Comptroller's Office; establish a new board with specific qualifications to govern DIR; require the Board to establish a customer advisory committee; and recommend that the Legislature fund DIR directly with General Revenue. DIR would continue to be responsible for providing focused, strategic, and coordinated IT and telecommunications services to state agencies. Directs the Comptroller's office to provide frequent reports to the Legislature on the progress of its HUB program, specifically in relation to HUB participation and usage in the statewide purchasing programs. Directs Sunset staff to review the status of the HUB program during the next Sunset review of the Comptroller's statewide purchasing functions.

Adopted Recommendations 4.2 and 4.3.

## ***Legislative Action***

The Legislature adopted Recommendation 4.1 with Modification 2 as amended, and Recommendation 4.2 in H.B. 2499, Regular Session, but the bill was vetoed by the Governor.

Recommendation 4.1 with Modification 2, as amended, included the Sunset provisions to continue DIR for six years and transfer DIR's ICT cooperative contracts program to the Comptroller of Public Accounts. However, after the Governor's veto of H.B. 2499, the Legislature instead continued DIR for two years, until 2013 in Senate Bill, 1st Called Session, and directed the Sunset Commission to re-examine DIR and make any recommendations it considers appropriate to the 83rd Legislature. Senate Bill 1 also requires DIR to negotiate with vendors to obtain the best value for the State in the purchase of IT commodity items, and authorizes DIR to consider strategic sourcing and other methodologies to select the vendor offering the best value on commodity items.

As a management recommendation not needing statutory change, Recommendation 4.3 did not result in legislative action.

*New Issues*

# New Issues

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The following issues were raised in addition to the issues in the staff report. These issues are numbered sequentially to follow the staff's recommendations.

5. As the state's designated information technology organization, DIR also serves as the statewide information security officer. In this role, DIR should provide additional advice and guidance to state agencies in the form of policies, procedures, and guidelines relating to information security, including information security education and services. DIR is in a unique position to assist many agencies that do not have the expertise or the human or financial resources to adequately protect the state's information resources from harm. (The Honorable Susan Combs, Comptroller of Texas – Texas Comptroller of Public Accounts, Austin)
6. Texas should adopt standards similar to the principles offered by the Sunlight Foundation regarding the Federal Public Online Information Act. These principles state that transparency is government's responsibility; public information means online information; and data quality and presentation matter. DIR should help adopt these standards by creating or contracting with a vendor to create a "widget" that all state agencies could use to respond to Texas Public Information Act requests online, creating efficiency, speed, and ease of use as we move away from paper and onto electronic, parseable documents. (Andy Wilson, Researcher/Organizer – Public Citizen Texas, Austin)
7. Require DIR to convene a 13-member advisory board to provide guidance on new technology issues. The advisory board should be comprised of:
  - eight legislators (two from each party of each house);
  - one representative from DIR;
  - one representative from the Attorney General's Office to insure recommendations fit current Texas Public Information Act standards;
  - two advisors from nonprofit entities with some expertise on technology, accessibility, and open government issues (one nominated by each party's representatives on the committee); and
  - one chair nominated and voted upon by the other 12 members who has the support of at least eight members and who should be from the internet/software/IT business world, as long as there is no conflict of interest.

The members would serve two-year terms beginning at the end of every Legislative session, and no restrictions on the number of times someone may serve on the advisory board would exist. The board would likely not meet during the Legislative session, but rather serve as advisors for changes to statutes.

The board would be authorized to vote to expand itself by invitation of specific individuals through simple majority vote. Every member would abide by strict conflict of interest rules.

No member of the board should be associated with or have a financial interest in a software or technology firm that currently has contracts with state agencies for technology and/or software.

The board would meet quarterly to review changing technologies and make recommendations about best practices that would be sent to the heads and executive directors of every state agency. Representatives from state agencies would be encouraged to attend and give input about feasibility and cost, as would members of the public who should be able to participate virtually as well as in person. These practices should be adopted unless an agency can show why this would be cost-prohibitive. The advisory board should take into account whether recommendations can be met within current agency budgets and in creating best practices for social and electronic media that generally comport with the Texas Public Information Act. Those issues which would require legislative changes or changes to agency budgets should be submitted in a report by the advisory board prior to the open of the bill-filing period.

(Andy Wilson, Researcher/Organizer – Public Citizen Texas, Austin)

8. To implement the public policy set out in Texas Government Code, section 2054.001(b) that establishes the legislative policy underlying the creation of DIR, the Sunset Commission should adopt legislative proposals that:
  - a. Incorporate the following principles of good government relating to the use of modern technology.
    - State government should use modern technology to fully and contemporaneously report its actions and its business operations to its citizens.
    - The technology the state should use in communicating with its citizens should be accessible to all segments of the Texas population including seniors, people with a disability, and people whose primary language is not English.
    - Any technology relied upon by the state to communicate with its citizens should be able to interact with older technologies and different operating systems to ensure that no citizen because of the computer operating system used by the person or because of the age of computer technology the person relied upon is denied access to online information from the person's government.
    - Government's online reporting of its actions and business operations to its citizens should be transparent and standardized agency-to-agency to ensure that the information provided is not concealed by the electronic formatting or web display of the data but revealed to its citizens.
    - Government should provide on each agency website for a portal addressing its citizens' requests for information under the public information act with that portal allowing direct access to documents online through multiple means to access the data such as site index, key word search, subject matter search, and other portals.
    - Expenditures from funds placed in the hands of state government by its citizens should be accounted for by full and complete disclosure online so that its citizens can know where the money came from and how it was spent.

- Because candidates are seeking a position of public trust in state government, that trust should be protected with full and transparent campaign and expenditure disclosure online so that citizens can know what person or entity either funded directly or indirectly a candidate's campaign or was funded by the campaign funds.
- b. Require state agencies to provide certain information (including staff directories, agency statutes and regulations, identification of agency departments with a contact listing, access to the agency's public information site, access to agency reports and publications, access to rulemaking proceedings and contested case proceedings) concerning that agency's business in standardized locations on agency homepages.
- c. Direct DIR to create web templates with public input into their designs for use by state agencies.
- d. Require the online publication of all documents prepared by or on behalf of the state agency or received by the agency with due regard to the Public Information Act (PIA).
- e. Require state agencies to place a PIA portal on their websites with the PIA page providing public requesters with online access to documents contemporaneously with the PIA request, and allowing for online tracking of agency challenges to the release of the requested information.
- f. Require state agency online archival of documents considered dated by the agency.
- g. Require state agencies to provide public access to online information through several search tools such as site index, key word, subject matter, and statutory authority.
- h. Ensure people relying upon older technology or relying upon operating systems not used by the agency have access to state agency online information.
- i. Ensure that people regardless of age, disability, or primary language have meaningful access to state agency online information.
- j. Require state agency online reporting and accounting of all revenues received and all expenditures made by each state agency.
- k. Direct state agencies to report all their business activities online, formatted in an accessible and user-centered design.
- l. Direct state agencies to restrict their reliance on hard copy filings by members of the public and on hard copy service requirements in contested case proceedings.
- m. Direct DIR to supervise and collaborate with state agencies in these recommended state agency directives.

(Lanetta Cooper – Texas Legal Services Center, Austin and on behalf of Public Citizen Texas, Texans for Public Justice, and Texas Impact)

## ***Commission Decision***

Adopted the following six new issues as management actions, not previously listed.

- Direct DIR to develop a detailed action plan of all actions needed to bring the performance of the Department to a satisfactory level. This action plan should be monthly or quarterly, as appropriate. Each month or quarter, the agency's accomplishments should be evaluated and corrective actions taken as needed to assure meeting the time table for satisfactory performance.
- DIR and each client agency should jointly develop Service Level Agreements that include agreed upon standards for services provided by or through DIR. DIR should hold service level meetings with each agency monthly or quarterly depending upon the complexity of the client agency.
- DIR should review all outside professional contracts for redundancy.
- DIR should implement a rigorous process of expense management to evaluate and control factors leading to the 115 percent increase in expenses over the past four years.
- Direct DIR to compare fees charged to client agencies to private sector fees, to the extent possible.
- Direct DIR to report its revenues, expenses, and results of operations separately for each of the agency's programs, in addition to consolidated results currently reported. Also, direct DIR to report trends and analytical data to the Board as appropriate to help ensure the Board fully understands the results of the agency's operations.

## ***Legislative Action***

As management recommendations not needing statutory change, the new issues did not result in legislative action.

*Provisions Added by Legislature*

# *Provisions Added by Legislature*

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House Bill 2499 was vetoed by the Governor.



# *Appendices*

# Appendix A

## Data Center Services Cost Comparison<sup>1</sup>

*Note:* This appendix is solely intended to compare how data center services costs have increased or decreased for most of the participating agencies. Various factors, such as delayed transformation under the contract and individual agencies' growth in consumption, may account for differences in costs.

Agency	2007 Pre-Contract Annual Data Center Costs <sup>2</sup>	FY 2010 Projected Data Center Costs Under IBM Contract <sup>3</sup>	Percentage Change
Aging and Disability Services, Department of	\$1,401,000	\$3,625,130	+159
Agriculture, Texas Department of	\$902,000	\$681,189	-24
Alcoholic Beverage Commission, Texas	\$442,000	\$599,720	+36
Assistive and Rehabilitative Services, Department of	\$4,427,000	\$3,243,038	-27
Attorney General, Office of the	\$16,389,000	\$24,782,257	+51
Criminal Justice, Texas Department of	\$12,399,000	\$15,122,433	+22
Education Agency, Texas	\$6,767,000	\$8,085,449	+19
Environmental Quality, Texas Commission on	\$5,401,000	\$8,371,383	+55
Family and Protective Services, Department of	\$5,496,000	\$3,020,850	-45
Health and Human Services Commission	\$40,823,000	\$47,041,829	+15
Health Services, Department of State	\$7,325,000	\$10,308,379	+41
Higher Education Coordinating Board, Texas	\$1,401,000	\$1,579,977	+13
Information Resources, Department of	\$1,524,000	\$1,139,470	-25
Insurance, Texas Department of	\$5,345,000	\$3,148,241	-41
Library and Archives Commission, Texas State	\$397,000	\$366,886	-8
Licensing and Regulation, Texas Department of	\$124,000	\$355,762	+187
Parks and Wildlife Department, Texas	\$1,950,000	\$3,364,459	+73

## Appendix A

### Data Center Services Cost Comparison<sup>1</sup>

Agency	2007 Pre-Contract Annual Data Center Costs <sup>2</sup>	FY 2010 Projected Data Center Costs Under IBM Contract <sup>3</sup>	Percentage Change
Public Utility Commission of Texas	\$210,000	\$286,762	+37
Railroad Commission of Texas	\$2,458,000	\$2,341,060	-5
Secretary of State	\$865,000	\$2,286,711	+164
Transportation, Texas Department of	\$17,952,000	\$21,275,673	+19
Water Development Board, Texas	\$750,000	\$1,665,303	+122
Workforce Commission, Texas	\$16,845,000	\$19,250,372	+14
Youth Commission, Texas	\$1,408,000	\$1,878,248	+33

<sup>1</sup> This comparison does not include the Facilities Commission, Department of Motor Vehicles, Veterans Commission, or Angelo State University because no comparable baseline cost data exist.

<sup>2</sup> Department of Information Resources, *DIR Agency Business Case* (Austin, Texas, February 2007).

<sup>3</sup> Department of Information Resources, *Fiscal Year 2010 Data Center Services Estimates* (Austin, Texas, July 17, 2010).

# Appendix B

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## Staff Review Activities

During the review of the Department of Information Resources (DIR), Sunset staff engaged in the following activities that are standard to all Sunset reviews. Sunset staff worked extensively with agency personnel; attended Board meetings; met with staff from key legislative offices; conducted interviews and solicited written comments from interest groups and the public; reviewed agency documents and reports, state statutes, legislative reports, previous legislation, and literature; researched the organization and functions of similar state agencies in other states; and performed background and comparative research using the Internet.

In addition, Sunset staff also performed the following activities unique to this agency.

- Toured DIR's two state data centers in San Angelo and Austin; the Health and Human Services Commission's Winters data center; and DIR's Network and Security Operations Center.
- Convened two focus groups with several state agency executives and IT managers involved in the data center services program.
- Worked extensively with staff from the Legislative Budget Board and State Auditor's Office, and greatly appreciate the time, assistance, and expertise they provided to the Sunset review team.
- Attended meetings of the Texas.gov Executive Steering Committee and Customer Advisory Council; a governance meeting for data center services customers; and a customer meeting and vendor conference for the Texas Agency Network.
- Conducted a survey of approximately 8,600 DIR customers, vendors, and stakeholders; and reviewed and evaluated the 1,600 responses.
- Attended DIR-sponsored events including the Power to Purchase Technology Expo, Information Security Forum, and trainings on the Texas Project Delivery Framework and IT project management practices.
- Attended the annual conference of the National Association of State Chief Information Officers and the Government Technology Conference Southwest.



# SUNSET STAFF REVIEW OF THE DEPARTMENT OF INFORMATION RESOURCES

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