



**A SPECIAL PERFORMANCE AUDIT  
OF THE  
DEPARTMENT OF GENERAL SERVICES  
*PROCUREMENT OF DELOITTE CONTRACTS*  
OCTOBER 2009**

**Bureau of Departmental Audits**

October 21, 2009

The Honorable Edward G. Rendell  
Governor  
Commonwealth of Pennsylvania  
225 Main Capitol Building  
Harrisburg, PA 17120

Dear Governor Rendell:

This report contains the results of the Department of the Auditor General's special performance audit of procurement contracts entered into by the Department of General Services (DGS). Specifically, the audit focused on contracts between state agencies and Deloitte Consulting LLP (Deloitte) that were in effect during the four-year period from January 1, 2004 to December 31, 2007. This audit was conducted pursuant to Sections 402 and 403 of the Fiscal Code and in accordance with generally accepted government auditing standards (GAGAS). The aforementioned standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Our audit found that a lack of true transparency within the procurement process created the potential for improprieties in the awarding of Commonwealth contracts, including the potential for vendor favoritism. The continued reluctance of management to be forthcoming only heightened our concerns. For nine months, management verbally and in written correspondence from DGS and the Office of General Counsel routinely denied or hindered our auditors' repeated requests for pertinent information under the veil of avoiding undue scrutiny, pressure, or challenge from outside entities. Our original draft and our final audit report continue to raise legitimate concerns about conflicts of interest and the potential for improprieties in the procurement process because of a lack of transparency and the ill-advised placement of former Deloitte personnel in key decision-making positions within the Office of Administration without considering limiting their input when their former employer is involved. Regrettably, management again attempts to minimize our recommendations and avoid the seriousness of the matter, as demonstrated in its formal response by choosing to reply to only 10 of our recommendations, ignoring the other 27 recommendations offered in our report.

Additionally, information requested by our auditors was missing because of the failure to retain vital documents. We learned that audited agencies destroyed documents that would have been instrumental to our audit during the audit period, including two contracts destroyed at least six months after our audit started. As such, our audit report recommends a change in retention policy so that all agencies adhere to proper retention schedules and comply fully with all requests for information by the Department of the Auditor General. Moreover, as demonstrated by our review of a questionable grant awarded to Deloitte by the Department of Community and Economic Development, totaling \$750,000 combined with \$1.5 million in tax credits, there is an acute absence of communication between agencies when taxpayer dollars are involved. Agencies should scrutinize vendors more thoroughly to determine the amount of Commonwealth contracts received by such vendors. Taxpayers will ultimately shoulder any financial burden stemming from poor procurement practices and the potential mismanagement of valuable funds.

Our audit also found that sole source, emergency, and change order procurements lacked adequate justification and approvals. Also, our review of the controls over the Commonwealth's information technology (IT) services expenditures authorized by contracts with Deloitte found concerns, including poor accountability of contracts totaling \$592.1 million and control weaknesses in approving expenditures totaling \$203.7 million.

We also found weaknesses in key procurement documents for 25 contracts resulting from Request for Proposals/Request for Quotes totaling \$173 million, as well as potential overbilling of facility costs totaling \$3.6 million. Furthermore, management indicated that DGS delegated its IT procurement authority to respective agencies, with the Office of Administration – Office of Information Technology (OA-OIT) approving IT contracts over \$100,000. Based on our interviews and review of OA-OIT documentation, we noted serious deficiencies related to OA-OIT's IT procurement review procedures, including lack of evidence of who actually performed the reviews. In addition, we noted that key OA-OIT management, responsible for approval of IT procurements and contract changes during the audit period, had the potential for, or the appearance of, conflicts of interest with Deloitte. Finally, the current organizational structure allows agencies to operate without the presence of mutual efforts of coordination and/or quality control.

We offer 37 recommendations that afford the public a more transparent government and significantly strengthen DGS policies, controls, and oversight of the Commonwealth's procurement process. While we understand that this audit was extensive, we would have appreciated more cooperation from DGS and the other agencies involved in this audit. We will follow up at the appropriate time to determine whether and to what extent all recommendations have been implemented.

Sincerely,

JACK WAGNER  
Auditor General

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**RESULTS IN BRIEF**

The Department of the Auditor General conducted a special performance audit of procurement contracts entered into by the Department of General Services (DGS). Specifically, the audit focused on contracts between state agencies and Deloitte Consulting LLP (Deloitte) that were in effect during the four year-period from January 1, 2004 to December 31, 2007.

This audit report details the Department of the Auditor General's modifications of its findings and recommendations, which were contained in the original draft audit report submitted for management response on January 23, 2009. The report also contains the verbatim responses of DGS and various Commonwealth agencies to each finding and recommendation, as well as our auditors' conclusions to each combined verbatim response. The revised findings and recommendations contained in this final report, which were submitted for management response on July 6, 2009, are the result of DGS and various Commonwealth agencies belatedly agreeing to provide our auditors with previously requested documentation and interviews, after they reviewed our original draft findings and recommendations.

Because the residents of Pennsylvania entrust their state government with the responsibility to ensure that it spends taxpayer dollars both appropriately and effectively, it is incumbent upon our state government to earn that trust through true transparency. Such transparency should allow the public to remain knowledgeable by providing full access to information relevant to the spending of the aforementioned tax dollars. Taxpayers will ultimately shoulder any financial burden stemming from poor procurement practices. Alarming, as our audit discloses, the procurement of goods and services by state agencies of the Commonwealth is an area in which management too frequently demonstrates a wanton disregard for the taxpayers of Pennsylvania. Unfortunately, we found this mindset to be prevalent in many of the agencies involved in our audit.

The divergence in opinion between our auditors and agency management on the extent of collaboration needed to conclude our audit was disconcerting. Despite our best efforts to ensure a timely completion of this audit, management's new protocols and inadequate responses continually delayed the release of our report. In certain instances, nine months passed before management finally provided information requested by our auditors. In addition, management's continued refusal to provide our auditors with specific requested information further heightened our concerns about transparency and proper oversight. Specifically, throughout the audit, management verbally and in written correspondence from DGS and the Office of General Counsel routinely denied or hindered our auditors' repeated requests for pertinent information under the veil of avoiding undue scrutiny, pressure, or challenge from outside entities. In the letter accompanying its formal response to our revised findings and recommendations, management claims that it "provided the Auditor General with all documents still in our possession over the seven-year audit period." However, key documents from at least 19 of the 33 contracts provided to our auditors should have been available for review under the Commonwealth's current retention schedule, but were unable to be located. Additionally, for two contracts, supporting procurement documents were destroyed at least six months after our audit commenced.

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Management also asserts, “We are pleased that the Auditor General has acknowledged that no laws were broken, as had been portrayed by the draft audit.” In our original draft audit report, we could not conclude that conflict of interest laws were, in fact, violated, and we do not do so in this final report. Nevertheless, we do raise legitimate concerns about conflicts of interest and the potential for improprieties in the procurement process because of a lack of true transparency. We put forth numerous recommendations in the report to address these weaknesses and others. Regrettably, management continues to attempt to minimize our recommendations and avoid the seriousness of the matter, as demonstrated by its formal response. Despite its protracted response, management chose to reply to only 10 of our recommendations, ignoring the other 27 recommendations offered in our report. Moreover, further evidence that agencies have failed to comprehend the gravity of our concerns is the response of management to our recommendation that it scrutinize all vendors to ensure that they are not improperly benefitting from state economic development programs. According to management, “Such a task would be unduly burdensome and unrealistic.” In essence, management has abdicated its oversight duties, which demonstrates a willingness to simply rely on vendors who are receiving the taxpayer-funded grants or tax credits to act in good faith and scrutinize themselves.

Additionally, management asserts that we failed to acknowledge in our revised findings particular reforms that the audited agencies have implemented to strengthen the procurement process. However, our auditors have not substantiated these reforms because they were not in place during the audit period, although we reserve the right to validate any reforms in a follow-up review and future audits. The need for confirmation is important, especially in the wake of management’s contention that it participated in our audit in the spirit of full disclosure, followed by its warning, “Please do not interpret this decision [to provide information] as consent to be provided with all documentation requested by you and your auditors on all future audits. We will continue to consider your document requests on a case by case basis.”

Management disregards our recommendations and attempts to refute our findings by avoiding the foundation of our evidence. Similar to its initial response, management intimates that evidence used to compile our findings is not proper and we should examine other information. As mentioned previously, while our auditors review all information that management provides, we will not rely on the audited agency to determine the relevance of requested audit evidence.

Furthermore, management states that “the auditors could only find one instance where a former Deloitte employee served as a voting member of an evaluations committee.” It is important to note that the Commonwealth did not provide original detailed scoring sheets prepared by the evaluators for 13 of 58 contracts with Deloitte awarded through the Request for Proposals (RFP) and Request for Quotes (RFQ) methods. Therefore, we could not verify the evaluators for these contracts. In addition, we found significant potential or perceived conflicts of interest within OA-OIT regarding individuals who were significantly involved in the IT procurement review process, as detailed in Finding No. 5.

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There still appears to be no consensus between our auditors and DGS and various Commonwealth agencies, as demonstrated in their letters accompanying their combined responses to our findings and recommendations. Management of DGS and various Commonwealth agencies have strongly expressed their disagreement with our findings and have even gone so far as criticizing the methods used in the performance of this audit. Therefore, for purposes of clarification, we believe that it is important to address such misconceptions with a brief summation of events. These summations are located in Appendix C, beginning on page 71, and in Appendix D, beginning on page 125.

We made several changes to our original draft findings and recommendations following our interviews and examination of the additional documentation that management ultimately decided to permit. Based on this new information, Finding No. 1 is a new finding in its entirety. Findings No. 3, No. 4, and No. 5 contain significant changes from the findings contained in our original draft report. Furthermore, the aforementioned findings include additional recommendations.

This audit has resulted in six findings. We also offer 37 recommendations to alleviate deficiencies identified by our auditors. These are addressed in detail in the main body of this report. However, a brief synopsis of our findings and recommendations is as follows:

**Finding No. 1** - We discuss our auditors' efforts and the lack of cooperation demonstrated by agencies' management to determine if contracts involving Deloitte comply with Commonwealth procurement laws. Management's lack of cooperation initially delayed our efforts to conclude on a number of objectives and fostered a perception of secrecy through a lack of transparency. In turn, this lack of transparency, as well as allegations of irregularities, created the potential for improprieties in the awarding of Commonwealth contracts, including the potential for vendor favoritism. Poor record retention by Commonwealth agencies perpetuated this belief. We were eventually able to identify several deficiencies and control weaknesses once the Office of the Governor directed DGS to release additional documents so that our auditors could complete the necessary review. However, because we did not receive all procurement documentation, we could not verify that agencies adhered to all Commonwealth procurement laws and regulations or exercised due diligence.

We recommend that Commonwealth agencies retain procurement documentation, including losing proposals and detailed scoring sheets, until the information has been subject to audit, as stated in the *General Administrative Records Retention and Disposition Schedule*. In addition, as part of all audits, we recommend that DGS and other Commonwealth agencies provide all procurement records to the Department of the Auditor General upon request, including, but not limited to, the names of the members of the proposal evaluation committee, copies of losing proposals, and detailed scoring sheets by each member of the proposal evaluation committee.



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**Finding No. 2** - Our finding discloses expenditures related to Deloitte contracts totaling \$592.1 million. Management indicated that the reason that it continually contracts with Deloitte and other vendors to develop and maintain information technology (IT) projects is because it lacks the expertise to develop and maintain such projects in-house. However, many Deloitte contracts contain a “knowledge transfer” provision, whereby the contractor agrees to provide Commonwealth IT staff with the skills and expertise, through training and mentorship, necessary for agency employees to maintain or upgrade the system in-house after the contract ends. We found that, in most instances, this IT knowledge is not being transferred to agency employees.

We recommend that DGS ensure that state agencies perform a detailed analysis as to whether a project should be completed in-house or whether a contractor should complete the project. Agencies should be required to include adequate knowledge transfer provisions in all IT contracts. Moreover, agencies should also be required to receive the appropriate amount of knowledge transfer and to maximize the use of in-house IT staff to perform maintenance and upgrades on systems in order to reduce the need for maintenance contracts with Deloitte. Furthermore, we suggest that DGS uses its advantage as the lead procurement entity to push the administration to consider increasing the IT staff complement of agencies, if deemed necessary.

**Finding No. 3** - We discuss our review of contracts and change orders for compliance with the Commonwealth’s *Procurement Handbook*, including proper justifications and approvals. The *Procurement Handbook* requires that most services be procured through a competitive sealed bidding method by using an RFP or an RFQ. We uncovered a multitude of weaknesses in the procurement process after a review of the 25 RFP/RFQ contracts for which we did receive all key procurement documentation. We were unable to adequately review the other 33 contracts totaling \$301 million because agencies did not provide all of the key procurement documents (see Finding No. 1). Our audit also found that sole source, emergency, and change order procurements lacked adequate justification and approvals. In many instances, less than suitable planning was involved prior to soliciting such contracts, causing agencies to select Deloitte in haste. Certain change orders also did not have the appropriate approvals.

We recommend that DGS ensure that agencies develop written policies and procedures to document a comprehensive RFP preparation, review, and approval methodology, including the approval of all reviewers of the RFP within the contract procurement file and to document a formal methodology for selecting evaluation committee members. In addition, it must ensure that agencies provide written instructions to evaluation committee members for completing the detailed scoring sheets. Agencies must formally document all evaluation committee meetings within the contract procurement file, as well as retain key procurement documents within the procurement file for the appropriate retention period. A pre-proposal conference should also be held for every RFP/RFQ issued.

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Additionally, DGS must ensure that agencies maintain detailed documentation to support justification of the use of the sole source, emergency, and change order procurements and ensure that all emergency procurements are necessary due to threat to public health, welfare, or safety or due to circumstances outside the control of the agency. Agencies must analyze and document the potential use of other vendors and not assume that Deloitte is the best vendor for the project without competitively bidding for the services. DGS must also ensure that agencies secure the proper approvals on the appropriate procurement forms.

**Finding No. 4** - Our review of the controls of the Commonwealth's IT services expenditures, authorized by contracts with Deloitte, found numerous concerns, including poor accountability of contracts totaling \$592.1 million, control weaknesses in approving expenditures totaling \$203.7 million, and potential overbilling of facility costs totaling \$3.6 million. A Department of Community and Economic Development (DCED) grant totaling \$750,000 and \$1.5 million in tax credits to Deloitte to create 502 new jobs and retain 1,538 existing jobs are questionable as to justification, verification, and compliance with the law. Moreover, according to DCED management, it failed to communicate with other state agencies to determine the magnitude of Commonwealth contracts with Deloitte prior to awarding the grant or credits.

We recommend that DGS ensure that agencies enter all contracts and related change order/amendment information into the SAP Procurement Module, the Commonwealth's main accounting system for procurement, to ensure complete accountability of all contracts. Agencies should also enter detailed expenditure information, including descriptions, into SAP at the time of payment to ensure better tracking and accountability of expenditures by contract. Expenditures must be monitored more closely, including facility costs, to ensure that services do not overlap between contracts and that overbilling does not occur. Agencies must monitor contracts by vendors to ensure awareness of situations such as Deloitte receiving a \$750,000 grant and \$1.5 million in tax credits in addition to receiving \$592.1 million in Commonwealth contracts. In addition, agencies must scrutinize thoroughly all vendors to ensure that they are not improperly benefitting from the misapplication of the law governing DCED grant monies and/or the Job Creation Tax Credit Program. Also, DCED must adhere to state law in awarding tax credits and ensure proper management controls over the grant and tax credit programs.

**Finding No. 5** - We explain the need for DGS to improve its oversight and monitoring of state agencies' IT procurement practices. Management indicated that DGS delegated its IT procurement authority to other Commonwealth agencies, thereby decentralizing the IT procurement process. Moreover, DGS stated that the Commonwealth's IT procurement structure provides for review by the Office of Administration – Office of Information Technology (OA-OIT). Once procurement authority was delegated, other than initially approving sole source and emergency procurements, DGS was not involved in agencies procuring Deloitte services unless requested by the agencies. Based on our interviews and reviews of OA-OIT documentation, we note serious deficiencies related to OA-OIT's IT procurement review procedures. Furthermore, we note that key OA-OIT management, responsible for the approval of IT procurements and contract changes during the audit period, had the appearance of, or the potential for, conflicts of interest with regard to Deloitte.

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We recommend that DGS ensure that Commonwealth agencies have standard operating procedures for IT procurement and that it review these procedures to ensure effectiveness and compliance with law and policy. DGS should also monitor the results and scoring of agencies' proposal evaluation committees. It should also review OA-OIT procedures relating to IT contract procurements and monitor the results to ensure an independent and unbiased environment. Employees with the potential for, or the appearance of, conflicts of interest should be excluded from evaluation committees. We include several recommendations to ensure that OA-OIT operates more effectively. In addition, DGS should audit agencies' IT contracting processes and expenditures on a regular basis and immediately investigate allegations of improprieties related to the awarding of contracts.

**Finding No. 6** - We note that the organizational structure currently in place fails to provide a centralized organizational structure, as well as independent oversight and monitoring of procurement activities, including potential conflict of interests concerns. The current structure allows agencies to operate without the presence of mutual efforts of coordination and/or quality control.

We recommend that DGS ensure that ethical standards are developed that require state employees who procure goods and services on behalf of the Commonwealth, including those who participate in proposal evaluation committees and/or approve contracts, to refrain from all direct or indirect relationships with any individual or enterprise that does business with the Commonwealth. DGS should also determine and develop certain educational, training, and/or experience requirements for individuals selected for proposal evaluation committees. In addition, it should develop policies for the review and approval of large procurements/contracts and certify that each agency's procurement process complies with law to ensure transparency. Furthermore, DGS should ensure that a database exists to enable state government to have full accountability of all contracts, change orders, and amendments.

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**BACKGROUND**

**Department of General Services** The Department of General Services (DGS) oversees the procurement of goods and services, manages non-highway capital projects, oversees the Commonwealth's minority- and women-owned business contracting program, and is responsible for numerous core operations of state government, including management of the vehicle fleet, Capital Police force, and state buildings and facilities. DGS also serves as the state's real estate agent and insurance broker and oversees the Commonwealth Media Services.

**Procurement Code** Act 57 of 1998, as amended, known as the Commonwealth Procurement Code, grants DGS the responsibility for formulation and promulgation of procurement policy governing the procurement, management, control, and disposal of supplies, services, and construction to be procured by Commonwealth agencies. DGS considers and decides on matters of policy within the provisions of the Procurement Code. DGS is charged with the responsibility to procure or supervise the procurement of all supplies, services, and construction needed by agencies under the control of the governor and those independent agencies for which DGS acts as the purchasing agency. Procurement authority may be delegated in writing by the Secretary of General Services. DGS may audit agency compliance with the Commonwealth Procurement Code and related regulations;<sup>1</sup> however, DGS management indicated that it has not historically conducted such audits. In addition, the Procurement Code grants the Department of the Auditor General the right to obtain all retained procurement records.<sup>2</sup>

**Procurement Handbook** As a result of the enactment of the Commonwealth Procurement Code, DGS published the *Procurement Handbook* (handbook) and continues to issue revisions. This handbook provides a standard reference to established policy, procedures, and guidelines for the procurement of supplies, services, and construction under the authority of the Commonwealth Procurement Code.

**Deloitte Contracts** Our special performance audit of DGS contract procurement focuses exclusively on contracts between Deloitte Consulting LLP (Deloitte) and Commonwealth agencies in effect during the four-year period of January 1, 2004 to December 31, 2007. Deloitte is an international consulting firm for business, operations, technology, and human resource planning. Commonwealth agencies contracted with Deloitte during this period for the procurement of information technology (IT) services, including the development of new systems, upgrade of existing systems, and maintenance and support for existing systems.

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<sup>1</sup> See 62 Pa. C.S. § 311.

<sup>2</sup> See 62 Pa. C.S. § 563.

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Fifteen Commonwealth agencies awarded \$592.1 million in contracts to Deloitte over this period. The contracts were awarded using various methods, including Request for Proposals (RFP) and Request for Quotes (RFQ) totaling \$474.4 million, sole source contracts totaling \$29.0 million, emergency contracts totaling \$88.0 million, and a grant totaling \$750,000. Expenditures related to these contracts for the same period totaled \$361.6 million (see Appendix B). In addition, Deloitte was provided Job Creation Tax Credits in September 2007 and September 2008 totaling \$1.5 million. For all contracts with Deloitte, DGS decentralized the process to procure the IT services by delegating procurement authority to the respective purchasing agencies. DGS management indicated that, once procurement authority is delegated to a Commonwealth agency, it is not necessary for DGS to monitor or oversee the IT procurement practices at the agencies, other than approving sole source and emergency procurements as required.

**RFP Process** The RFP process is a competitive sealed proposal method. Part III, Chapter 7 of the handbook details the step-by-step process that must be followed to procure services through the RFP process. Proposals are solicited through an RFP and the contract is awarded to the vendor whose proposal is determined to be the most advantageous to the purchasing agency. The purchasing agency's issuing office drafts the RFP; fixes the qualitative evaluation criteria and weights for evaluating proposals; selects members of an evaluation committee; conducts a pre-proposal conference; screens all proposals received to ensure that mandatory requirements are met and are responsive; collects technical, cost, and Disadvantaged Business Participation scores for each proposal and ranks proposals accordingly; solicits Best and Final Offers; prepares the recommendation for final selection; and conducts contract negotiations.

**Evaluation Committee** The evaluation committee evaluates the technical merit of responsive proposals using detailed scoring sheets provided by the issuing office. The handbook states:

The evaluation committee should be composed of a minimum of three (five or seven is recommended) Commonwealth employees who possess technical and managerial expertise in the appropriate field. As appropriate, individuals from other agencies of the Commonwealth may be given the opportunity to participate as voting or non-voting members on all committees. An agency is required to invite its comptroller to participate as a non-voting committee member. Once appointed to the committee, no committee member, whether voting or non-voting, may meet or discuss the RFP or related matters with offerors or other committee members except in formal, scheduled meetings of the committee or as the issuing office may direct and arrange.

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**RFQ Process** The RFQ process is similar to the RFP process with the exception that quotes are solicited from vendors who are pre-qualified by DGS to perform the IT services. The proposals received from the vendors are evaluated in a manner similar to the RFP process. Standard terms and conditions specified in the pre-qualification of vendor process cannot be changed by the purchasing agencies. The standard terms and conditions include maximum length of time and dollar amount of IT services. If a project is estimated to extend past the maximum length of time or dollar amount set in the standard terms and conditions, agencies are required to use the RFP process to procure the services instead of the RFQ process.

**Sole Source Procurements** The sole source process is utilized when services are to be procured directly from one supplier. In order to procure IT services using the sole source method, one or more of the following criteria must be satisfied: (1) Only a single supplier is capable of providing the services, (2) Supplier is the only known source – similar services are not available from another supplier, (3) Service must be provided by a supplier to ensure compatibility, (4) A federal or state statute or federal regulation exempts the services from the competitive procedure, (5) It is clearly not feasible to award the contract for services on a competitive basis, (6) The services involve the repair, modification, maintenance, or calibration of equipment and are to be performed by the manufacturer of the equipment or by the manufacturer's authorized dealer, provided that the contracting officer determines that bidding is not appropriate under the circumstances, or (7) The contract for services is in the best interest of the Commonwealth.

Agencies must complete and submit a Sole Source Justification Form to DGS. DGS reviews the sole source request and either approves or disapproves. DGS's review includes several levels of approval based on dollar amount. The request is first assigned to a sole source commodity specialist whose determination is sent to a commodity supervisor for review and approval. All sole source requests are also reviewed by DGS's sole source coordinator. Requests over \$100,000 are also reviewed by the Chief Procurement Officer and requests over \$500,000 are reviewed by the Deputy Secretary for Procurement.

**Emergency Procurements** Agencies may use emergency procurement procedures to procure services which are urgently needed and the procurement cannot be delayed by the use of formal competitive procures. Emergency procurements are only authorized when (1) There exists a threat to public health, welfare, or safety, or (2) Circumstances outside the control of the agency create an urgency of need which does not permit the delay involved in using more formal, competitive procedures.

Agencies must complete and submit an Emergency Procurement Approval Request Form to DGS. The DGS Director of Services of the Strategic Sourcing Division and the Operational Services Manager review the request and either approve or disapprove the emergency procurement. In addition, the request may be reviewed by upper management, including the Chief Procurement Officer and/or the Deputy Secretary of Procurement, for procurements of higher dollar levels.

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**Change Orders/Amendments** Changes to contracts are made with amendments and change orders. Amendments are issued for any change to the term, conditions, requirements, or costs of a contract. Amendments require the signatures of the contractor and the same Commonwealth officials as the original contract. Change orders are notices to contractors of a change which one or both parties have the option to change under the contract or purchase order. They can also be used as a notification of a correction. Changes orders may be used to modify quantity, price, services within the scope of the contract, or time performance within the scope of the contract if the contract gives the Commonwealth the right or option. Contract renewals or extensions can be effectuated through change orders if the contract gives the Commonwealth the option to renew or extend. Change orders must be signed by the purchasing agency contracting officer. Comptroller approval may be required if additional funds need to be encumbered.

**Types of Contracts** Two types of contracts were used by Commonwealth agencies to purchase services from Deloitte during the period January 1, 2004 to December 31, 2007. These two contract types are (1) firm, fixed-price contracts; and (2) time and materials contracts. Firm, fixed-price contracts provide a price for deliverables which is not subject to an adjustment due to costs experienced by the contractor in performance of the contract. This type of contract is suitable for use in procurements when reasonably definite work statements, specifications, and performance requirements are available and reasonable costs can be established at the outset. Time and materials contracts provide for the procurement of services on the basis of direct labor hours at specified fixed hourly rates. The time and materials contract is used where it is not possible at the time of placing the contract to estimate the extent or duration of work or to anticipate costs with any reasonable degree of confidence.

**Governor's Office of Administration – Office for Information Technology** In addition to DGS's procurement powers and duties, the current governance of IT procurements, established by the Governor in April 2004 through Executive Order 2004-8 and Information Technology Bulletin ITB-EPM003, requires the Governor's Office of Administration – Office for Information Technology (OA-OIT) to review and approve scopes of work greater than \$100,000 for pre-issuance approval for all agencies' IT contracts. In addition, OA-OIT must review and approve all IT project contract changes, including amendments, renewals, work orders, and change orders greater than \$100,000. Commonwealth agencies must submit IT procurements and contract changes greater than \$100,000 to the designated Community of Practices Office within OA-OIT for review and approval. OA-OIT has four Community of Practice Offices, including Environmental, Public Safety, Health and Human Services, and General Operations. OA-OIT's Chief Technology Officer and Deputy Chief Information Officer from the appropriate OA-OIT Community of Practice Office make the final decision on IT procurements.

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**BACKGROUND**

**Enterprise Information Technology Governance Board** Executive Order 2004-08 also created the Enterprise Information Technology Governance Board (Board) to “establish an Enterprise IT Governance Structure to oversee the investment and performance of information solutions across the Commonwealth’s agencies.” The members of the Board are composed of the Secretary of Administration, Secretary of the Budget, Secretary of General Services, Governor’s Chief of Staff, and Deputy Secretary for Information Technology/Office of Administration (who also serves as the Commonwealth’s Chief Information Officer).

**Office of the Budget** The Office of the Budget, through the respective agency comptrollers, encumbers sufficient funds for the payment of invoices. In addition, except for contracts under the dollar threshold established by DGS for small procurements and statewide requirements contracts for services, the respective agency’s comptroller reviews and approves all contracts for services for fiscal responsibility, budgetary appropriateness, and availability of funds. The purchasing agency’s comptroller may also serve as a nonvoting member of an Evaluation Committee for RFPs or RFQs.

**Legal Counsel** The purchasing agency’s counsel, the Governor’s Office of General Counsel, and/or the Office of the Attorney General review and approve contracts for form and legality.

**SAP Accounting System** The SAP accounting system is the Commonwealth’s primary computer system for accounting records. The SAP system has various modules, including the SAP Procurement Module and the Financial Module. Once contracts are awarded to procure IT services, the purchasing agencies choose whether to enter the contract data into the SAP Procurement Module. Purchasing agencies have stated that IT service contracts often are not entered into the SAP Procurement Module due to their size and/or complexity. When contracts are entered into the SAP Procurement Module, the purchasing agency prepares a purchase order. A goods receipt is entered into SAP when the services are received. After the invoice is received and entered into the SAP Financial Module for payment, SAP performs an automated three-way match ensuring that the purchase order, goods receipt, and invoice all match before payment is made.

If the contract is not entered into the SAP Procurement Module, no purchase order is prepared. Instead, a funds commitment is entered into the SAP Financial Module to encumber the funds for the respective contract in order to make payments against the contract. No detail data for the contract is maintained in SAP. When services are received, no goods receipt is entered. When the invoices are received, direct payments are made to the vendor without SAP performing a three-way match. The invoices are reviewed manually by the respective purchasing agency and/or comptroller’s office to ensure the services were received and the amount agrees to the contract price. Therefore, when contracts are not entered into the SAP Procurement Module, the accounting system’s design to maximize automated controls and the control environment is not being utilized. In addition, DGS has no accountability of contracts which are not entered in to the SAP Procurement Module.



***DEPARTMENT OF GENERAL SERVICES  
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***BACKGROUND***

**The Auditor General's Decision to Audit DGS Procurement, Focusing Exclusively on Contracts Between Deloitte and Commonwealth Agencies** Allegations of potential impropriety, including conflicts of interest, regarding Deloitte contracts with Commonwealth agencies have been reported both in newspapers and by multiple individuals who contacted the Department of the Auditor General directly. Many of the allegations were consistent in nature, thereby giving more credence to what was alleged. These allegations, among other concerns, including the large dollar amount of contracts and payments made to a single contractor, led to the Department of the Auditor General's decision to conduct this special performance audit.

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**AUDIT OBJECTIVES, SCOPE, AND METHODOLOGY**

**Objectives**

The objectives of this special performance audit were to determine whether:

- Contracts were awarded in compliance with Commonwealth procurement law (see Findings No. 1, No. 2, No. 3, No. 5, and No. 6);
- Sole source and emergency contract payments were warranted and justification was adequately documented (see Finding No. 3); and
- Contracts were appropriately managed and monitored to ensure that the Commonwealth received goods and/or services of expected quantity, and price (see Findings No. 1 through No. 6).

**Scope**

Our audit covered DGS's duties and responsibilities with regard to contract procurement for the period July 1, 2000 through December 31, 2007. Specifically, our audit focused exclusively on contracts between Deloitte and Commonwealth agencies.

**Methodology**

The methodology in support of the audit objectives included:

- Reviewing appropriate laws, Executive Orders, Information Technology Bulletins, *Procurement Handbook*, related information from DGS's and Commonwealth agencies' websites, and newspaper articles;
- Interviewing and corresponding with DGS's and Commonwealth agencies' management and staff from procurement and information technology offices to assess controls and gain an understanding of policies and procedures used in procuring and managing contracts for information services;
- Sampling contracts, change orders/amendments, and expenditures for detail testing;
- Reviewing procurement documentation to verify whether contracts were awarded in compliance with Commonwealth procurement laws and policies;
- Reviewing sole source and emergency contracts and supporting documentation to verify whether the use of sole source or emergency procurements was justified and adequately documented;

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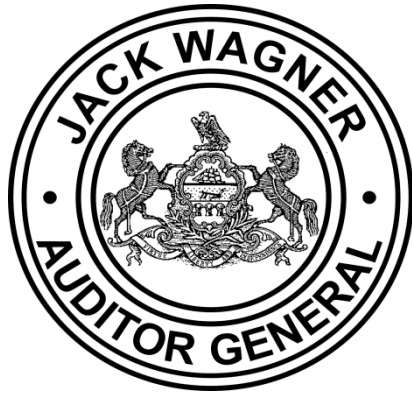
***AUDIT OBJECTIVES, SCOPE, AND METHODOLOGY***

- Reviewing contract change orders/amendments (change orders) to verify whether the change orders were justified, reasonable, and properly approved;
- Reviewing expenditure invoices and supporting documentation to verify whether invoices were properly reviewed and approved prior to making payment; and
- Performing data analysis of the expenditure data file, including analyzing the categories of expenditures and whether the expenditures were subject to SAP's three-way match controls.

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***FINDINGS AND RECOMMENDATIONS***

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**FINDINGS AND RECOMMENDATIONS**

***Finding No. 1 – Although Public Pressure From the Appearance of a Lack of Transparency Led Various State Agencies to Provide all Deloitte Contract Documentation to the Auditors, Review of the Provided Documentation Disclosed Deficiencies and Control Weaknesses***

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**Condition:** As part of our objective to determine whether Deloitte contracts were awarded in compliance with procurement law, we requested that 15 Commonwealth agencies provide us with award documentation related to all Deloitte contracts in effect during the four-year period of January 1, 2004 to December 31, 2007. Additionally, we requested interviews with key management from various Commonwealth agencies. However, up until February 2009 (nine months after the audit began and after the draft report was sent to DGS), the Commonwealth prevented us from concluding on a number of objectives because:

- we were denied access to award-related (e.g., listings of evaluation committee members and detailed scoring sheets) and other documentation; and
- our requests to schedule certain interviews were refused, including with key management at the Office of Administration-Office of Information Technology (OA-OIT), who review and approve scopes of work greater than \$100,000 for pre-issuance approval for all agencies' information technology (IT) contracts (see Finding No. 5 for more details), and management at the Department of Community and Economic Development (DCED), with regard to a \$750,000 grant awarded to Deloitte for furniture, machinery, and equipment in exchange for hiring additional employees (see Finding No. 4 for more details).

More importantly, this lack of cooperation gave the perception of secrecy through a lack of transparency. This lack of transparency created the potential for improprieties within the awarding of Commonwealth contracts, including the potential for vendor favoritism, especially because, both prior to and during our audit, allegations of potential impropriety, including conflicts of interest, regarding Deloitte contracts with Commonwealth agencies have been reported in newspapers and by several individuals who contacted the Department of the Auditor General.

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**FINDINGS AND RECOMMENDATIONS**

***Finding No. 1***

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After media reports regarding the results of our draft report criticizing the Commonwealth on a lack of transparency, the Department of General Services was instructed to release additional documents to us. As a result, in March 2009, we again requested contract documentation related to Deloitte Request for Proposals (RFP)/ Request for Quotes (RFQ) contracts and related documents from various agencies. Additionally, the Commonwealth informed us that we were permitted to interview management from OA-OIT, DCED, and others in order to complete our audit objectives. Our conclusions are reflected in the revised findings in this report, including our conclusion in Finding No. 5 that, although our review did not reveal that OA-OIT violated any laws regarding conflicts of interest with respect to Deloitte contracts, OA-OIT did have the appearance of having conflicts of interest.

Based on the contract documentation provided since March 2009, we found the following deficiencies that continued to support weaknesses in Commonwealth procurement.

Of the 58 Deloitte RFP/RFQ contracts in effect during the period January 1, 2004 through December 31, 2007, totaling \$474 million, we were only provided complete documentation necessary to audit 25 contracts totaling \$173 million (see Finding No. 3 for the results of our testing). Of the remaining 33 contracts, we were unable to audit them because of one or more of the following documents were not provided:

- Original detailed scoring sheets signed by the evaluators;
- RFPs/RFQs, including portions of RFPs/RFQs;
- Purchase order/contract;
- Statements of work;
- Deloitte proposal; and/or
- Losing vendor proposals.

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**FINDINGS AND RECOMMENDATIONS**

***Finding No. 1***

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Using the three-year retention requirement established by the Commonwealth Procurement Code, documentation for at least 19 of the 33 contracts should have been available to the auditors. Additionally, because not all of these contract documents had been subject to audit in the past, it would be reasonable for the Commonwealth to retain the documents related to all 33 contracts until an audit was completed. Six agencies admitted that they had discarded the contract documentation for eight of the 19 contracts within the three-year retention requirement, including the Department of Education, which indicated that the original detailed scoring sheets and losing vendor proposals for one contract were discarded at the end of 2008 (subsequent to the start of the audit period). Also, the Office of Administration stated that it discarded documentation for one Deloitte contract, no longer required to be retained, during the audit. For the remaining Deloitte contracts, the agencies either acknowledged that the documents could not be located or the documents were not provided. These discrepancies violate the law and precluded these contracts from being audited.

***Criteria:*** Good internal controls require management to maintain sufficient documentation to demonstrate that proper purchasing procedures are reasonably followed and contracts are properly awarded. Adherence to good internal controls is reaffirmed by the Commonwealth Procurement Code, which states:

Retention of Procurement Records. All procurement records, including any written determinations issued in accordance with section 561 (relating to finality of determinations), shall be retained for a minimum of three years from the date of final payment under the contract and disposed of in accordance with records retention guidelines and schedules as provided by law. In accordance with applicable law, all retained documents shall be made available to the...Auditor General...upon request.<sup>3</sup>

According to Manual M210.9 Amended, the *General Administrative Records Retention and Disposition Schedule* (General Administrative Schedule), effective February 27, 2008:

Specific circumstances may require a record to be retained for a period beyond that as indicated in the General Administrative Schedule. For example, records subject to audit must be retained for the periods listed in the schedule. Once an audit begins, relevant records may not be destroyed until the final report of audit is issued and/or the audit is otherwise concluded.

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<sup>3</sup> 62 Pa.C.S. § 563.



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***Finding No. 1***

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**Cause:** DGS management stated, “In many cases the information will not be available as the Commonwealth’s retention schedule is three years for RFP documentation and six months for losing proposals. Of course, all requested documents that are still available will be shared with the auditors.” We disagree with DGS’s position that losing proposals should only be retained for six months. Although the General Administrative Schedule states six months, it also states that circumstances may require records to be retained longer and includes subject to audit as the example. As DGS is aware, the Department of the Auditor General has attempted for several years to obtain the same type of procurement documents for audit, but has continually been denied. DGS believes that this procurement documentation is not public information. It contends, “The purpose of this policy is to ensure that evaluation committee members can perform their duties without any undue scrutiny, pressure or challenge from outside entities.” We disagree. All government activities should be open to ensure integrity, objectivity, and accountability, especially to those in charge of examining the books and records of the Commonwealth. Our entitlement to documents and information is not limited to what may be available to the general public.

**Effect:** Without receiving all procurement documentation, we could not verify that agencies adhered to Commonwealth procurement law or exercised due diligence in awarding 33 Deloitte contracts through the RFP and RFQ methods totaling \$301 million. Furthermore, we could not verify that steps were completed adequately and without bias related to the appointment of proposal evaluation committee members and evaluation of the vendor proposals. A lack of transparency by government when government is spending public funds translates into an increased risk of impropriety and reduces citizens’ confidence in government.

**Recommendations:**

1. We recommend that Commonwealth agencies retain procurement documentation, including losing proposals and detailed scoring sheets, until the information has been subject to audit as stated in the Commonwealth Procurement Code and the General Administrative Schedule.
2. As part of all audits, we recommend that DGS and other Commonwealth agencies provide all procurement records to the Department of the Auditor General upon request, including, but not limited to, the names of the proposal evaluation committee members, copies of losing proposals, and detailed scoring sheets by each member of the proposal evaluation committee.

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**FINDINGS AND RECOMMENDATIONS**

**Finding No. 2 – Agencies Relied Too Heavily on Deloitte Due to a Lack of IT Expertise and a Reluctance to Train Information Technology Staff on Newly Developed Systems**

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**Condition:** As part of our test work, we analyzed the type of expenditures paid to Deloitte. Based on data and our review of certain contracts, of the \$361.6 million paid to Deloitte during the four-year period ended December 31, 2007, we noted that \$214.7 million (59 percent) was directly paid as personnel costs; \$139.1 million, categorized as miscellaneous, encompassed mainly fixed-price deliverables such as progress or status reports, which was also labor intensive; \$3.6 million was paid for facilities costs; and \$4.2 million was paid for user and IT staff training (see Appendix A). These expenditures related to Deloitte contracts totaling \$592.1 million, consisting of RFP/RFQ contracts totaling \$474.4 million, sole source contracts totaling \$29.0 million, emergency contracts totaling \$88.0 million, and a grant totaling \$750,000 (see Appendix B). In addition, Deloitte was provided Job Creation Tax Credits in September 2007 and September 2008, totaling \$1.5 million. Based on our analysis, we conducted interviews with four agencies: Department of Public Welfare (DPW), Department of Labor and Industry (L&I), Department of Transportation (PennDOT), and Department of Health (DOH) and found that agencies lack adequate information technology (IT) expertise, resulting in agencies needing to continue to contract for IT services with vendors. The following describes our results:

**Lack of sufficient IT expertise to develop, maintain, and monitor systems**

Based on our interviews with DPW, DOH, L&I, and PennDOT, we found that agencies gave some consideration as to whether certain IT projects could have been accomplished in-house with current staff and current expertise; however, no documented detailed analysis was performed, including projecting the resources required to complete the project. Overall management at these agencies indicated that they lack the expertise to not only develop IT projects in-house, but also to maintain and monitor the systems once developed. As a result, agencies contract with vendors to develop IT projects and have to continually contract with vendors to maintain these systems, such as Deloitte.

In addition to lacking expertise to develop and maintain systems, we noted that L&I also contracted with a third-party vendor to manage and monitor a Deloitte contract related to the development of a new IT system. L&I management stated that the third-party contract was necessary due to L&I lacking the necessary expertise to manage and monitor the Deloitte contract.

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**FINDINGS AND RECOMMENDATIONS**

***Finding No. 2***

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**Lack of knowledge transfer to maintain systems**

Many Deloitte contracts contain a “knowledge transfer” provision, whereby the contractor agrees to provide Commonwealth IT staff with the skills and expertise, through training and mentorship, necessary for them to maintain or upgrade the system in-house after the contract ends. However, according to interviews with DPW, DOH, L&I, and PennDOT, we found that IT knowledge is not being transferred in most instances due to insufficient IT staff and agencies contracting with Deloitte to perform the system maintenance. Therefore, rather than allowing agency IT employees to be trained on new systems to allow for in-house maintenance and upgrade capability, these agencies continue to contract with Deloitte to maintain and upgrade the systems.

**Criteria:** Good business practices dictate that a detailed analysis should be documented when contemplating whether a project should be undertaken in-house or contracted to a vendor. Consideration should be given as to current and future costs, staffing, in-house capability, and time constraints. Also, prudent business operations would include maximizing existing staff potential and resources prior to contracting services to a vendor.

**Cause:** Within DPW, management stated that utilizing outside vendors to perform IT services is not due to a lack of staff, even though DPW’s Bureau of Information Systems currently has approximately 50 vacancies with a complement of approximately 360; rather, it is mostly due to existing IT staff not having the appropriate skills for the project. Additionally, management indicated that current IT staff is proficient with DPW’s older systems, and believes that it would be difficult for the current IT staff to learn and be trained on the newer systems or technology. Furthermore, DPW management stated that some staff have no desire to learn newer systems, while others do not have the capability of understanding certain IT topics regardless of how much training is provided to them. With regard to transfer of IT knowledge to the Commonwealth, DPW management indicated that, in general, Deloitte is contracted to maintain the newer systems it has developed. When Deloitte is contracted to maintain these systems, knowledge is not transferred to DPW’s IT staff. DPW management indicated that it has only transferred knowledge in order for DPW IT staff to maintain two applications in its newer systems, the Master Provider Index (MPI) and the Home and Community Services Information Systems (HCSIS) incident management application. We disagree with DPW’s reasoning. DPW’s IT staff should be provided the training and mentorship for maintaining and upgrading the new systems being utilized by DPW. Utilizing existing staff may be more cost efficient than contracting out and will provide professional development that will benefit DPW, not only through cost savings, but also by increasing employees’ value to the department, thereby increasing job satisfaction, job security, and increased production. We noted that DPW only spent approximately \$25,000 on deliverables from Deloitte related to IT training during the period January 1, 2004 to December 31, 2007.

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**FINDINGS AND RECOMMENDATIONS**

***Finding No. 2***

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Within DOH, management stated that there are no formal meetings held or any documentation to support the decision-making process for determining whether to utilize agency staff or contract to a vendor. With regard to transfer of IT knowledge to the Commonwealth, DOH management stated that, because current contracts require Deloitte to maintain its systems, DOH does not exercise the “knowledge transfer” provision. We disagree with management’s logic. DOH’s unwillingness to allow the knowledge transfer will force the Commonwealth to continue to execute future Deloitte contracts for maintaining systems, because the Commonwealth will not gain the knowledge to maintain systems itself. DOH did spend approximately \$1.2 million on training from Deloitte; however, this training was for the users of the system and not for training DOH’s IT staff.

Within L&I, management stated that it does not have sufficient staff to perform its IT services. Additionally, L&I acknowledged that, due to a lack of expertise, it has needed to contract with a third-party vendor in order to monitor its largest contract with Deloitte to ensure that L&I’s goals and deliverables are met. This reasoning is disturbing because L&I would have created the project work statement as part of its evaluation and contracting process. Management also stated that, even though it has requested more IT employees for several years, the complement for IT employees has not increased since 2000. With respect to transfer of IT knowledge to the Commonwealth, L&I management stated that it allows the knowledge transfer to occur with its employees. L&I has spent more than \$2.3 million on IT training from Deloitte; however, it does not have enough staff to maintain its systems and, as a result, L&I must contract with Deloitte to perform continuous maintenance.

Within PennDOT, management stated that it would not be practical or reasonable to consider hiring enough staff with the necessary expertise to develop a large system or perform a major upgrade to a current system. Management believes that, once a system or upgrade is completed, the additional IT staff would no longer be needed. However, no detailed analysis was provided by PennDOT projecting resources required to complete the project in-house. Furthermore, a list of IT job position vacancies provided by PennDOT showed 60 current vacancies. With regard to transfer of IT knowledge, management indicated that, for the current contract with Deloitte, PennDOT is allowing the knowledge transfer to occur. The contract is planned to be completed in February 2009. PennDOT management stated that it planned to perform in-house maintenance of the system; however, if major system changes or foundational modifications are needed, PennDOT may contract out for these services.

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**Effect:** Failing to perform a comprehensive cost analysis as to whether a project should be performed in-house or by a contractor may result in the Commonwealth spending an excessive amount for the services provided. In addition, failing to allow the “knowledge transfer” that is already included in most Deloitte contracts not only fails to take advantage of the training opportunities, but also does not allow professional growth of Commonwealth agencies’ IT staff and could ultimately force IT staff out of jobs if existing systems become obsolete and are replaced. Additionally, significant cost savings may be achieved by utilizing in-house IT staff rather than contracting for these services, including needing to contract with a third-party vendor to monitor a contractor. Finally, failing to have adequate IT expertise in state government could also preclude agencies from negotiating the best contracts and indirectly may result in Commonwealth agencies being held hostage by contractors.

**Recommendations:** Given that DGS is legally responsible for the procurement of goods and services for the Commonwealth, we recommend that DGS take the lead to:

3. Ensure that agencies perform a detailed analysis as to whether a project should be completed in-house or whether the project should be completed by a contractor. This analysis would include determining the resources needed for the Commonwealth to perform the project in-house, including the hiring of expert IT staff;
4. Require agencies to include adequate knowledge transfer provisions in all IT contracts;
5. Require agencies to receive the appropriate amount of knowledge transfer and to maximize the use of in-house IT staff to perform maintenance and upgrades on systems to reduce the need for maintenance contracts with Deloitte; and
6. Use its leverage as the lead procurement entity to push the administration to consider increasing the IT staff complement, if determined necessary for certain agencies.

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**FINDINGS AND RECOMMENDATIONS**

***Finding No. 3 – RFP/RFQ Process Needs to be Improved and Sole Source, Emergency, and Change Order Procurements Lacked Adequate Justification and Approvals***

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**Condition:** Although the Department of General Services (DGS) acts as the purchasing agency for procuring most services for Commonwealth agencies, DGS management stated that it has largely decentralized the procurement of information technology (IT) services by delegating procurement authority to respective Commonwealth agencies, including all contracts awarded to Deloitte that were in effect during the period January 1, 2004 to December 31, 2007. Based on data provided by the Office of the Budget, we noted that 15 different Commonwealth agencies executed 84 contracts with Deloitte totaling \$592.1 million by using one of four methods: Request for Proposal (RFP), Request for Quote (RFQ), Sole Source, Emergency, or Grant award. See Appendix B for contract summary by agency.

Generally, DGS procurement policy, contained in the *Procurement Handbook* (handbook), requires that most services should be procured through a competitive sealed bidding method, which includes evaluation committees and a scoring process, such as the RFP or RFQ. However, there are special circumstances where “bidding” is not an option, such as when only one vendor can perform the services, known as sole source procurement, or when time is of the essence and bidding would take too long, known as emergency procurement. These procurements do not involve evaluation committees or a scoring process. For each method of procurement, the handbook requires specific procedures to be followed by the purchasing agency, comptroller’s office, and DGS. Additionally, policies exist for issuing change orders/amendments to contracts.

As part of our audit, we requested and reviewed Deloitte sole source procurements, emergency procurements, and contract change orders/amendments from the three agencies which procured the highest total dollar amounts of Deloitte services: Department of Public Welfare (DPW), Department of Labor & Industry (L&I), and Department of Health (DOH).

Additionally, we requested the procurement documentation for the 58 RFP/RFQ contracts totaling \$474 million dollars from agencies. We received all of the key procurement documents for 25 of these contracts totaling \$173 million. We were unable to adequately review the other 33 contracts totaling \$301 million because agencies did not provide all of the key procurement documents (see Finding No. 1). We reviewed contracts and change orders for compliance with the handbook, including proper justifications and approvals. Based on our interviews with agency management and review of procurement documentation, we found the following weaknesses:

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***Finding No. 3***

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**Weaknesses in the RFP/RFQ Process**

Of the 25 RFP/RFQ contracts in which we received all key procurement documentation, we reviewed the six largest contracts totaling \$168 million (97%), including one Pennsylvania Liquor Control Board (PLCB) RFP contract, two DPW RFP contracts and three DPW RFQ contracts. Based on the results of our testing, we noted the following weaknesses:

- DPW and PLCB had no formal methodology for selecting the evaluation committee members, including documenting each member's qualifications.
- The technical detailed scoring sheets were obtained by DPW and PLCB for the three RFP contracts reviewed. We found these scoring sheets were inadequate in documenting pertinent scoring information. For instance, 67 of the 69 scoring sheets provided were all missing signatures of the evaluators. The other two scoring sheets were not retained by PLCB. Additionally, on a DPW RFP contract, three of the five evaluators did not document their final scores after the best and final offer from vendors. Furthermore, we found that, for all three RFPs, the evaluators were not consistently documenting justifications for both their original scores and score adjustments.
- DPW and PLCB evaluation committee meetings were not formally documented within the procurement file.
- DPW and PLCB did not have written policies and procedures for the RFP review and approval process. Additionally, the RFP approvals were not formally documented within the procurement file.
- PLCB management chose not to conduct a pre-proposal conference for their ERP contract.
- For the three RFQ contracts, DPW management was unable to provide documentation to determine if a pre-proposal conference was conducted, if vendors were provided at least 30 days to submit their proposals, and if disadvantaged business evaluations were performed.

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**FINDINGS AND RECOMMENDATIONS**

***Finding No. 3***

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**Inadequate justification for sole source procurements**

We reviewed six sole source contracts executed by DPW, L&I, and DOH, totaling \$28.7 million. The Commonwealth Procurement Code and the handbook specify the criteria which must be satisfied in order to procure services from one vendor. The six contracts we reviewed included four reasons for using the sole source procurement method as follows: 1) only a single contractor is capable of providing the services, 2) similar services cannot be obtained from another contractor, 3) the services must be provided by the contractor to ensure compatibility, and 4) the contract for services is in the best interest of the Commonwealth. As a result of our test work, we noted that the sole source justifications for all six awards were inadequate.

Each justification was based on the reason that only a single contractor is capable of providing the services. However, for five contracts, totaling approximately \$15.2 million, the respective agencies failed to include within their justification information as to whether they considered if any other vendors could perform the work. For the sixth contract, the agency acknowledged that other vendors had performed this type of work in the past, but provided the justification that Deloitte's customer service was exceptional. Additionally, for all six contracts, the agencies failed to include adequate information to support that services must be provided by Deloitte to ensure system compatibility. Therefore, we do not believe that the justifications outweighed the possible benefits of the competitive bidding process; these sole source contracts may not have been in the best interest of the Commonwealth and should have been awarded on a competitive basis.

**Inadequate and unreasonable justification for emergency procurements**

We reviewed 16 emergency contracts executed by DPW and DOH totaling \$87.2 million. According to the Commonwealth Procurement Code and the handbook, the two conditions for using the emergency procurement method include: 1) the existence of a threat to public safety, health, or welfare, or 2) there are circumstances outside the control of the agency which create an urgency of need which does not permit the delay involved in using more formal, competitive methods. As a result of our test work, we noted that the justifications for these emergency procurements were inadequate or unreasonable. The following summarizes our exceptions:



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***Finding No. 3***

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- According to DOH and DPW, they executed 13 emergency contracts (12 were DPW's) because they were bridging a gap between an old Deloitte contract and preparing for a new contract. Reasons why the new contracts were not executed timely included lengthy negotiations, delay in the signature approval process, delay in obtaining funding, or the work of the previous contract was not finished. Based on our review of these DPW emergency contracts, we also noted that several of these contracts were for the same projects and for consecutive periods. For example, DPW executed three consecutive three-month emergency contracts for Deloitte's services on one of its systems. Overall, 10 of these DPW emergency contracts were for four projects – two projects had three consecutive emergency contracts executed and two projects had two consecutive emergency contracts executed. While these circumstances may have created an urgency of need, with better planning and foresight, these emergency contracts could have been avoided.
- According to DOH, one emergency contract was executed in 2005 because it had not yet become compliant with federal regulations regarding a computer system. However, DOH had been non-compliant since 2003 and, for a period of time, there was no DOH employee dedicated to this project. Because DOH was non-compliant with federal regulations for approximately two years, this justification for an emergency contract does not seem reasonable and should not have been approved. Instead, a competitive award should have been considered.
- DPW stated that one emergency contract was executed because there were problems with the data conversion/integration of a system that was implemented in August 2004. Although DPW claimed to have several automation problems with this system since implementation, no corrective action was taken until July 2005, when an emergency contract was initiated. This justification for an emergency contract does not seem reasonable and should not have been approved. Rather, a competitive award should have been considered.
- DPW indicated that one emergency contract was executed in order to retain one Deloitte employee for one month. DPW's chief information officer (CIO) stated that she wanted to keep Deloitte engaged as long as possible, even though state employees had taken over the work and the previous Deloitte contract was completed. This justification for an emergency contract does not seem reasonable and should not have been approved.

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**Lack of change order justification and proper approvals**

In addition to obtaining a list of sole source and emergency awards, we also requested a list of change orders/amendments (change orders) related to Deloitte contracts from 15 agencies identified by OB as having Deloitte contracts. Using that list, we reviewed change orders from the three sampled departments: DPW, DOH, and L&I. We found that 19 contracts totaling \$210.2 million had change orders issued after the contracts were originally awarded. In all, a total of 84 change orders added \$120.3 million (57 percent) to the value of the original contracts as noted in the below table:

Table 1 – Change Orders from January 1, 2004 to December 31, 2007 for Selected Agencies

Commonwealth Agency	Number of Contracts	Dollar Amount of Contracts	Number of Change Orders	Dollar Amount of Change Orders	Total Adjusted Contract Amount
Department of Public Welfare	15	\$131,733,885	52	\$100,592,495	\$225,623,472
			20	(6,702,908)	
Department of Labor & Industry	3	69,512,894	10	22,234,840	91,747,734
Department of Health	1	8,946,866	2	4,156,428	13,103,294
<b>Total</b>	<b>19</b>	<b>\$210,193,645</b>	<b>84</b>	<b>\$120,280,855</b>	<b>\$330,474,500</b>

We consider 84 change orders, as noted in Table 1, to be excessive. Change orders for three of DPW's contracts resulted in more than doubling the value of the original contracts. For example, one contract totaling approximately \$23.0 million had 34 change orders, adding \$72.6 million to the original contract.

Of the 84 change orders identified above, we selected the 18 change orders, totaling approximately \$118.3 million, that each increased the contract value by more than \$1 million, and reviewed them to determine whether they were in compliance with procurement policy. Our testing found the following:

- The two DOH change orders lacked approval by the Office of Administration-Office of Information Technology (OA-OIT);
- Of the six L&I change orders, two lacked approval by the OA-OIT and adequate justification; and

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- Of the 10 DPW change orders, five had deficiencies, including the lack of various approvals (all five change orders), lack of justification (three of the five change orders), and the fact that they were issued after the contract expired (one of the five change orders).

**Criteria:** The purpose of the proposal evaluation committee is to systematically select and recommend a vendor that will best achieve the intended need at the lowest price. According to the *Procurement Handbook*, Part 1, Chapter 6, Section B.3.a., “the evaluation committee should be composed of a minimum of three (five or seven is recommended) Commonwealth employees who possess technical and managerial expertise in the appropriate field. As appropriate, individuals from other agencies of the Commonwealth may be given the opportunity to participate as voting or non-voting members on all committees. An agency is required to invite its comptroller to participate as a non-voting member. Once appointed to the committee, no committee member, whether voting or non-voting, may meet or discuss the RFP or related matters with offerors or other committee members except in formal, scheduled meetings of the committee or as the issuing office may direct and arrange.”

The technical detailed scoring sheets serve as an integral part of the basis for vendor selection within the procurement process. These sheets need to be complete and all scores and score changes need to be documented. The evaluators need to sign the sheets to attest that the scores are accurate and unbiased. Additionally, all meetings involving significant discussions and decision making should be documented and retained to maintain complete and accurate procurement files.

Furthermore, agency management must ensure that adequate controls, including a multi-level RFP review and approval process, are in place to ensure the quality and accuracy of the RFP before being issued to the public.

According to the *Procurement Handbook*, Part 1, Chapter 6, Section B.7.a., choosing to conduct a pre-proposal conference provides the issuing office the opportunity to “explain the background of the RFP to offerors who intend to submit a proposal; emphasize portions of the RFP considered especially important; answer any written questions previously submitted by the potential offerors; and provide potential offerors with an opportunity to ask additional questions, in writing, on forms provided during the pre-proposal conference.”

According to the *Procurement Handbook*, Part 1, Chapter 6, Section B.5., “the Issuing Office must provide potential offerors with sufficient time to prepare their proposals. Normally, no fewer than 30 calendar days should be allowed for submission of proposals.”

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According to the DGS Special Assistant to the Deputy Secretary for Administration IT RFQs over \$250,000 require a Disadvantaged Business evaluation to be performed by the Bureau of Minority and Women Business Opportunities (BMWBO) within DGS. According to the *Procurement Handbook*, Part 1, Chapter 6, Section B.8.g., BMWBO “will supply the Disadvantaged Business and Enterprise Zone Small Business (EZSB) scores to the issuing office upon completion of BMWBO’s review and evaluation of the Disadvantaged Business Participation submittals.”

With regard to sole source procurements, the *Procurement Handbook*, Part 1 Chapter 6 Section E.2.f., states that “the contractor’s prior association with the agency is not in itself acceptable justification for a sole source award. Terms and phrases such as ‘unique experience,’ ‘uniquely qualified,’ ‘only qualified contractor,’ and similar unsupported and meaningless statements will not be acceptable justification.”

With regard to emergency procurements, the *Procurement Handbook*, Part 3 Chapter 6 Section A.2., states:

Emergency procurements are only authorized when:

- a. There exists a threat to public health, welfare, or safety.
- b. Circumstances outside the control of the agency create an urgency of need which does not permit the delay involved in using more formal, competitive procedures.

The DGS Deputy Secretary for Procurement stated that, when DGS evaluates the emergency justification, the request will be denied if there is no threat to public safety. He stated that poor planning is not acceptable justification for an emergency contract.

Additionally, the current governance of IT procurements, established by the Governor in April 2004 through Executive Order 2004-8 and Information Technology Bulletin ITB-EPM003, requires OA-OIT to review and approve scopes of work greater than \$100,000 for pre-issuance approval for all agencies’ IT contracts. In addition, OA-OIT must review and approve all IT project contract changes, including amendments, renewals, work orders, and change orders greater than \$100,000.

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Furthermore, the *Procurement Handbook*, Part 1 Chapter 32 Section B.9., states, “Change orders must be signed by the purchasing agency contracting officer....Comptroller approval may be required if additional funds need to be encumbered.” Also, Part 1 Chapter 32 Section B.11. states, “Any change orders issued to renew a contract must be signed and issued prior to the expiration of the contract.”

**Cause:** Based on interviews, DPW management explained that the evaluation committees are selected by management and approved by DPW’s legal office, comptroller, and DPW executive management. The decision is mainly based on the knowledge and expertise of the members; however, management also considers the diversity of members and at times tries to include individuals from other state agencies to incorporate a different perspective. Likewise, PLCB management stated the evaluation committee members were subject matter experts, representing the different areas of expertise related to the contract. However, DPW and PLCB management stated they do not have a written methodology for selecting evaluation committee members and the justification for choosing each member is not formally documented within the procurement file.

With regard to the inadequately documented scoring sheets, no written instructions were provided to the PLCB evaluation committee members on how to complete the technical detailed scoring sheets. PLCB management stated that the evaluation committee members were provided verbal instructions on how to complete the technical scoring sheets; however, no written instructions were provided to the members. We were unable to verify the extent of the verbal instructions provided. DPW provided detailed written instructions to the evaluation committee members including the need to document their comments for each score and all justifications for score changes. However, the written instructions provided did not require the evaluators to sign the scoring sheets. According to DPW management, the reason why all of the best and final offer scores were not documented on the scoring sheets was due to the fact that the scores were read aloud and recorded into a summary spreadsheet during a meeting; however, these scores were not recorded on the evaluators’ detail score sheets with explanation or justification for the change in their score.

With regard to documentation of evaluation committee meetings, both DPW and PLCB management stated that the individuals attending the evaluation committee meetings take informal notes; however, no formal minutes are documented.

With regard to the RFP review and approval not being documented, PLCB management stated that the approvals were in e-mail format, but were not retained within the procurement file. Similarly, DPW management stated the RFP approvals were obtained through emails or phone calls, but were not retained within the procurement file.

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With regard to a lack of a pre-proposal conference, PLCB management stated that, prior to issuing the RFP for this contract, vendors, including those who subsequently submitted proposals, had conducted demonstrations for the PLCB on the functionality of the ERP system and, therefore, the pre-proposal conference was not necessary. However, this decision was not formally documented within the procurement file.

Additionally, DPW management stated that they provided all of the contract documentation contained in DPW's procurement files to us, and that the documentation regarding the pre-proposal conference and the minimum 30-day vendor response time period, as well as any disadvantaged business documents were not retained. DPW management stated that the disadvantaged business evaluation was not required for the RFQs in question. However, during an interview with DPW and DGS management, the DGS Deputy Secretary for Administration and Procurement told the auditors that the requirements would be according to documentation prepared for the auditors that states that the disadvantaged business evaluation is required and will be performed by BMWBO for RFQs over \$250,000. All three RFQs in question were greater than \$250,000, thus proper documentation should have been retained.

With regard to sole source procurements, agencies stated that they only document what is required on the DGS Sole Source Justification Forms; no other documentation or decision-making support is maintained. We disagree with a process that includes so little documentation and support. In order for sole source procurements to be justified, support must be adequate and well documented to ensure that the benefits of sole source outweigh the benefits of the competitive bidding process.

With respect to emergency procurements, despite DGS's policy that limits emergency procurements to two conditions, agencies were routinely using emergency procurements to bridge the gap between an old contract and a new contract when negotiations extended past the old contract's expiration date. In fact, DPW management stated that an emergency procurement is an excellent tool to extend negotiations as long as it results in getting a better price on the new contract. We disagree with the rationale that poor planning and/or the Commonwealth's desire to get a better price on a future contract justifies agencies' use of the emergency procurement method. Although DGS's Deputy Secretary for Procurement stated that requests for an emergency procurement by agencies using poor planning as justification are not approved, our test work found that DGS's Chief Procurement Officer and respective directors and managers are approving such emergency procurements.

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With regard to the change order process, DPW management indicated that most change orders are initiated during annual “scoping meetings” with Deloitte. DPW believes that new initiatives may require additional work that was not included in the original work statement, thus requiring a change order. Yet management also indicated that initiatives cannot be added to the original work statement of a contract until the funds become available. When funds become available, change orders are prepared. However, the sheer volume and dollar amount of change orders indicate that better upfront planning and work statement preparation are needed to reduce the number of change orders.

***Effect:*** The lack of documentation regarding why each evaluation committee member was selected, including their past experiences and expertise creates the potential for improprieties. Within the procurement file, no written evidence exists that the evaluation committee members possessed adequate technical and managerial expertise in the appropriate fields. In addition, without documented and consistent instructions to each of the evaluation committee members, there is no assurance that the evaluation committee members understood the scoring process and scored the proposals in a consistent and unbiased manner. Furthermore, without formal documentation, discussions and decisions at evaluation committee meetings cannot be evaluated for appropriateness by external parties.

Without ensuring the proper RFP review and approval controls are in place, the RFP could contain inadequate or inaccurate information that could be released to the public, resulting in vendors misunderstanding the needs of the agency. In turn, vendor proposals may not adequately address the agency’s needs or could include unnecessary costs.

The pre-proposal conference offers potential vendors additional information for the RFP/RFQ including background information and an emphasis on the important issues. It also provides an open forum for vendors to ask additional questions. Without this opportunity for vendors to come together and receive clarification of the RFP, the vendors could potentially misunderstand what is needed from the agency. Such misunderstandings could result in future conflicts or changes in the contract.

By not retaining information regarding the pre-proposal conference, establishing the minimum 30-day vendor response period, and disadvantaged business scoring, external parties are unable to verify if the procurements were in compliance with the appropriate laws and regulations.

The failure to award service contracts through a competitive bidding method, rather than through the sole source or emergency method, could result in the Commonwealth paying an excessive amount for a service and may not receive the best quality of service. In addition, failure to properly justify sole source contracts leads to less transparency of the contracting process.

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Furthermore, failing to properly plan future procurements has resulted in issuing an excessive number of change orders. During the period January 1, 2004 to December 31, 2007, three agencies added 84 change orders, totaling \$120.3 million, to 19 of Deloitte's contracts originally valued at \$210.2 million, for an adjusted total amounting to \$330.5 million. The routine decision of annually adding work to an existing contract, as opposed to competitively bidding the new work as part of a new contract, may cause the agency to pay an excessive amount for that service. Additionally, DPW's reasoning that new initiatives cannot be added to the original work statement of a contract until funds become available is disturbing. This process could lead to potential vendor favoritism by giving more work to Deloitte through the use of change orders that are not competitively bid or do not require sole source or emergency justification and DGS approval.

**Recommendations:** We recommend that DGS:

7. Ensure that agencies develop written policies and procedures to document a comprehensive RFP preparation, review, and approval methodology, including the approval of all reviewers of the RFP within the contract procurement file and to document a formal methodology for selecting evaluation committee members;
8. Ensure that agencies provide written instructions for completing the detailed scoring sheets to the evaluation committee members, including requirements such as signing the scoring sheets, writing comments, and documenting score adjustments;
9. Ensure that agencies formally document all evaluation committee meetings within the contract procurement file;
10. Ensure that agencies conduct a pre-proposal conference for every RFP/RFQ issued, or formally document the justification as to why a pre-proposal conference is not necessary;
11. Ensure that agencies retain key procurement documents within the procurement file for the appropriate retention period;
12. Ensure that agencies maintain detailed documentation to support justification of the use of the sole source procurement method beyond just noting on the form "due to previous experience with the contractor" or "due to a tight timeframe" as result of poor planning by the agency;



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13. Ensure that emergency procurements are necessary due to a threat to public health, welfare, or safety or due to circumstances outside the control of the agency, and the reason for the emergency is well documented. Habitual use of emergency contracts during the negotiation phase of new procurements due to poor planning should not be accepted as a justification;
14. Ensure that agencies maintain detailed documentation to support the justification of change orders;
15. Monitor change orders to contracts to ensure that they are justified and properly approved;
16. Ensure that agencies analyze and document the potential use of other vendors and not assume that Deloitte is the best vendor for the project without competitively bidding for the services; and
17. Ensure that agencies obtain the proper approvals on the appropriate procurement forms.

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***Finding No. 4 – Poor Accountability and Control Weaknesses found for IT Contracts and Expenditures***

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**Condition:** In order to determine the adequacy of the Commonwealth's managing and monitoring of Deloitte contracts, we conducted interviews with four of the 15 agencies that procured information technology (IT) services from Deloitte, including the Department of Public Welfare (DPW), the Department of Health (DOH), the Department of Labor and Industry (L&I), and the Pennsylvania Department of Transportation (PennDOT). We also conducted interviews with key personnel from the Department of General Services (DGS). In addition, we obtained and analyzed contract and expenditure data files from the Office of the Budget for all Deloitte expenditures and contracts effective during the period January 1, 2004 to December 31, 2007. We selected a sample of expenditure invoices from DPW, DOH, L&I, and PennDOT within four broad categories of personnel, facilities, training, and miscellaneous. We also reviewed one payment made to Deloitte related to a grant from the Opportunity Grant Program and reviewed the Job Creation Tax Credits provided to Deloitte by the Department of Community and Economic Development (DCED).

Our review of the controls over the Commonwealth IT services expenditures authorized by contracts with Deloitte found concerns, including poor accountability of contracts totaling \$592.1 million, control weaknesses in approving expenditures totaling \$203.7 million, potential overbilling of facility costs totaling \$3.6 million, and a questionable DCED grant totaling \$750,000 and tax credits totaling \$1.5 million.

**Poor accountability of contracts and change orders**

In order to perform our audit, we initially requested from DGS a listing of all Deloitte contracts with Commonwealth agencies effective during the period January 1, 2004 to December 31, 2007. DGS was unable to provide a list of all Commonwealth contracts with Deloitte. DGS stated that it could only provide a list of contracts which have been entered into the SAP Procurement Module, which is the Commonwealth's main accounting system of procurement; however, we learned that not all agencies entered Deloitte contract information into the SAP Procurement Module. Therefore, DGS does not have a means of ensuring accountability of all Deloitte contracts with Commonwealth agencies. The DGS list only accounted for approximately \$163.9 million of the \$592.1 million, or 28 percent, of Commonwealth contracts with Deloitte.

At the suggestion of DGS, we subsequently requested from the Office of the Budget a list of all Deloitte contracts effective during the period. When we received the contract list, the Office of the Budget stated that it compiled a list using the information available in SAP's Procurement and Financial Modules. However, the list contained various missing information, including type of award (i.e. RFP, RFQ, sole source, or emergency), effective dates, contract descriptions, and the identification of change orders/amounts.

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In an effort to validate an accurate population to test, we requested that the 15 Commonwealth agencies with Deloitte contracts provide us with a list of their accounting of Deloitte contracts, including any change orders or amendments that were active during the period. We used each department's accounting to reconcile against Office of the Budget's list. We found the following issues:

- The Department of Labor and Industry took over three months to compile a list of contracts and change orders.
- The Office of Administration (OA) denied having a contract with Deloitte on several occasions and did not explain what the payments to Deloitte were for after we questioned this discrepancy. We verified through our own investigation that OA had made payments to Deloitte related to three contracts or purchase orders, including one contract totaling more than \$3.5 million. This contract relates to OA's Business Solution Center of Excellence project. We are concerned that OA denied having this contract considering the various potential conflicts of interest OA had with Deloitte during this contract period, which we note in Finding No. 5.
- DPW was unable to provide us a complete and accurate list of Deloitte contracts in a timely manner. Thirty contracts with Deloitte were omitted from DPW's initial list. Also, DPW's accountability of change orders was inadequate. DPW took over six weeks to compile a list of change orders. When we reviewed change orders, we found discrepancies of approximately \$12.7 million. As a result, DPW's Director of Division of Procurement stated that the list provided previously to the auditors by DPW was incorrect.

**Control weaknesses in approving expenditures**

We obtained from the Office of the Budget a data file of expenditures related to contracts with Deloitte during the period January 1, 2004 to December 31, 2007. The following table summarizes the expenditures by major category:

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Table 2 – Deloitte Contract Expenditures for the Period January 1, 2004 to December 31, 2007

Expenditure Category	Direct Payment Amount	SAP Three-Way Match Payment Amount	Total Commonwealth Amount
Personnel	\$ 96,351,639	\$118,375,057	\$214,726,696
Facilities	2,032,895	1,533,933	3,566,828
Training	2,364,300	1,808,168	4,172,468
Miscellaneous	102,957,836	36,178,999	139,136,835
<b>Total Expenditures</b>	<b>\$203,706,670</b>	<b>\$157,896,157</b>	<b>\$361,602,827</b>

Note: We had to manually categorize a number of expenditures ourselves because the description fields in the data file provided by the Office of the Budget were either blank or extremely vague and some expenditures were combined into one line item rather than detailed by expenditure type.

When compiling the data, we noted that agencies failed to enter all of the contracts into SAP so that payments would have been subject to the SAP three-way match controls. SAP three-way-match controls ensure that the purchase order, receipt of services, and invoice all match before payment is made. The Commonwealth has not maximized SAP’s functionality and control environment by subjecting its contract payments to this key automated control in the SAP software. In fact, over 50 percent of the payments made to Deloitte during this audit failed to go through SAP’s three-way match controls and were instead processed as direct payments.

Direct payments are reviewed manually and avoid the detailed automated process of matching contract information with services rendered. DPW, DOH and PennDOT management all indicated that they have no written policies and procedures for the review and approval of IT invoices. During our initial meeting with DOH, the individual who signed several of the invoices as approved, as well as the other management attending the meeting, could not recall their procedures to review time and material invoices.

**Potential overbilling of facility costs**

Several Deloitte contracts with DPW and L&I contain facility costs totaling \$3.6 million. DOH and PennDOT did not have any facility costs. According to DPW management, the facility costs consist of any expense in the broad category of occupancy expense. Our review of the invoices for facility costs found an array of expenses incurred by Deloitte, including rent, taxes, insurance, repairs and maintenance, security, utilities, cleaning supplies, janitorial service, and parking.

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These expenses are billed to the Commonwealth for Deloitte's Camp Hill and Harrisburg facilities, which are utilized by Deloitte staff working on the state projects. The facility costs are established at the beginning of the contract and are a fixed monthly rate. DPW management stated that it does not verify the reasonableness of the costs or perform any review to ensure that costs for use of the same facilities over multiple contracts are not overlapping and potentially being double billed to the Commonwealth. We were unable to validate if any overbilling occurred due to lack of supporting documentation. In addition, DPW could not validate for the same reason.

DPW and L&I management stated that they do not verify whether the facility costs are utilized solely by Deloitte staff or whether Deloitte staff are performing other work for Deloitte unrelated to contracts with the Commonwealth.

**DCED's \$750,000 grant and \$1.5 million tax credits to Deloitte to create 502 new jobs and retain 1,538 existing jobs are questionable as to justification, verification, and compliance with the law**

In September 2007, DCED awarded Deloitte an Opportunity Grant (grant) totaling \$750,000. This grant program's stated purpose is to provide grants to eligible persons for certain projects which encourage the creation and/or retention of jobs in the Commonwealth. According to the grant documentation, the grant monies would be used to reimburse Deloitte for machinery, equipment, furniture, and fixtures at sites located within Pennsylvania (Philadelphia, Harrisburg, and Allegheny County). To receive this grant, Deloitte agreed to 1) invest approximately \$18 million in private money at its Pennsylvania sites, 2) operate at these sites for a minimum of five years, and 3) retain 1,538 Pennsylvania jobs beginning January 1, 2005 for four years and create 502 full-time jobs within four years beginning January 1, 2005.

In addition, DCED provided Deloitte with Job Creation Tax Credits (credits) in September 2007 and September 2008 totaling \$1.5 million for the creation of the same 502 full-time jobs as noted in the grant agreement. Similar to the grant program, the stated purpose for the credits is to secure job-creating economic development opportunities through the expansion of existing businesses and the attraction of economic development prospects to the Commonwealth. A business may apply the credit to 100 percent of the business's state corporate net income tax, capital stock and franchise tax or the capital stock and franchise tax of the shareholder of the business if the business is a Pennsylvania S corporation, gross premiums tax, gross receipts tax, bank and trust business shares tax, mutual thrift institution tax, title insurance business shares tax, personal income tax or the personal income tax of shareholders of a Pennsylvania S corporation, or any combination thereof.

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To emphasize, the creation of 502 jobs identified for the credits are the same jobs being created and identified under the grant. Therefore, Deloitte is receiving a total incentive package from the Commonwealth of \$2.25 million to create 502 and retain 1,538 existing jobs.

However, based on the grant and tax credit documentation and the fact that Deloitte has received contracts valued at more than \$500 million from the Commonwealth, we question the justification for the grant and credits. Because the grant and credits do not specify what contracts would pay for these retained/new employees, Deloitte could be hiring/retaining these jobs from existing “Commonwealth-funded” contracts rather than private “non-Commonwealth-funded” contracts. Therefore, if these jobs are retained/created as a result of Commonwealth contracts with Deloitte, the Commonwealth, in essence, has given Deloitte \$750,000 for furniture, machinery, and equipment and \$1.5 million in tax credits, with little benefit to the Commonwealth. In fact, DCED management acknowledged that some jobs are retained/created as a result of Commonwealth contracts with Deloitte, but it feels that the majority of jobs were retained/created due to business Deloitte conducts outside of Commonwealth funded contracts. In addition, DCED stated in its competitive assessment regarding the Philadelphia Project included on the Governor’s Action Team Offer Summary that “there is no risk of losing the existing [Deloitte job] positions” in Pennsylvania. It was documented that relocation of Deloitte’s facilities that had excess capacity appeared unlikely. However, the offer was ultimately given by DCED in support of Deloitte’s expansion to ensure that future company growth occurs in Pennsylvania.

Furthermore, based on our review of grant and tax credit documentation and interviews with DCED management, we noted the following additional noncompliance, weaknesses, and concerns:

- DCED was in noncompliance of the law and program guidelines, when awarding Deloitte a credit of \$3,000 per job created instead of \$1,000 per job created.
- DCED’s grant close-out audit consisted of obtaining a one-page document from Deloitte that Deloitte attested to meeting the job retention/creation and private investment requirements. DCED relied on the information provided from Deloitte. No on-site review was performed and DCED did not verify the employment and private investment figures provided by Deloitte.
- DCED management stated there was no communication with other state agencies to determine the magnitude of Commonwealth contracts with Deloitte prior to awarding the grant or credits.

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- DCED exclusively relied on information provided by Deloitte without performing any verification. DCED did not independently verify initial employment information provided by Deloitte at the time of the offer or affidavits stating the number of full-time employees of Deloitte from 2005 to 2007.
- DCED management stated that there are no workpapers or documented procedures supporting DCED's review of invoices submitted by Deloitte to ensure compliance with the grant agreement.
- We question DCED's logic in allowing Deloitte to retroactively calculate the number of retained/new jobs back to 2005 when the grant was awarded on September 2007 and the credits were awarded on September 2007 and September 2008. DCED management indicated that this methodology is a common practice.
- Governor's Action Team (GAT), a unit within DCED, which performs the initial negotiations and offer of an incentive package, does not have written standard operating procedures.

**Criteria:** For ongoing effective governance and management of information technology investments, the Commonwealth should comprehensively understand its information costs. The ability to accurately capture and monitor these costs is essential for ensuring accountability and effective budget practices. Payments should be divided into the different categories of costs. This information allows state agency management and state decision makers to monitor expenditure streams, evaluate trends, and plan for the future.

Regarding the Tax Credit Program, Act 23 of 2001 (Act 23) states that “[a] company may claim a tax credit of \$1,000 per new job created up to the maximum job creation tax credit amount specified in the commitment letter” issued by DCED. Act 23 does not state or imply that the same new job can provide the basis for tax credits in more than one year. In addition, the Job Creation Tax Credit Program Guidelines indicate the same criteria for the \$1,000 requirement.

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**Cause:** DGS management indicated that it is the responsibility of each agency to enter the contract information into the Procurement Module of SAP. In addition, management from the Office of the Budget also indicated that contract and expenditure data was incomplete due to the fact that the agencies are not entering all of the information into SAP. This includes contracts not being entered into SAP when initiated and/or contract information or payment descriptions not being entered into SAP when invoices are entered for payment. Office of the Budget management indicated that the data is only as good as the information entered by the agencies. Both DPW and PennDOT management stated that the size and complexity of the Deloitte contracts made it impractical to enter contract information into the SAP Procurement Module, thus properly utilizing the three-way match controls. We disagree. The accounting system was designed to maximize automated controls and the control environment by subjecting its contract payments to the three-way match feature.

DPW's Director of Division of Procurement explained that the incomplete list of Deloitte contracts was due to a change in Deloitte's vendor number, which caused old Deloitte vendor numbers to be deleted from the system, resulting in the omission of contracts from the list. In addition, he explained that the difference in the change orders was due to employees not properly entering the change order information into DPW's system.

Facility costs are established by the negotiation process at the beginning of the contract and are a fixed monthly rate. According to DPW management, the reasonableness of the costs is not verified due to the immaterial dollar amount of the facilities costs compared to the total contract amount. However, facility costs over four years totaled \$3.6 million. DPW's Director of the Bureau of Financial Operations stated that, during the negotiation process, the facilities charges are of little concern to him and he does not micromanage every line item in the contract as long as the overall price is reduced to an acceptable amount. Additionally, DPW does not request any documentation from Deloitte to verify reasonableness and the accuracy of the facility costs during the invoice review process.

With regard to DCED's award of grant and tax credits to Deloitte, the Director of the GAT stated that DCED was aware that Deloitte had other contracts with the Commonwealth but was not aware of the magnitude. DCED did not communicate with other state agencies to determine the amount of contracts because DCED's primary focus was retention and creation of jobs in Pennsylvania. DCED management indicated that it aggressively pursued Deloitte with offers of funding to ensure that Deloitte expansion occurred in Pennsylvania. DCED felt that, while some of the Deloitte jobs would be the result of Commonwealth contracts, the majority of jobs would be retained/created due to business that Deloitte conducts outside of contracts with the Commonwealth. We disagree. DECD provided no evidence that jobs were created due to the grants and tax credits compared to jobs created from state contracts.



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The Director of GAT stated that, with regard to having no written standard operating procedures, each offer of funding is determined on a case-by-case basis. GAT utilizes Offer Summary and Project Matrix templates completed for each project; however, procedures utilized to complete these templates and make funding decisions are not documented.

DCED stated that the amount of credit that can be awarded per job created is \$1,000 per job per year. Each tax credit provided to Deloitte was for a three-year period; therefore, \$3,000 credit per job created was awarded. We disagree. The program guidelines clearly state that “every new full-time job, up to a set maximum which meets certain minimum wage standards, will result in a \$1,000 tax credit that the business can use to pay a number of state business taxes.” Also, Act 23 does not state or imply that the same new job can provide the basis for tax credits in more than one year. Therefore, the tax credits provided through the Job Creation Tax Credit Program must be claimed per new job on a one-time basis rather than in multiple years. When the auditors asked DCED management to provide a copy of the regulations which allow credits of \$1,000 per job per year, management indicated that it is not stated in law or regulation. DCED’s justification was that this practice has been utilized for years.

With regard to relying on the information from Deloitte without performing any independent verification, the Director of GAT stated that it would be a daunting task for DCED to do an on-site visit as it does not have the manpower to look at the details of each grant. He stated that DCED does receive and review the invoice and shipping documents, which he feels is enough to substantiate the goods received. His perception was that a company would have to go to great length to produce fake documentation to deceive DCED and he does not believe this would happen.

The Director of the Grant Division stated that, with regard to review of invoices, there is a general procedural manual, but because no two projects are the same, the manual is not specifically utilized. She stated that DCED’s analysts “know what to look for,” but do not document their review.

Finally, the Director of GAT explained that DCED allowed Deloitte to retroactively calculate the number of retained/new jobs back to 2005 despite the grant being awarded on September 2007 due to the fact that the negotiations for Deloitte expansion began in 2004 and continued through March 2006. We disagree; job retention/creation requirements should correspond to the service period of the grant contract or September 2007.

**Effect:** Due to the lack of agencies utilizing the current accounting system, SAP Procurement Module, DGS cannot account for all contracts awarded to a certain vendor, such as Deloitte. Also, because agencies had difficulty with properly accounting for all of their contracts and change orders, we could not be assured that the contract lists provided were complete and accurate.

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The effects of this lack of accountability were demonstrated when the DGS Deputy Secretary for Procurement stated that he was unsure if the Commonwealth even had an emergency procurement with Deloitte. Subsequently, we determined that there were 18 emergency procurements with Deloitte during our audit period totaling \$88.0 million. The Deputy Secretary is responsible for approving these emergency procurements.

Regarding internal controls of the three-way match, because the majority of payments do not go through this control functionality, the risk is increased that payments may be made for services which are not included within the scope or terms of the contract.

Regarding the DCED grant of \$750,000 and tax credits totaling \$1.5 million awarded to Deloitte, if jobs are created/retained as a result of existing contracts with the Commonwealth, the financial incentives provided by DCED may be of little to no benefit. Also, by providing credits of \$3,000 per job created instead of \$1,000, DCED is in non-compliance with Act 23 and its own program guidelines. Additionally, without verifying the invoice, employment, and private investment information provided by Deloitte, DCED cannot be assured that the information is accurate and that all program requirements/deliverables were met.

**Recommendations:** We recommend that DGS:

18. Ensure that agencies enter all contracts and related change order/amendment information into the SAP Procurement Module to ensure complete accountability of all contracts. In addition, this will ensure that all payments are subject to proper controls of the SAP three-way match procedures;
19. Require that agencies enter detailed expenditure information including descriptions into SAP at the time of payment to ensure better tracking and accountability of expenditures by contract;
20. Monitor expenditures more closely, including facility costs, to ensure that services do not overlap between contracts and that overbilling does not occur; and
21. Scrutinize thoroughly all vendors wishing to receive contracts from the Commonwealth to ensure that such vendors are not improperly benefitting from the misapplication of the law governing DCED grant monies and/or the Job Creation Tax Credit Program.

Additionally, we recommend that DCED:

- Adhere to Act 23 and the Job Creation Tax Credit Program Guidelines and award a vendor no more than \$1,000 tax credit per new job created over the award period;

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- Communicate with other agencies to determine the magnitude of existing Commonwealth contracts with a vendor before awarding grants and tax credits;
- Verify by reviewing source documentation that vendors actually hire and retain the number of employees agreed upon;
- Document its review of grant expenditures, including using workpapers and documented procedures performed; and
- Develop written standard operating procedures for review and approval of the grant and Job Creation Tax Credit process.

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***Finding No. 5 – DGS Needs to Improve its Oversight and Monitoring of Agencies’ IT Procurement Practices***

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**Condition:** As part of our audit, we interviewed Department of General Services’ (DGS) management regarding how it monitors and oversees the information technology (IT) procurement practices of Commonwealth agencies. Management indicated that, during the audit period, DGS delegated its IT procurement authority to respective agencies, thereby decentralizing the IT procurement process. Once procurement authority was delegated, other than initially approving sole source and emergency procurements, DGS had no involvement in agencies procuring Deloitte services unless requested by the agencies. Based on this information, we noted that DGS needs to improve its oversight and monitoring of agencies’ IT procurement practices. Specifically, we found that:

- DGS did not verify that each agency has standard operating procedures regarding IT procurement and, if available, did not review the procedures to ensure effectiveness and compliance with procurement law and policies;
- DGS did not monitor the results and scoring of agencies’ proposal evaluation committees;
- DGS did not review the Office of Administration – Office of Information Technology (OA-OIT) procedures relating to IT contract procurements and monitor the results to ensure an independent and unbiased environment;
- DGS did not receive or review IT contract amendments/change orders;
- DGS did not perform any audits of IT contracts or expenditures to ensure compliance with law and policies; and
- Although management acknowledged that it was aware of the conflict of interest allegations regarding Deloitte contracts, DGS management stated that it took no investigative action and performed no monitoring or auditing regarding the validity of the purchasing agencies’ procurement of these contracts. Interviews with management of DPW, L&I, PennDOT, and DOH confirmed that DGS performed no monitoring or auditing of the Deloitte contracts.

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DGS stated that the Commonwealth's IT procurement structure provides for review of IT procurements by OA-OIT. Specifically, Executive Order 2004-8, issued on April 29, 2004 and amended on May 9, 2007, along with Information Technology Bulletin ITB EPM003 assigns OA-OIT the responsibility to provide pre-issuance review and approval of all RFPs, RFQs, IT sole source requests, and IT emergency contracts over \$100,000. In addition, OA-OIT has the responsibility to review and approve all IT project contract changes including amendments, renewals, work orders, and change orders greater than \$100,000.

As part of our audit, we interviewed OA-OIT's Chief Information Officer and Deputy Chief Information Officer regarding how OA-OIT reviews and approves IT procurements and contract changes. For IT procurements and contract changes over \$100,000, OA-OIT stated that, beginning around mid-2006, the agency CIO or designee submits to their respective Community of Practice (COP) Planner within OA-OIT an IT Procurement Review Form along with the respective RFP, RFQ, sole source request, emergency contract, or change order documentation. The Technical Architecture Review Board (TAR), comprised of various subject matter experts, performs a technical review of the documentation provided by the agency with the Chief Technology Officer providing approval or denial based on TAR's comments. In addition, the Deputy CIO of the respective Community of Practice performs a business review and provides final approval or denial. From 2004 to implementation of this review process in mid-2006, OA-OIT's respective Community of Practice performed the review with the COP Planner providing approval or denial to the agency. From 2000 to 2004, there was no centralized review of IT procurements and contract changes.

Based on our interviews and review of OA-OIT documentation, we noted areas of serious deficiencies related to OA-OIT's IT procurement review procedures as follows:

- OA-OIT has no written standard operating procedures for its review of IT procurements. OA-OIT did provide various Executive Orders/Bulletins and Training Manuals; however, this documentation does not address the day-to-day operation of key documents and detail review procedures.
- IT Procurement Review Form is the only evidence of OA-OIT's review. The review evidence on this form is comprised of a single check box approval for the TAR Board and the Deputy CIO. OA-OIT has no detail documentation or working papers supporting the review performed by each of the TAR members or the Deputy CIO.
- OA-OIT cannot conclusively determine which individuals actually performed the review. Approvals by reviewers are done during TAR meetings and conference calls that are not documented and no minutes are kept for the meetings.

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- OA-OIT's record keeping system needs improved. When the auditors requested copies of the one-to-two-page IT Procurement Review Form for all Deloitte contracts and contracts changes over \$100,000 during the period January 1, 2004 to December 31, 2007, and provided OA-OIT with a list of the contract numbers and change order numbers, OA-OIT management stated that it would take weeks to go through thousands of documents and be very costly for its staff to produce these forms.
- There were a total of 60 contracts and changes to contracts with Deloitte over \$100,000 from the date of Executive Order 2004-8 of April 29, 2004 that required OA-OIT to provide review/approval until the end of our audit period of December 31, 2007. Of these 60 contracts and contract changes, OA-OIT could not provide evidence for review/approval for 26, including 5 RFPs/RFQs, 2 Sole Source Contracts, 5 emergency contracts, and 14 contract changes.
- OA-OIT does not perform reviews of the purchasing agencies' selection of evaluation committee members, scoring by the committee members, or selection of the vendor to ensure that selection of the vendor is reasonable and unbiased.

In addition, we noted that key OA-OIT management responsible for approval of IT procurements and contract changes during the period January 1, 2004 to December 31, 2007 had potential or perceived conflicts of interest with Deloitte. These potential conflicts of interest include:

- The OA-OIT Chief Information Officer from March 3, 2003 to June 4, 2005 was a former Deloitte employee.
- The OA-OIT Chief Information Officer from June 4, 2005 to September 21, 2007 was a former Deloitte employee and then returned to employment with Deloitte after leaving the CIO position in September 2007.
- The Deputy Chief Information Officer of the Health and Human Services Community of Practice from October 1, 2005 to March 21, 2008 was a former Deloitte employee. She is currently working as a Project Manager within the Health and Human Services Community of Practice. Also, we noted that this individual was included on an evaluation committee for an IT procurement from Deloitte to develop the Comprehensive Workforce Development System at L&I.

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OA-OIT management indicated that it does not have policies or procedures of its own to address the appearance of conflicts of interest related to the review process for IT procurements and contract changes. OA-OIT stated that it adheres to various laws and policies that address ethical issues in procurement, including the Governor's Code of Conduct (4 Pa Code Chapter 7), the Public Official and Employees Ethics Act (65 Pa. C.S. § 1101 *et seq.*), the Procurement Code (Chapter 23, "Ethics in Public Contracting", 62 Pa. C.S.A. § 2301), and the Procurement Handbook (Part 1 Chapter 60). However, these laws and polices address actual conflicts of interest, but not the appearance of conflicts of interest.

Additionally, due to the deficiencies in OA-OIT's controls noted above related to inadequate documentation of review and approval, OA-OIT could not give us a list of IT procurements and contract changes related to Deloitte contracts that were reviewed and approved by the individuals with the perceived conflicts of interest noted above. Therefore, we could not conclusively determine what reviews and approvals these individuals performed during our audit period. However, based on the responsibilities of their job position, it is clear that these individuals were significantly involved in reviewing and approving the IT procurements and contract changes during the period January 1, 2004 to December 31, 2007. Based on the limited information that we were able to obtain, we are not aware of any violations of law; however, there was clearly an appearance of, or potential for, conflicts of interest that could have been avoided by excluding the former Deloitte employees from involvement with Deloitte contracts.

Furthermore, OA-OIT management indicated that it works together with the Office of Administration's Human Resources Office to define the minimum education, training, and experience requirements for the agency CIO positions. Management indicated that OA-OIT monitors and ensures that these positions are filled in compliance with the established job requirements. However, when the auditors made inquiry to OA-OIT regarding an allegation that was received by the auditors stating that an agency CIO was taking college courses paid by the Commonwealth to fulfill the minimum job requirements after being hired and requested Out-Service-Training/Travel Authorization Request forms, OA-OIT stated that it does not approve professional training for agency IT staff. OA-OIT management stated that training requests would be handled by the agencies. We disagree. OA-OIT has the responsibility to monitor and ensure that the agency CIOs, who report directly to the OA-OIT Deputy CIO for the respective Community of Practice, meet minimum education and training job requirements, and therefore, should review and scrutinize out-service-training requests for college/university courses in order for an agency CIO to meet minimum job requirements.

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**Criteria:** The Commonwealth Procurement Code states that DGS has the duty to “[p]rocure or supervise the procurement of all supplies, services and construction needed by executive agencies and those independent agencies for which the department acts as the purchasing agency. Procurement authority may be delegated in writing by the Secretary of General Services.”<sup>4</sup> The Code further states that “[t]he department may audit and monitor the implementation of its regulations and the requirements of this part.”<sup>5</sup>

As part of overseeing any operation, management must develop an internal control structure to ensure that operations are functioning properly.

Executive Order 2004-8, issued on April 29, 2004 and amended on May 9, 2007, along with Information Technology Bulletin ITB EPM003 assigns OA-OIT the responsibility to provide pre-issuance review and approval for all RFPs, RFQs from the IT-ITQ Contract, IT sole source requests, and IT emergency contracts over \$100,000. In addition, OA-OIT has the responsibility to review and approve all IT project contract changes including amendments, renewals, work orders, and change orders greater than \$100,000.

Policies governing out-service training for Commonwealth employees, including reimbursement for courses resulting in academic credit are outlined in Management Directive 535.3, dated November 16, 1999. Employees are expected to possess the minimum experience and training requirements for the job for which they are hired and out-service training should not be used to rectify any inadequate hiring decision. Where the minimum education requirements to be hired for the job position are lacking, employees are responsible for using personal resources to improve their competencies to the level required in the position. Agencies are authorized to approve academic credit courses that provide technological updates in subject areas that cannot effectively be provided in on-the-job situations or short-term seminars and conferences.

**Cause:** Management indicated that, once procurement authority is delegated to a Commonwealth agency, it is not necessary for DGS to monitor or oversee the IT procurement practices at agencies, other than the requirement that it needs to approve sole source and emergency procurements. DGS management acknowledged that it has the authority to audit agencies for compliance with procurement regulation; however, DGS has historically never chosen to exercise this option.

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<sup>4</sup> 62 Pa. C.S. § 321(1).

<sup>5</sup> 62 Pa. C.S. § 311.



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With regard to the serious deficiencies noted with OA-OIT's IT procurement review procedures, the OA-OIT CIO stated that the IT Procurement Review Form is automated and transmitted electronically to the appropriate individuals for review and approval based on roles set up in OA-OIT's system. She concluded that auditors think of documentation only as paper and that, although she does not have paper evidencing who performed the review, it does not mean that the review was not performed. In addition, she stated that she knows and tracks all of the persons performing the reviews and there has not been much change in these personnel over the years. We disagree. Even though the IT Review Form is an online document there should still be an audit trail either electronic or hardcopy. Good IT controls dictate that, even though documentation is online, there should still be evidence of an audit trail to determine who reviewed and approved the form.

When the auditors inquired as to who actually reviewed and approved specific IT Procurement Review Forms, OA-OIT management could not conclusively determine. When the auditors asked for any documentation (hardcopy or electronic) or screen printouts from OA-OIT's system to evidence who approved the form, management stated it could not be done. Additionally, there are no working papers or documentation of review by the TAR Board and Deputy CIO. Approvals of TAR members are verbal at meetings or through conference calls and no documentation or phone logs are kept for these meetings.

With regard to OA-OIT's record keeping system, OA-OIT's CIO and Deputy CIO stated that their reviews are performed prior to the awarding of the contract and, therefore, have no associated contract number. OA-OIT's staff must manually match the contract number to the RFP or RFQ, which has a different number, by manually looking through thousands of pages of documents. We disagree. OA-OIT reviews sole source procurements, emergency procurements, and contract changes are for a specific contract. Additionally, OA-OIT does not require another review form or documentation to be submitted by the agency after vendor selection is made and the contract is awarded and, therefore, OA-OIT does not link the RFP/RFQ to the contract awarded.

With regard to lack of OA-OIT reviews for sole source and emergency contracts greater than \$100,000, OA-OIT management stated that there was confusion early in the process when the Deputy CIO organizations were first being established within OA-OIT as to whether OA-OIT would review sole source and emergency procurements. OA-OIT stated that this policy has been clarified since that time and sole source and emergency procurements over \$100,000 are to be reviewed by OA-OIT. Additionally, OA-OIT management stated that the lack of review/approval for the RFP/RFQs and contract changes was due the fact that OA-OIT's review process was in a state of change over the first few years after Executive Order 2004-8 was signed by the Governor on April 29, 2004, assigning IT procurement review responsibility to OA-OIT. However, the fact remains that as of April 29, 2004, OA-OIT has the responsibility to review IT procurements and should have been proactive to implement and perform these reviews as required.

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With regard to conflict of interest situations, OA-OIT management does not feel that it is necessary to have its own policies beyond the Governor's Code of Conduct, the Public Officials and Employees Ethics Act, the Procurement Code, and the Procurement Handbook. OA-OIT management stated that the OA-OIT CIO does not serve as a member on any agency selection committee for IT service projects, making it impossible for the person in that role to manipulate outcomes. In addition, DGS's Deputy Secretary for Administration and Procurement stated that the competitive procurement evaluation process is highly technical and structured, making it nearly impossible for any one evaluation member to sway the selection to any one vendor. DGS's Deputy Secretary further added that just because a person is a former employee of a vendor does not necessarily mean there is a conflict of interest. We disagree. Policies and procedures should be in place for not only actual conflict of interest situations but also for potential conflicts of interest and the appearance of conflicts of interest.

The DGS Deputy Secretary of Administration and Procurement stated that she is confident in OA-OIT's current system of review and approval of IT procurements and contract changes. We disagree and determined that OA-OIT has improper and inaccurate oversight.

**Effect:** Failing to adequately monitor and oversee IT procurement activities by Commonwealth agencies increases the potential for contract impropriety, including vendor favoritism. In fact, as noted in Finding No. 1, numerous allegations of impropriety have been made. Also, without adequate monitoring and oversight, DGS lacks assurance that management's controls over IT procurement activities of agencies are adequate and functioning as prescribed.

**Recommendations:** We recommend that DGS:

22. Ensure that Commonwealth agencies have standard operating procedures for IT procurement;
23. Review agencies' IT procurement standard operating procedures to ensure effectiveness and compliance with law and policy;
24. Monitor the results and scoring of agencies' proposal evaluation committees;
25. Review OA-OIT procedures relating to IT contract procurements and monitor the results to ensure an independent and unbiased environment;

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26. Ensure that OA-OIT:

- Excludes employees with the potential for, or the appearance of, conflicts of interest from participating on any contract evaluation committees.
- Develops standard operating procedures for review and approval of IT procurements and contract changes over \$100,000;
- Documents its review of IT procurements and contract changes, including detailed comments and decision making process of the reviewers, sign-offs by the reviewers, and sign-offs of the person(s) providing final approval;
- Improves its record keeping to ensure that documentation of reviews/approvals of IT procurements and contract changes can be retrieved in a timely manner;
- Reviews and approves all RFPs, RFQs from the IT-ITQ Contract, IT sole source requests, IT emergency contracts, and IT contract changes over \$100,000 in accordance with Executive Order 2004-8; and
- Adequately monitors Agency CIO's education, experience and training to ensure that minimum requirements are met for the job position;

27. Audit agencies' IT contracting processes and expenditures on a regular basis; and

28. Immediately investigate the allegations of impropriety regarding the awarding of contracts.

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***Finding No. 6 – Pennsylvania’s Existing Procurement Organizational Structure Failed to Provide Centralized and Independent Oversight and Monitoring, Including Conflict of Interest Concerns***

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**Condition:** Based on information obtained through interviews and other audit procedures, we noted a lack of oversight over procurement within the Commonwealth of Pennsylvania. Specifically, the organizational structure currently in place fails to independently monitor procurement activities as a whole, fails to prevent or address conflict of interest concerns, allows agencies to decide who should participate in proposal evaluation committees, fails to address the credentials and experience of evaluation committee members, and fails to ensure that proper internal controls are in place and functioning as prescribed.

The organizational structure of procurement is based in the Commonwealth Procurement Code and is made up of various entities:

- The Department of General Services (DGS) is authorized by the Code to promulgate procurement regulations and to formulate procurement policy for use by Commonwealth agencies;<sup>6</sup>
- The Governor’s Office of Administration – Office for Information Technology (OA-OIT), through Executive Order 2004-8, was charged with implementing several responsibilities, including IT procurement and contract management. All agencies are required to first receive approval from OA-OIT before issuing IT procurement documents and requests;
- The Enterprise Information Technology Governance Board (Board), created by the Governor in April 2004 through Executive Order 2004-8, is to “establish an Enterprise IT Governance Structure to oversee the investment and performance of information solutions across the Commonwealth’s agencies”; and
- Commonwealth agencies are responsible for procuring goods and services in accordance with the procurement policy established by DGS.

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<sup>6</sup> See 62 Pa. C.S. § 311.

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Although the above organizational structure appears to be independent in nature and establishes separate responsibilities and duties, agencies actually operate without the presence of mutual efforts of coordination and/or quality control. This structure does not include a level of centralized independent oversight. It has not prevented the appearance of, or the potential for, conflict of interest situations, it has not detected weaknesses in the decentralization of the procurement process which allows agencies to do what they want, and it does not require mandatory review/audit of Commonwealth agencies' purchasing practices. The following explains our concerns:

**Weaknesses in OA-OIT's IT Procurement Review Process and Appearance of Conflicts of Interest**

DGS stated that the Commonwealth's IT procurement structure provides for centralized review of IT procurements by OA-OIT. Specifically, Executive Order 2004-8, issued on April 29, 2004 and amended on May 9, 2007, along with Information Technology Bulletin ITB EPM003 assigns OA-OIT the responsibility to provide pre-issuance review and approval of all RFPs, RFQs from the IT-ITQ Contract, IT sole source requests, and IT emergency contracts over \$100,000. In addition, OA-OIT has the responsibility to review and approve all IT project contract changes including amendments, renewals, work orders, and change orders greater than \$100,000. However, based on the results of interviews of OA-OIT's Chief Information Officer and Deputy Chief Information Officer and our review of OA-OIT documentation, we found serious deficiencies in OA-OIT's IT procurement review procedures along with the conflicts of interest concerns involving key OA-OIT management as noted in Finding No. 5. Due to weaknesses and the appearance of, and potential for, conflicts of interest, and the various other weaknesses noted in Findings No. 1 through No. 5, we have concerns with the current organizational structure of procurement.

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Furthermore, Deloitte employees and Commonwealth employees work very closely together while performing contract work. Deloitte has employees physically working within state office buildings. For instance, according to the CIO of PennDOT, the number of Deloitte employees working within state office buildings at times can exceed 100 for a single contract. In addition, on several DPW contracts state employees are also permanently working in Deloitte office buildings. While some precautions appear to have been taken to separate Deloitte employees from Commonwealth employees, Commonwealth management has admitted that it is nearly impossible to ensure that all confidential communications are kept from Deloitte employees because, in many cases, they can move freely around the state offices, similar to Commonwealth employees. In fact, a ranking agency official inadvertently exposed the potential for entanglement between the Commonwealth and Deloitte, publicly asserting, “I am also very pleased that we have selected a partner like Deloitte Consulting to work with us and to guide us....You can tell the value of a good partnership when the lines are blurred, and you can’t tell who works for whom.”<sup>7</sup> As a result, when employees have this close of a relationship with the vendor, it becomes very difficult to avoid bias or favoritism towards this same vendor on future procurements.

**DGS decentralized the procurement process**

Although DGS created the *Procurement Handbook* (handbook) to provide Commonwealth agencies with procurement policy and procedures, based on interviews with DPW, DOH, L&I, and PennDOT, these agencies have no formal structured methodology for selecting proposal evaluation committee members, including documenting each member’s qualifications and determining whether conflicts of interest exist. Furthermore, management indicated that DGS does not perform any review of the appropriateness of the committee members on these committees.

In addition to the above example, we noted other instances of weaknesses and deficiencies regarding DGS’s decentralization of the procurement process in Findings. No. 1 through No. 5.

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<sup>7</sup> Serian, Betty L. “Message from Betty Serian, Deputy Secretary for Safety Administration,” The .entric Times, Vol. I, Issue 4, December 2006 (PennDOT business partner newsletter found on PennDOT’s website).

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**Lack of mandatory review/audit of Commonwealth agencies' purchasing practices**

Based on the results of our audit, nothing came to our attention that indicated that any internal entity is performing or required to perform reviews/audits of the Commonwealth agencies' purchasing practices. Although the Board was created to govern, evaluate, and monitor IT-related procurement, Executive Order 2004-8 does not require the Board or OA-OIT to perform reviews/audits of IT-related contracts. Furthermore, although DGS has the authority to conduct audits of the procurement process, management indicated that DGS has not exercised this option to date.

The above concerns demonstrate that the existing organizational structure fails to provide independent oversight and monitoring. Of these entities, no one is ensuring that conflicts of interest do not exist, or if they exist, ensuring that these individuals remove themselves from any decision-making situations involving entities with personal or business connections. Furthermore, DGS has not exercised its authority to ensure that agencies are engaging in procurements properly. Additionally, although the Board is to function as an umbrella over IT matters, its lack of independence and the deficiencies noted within this audit report clearly demonstrates that a new level of independent oversight and monitoring is needed or the existing structure needs to be significantly modified.

**Criteria:** The Commonwealth Procurement Code states:

Employees.--Any attempt to realize personal gain through public employment by conduct inconsistent with the proper discharge of the duties of the employee is a breach of a public trust. In order to fulfill this general, prescribed standard, employees must avoid any conflict of interest or improper use of confidential information.<sup>8</sup>

With regard to the evaluation committee, the *Procurement Handbook*, Part 1, Chapter 6 Section B.3.a., states:

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<sup>8</sup> 62 Pa. C.S. § 2302(a).

**DEPARTMENT OF GENERAL SERVICES  
PROCUREMENT OF DELOITTE CONTRACTS  
JULY 1, 2000 THROUGH DECEMBER 31, 2007**

**FINDINGS AND RECOMMENDATIONS**

***Finding No. 6***

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The evaluation committee should be composed of a minimum of three (five or seven is recommended) Commonwealth employees who possess technical and managerial expertise in the appropriate field. As appropriate, individuals from other agencies of the Commonwealth may be given the opportunity to participate as voting or non-voting members on all committees. An agency is required to invite its comptroller to participate as a non-voting committee member. Once appointed to the committee, no committee member, whether voting or non-voting, may meet or discuss the RFP or related matters with offerors or other committee members except in formal, scheduled meetings of the committee or as the issuing office may direct and arrange.

No other structured methodology exists for selection of evaluation committee members, including review and documentation of members' qualifications and review for any conflicts of interest.

DGS management indicated that DPW's policies and procedures require several levels of review and approval for sole source procurements, including the sole source commodity specialist, commodity supervisor, sole source coordinator, Chief Procurement Officer for requests over \$100,000, and the Deputy Secretary for Procurement for requests over \$500,000.

Furthermore, the current governance of Information Technology (IT) procurements, established by the Governor in April 2004 through Executive Order 2004-8 and Information Technology Bulletin ITB-EPM003, requires OA-OIT to review and approve scopes of work greater than \$100,000 for pre-issuance approval for all agencies' IT contracts. In addition, OA-OIT must review and approve all IT project contract changes, including amendments, renewals, work orders, and change orders greater than \$100,000. OA-OIT's Chief Technology Officer and the appropriate Community of Practice Deputy Chief Information Officer make the final decision on IT procurements.

**Cause:** Based on our interviews, the agencies, including DGS, believe that the procurement organizational structure currently in place is functioning adequately. We asked procurement management within several agencies whether an independent oversight entity would help agencies regarding their procurement process/needs. They indicated that either they believed that it would not be beneficial or they refused to comment because that change would require legislative intervention. We disagree. As noted in the condition section of this finding, no independent oversight entity exists and currently the existing entities are not collectively performing the necessary functions for ensuring that procurement practices are proper, in compliance with policy and procedures and free from improprieties.



**DEPARTMENT OF GENERAL SERVICES  
PROCUREMENT OF DELOITTE CONTRACTS  
JULY 1, 2000 THROUGH DECEMBER 31, 2007**

**FINDINGS AND RECOMMENDATIONS**

***Finding No. 6***

---

**Effect:** Failure to have independent oversight over procurement resulted in the deficiencies noted in Findings No. 1 through No. 5, which potentially resulted in the Commonwealth overpaying for IT procurement. Additionally, these appearances of conflict of interest give the perception that improprieties have occurred with respect to awarding contracts to Deloitte totaling \$592.1 million.

**Recommendations:** We believe that Pennsylvania's organizational structure of procurement needs improved by significantly realigning and modifying the existing entities.

29. DGS should develop and enforce ethical standards that require state employees who procure goods and services on behalf of the Commonwealth, including those who participate in proposal evaluation committees and/or approve contracts, to refrain from all direct or indirect relationships with any individual or enterprise that does business with the Commonwealth;
30. DGS should develop education, training, and/or experience requirements for individuals to be selected for a proposal evaluation committee;
31. DGS should develop policy stipulating when large procurements/contracts need to be reviewed and approved;
32. DGS should review/audit and certify that each agency's procurement process is in compliance with law and regulations to ensure transparency. If deficiencies are noted, require agencies to rectify them;
33. DGS should develop a timeframe for recertifying agencies' procurement processes;
34. DGS should ensure that a database exists to enable state government to have full accountability of all contracts, change orders, and amendments;
35. DGS should monitor contracting and purchasing activities of Commonwealth agencies for reasonableness, consistency, and compliance;
36. DGS should determine the annual training needs of the agencies' procurement professionals and ensure that those needs are met; and
37. DGS should monitor to ensure that all agency chief information officer positions are filled in compliance with minimum educational, training, and experience requirements.

**DEPARTMENT OF GENERAL SERVICES  
PROCUREMENT OF DELOITTE CONTRACTS  
JULY 1, 2000 THROUGH DECEMBER 31, 2007**

**FINDINGS AND RECOMMENDATIONS**

***Finding No. 6***

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In addition, we reemphasize the two recommendations in Finding No. 1:

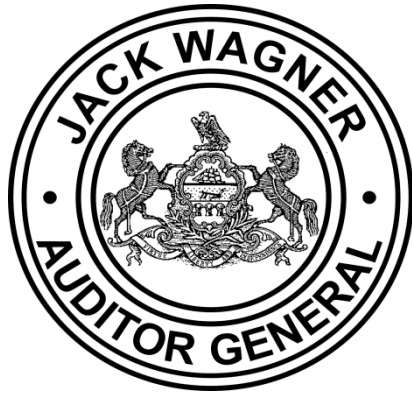
We recommend that Commonwealth agencies retain procurement documentation, including losing proposals and detailed scoring sheets, until the information has been subject to audit as stated in the Commonwealth Procurement Code and the General Administrative Schedule.

As part of all audits, we recommend that DGS and other Commonwealth agencies provide all procurement records to the Department of the Auditor General upon request, including, but not limited to, the names of the proposal evaluation committee members, copies of losing proposals, and detailed scoring sheets by each member of the proposal evaluation committee.



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*APPENDIX A*



**APPENDIX A**

**Commonwealth Expenditures Related to Contracts With Deloitte  
For the Period January 1, 2004 to December 31, 2007**

<u>Expenditure Category</u>	<u>Direct Payment Amount</u>	<u>SAP Three-Way Match Payment Amount</u>	<u>Total Payment Amount</u>
<b><u>Personnel by Position Type:</u></b>			
Administrative	\$ 0	\$ 521,171	\$ 521,171
Analyst	0	20,377,122	20,377,122
Architect	0	222,947	222,947
Consultant	0	10,630,730	10,630,730
Controller	0	6,762	6,762
Developer	0	44,826	44,826
Director	0	181,339	181,339
Lead	0	524,037	524,037
Manager	0	8,493,472	8,493,472
Partner	0	1,108,785	1,108,785
Principal	0	9,000	9,000
Programmer	0	4,488,167	4,488,167
Senior Consultant	0	14,061,967	14,061,967
Senior Manager	0	3,943,096	3,943,096
Specialist	0	2,008,084	2,008,084
Support	0	534,911	534,911
Test	0	771,654	771,654
Various Personnel	96,351,639	50,446,987	146,798,626 (1)
<b>Total Personnel</b>	<b>\$ 96,351,639</b>	<b>\$118,375,057</b>	<b>\$214,726,696</b>
<b>Facilities</b>	<b>2,032,895</b>	<b>1,533,933</b>	<b>3,566,828</b>
<b>Knowledge Transfer / Training</b>	<b>2,364,300</b>	<b>1,808,168</b>	<b>4,172,468</b>
<b>Miscellaneous</b>	<b>102,957,836</b>	<b>36,178,999</b>	<b>139,136,835 (2)</b>
<b>Total Expenditures</b>	<b>\$203,706,670</b>	<b>\$157,896,157</b>	<b>\$361,602,827</b>

(1) – The data for these personnel expenditures included only a total amount and did not provide detail by position. In addition, we noted that several of the invoices also included facility costs lumped into the same total.

(2) – The Miscellaneous category includes various fixed-price deliverables. Within this category are facility costs for L&I contracts; however, we could not determine the amounts because the descriptions were not included in the data file. In addition, this category includes a payment of \$750,000 to Deloitte for office furniture as part of the Opportunity Grant Program.

Source of information: Office of the Budget, July 14, 2008.



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***APPENDIX B***





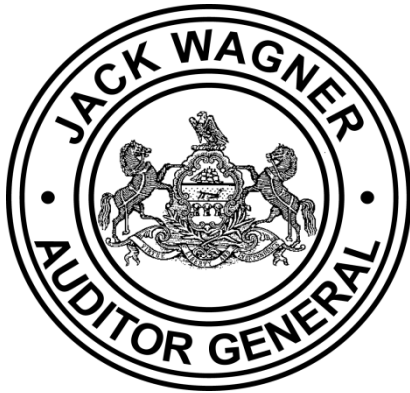
## APPENDIX B

### Deloitte Contracts with Commonwealth Agencies and Related Expenditures For the Period January 1, 2004 to December 31, 2007

Agency	(1) RFP/RFQ		(1) Sole Source		(1) Emergency		Grant		(1) Total Contracts		Total Expenditures
	#	Dollar Amount	#	Dollar Amount	#	Dollar Amount	#	Dollar Amount	#	Dollar Amount	
1. Department of Public Welfare	34	\$278,911,236	2	\$7,743,642	14	\$81,655,262			50	\$368,310,140	\$241,383,878
2. Department of Labor and Industry	2	\$71,892,515	2	\$13,716,595					4	\$85,609,110	\$40,748,831
3. Department of Transportation	3	\$42,935,034							3	\$42,935,034	\$13,204,082
4. Department of Health	4	\$20,369,822	2	\$7,243,850	2	\$5,589,898			8	\$33,203,570	\$31,556,274
5. Liquor Control Board	1	\$28,259,997							1	\$28,259,997	\$8,396,033
6. Department of Insurance	4	\$19,513,505			1	\$599,999			5	\$20,113,504	\$15,357,894
7. Department of Education	1	\$5,237,331	1	\$274,528					2	\$5,511,859	\$2,703,528
8. Office of Administration	3	\$3,665,386							3	\$3,665,386	\$3,662,524
9. Department of State	1	\$1,381,926			1	\$171,823			2	\$1,553,749	\$1,553,571
10. Department of Corrections	1	\$813,898							1	\$813,898	\$813,895
11. Department of Community and Economic Development							1	\$750,000	1	\$750,000	\$750,000
12. Department of Revenue	1	\$595,000							1	\$595,000	\$85,000
13. State Employees Retirement System	1	\$458,420							1	\$458,420	\$1,069,834
14. Department of Banking	1	\$250,000							1	\$250,000	\$250,000
15. Public Utility Commission	1	\$67,483							1	\$67,483	\$67,483
<b>Total</b>	<b>58</b>	<b>\$474,351,553</b>	<b>7</b>	<b>\$28,978,615</b>	<b>18</b>	<b>\$88,016,982</b>	<b>1</b>	<b>\$750,000</b>	<b>84</b>	<b>\$592,097,150</b>	<b>\$361,602,827</b>

(1) - Related change orders are included in contract dollar amount.

Source of information: Office of the Budget, July 14, 2008.



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*APPENDIX C*



## *APPENDIX C*

Appendix C contains the combined verbatim responses of the Department of General Services (DGS) and various Commonwealth agencies to our original draft findings and recommendations, which were submitted for management response on January 23, 2009. Appendix C also contains our auditors' conclusions, which address each combined verbatim response submitted by the various Commonwealth agencies. Subsequent to reviewing our original draft, management belatedly agreed to provide our auditors with previously requested documentation and interviews. After a review of the documentation and completion of the interviews, auditors revised several of the original findings and recommendations, which we then forwarded to management for their review and response on July 6, 2009. The revised findings and recommendations, as well as management's new responses and our auditors' conclusions are located in Appendix D, beginning on page 125. However, we only forwarded for a response those findings and recommendations that changed significantly; those that did not require changes remain in their original format in Appendix C. By reviewing the original findings and recommendations contained in Appendix C, as well as our auditors' conclusions to management's responses, the reader will be able to transition more easily into the revised findings and recommendations that are contained in Appendix D.

The Department of the Auditor General conducted a special performance audit of procurement contracts entered into by DGS. Specifically, the audit focused on contracts between state agencies and Deloitte Consulting LLP (Deloitte) that were in effect during the four-year period from January 1, 2004 to December 31, 2007. In response to the findings contained in our audit report, management of the audited agencies have strongly expressed their disapproval with our findings and have even gone so far as criticizing the methods used in the performance of this audit. For purposes of clarification, we believe that it is important to address such misconceptions with a brief summation of events, as well as our findings.

The divergence in opinion between our auditors and agency management on the extent of collaboration needed to conclude our audit was disconcerting. Despite our auditors' best efforts to ensure a timely completion of the audit, DGS and participating agencies' protocols and untimely and inadequate responses delayed the release of our report. Under the guidance of the Governor's Office of General Counsel, audited agencies continually challenged our auditors' repeated requests for reasonable documentation and information. Much of the information that our auditors did receive was forwarded weeks after our initial request. In addition, the hostility and resistance demonstrated by particular agency management during our interviews was unwarranted and only further hindered the timely release of our report. Such actions by management show a blatant disregard for Pennsylvania taxpayers, who will ultimately shoulder any financial burden stemming from poor procurement practices. Furthermore, there still appears to be no consensus between our auditors and the respective audited agencies, as demonstrated in the letter accompanying management's response to our findings and recommendations.

## *APPENDIX C*

In the letter accompanying its formal response, management asserts, “It is unfortunate we must take time to respond to a report that relied on anonymous, ill-informed and uncorroborated sources as its basis.” Contrary to this assertion, while the Department of the Auditor General works diligently to maintain the privacy of those individuals requesting confidentiality, all audit evidence obtained and used in our report is thoroughly corroborated. Moreover, in accordance with provisions referenced as part of generally accepted government auditing standards (GAGAS), our auditors apply the highest ethical principals when conducting an audit, including taking on only work that the auditor is competent to perform, performing high-quality work, and following the applicable standards cited in the audit report. The auditors assigned to perform this audit have a combined 80 years of auditing experience and possess extensive education and training in the fields of accounting and information technology. Therefore, we are confident that our report reflects a fair and accurate assessment of state agencies’ contracts with Deloitte Consulting LLP for the procurement of IT services.

It is also management’s contention that our auditors “were not denied a single interview request or access to documents that were available or relevant to this audit.” As such, management stresses that affording these interviews and documentation to our auditors “clearly indicates a lack of favoritism in the selection of Deloitte.” In actuality, our auditors were repeatedly delayed or denied access to specific requested information throughout the course of our audit, including copies of all losing bid proposals, identities of proposal evaluation committee members, and the individual score sheets used by evaluation committee members when considering submitted bid proposals. Agencies also failed to provide other award-related documentation, despite our auditors providing a written explanation as to why the requests for such information were necessary to complete our audit objectives. Furthermore, because auditors must comply with GAGAS and provide reasonable assurances that they have obtained sufficient, appropriate evidence to support the conclusions reached, at no time will our auditors rely on the audited agency to determine the relevance of requested audit evidence.

It was not until DGS was in possession of our original draft report (which immediately preceded a breach in the confidentiality of the report outside of the Department of the Auditor General) that it agreed to provide much of the aforementioned documentation. This original scope limitation not only prevented us from initially concluding on a number of our audit objectives, but also, and more importantly, fostered the perception of secrecy through a lack of transparency. The reluctance of management to abandon such secrecy is apparent in its formal response to our findings and recommendations. In its response, management declares that it participated in the spirit of full disclosure; however, after belatedly agreeing to provide specific requested information, it contradicts itself, warning, “Please do not interpret this decision as consent to be provided with all documentation requested by you and your auditors on all future audits. We will continue to consider your document requests on a case by case basis.” This perception of secrecy only furthers the belief that the awarding of state government contracts is in some way inequitable and affords certain contractors unfettered access to key government employees. Thus, it remains our position that it is the lack of transparency within the Commonwealth’s procurement process that contributes to the potential for improper vendor favoritism.

## APPENDIX C

Management also expressed its disagreement with our finding and recommendations to alleviate the potential for, or the appearance of, conflicts of interest within the current organizational structure of the procurement process. Management states, “The report makes vague, unsupported allegations of conflicts of interest between Deloitte and employees of OA and other Commonwealth agencies.” In fact, as noted in our report, our auditors became aware of allegations regarding conflicts of interests from various sources, including numerous individuals with first-hand knowledge of the Commonwealth’s procurement process. Such allegations were likely enhanced due to the appointment and hiring of former Deloitte personnel to fill key positions within the Office of Administration (OA), the agency responsible for the oversight of the majority of IT contracts. We addressed such conflict of interest issues by encouraging management to adopt our suggested recommendations in order to preclude the perception that improprieties have occurred with respect to awarding contracts to Deloitte totaling \$592.1 million.

Finally, after our auditors received the audited agencies’ combined formal response to our original draft findings and recommendations, Governor Rendell directed all agencies to release additional documents to us. The Governor’s actions followed the publication of an article by *The (Harrisburg) Patriot-News* on the results of our draft report, criticizing the Commonwealth for a lack of transparency within the procurement process. Upon the Governor’s directive, our auditors again requested specific information from management that was denied previously. However, the Commonwealth could not provide certain procurement documentation for many of the Deloitte contracts (see Finding No. 1). We were only provided complete documentation necessary to audit 25 contracts totaling \$173 million, out of 58 RFP/RFQ contracts totaling \$474 million. (See Finding No. 3 for the results of our testing.) Moreover, the Commonwealth informed us that our auditors were permitted to interview management from OA-OIT, DCED, and other agencies in order for us to complete our audit objectives. We conducted interviews and reviewed documentation at DCED, which found weaknesses in DCED’s procedures for awarding grants and tax credits (see Finding No. 4). Furthermore, we conducted interviews with management from OA-OIT and reviewed all information provided by management. We concluded that significant deficiencies are present involving OA-OIT’s IT procurement review process (see Finding No. 5).

Following our interviews and examination of the additional documentation provided by management, we made several changes to our original draft findings and recommendations. Based on this new information, we consider the changes made to Findings No. 1, No. 3, No. 4, and No. 5, which included additional recommendations, to be significant. However, we do not consider ancillary changes made to Findings No. 2 and No. 6 to be significant in that the changes did not alter our original conclusions.



*APPENDIX C*



**COMMONWEALTH OF PENNSYLVANIA**

February 20, 2009

The Honorable Jack Wagner  
Auditor General  
Commonwealth of Pennsylvania  
Harrisburg, Pennsylvania 17120

Dear Auditor General Wagner:

Thank you for the opportunity to review your draft of the Special Performance Audit relating to procurements undertaken with Deloitte Consulting LLP during the period July 1, 2000 to December 31, 2007. I want to also thank you and your staff for agreeing to extend the deadline for our response to February 20<sup>th</sup>. This allowed us ample time to examine your comments and gather much needed information to improve the accuracy of your draft audit, which we believe is misleading and inaccurate in many of its conclusions.

There is no favoritism for Deloitte by Governor Rendell or his Administration. As we have told your auditors since the first time we met, no senior level decision makers in this Administration who were former Deloitte employees were involved in the scoring and selection of Deloitte for contracts. We have identified only one former Deloitte employee who provided technical expertise on an RFP because of her position as an IT policy specialist (a more detailed response to her participation can be found under Finding 1). The insinuation by your auditors that Deloitte has been awarded contracts because of ties to our Administration is unfounded based on the facts. While Deloitte is recognized as a firm with a strong focus on the public sector, Deloitte competes and is awarded contracts only when their proposal has been judged by an independent panel of Commonwealth employees as best suited for the subject assignment.

## *APPENDIX C*

We realize that during the review period, we were hesitant to provide you with the names of individuals who served on the various selection committees that awarded work to Deloitte. As we wrote to you on June 18, 2008, we feel that keeping the names of committee members confidential is an important part of maintaining the integrity of the procurement process. Since many committee members are used for industry specific committees, it shelters them from contact with potential vendors and protects the committee from inappropriate contact with vendors. Shortly after receipt of your draft audit, Governor Rendell directed us to release the names to you so that you and your team could complete the necessary review to assure the public that a “revolving door” does not exist. As I wrote to you on February 10, 2009, we are now prepared to give you names of the evaluation committee members. We will provide you this information at the February 23<sup>rd</sup> closing conference.

The history and facts surrounding Deloitte’s business with the Commonwealth are clear: there was no “windfall” or sudden dramatic increase in work for the firm after Governor Rendell took office. Deloitte was successful in the previous Administration also, arguably because they provide excellent product and services. According to Treasury records, Deloitte was paid \$81 million in 2002 and \$83 million in the first year of the Rendell Administration. Of the \$161 million in Deloitte contracts reviewed by your auditors for Department of Public Welfare projects, \$100 million was awarded under a prior administration. One significant contract reviewed by your auditors for Department of Labor was not only awarded under a prior administration, it was awarded as a sole source by that administration. The National Electronic Disease System awarded to Deloitte for the Department of Health was first awarded to Deloitte under a prior administration, and subsequently competitively bid under our administration.

Fair competition and rigorous analysis are at the heart of our procurement practices. Effective competitive proposals, solid performance, and cost savings are the reasons why companies such as Deloitte are successful in winning our business. In fact, the number of sole source contracts awarded annually by the Commonwealth has been reduced by more than 50 percent since Governor Rendell took office in 2003. Only 5 percent of Deloitte contracts were awarded through sole source during your audit period.

## *APPENDIX C*

It is unfortunate that you and your staff have wholly ignored the important achievements of the Rendell Administration in reforming Commonwealth procurement and IT operations. No state in the nation has undertaken a more dramatic and successful reorganization of its IT procurement and operations to better incorporate private sector best practices than the Commonwealth of Pennsylvania. So far, we have identified more than \$300 million in cost savings through programs such as the Governor's Strategic Sourcing Initiative and IT consolidation. But, the taxpayers have not just benefited from savings, they now benefit from a procurement system that forces competition and recognizes performance.

Let us address the most serious flaws in your draft report:

**Your office was provided with information that clearly indicates a lack of favoritism in the selection of Deloitte.** To the best of our knowledge, you were not denied a single interview request or access to documents that were available or relevant to this audit. Your agency extensively interviewed representatives from at least seven agencies and to the best of their knowledge they answered all of your questions. Among the hundreds of documents shared with you were contracts, Request for Proposals, policies and procedures, sole source and emergency justification documents, overall scoring, and RFP recommendation memos.

**The report makes unsupported allegations of conflict of interest:** The report makes vague, unsupported allegations of conflicts of interest between Deloitte and employees of OA and other Commonwealth agencies. There is not a single shred of evidence to support the contention that procurements were awarded because of ties between Commonwealth employees and Deloitte. The use of these inaccuracies as "facts" (as your report indicates, some drawn from anonymous media sources) to then draw the conclusion that OA and DGS did not exercise appropriate scrutiny over Deloitte procurements is careless.

**Your audit team lacks IT expertise, understanding of IT project management and has limited qualifications by which to properly audit IT projects.** The report contains numerous statements that counter IT best practices and basic principles of IT procurement. For example, the report's suggestion that agencies (like L&I) should utilize their own staff to develop the referenced project (Workforce Development) makes no sense. If we had done this, you would have criticized us for not outsourcing – one of the best practices of any well run organization for a highly technical or short-term project. The Workforce Development project would have entailed hiring over 100 Commonwealth employees who subsequently would have been let go at project completion. Also on large complex projects such as Workforce Development, skill sets change throughout the life cycle of the project, so

*APPENDIX C*

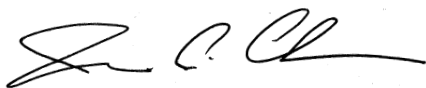
in effect the Commonwealth would have had to temporarily hire 200 or more different persons to complete various aspects of the project. That would be a logistical nightmare and an unbelievable waste of money. No business or government in the country staffs large IT projects with large percentages of their own staff. Using IT vendors is the most flexible and cost effective way to manage a large IT project. IT vendors have a large pool of people to draw upon to provide the precise skills needed at the right time and they work in close cooperation with an organization's in-house IT staff. Your report criticizes us for close cooperation but as managers, we certainly prefer team-based solutions between in-house staff and consultants.

These are only some of the most serious flaws found throughout the report. To properly document each factual error and analytical shortcoming, we have attached an appendix that is over 40 pages.

As Agency heads, we are grappling with some of the state's most serious challenges in decades. It is unfortunate we must take time to respond to a report that relied on anonymous, ill-informed and uncorroborated sources as its basis. Yet we recognize our responsibility to provide Pennsylvania taxpayers with a complete and accurate account of our operations in order to demonstrate that we have been good stewards of their money. Unfortunately, Pennsylvania taxpayers cannot possibly get a fair and accurate assessment of our contract awards by reading your draft report.

We look forward to our February 23<sup>rd</sup> closing conference so we can share additional information and continue our discussion prior to the release of the final report.

Sincerely,



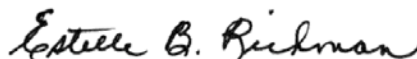
James P. Creedon  
Secretary, General Services



Naomi Wyatt  
Secretary, Office of Administration




Sandi L. Vito  
Acting Secretary, Labor & Industry



Estelle B. Richman  
Secretary, Public Welfare

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Allen D. Biehler  
Secretary, Transportation



Everette James  
Secretary, Health



George E. Cornelius  
Acting Secretary, Community & Economic Development

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COMMONWEALTH OF PENNSYLVANIA

**Response to  
"Special Performance Audit relating to the procurement of contracts with  
Deloitte Consulting LLP during the period July 1, 2000 to December 31,  
2007."**

*Finding 1 - A Lack of Transparency Contributed to the Potential for Improper Vendor Favoritism within the Commonwealth's Procurement Process.*

**Commonwealth Response:** The basic logic of this finding is flawed. There is no support for the underlying contention that favoritism existed. Further, had your office included a closing conference with our agencies before release of the final draft, many of these issues could have been addressed and several of the findings eliminated.

There was a specific set of information that admittedly we were reluctant to provide your auditors. It has been our consistent policy and strong belief that to protect the integrity of the review and selection process, companies competing for our business should not know the names of the members of a committee that will review their proposal or know their individual scoring. Other states follow this practice as well. We also believe that some of your document requests were outside the scope of the audit.

## *APPENDIX C*

Nonetheless, Governor Rendell has directed that the public would be best served by releasing the names of committee members, losing proposals and other IT-related documents requested by your team, so everyone can see first-hand that our process is beyond reproach. Your office should not make evaluation committee member names available to the public. Names of evaluators are not public information and are clearly exempt from access under Right to Know Law [65 Pa.S. Section 67.798(b)(26)].

We found only one instance in which a former Deloitte employee provided technical scoring on an RFP because of her expertise as an IT Policy Specialist for OA-OIT. We will gladly provide your auditors with the 47 pages of highly detailed technical scoring which shows that all seven evaluators for the RFP scored consistently for all four vendors. In fact, all seven evaluators scored Deloitte nearly 20% higher than the second place finisher. The former Deloitte employee's scores for Deloitte fell in the middle of the range, with three evaluators scoring Deloitte higher, and three scoring Deloitte lower.

Even without having the names of evaluation committee members, the report also fails to include significant facts that contradict this finding. Your team was provided with documentation showing that a significant portion of the audited contracts were awarded under previous administrations, or were the continuation of projects first awarded to Deloitte under the previous administration.

Moreover your auditors failed to examine those contracts that Deloitte did not win. For example, in 2004, Deloitte competed aggressively for a multi-year \$100+ million staff augmentation contract. At that time, Deloitte was the second largest provider of staff augmentation services to the Commonwealth. After a highly competitive RFP process, Deloitte lost the contract to Computer Aid, Inc, a Pennsylvania based company that will save Pennsylvania taxpayers more than \$81 million by 2010 through their low prices - and has provided more than 50% of their work to small woman and minority owned businesses.

## *APPENDIX C*

The Commonwealth provided your auditors with unlimited access to its employees and hundreds of pages of documents – all in the spirit of full disclosure and in compliance with the Right to Know law. In fact, many of our agencies offered your auditors documentation and discussion to demonstrate analysis, oversight and strong management of the Deloitte contracts, but your team chose not to pursue this information and omitted it from the report. To include a finding that suggests we were uncooperative or not forthcoming belies the facts and, therefore, should be removed from the final report.

We trust that the provision of this information will eliminate the need for this finding. We nonetheless state our disagreement with the finding as currently drafted, and any suggestion that the Commonwealth makes procurement decisions based on anything but the best interests of the taxpayers.

*AG Report: Page 1, “DGS refused to allow agencies to provide copies of award-related information.”*

**Commonwealth Response:** With respect to whether the information the Agencies provided was sufficient for your review, the Office of General Counsel reached a compromise with your auditors on access to confidential information, which we would not normally release under the Procurement Code, by providing them with overall scoring, RFP recommendation memos and confirmation about whether evaluation committee members were or were not former employees of Deloitte. Your auditors told us this was sufficient. As you agreed to the sufficiency of the information provided, it is inaccurate to include a finding that suggests a lack of cooperation, transparency or provision of information.

As we’ve already discussed, we had serious concerns about disclosing individual evaluation committee members. **We will provide you with committee member names, where they are still available, on the condition that no contact is made with committee members before first discussing with DGS.** Please do not interpret this decision as consent to be provided with all documentation requested by you and your auditors on all future audits. We will continue to consider your document requests on a case by case basis.



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Agencies provided the auditors with access to hundreds of pages of documents, including:

- The relevant Deloitte contracts;
- The relevant RFPs or RFQs;
- Summary documentation regarding the overall scoring and selection process, including maximum point values assigned to each major criterion;
- Information as to whether any evaluation committee members were former employees of Deloitte;
- Any summary memorandums of the selection process and recommendation(s);
- Several hundred pages of policy and procedure manuals for procurement;
- All supplements to the procurement code from 2000 to 2007;
- A report of all Deloitte contracts from January 2004 to December 31, 2007;
- Examples of emergency services and sole source justifications;
- Examples of delegation letters;
- Approvals for sole source contracts, including justification form, cost/pricing data certificate, STD 168 MBE/WBE solicitation, STD 1231 Compliance Review form.

You state that Louisiana, South Carolina and Virginia provide award-related documentation. We can point to three states – South Dakota, Arizona and New Jersey -- that do not provide all award-related information to the public. In fact, states have varying responses based on their confidentiality laws and policies. Therefore this issue is not as straightforward as your auditors would lead the public to believe.

*AG Report: Page 2, "Agencies failed to provide other audit-related documentation."*

**Commonwealth Response:** Agencies offered to provide information to your auditors to demonstrate strong oversight and management of the Deloitte contracts, but these offers were ignored or not pursued.

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For example, PennDOT offered information about oversight of the Deloitte contract, but the auditors did not follow-up with a single question. PennDOT offered information about the quality of the deliverables and work product provided by the vendor. None of that appeared in your report. Finally, PennDOT provided information on their intent to cancel a then-current contract with Deloitte. This information directly related to the stated objective of the audit, but it was not examined or mentioned in the final report. By not pursuing and excluding such information the report presents a biased representation of the facts. To correct this bias, all evidence provided, including information that supports the fact that the Commonwealth managed its contract with Deloitte well, must be included.

We argue that agency IT organization charts and current vacancies are useless information without understanding the current and planned IT workload of each agency. This includes the demand for operational support, federally mandated projects, projects currently under way and those planned. Any analysis less than that would result in incorrect conclusions. While we do not believe the late-requested documents have any relevance and despite the fact that your auditors were unable to articulate how these documents are within the scope of your audit, we will provide you with:

- IT organization charts
- CIO job descriptions
- IT vacancies
- Losing proposals, when still available

*AG Report: Page 3, "Agencies failed to respond to our request to schedule interviews."*

**Commonwealth Response:** Key personnel in seven agencies were made available to your staff for interviews. Agencies provided your auditors with access to dozens of employees who oversaw the execution or management of their Deloitte contracts. In DGS alone, you met with Anne Rung, Deputy Secretary for Administration and Procurement, Jeff Mandel, Director of the Bureau of Procurement, Gary Lee, Special Assistant, Roxana Dietz, Director of Procurement Services, Mike Richart, Commodity Manager, Pam Cross, Procurement Counsel, and Secretary James P. Creedon.

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It is untrue that DCED and OA-OIT refused to meet with you. You met with Patti Chapman, Purchasing Team Manager, IES, within OA-OIT as far back as May 8, 2008. In addition, OA-OIT offered to meet with your office on multiple occasions and your office failed to confirm the meeting date and/or time. OA-OIT staff were still attempting to schedule the meeting when you released your draft report.

Further, no one within DCED recalls having any discussions with your office on the Deloitte audit, including any requests for a meeting.

While the report erroneously states that OA-OIT refused to meet with your office, to be clear, your office never sought to discuss the role of OA in the IT procurement process and never specifically sought to discuss Executive Order 2004-8 and supporting policies with OA-OIT. Executive Order 2004-8 and its supporting policies do, in fact, provide the framework for appropriate and adequate independent review of IT procurement at multiple levels. Since your office did not seek to discuss or clearly understand the operation of the Executive Order, it is not surprising that the report fails to understand how the checks and balances and policies within OA-OIT are designed to work. This hole in your analysis and the report must be addressed before the final report is published.

*AG Report, Page 4, "Failing to provide all award-related information purports a sense of secrecy as opposed to openness with regard to procurement."*

**Commonwealth Response:** The statement that the Commonwealth's "failing to provide all award related information purports a sense of secrecy" is unfounded and not supported by fact. As we stated above, we provided your office with numerous documents and many interviews. We are providing, with this response, additional documentation to further evidence our openness.

*AG Report Recommendation 1: Page 5, "Provide all procurement records, including, but not limited to, the names of the proposal evaluation committee members, copies of losing proposals and detailed scoring sheets."*

**Commonwealth Response:** We will provide you with losing proposals and individual committee names (where still available), and all IT organizational related information.

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**Auditors' Conclusion:** In February 2009, after *The (Harrisburg) Patriot-News* published an article about the results of our original draft report criticizing the Commonwealth for a lack of transparency, Governor Rendell directed the Department of General Services to release additional documents to us so that we could complete this audit. As a result, in March 2009, we again requested contract documentation related to Deloitte RFP/RFQ contracts and related documents from various agencies.

Of the 58 Deloitte RFP/RFQ contracts in effect during the period January 1, 2004 through December 31, 2007, totaling \$474 million, we were only provided complete documentation necessary to audit 25 contracts totaling \$173 million (see Finding No. 3 for the results of our testing). Of the remaining 33 contracts, we were unable to audit them because certain procurement documentation was not provided (see Finding No. 1).

Additionally, the Commonwealth informed us that we were permitted to interview management from OA-OIT, DCED, and others in order to complete our audit objectives. Our conclusions are reflected in the revised findings in this report, including our conclusion in Finding No. 5 that, although OA-OIT may not have violated any laws regarding conflicts of interest with respect to Deloitte contracts, there was the appearance of, and potential for, conflicts of interest.

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### *Finding 2 - Agencies Rely Too Heavily on Deloitte Due to a Lack of IT Expertise and a Reluctance to Train Information Technology Staff on Newly Developed Systems.*

Commonwealth Response: As already noted, the findings in the report strongly suggest that the audit team has no expertise with or understanding of IT project management. The office's suggestion that agencies such as Labor and Industry (L&I) should utilize their own staff to develop the project referenced (Workforce Development) is perplexing. The Workforce Development project would have entailed hiring over 100 Commonwealth employees who subsequently would have been let go at project completion. Also on large complex projects such as Workforce Development, skill sets change throughout the life cycle of the project. IT vendors have a large pool of people to draw upon; it would be grossly inefficient for the Commonwealth to carry a workforce with the scope of skills required. Using IT vendors is the most flexible and cost effective way to manage large IT projects.

The audit team's lack of expertise to properly audit IT project structures is further evidenced by its comment on L&I's use of IV&V (Independent Verification and Validation). The report suggests that independent verification should be the job of the CIO. In fact, the use of third party IV&V is an established industry best practice for large, complex projects and should be used throughout the project life cycle OR when projects run into trouble. The Commonwealth follows this best practice and is proactive with its large, complex projects. In fact, IV&V work often is a federal or state mandate required to obtain project funding. The suggestion that independent verification work could be provided by the CIO who is already managing a full portfolio of multi-million dollar projects and overseeing operational support for a large agency shows a lack of understanding of large IT projects management and IV&V work.

The report also criticizes the agencies for not taking advantage of knowledge transfer and concludes their IT staff is incapable or lacks the desire. That is absolutely untrue - each agency does exercise knowledge transfer in all contracts, including Deloitte contracts.

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For example, when DPW completed knowledge transfer for the master provider index and the HCSIS incident management application, nine Commonwealth staff were able to perform work initially performed by Deloitte. The knowledge transfer that occurred on the Health and Safety (HandS) project is another excellent example of knowledge transfer. Formal classroom training was provided for in the contract as was one-on-one mentoring. Commonwealth staff worked together with Deloitte to accomplish the project work. At the end of the contract Deloitte left and the Commonwealth staff effectively maintained the application.

It also should be noted that Commonwealth IT employees are constantly asked to do more with less and on a regular basis take on new projects that are driven by state legislative mandates, federal mandates and new initiatives leading to a reduction of overall costs or additional services to our citizens. While knowledge transfer takes place for a specific project (from the vendor to the employee), often new projects arise necessitating a redirection of personnel with a specific skill set.

*AG Report, Page 6, "We noted that L&I also contracted with a third-party vendor to manage and monitor a Deloitte contract related to the development of a new IT system."*

Commonwealth Response: L&I advised your auditors that IV&V (the "third party vendor to manage and monitor") is necessary to ensure unbiased performance review of Deloitte. Indeed, as the audit team was told, IV&V is precisely the type of independent oversight the report suggests is necessary to ensure that proper procedures are followed and that the contract is free from even the appearance of improprieties.

The report inaccurately implies that L&I is using the IV&V contract for more than one Deloitte contract. This simply is not the case. The IV&V contract is solely used in connection with the Comprehensive Workforce Development System (CWDS) – an extremely large complex system development project that encompasses three program areas. All other contracts with Deloitte are subject to L&I's monitoring.

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Typically, agencies use IV&V as an essential part of their project to review thousands of pages of requirements for completeness and quality. Reviewing deliverables is the job of the IV&V contractor, while Commonwealth staff complete other project duties such as reviewing the functional specifications and other project deliverables. This division of labor is an industry standard best practice and it should be so noted in the report.

Generally, Commonwealth staff do not possess the expertise or the in-depth understanding required when validating very large IT project requirements and ensuring the end to end traceability of the business functions through testing and coding. IV&V contractors possess special skills and utilize complicated tools to automatically review thousands of pages of requirements.

L&I in particular used the expertise of the IV&V contractor to identify when details were deficient or requirements were missed or combined. The IV&V also helped to determine whether items/tasks were in scope or out of scope. The work of the IV&V vendor allowed issues to be identified earlier in the project, when it was less expensive to identify and resolve. Their review saved money and time.

IV&V vendor's are particularly skilled in facilitation of JAD (joint applications development) sessions which again, resulted in issues being caught early and resolved, avoiding costly project delays. With Department of Labor, the IV&V assisted Commonwealth staff to understand and create user acceptance scenarios, to plan for the testing and to understand what quality acceptance meant.

It was also the IV&V that pushed Deloitte to adhere to specific coding standards and to do a better job of enforcing the standards across the many, many developers on the project.

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*AG Report, Page 6, “no documented detailed analysis was performed, including projecting the resources required to complete the project.”*

**Commonwealth Response:** Contrary to your report, L&I informed the audit staff that it reviewed current workloads, staffing levels, complexity of the project, scope and size and did, in fact, perform a project cost/benefit analysis.

*AG Report: Page 7, “Lack of knowledge transfer to maintain systems.”*

**Commonwealth Response:** This incorrect statement results from the auditors failing to understand that there are different types of knowledge transfer, taking statements out of context, reaching incorrect conclusions and failing to include specifically provided examples of required knowledge transfer. The report needs to be corrected to reflect accurate information on this topic.

For example, L&I requires that knowledge transfer takes place. However, the Commonwealth is not always able to retain such highly trained employees. In many cases once IT staff are trained and the knowledge transfer has occurred, these individuals discover that they have increased marketability in the private sector or qualify for promotional opportunities within the Commonwealth. Consequently, many times employees take advantage of their professional growth by taking more lucrative positions. This is a reality of the workplace and cannot be prevented.

Your report states on Page 7, “With regard to transfer of IT knowledge to the Commonwealth, DPW management indicated that there is no need to utilize the knowledge transfer provision because Deloitte has always won the next contract.” The report incorrectly attributes this statement as the agency’s position concerning “vendor to DPW staff knowledge transfer” when it was obviously in reference to “vendor to vendor knowledge transfer” in the event of the new contract award. Knowledge transfer between Deloitte staff and DPW staff is a contract requirement.



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Department of Health (DOH) IT management staff also told audit staff that there is routine knowledge transfer in its contract which occurs frequently with DOH IT staff. DOH's contract with Deloitte contains a separate knowledge transfer provision clause that requires knowledge transfer at the end of a contract either to a new contractor or to Commonwealth staff. In 2005, DOH had the option at the end of the last PA NEDSS contract to either take on the contract internally or to competitively bid the contract. DOH opted to competitively bid the contract since the work was being performed by 45 Deloitte staff and it was not cost effective or efficient to hire a large volume of IT professionals to handle the work in-house. Since that time, DOH has worked with the Office of Administration to expand IT job classifications to allow DOH to do more of this work in-house. DOH is now working on a contractor replacement initiative with the PA NEDSS contract and will be exercising the knowledge transfer clause in the contract so that Commonwealth staff will take on the work currently performed under the contract.

Finally, your report states on page 9 that "PennDOT is allowing knowledge transfer to occur." To be clear, as PennDOT explained to the auditors, knowledge transfer is a requirement and part of all PennDOT IT development contracts.

*AG Report: Page 7, "Good business practices dictate that a detailed analysis should be documented when contemplating whether a project should be undertaken in-house or contracted to a vendor."*

Commonwealth Response: The Commonwealth agrees with this general proposition. However, the report inaccurately suggests such analysis does not occur. These assertions are the result of incomplete analysis of the Commonwealth IT procurement process. Had the auditors taken the time to understand and discuss the role of agency IT departments and OA in the procurement process within the context of Executive Order 2004-8 and supporting policies, they would have had a clear understanding of the process used for reviewing procurements and the analysis that takes place regarding completing the project internally or externally. Factors such as workloads, skillsets and timing are ALL taken into consideration when IT projects are reviewed.

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For example, OA–OIT recently reviewed an Offender Management System within the Department of Corrections IT Department and determined that this was best suited for development by an outside vendor due to the size and complexity of the project. However, the e–Grants project was determined to be best completed internally by staff from the Department of Environmental Protection and the Office of Information Technology, since subject matter experts were available internally.

*AG Report, Page 8 “Additionally, management indicated that current IT staff is proficient with DPW’s older systems and believes that it would be difficult for the current IT staff to learn and be trained on the newer systems or technology. Furthermore, DPW management stated that some staff have no desire to learn newer systems, while others do not have the capability of understanding certain IT topics regardless of how much training is provided to them.”*

Commonwealth Response: The Department of Public Welfare (DPW) did not make any statements implying that their IT staff was unable or unwilling to learn new systems and software languages. IT staff within DPW are hard working and dedicated employees and, unfortunately, they too often do not get the credit they deserve. DPW takes exception to the audit’s attempt to demean their efforts.

For example, the draft audit report misrepresents a reference DPW made to a research study by the Gartner Group (a research/consulting firm) that notes that efforts to retrain COBOL programmers to .net technology have failed at a rate of approximately 70 percent nationwide. At the time, DPW made clear that this reference was made as part of an overall discussion concerning potential management challenges that DPW faces in maintaining systems written in multiple languages and that it was not directed at DPW employees.

Also, the report incorrectly cites DPW’s current complement for IT positions at 410 when it is actually 360 and mistakenly cites a number of vacancies in some information technology positions with our use of private contractors for other functions. As was pointed out to audit staff, many of these vacancies are not in the application development portion of our IT staff but rather in positions that are budgeted for other functions such as maintenance of other existing systems. The ability of DPW to keep these applications running despite some of these vacancies is actually a testament to the level of professionalism and hard work of our staff.

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The final report should not include these inaccurate statements regarding DPW employees.

*AG Report, Page 8, "Within DOH, management stated that there are no formal meetings held or any documentation to support the decision making process for determining whether to utilize agency staff or contract to a vendor."*

Commonwealth Response: DOH IT management involved in the audit related interviews do not recall making these statements. However, it is possible that such statements are being inappropriately attributed to the fact that DOH IT management may not have had documentation to prove that a process was used to make that determination for the specific contracts in question. What should be noted in the report is that the contracts at issue and related decisions were executed prior to the current management team's tenure.

Nevertheless, DOH does have a project feasibility study that is performed on larger scale projects that helps to scope out IT projects and identifies the feasibility of doing the work in house. Therefore, a general statement of this nature is inaccurate and should not be part of the final report.

*AG Report, Page 8, "Within L&I, management stated that it does not have sufficient staff to perform its IT services."*

Commonwealth Response: L&I takes issue with this statement. In particular, L&I disagrees with the assertion that due to a lack of staff, it must contract with Deloitte to perform continuous maintenance of its IT systems. Deloitte provides continued maintenance on only one of the four contracts it has had with L&I. The CWDS project is an ongoing IT system development project and continued maintenance support is an expected, appropriate service. The Strategic Oriented Architecture contract was a limited term project with no maintenance deliverables and the Workers Compensation HANDS project was new systems development with internal L&I IT staff successfully maintaining the system based on the knowledge transfer they received. The New Hire Data Collection contract manages and operates the Data Collection Operations Center for the New Hire Reporting system.

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Aside from the specific inaccuracy of the statement, the statement is also overbroad and implies a general lack of staffing at L&I. This is not the case and the statement should be tailored to the scope of the audit.

*AG Report, Page 8, "We noted that DPW only spent approximately \$25,000 on deliverables from Deloitte related to IT training."*

Commonwealth Response: This statement is inaccurate. Clearly the auditors misread the contract, as the training referenced in the statement above is for end-user training (training for those who actually use the applications) – not training for Commonwealth IT staff. As such, \$25,000 for end-user training is entirely appropriate.

*AG Report, Page 9, "No detailed analysis was provided by PennDOT projecting resources to determine if the requirements are reasonable."*

Commonwealth Response: This statement is inaccurate because it ignores documents provided by PennDOT that completely contradict this finding.

PennDOT provided the auditors with the study conducted in preparation for its major business reengineering and system rewrite project. Also, PennDOT provided the decision-making documents (ITR) outlining its lack of appropriate internal resources for this project.

In general, this comment and findings show a lack of understanding of major IT projects and system reengineering/rewrite efforts. If one were to follow the logic proposed by the report, one would have to ask the questions like: should facility managers build actual facilities? Should fleet managers build the cars that make up the fleet? The answer to the questions cannot be "yes." The comment should be removed from the report.

*AG Report, Page 9, "The contract will be completed by February 2009. However PennDOT management does not currently know whether it will begin in-house maintenance of the system or whether it will contract this service to an outside vendor."*

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Commonwealth Response: This statement contradicts information provided to the auditors and presents a forward-looking statement as current fact. PennDOT specifically told the auditors that PennDOT will be doing in-house maintenance of the system. PennDot maintains the system today. PennDOT also told the auditors that in the long-term, major system changes *may* be needed if/when legislation is passed (or other initiatives) that affect the way they do business. Those changes *may* result in foundational system modifications. If so, PennDOT *may* decide to contract out for those modifications. Please correct the final report accordingly.

*AG Recommendation 3: "Ensure that agencies perform a detailed analysis as to whether a project should be completed in-house or whether the project should be completed by a contractor."*

Commonwealth Response: The Commonwealth agrees with this general proposition. However, the report inaccurately suggests such analysis does not occur. These assertions are the result of incomplete analysis of the Commonwealth IT procurement process. Had the auditors taken the time to understand and discuss the role of agency IT departments and OA in the procurement process within the context of Executive Order 2004-8 and supporting policies, they would have had a clear understanding of the process used for reviewing procurements and the analysis that takes place regarding completing the project internally or externally. Factors such as workloads, skill-sets and timing are ALL taken into consideration when IT projects are reviewed. We would like to note, however, that DGS has no authority to refuse to procure services if it feels that the Agency should do the work in-house. However, OA-OIT reviews these requests and will deny or approve. DGS has written policy on determining contract need found in Part I, Chapter 4 of the Procurement Handbook.

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*AG Recommendation 4: “Require agencies to include adequate knowledge transfer provisions in all IT contracts.”*

Commonwealth Response: When appropriate, IT Services contracts do contain the provision for knowledge transfer. The findings related to knowledge transfer throughout the report seems to result from the auditors’ misunderstanding of Agency comments or evidence a lack of understanding by the auditors of the proper circumstances for knowledge transfer. We would like to discuss these findings so the report accurately reflects knowledge transfer that is occurring.

If there was an inadequate knowledge transfer on IT projects, we would have cost overruns and extensive use of EPO’s for maintenance, and that is not the case.

*AG Recommendation 5: “Require agencies to receive the appropriate amount of knowledge transfer and to maximize the use of in-house staff to perform maintenance and upgrades.”*

**Commonwealth Response:** See Response to Finding No. 2, above.

*AG Recommendation 6, “Use its leverage as the lead procurement entity to push the administration to consider increasing the IT staff complement, if determined necessary for certain agencies.”*

Commonwealth Response: The Commonwealth does consider before each procurement whether it would be more efficient or effective to use in-house staff or outside consultants for our IT projects. Among the factors we consider are staffing needs, recruiting practices, hiring requirements, salary comparisons and cost benefit analyses. As we explained earlier, increasing staff compliment is not typically an efficient or cost effective way to run large, complex IT projects. Typical large projects often require hundreds of different skill sets at different times during the project. This is why business and governments use IT vendors to staff such projects. IT vendors have a large pool of people to draw upon and this approach is much more flexible and cost effective over the life of the project.

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This recommendation may keep the Commonwealth from hiring outside firms for IT projects. The Commonwealth has had difficulties recruiting and retaining employees with the many diverse and high-level skills necessary for IT system implementation work. The factors hindering recruitment and retention include competition with the private sector, civil service requirements, and governmental salaries. Not being able to hire employees or contract out the work can ultimately cause system degradation, thereby impeding the Commonwealth's ability to provide appropriate service to its constituents.

**Auditors' Conclusion:** With regard to the Commonwealth's response regarding whether to use in-house staff to perform IT projects, we are recommending that agencies perform and formally document a detailed analysis as to whether the project should be completed in-house or whether the project should be completed by a contractor. This detailed analysis should determine the resources needed for the Commonwealth to be able to perform the project in-house, including hiring of IT staff. By performing this analysis, the Commonwealth can determine whether it may be cost-beneficial to perform the project in-house. If it would not be beneficial to perform the project in-house, then the Commonwealth should document the reason why not. DPW, L&I, and DOH management stated that any analysis performed is not formally documented. The documentation provided by PennDOT was very brief regarding consideration of performing the IT project in-house or contract with an outside vendor. There was no detailed analysis of what resources would be necessary to perform the project in-house. The decision-making document briefly stated that heavy reliance on outside vendors would be necessary.

With regard to L&I's use of a third-party contractor to manage and monitor a Deloitte contract related to the development of a new system, L&I did not state that the use of an Independent Verification and Validation (IV&V) was required. L&I responded to the auditors that it does not have an adequate number of staff with adequate expertise to manage a large IT project such as CWDS. Because this project was in the public's eye, L&I wanted to make sure the project was done right. While the Commonwealth has responded that an IV&V is a best practice, this practice has not been utilized at DPW, where the Commonwealth has procured contracts with Deloitte totaling \$241.4 million during the period January 1, 2004 to December 31, 2007.

With regard to knowledge transfer, our comments in the finding refer to the transfer of knowledge from Deloitte to Commonwealth IT staff at the end of a project to enable the Commonwealth IT staff to gain the knowledge necessary to maintain the system, and perform minor upgrades itself without contracting with the outside vendor for these services. If Deloitte were awarded a subsequent contract to maintain the system, then the necessary knowledge would not be transferred to the Commonwealth's IT staff to maintain the system itself. We commend DOH for its response that it is working towards performing more of the work in-house that is currently being performed under the contract with Deloitte.

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We want to emphasize that we are not demeaning the efforts of DPW's IT staff. To the contrary, we are recommending that DPW ensure that knowledge transfer occurs and maximize the use of in-house IT staff to perform maintenance and upgrades on the systems to reduce the need for maintenance contracts with Deloitte. Our interviews with DPW management revolved around use of DPW IT staff to develop, upgrade, and/or maintain its own systems. DPW management may have been using the study performed by the Gartner Group, which was mentioned in the response, to generalize about its IT staff, but we were specifically discussing DPW IT staff in relation to work performed under Deloitte contracts. This study was not mentioned during our interview with DPW management. DPW management did provide auditors with documentation supporting 360 vacant IT positions subsequent to responding to the original draft audit report. We modified the draft report accordingly. In addition, utilizing the expenditure descriptions included in data file of payments made to Deloitte during the period January 1, 2004 to December 31, 2007 provided by the Office of the Budget, DPW only spent approximately \$25,000 on deliverables from Deloitte related to IT training. Based on our review of the invoice, this training is for IT staff and not end-users as stated in DPW's response.

As stated in Finding No. 1, the Commonwealth permitted us to interview OA-OIT after our original draft audit report was submitted to DGS. As a result of our interviews with OA-OIT and review of documentation from OA-OIT, we reported weaknesses in OA-OIT's procurement review process, including the appearance of, and potential for, conflicts of interest in Finding No. 5.

Based on the Commonwealth's response, our recommendations remain as stated in Finding No. 2.



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### *Finding 3 - Sole Source, Emergency, and Change Order Procurements Lacked Adequate Justification and Approvals*

Commonwealth Response: Fair competition and rigorous analysis are at the heart of our business approach. Effective competitive proposals, solid performance, and cost savings are the reasons why companies such as Deloitte are successful in winning our business. There are no other reasons. Only 5% of Deloitte contracts were awarded through sole source during the audit years.

The number of sole source contracts awarded annually by the Commonwealth has been reduced by more than 50 percent since Governor Rendell took office in 2003. In fact, in 2003 Rendell administration officials were handed a list of sole source requests from the prior administration and told to approve them. We carefully reviewed the requests and denied over \$20 million worth of proposed sole source contracts – we are aware of no other administration so carefully scrutinizing sole source requests.

With the movement towards centralization of procurement in 2004, DGS implemented the Commonwealth's first rigorous review of agency sole source requests. Under Governor Rendell, agencies are required to submit a sole source justification form that requires a detailed explanation of why the procurement is being proposed as a sole source as well as additional background information. DGS reviews the form, conducts an extensive multi-level review of the agency request, including research and discussion with other potential vendors, and ultimately DGS approves or denies. Because of DGS' new sole source review process, the number of sole source requests has decreased by 60%, from 801 requests in FY 02–2003 to 320 in FY 07–2008.

We would be willing to provide your office with specific examples of IT sole source requests submitted by agencies which DGS reviewed and ultimately denied, including a \$1.5 million sole source request for IT services submitted in October, 2007, one submitted for \$1.5 million in October, 2008 and one submitted in June 2008 for \$500,000.

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DGS recently took another major step forward in improving the sole source process by providing the public with greater transparency into the process. In February, 2009, DGS launched a new sole source page to their website which posts all important sole source award information for public viewing, including the agency justification form, the contractor name, the anticipated spend, and whether DGS approved or denied. We are not aware of any other state in the nation that provides such transparency into its sole source process. Not only does it provide the public with complete transparency into the sole source process, but it also allows vendors ten days to review the documentation and contact us if they believe they are also capable of providing the commodity or service. If we agree, we will deny the Agency request and competitively bid the procurement.

The audit report questions some of the emergency contracts entered into by DPW with Deloitte. We agree that the number of emergency procurements executed should be limited. However the fact that a small subset of contracts with Deloitte – less than 15% of the total amount spent for valuable Deloitte services over your audit years – were subject to emergency contracting does not evidence favoritism. In those instances where emergency contracting occurred the requirements for such procurements were followed. Extending a contract or procuring services through a sole source occurred only in compelling circumstances, for example when it ensures there is no break in services or is the most cost effective means of purchasing services by the only available provider.

*AG Report, Page 10 “Inadequate justification for sole source procurements.”*

Commonwealth Response: The report fails to identify which sole source contracts were included in the audit. Consequently, we can only speculate as to which contracts are subject to this finding and cannot adequately respond to specific allegations. However, as all of the contracts we reviewed for sole source justification were properly supported, we disagree with the assertion that any of the sole source justifications were inadequate.

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The sole source justification for L&I's New Hire Data Collection contract specifically included information regarding other contractor's performance of similar work in other states, Deloitte's knowledge of the systems required for the program requirements, and collection software and the impending need for the contract to be in compliance with federal law. Deloitte was previously involved in the process and due to the nature of the work, the Commonwealth would not have benefited from the competitive bidding process in this case.

The security design submitted by Deloitte in response to the CWDS RFP was reviewed by architecture and security teams at both L&I and the OA/OIT. It was aligned with the COPA initiative to present a single facing security system approach to the public, employers and providers as well as single sign-on capabilities for internal staff users. The design was approved to be the Enterprise Security approach for L&I, and Deloitte was asked to implement their approach as an Enterprise solution and not just a single CWDS project solution. The sole source approval was the most cost effective approach to achieving a single solution for the L&I organization.

*AG Report: Page 11, "Inadequate and unreasonable justification for emergency procurements."*

**Commonwealth Response:** The report again fails to identify which emergency procurements are the sources of this statement. Consequently, we can only speculate as to which procurements are subject to this finding and cannot adequately respond to specific allegations. However, as all of the contracts we reviewed for emergency procurement approval were properly supported, we disagree with the assertion that any of the emergency procurement justifications were inadequate.

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The report faults DPW for using emergency procurements when they were often used to extend contracts briefly because of on-going negotiations and resulting delays in the approval process. Extending contracts via emergency procurement allowed the Department to conduct more thorough negotiations, which ultimately led to better contract terms and a savings to the taxpayers of \$6.3 million annually. While DPW would prefer to complete negotiations as quickly as possible, it is not reasonable to suggest that it should have arbitrarily ended negotiations earlier and not achieved the highest level of savings possible for the taxpayers simply to avoid extending a contract for a few months.

In the end, in a number of cases, the EPO was the only alternative to avoid an interruption or loss of services.

DGS' Bureau of Procurement is instituting a new process requiring advance notice of forthcoming procurements, which should improve contract transition and reduce the need for emergency procurements in the future.

*AG Report, "According to DOH, one emergency contract was executed in 2005 because it had not yet become compliant with federal regulations...justification for an emergency procurement does not seem reasonable and should not have been approved. Instead, a competitive award should have been considered."*

Commonwealth Response: Questions regarding this specific emergency procurement were never raised in the meetings between DOH and the audit staff. Given the complex nature of such procurements, it is inappropriate to reach a conclusion solely based on the documentation and without discussion of the particular facts at issue.

Indeed, the report concludes that since the DOH system was out of compliance for more than two years, DOH should have pursued a competitive bid. The report fails to understand the purpose of this emergency procurement was to make modifications to DPW's HCSIS application that at the time was under contract to be maintained by Deloitte. It was not appropriate to seek a competitive bid at that time and the report should be revised to reflect this.

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*AG Report: Page 12, "Lack of change order justification and proper approvals."*

**Commonwealth Response:** As with other types of procurements, the report also fails to identify which change orders were reviewed. Consequently, the agencies are unable to respond with specifics to the report's general allegations. However, as change orders are important procurement documentation, and we make every effort to provide more than adequate support for all change order requests, we assert that all agency change orders were required and have adequate support and justification.

*AG Report, Page 15, ""The routine decision of annually adding work to an existing contract, as opposed to competitively bidding the new work as part of a new contract, may cause the agency to pay an excessive amount for that service. Additionally, DPW's reasoning that new initiatives cannot be added to the original work statement of a contract until 'funds become available' is disturbing. This process could lead to potential vendor favoritism by giving more work to Deloitte through the use of change orders which are not competitively bid or do not require sole source or emergency justification and DGS approval."*

**Commonwealth Response:** The audit report's characterization of this statement is of particular concern to DPW, as it conveys a lack of understanding of the scope of the procurement at issue as well as of the annual scoping process. To be clear, at no time did DPW procure services outside the scope of work of the contract, nor could it under the existing contract terms as the draft audit implies.

Large IT projects usually contain multiple phases of works and span a number of years. When a large IT project is procured, the entire scope of the project is part of the RFP. However, the RFP also will make clear that different portions of the project may or may not be completed depending on a number of factors, including available funding and agency priorities.

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The statement “when funding becomes available” was made in reference to the annual budget process and the reality that funds for any given project may not be fully funded each fiscal year. Further, the procurement code allows all contracts, including this one, to have change orders executed for work within the scope of the contract. This is particularly applicable for larger and technically complex projects. Not only is this process entirely appropriate, it is necessary to allow projects to respond to changing needs and funding over the life of a multiple year under taking. This is an IT contracting best practice followed by public and private sector IT purchasers.

**Auditors’ Conclusion:** Based on the results of our testing of RFP/RFQ procurement documentation provided as stated in Finding No. 1, we have made five additional recommendations to DGS numbered 7 through 11. We acknowledge the new procedures implemented by DGS to partially address Recommendations 13 and 16 identified in Finding No. 3.

With regard to the remainder of DGS’s response to the finding, DGS and the various Commonwealth agencies should be aware of which sole source and emergency contracts we reviewed because the auditee provided us with the contracts that were in effect during the period January 1, 2004 and December 31, 2007. Note that PennDOT did not have any sole source contracts with Deloitte during this period and PennDOT and L&I did not have any emergency procurements with Deloitte during this period.

With regard to L&I’s sole source justification for L&I’s New Hire Data Collection contract, we question how the Commonwealth could be certain that it would not have benefited from the competitive bidding process without obtaining other vendor proposals. Additionally, for the other sole source contract at L&I, as part of the sole source justification, research as to whether other vendors could perform the work needs to be performed and documented to ensure that the sole source award is the most cost-effective approach.

With regard to DGS’s response to emergency procurements, we found that DPW habitually used emergency procurements to bridge the gap between an old Deloitte contract and preparing for a new contract, including lengthy negotiations, delay in approval process, delay in obtaining funding, or the work of the previous contract was not finished. This situation occurred 12 times at DPW during the four-year period January 1, 2004 to December 31, 2007. Clearly, better foresight and planning is needed.

Additionally, DOH cancelled meetings with the auditors on two occasions and never rescheduled. The auditors stated to DOH that the meeting pertained to follow-up questions regarding our procurement test work at DOH. Our conclusions regarding the emergency contracts at DOH were based on the documentation provided.

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With regard to contract change orders, DPW, L&I, and DOH provide the auditors with a list of all change orders to contracts in effect during the period January 1, 2004 to December 31, 2007. The auditors stated that change orders which increased the value of the contract by more than \$1 million were tested. We agree that change orders are at times necessary and appropriate; however, we question the excessive use of change orders. For example, one contract at DPW totaling approximately \$23.0 million at its onset at January 1, 2007 had 34 change orders, adding \$72.6 million to the original contract through December 31, 2007. It is our understanding that change orders continued to be made to this contract subsequent to our audit period.

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### *Finding 4 - Poor Accountability and Control Weaknesses found for IT Contracts and Expenditures*

Commonwealth Response: This vague and overbroad statement shows how little time was spent understanding the Commonwealth's IT procurement process. It is unfortunate that the auditors never sought to discuss the role of OA in the procurement process and never specifically sought to discuss Executive Order 2004-8 and the supporting policies. The Executive Order and policies provide the very framework for appropriate and adequate independent review of IT procurement at multiple levels that the report wrongly states are lacking. Since the auditors did not seek to discuss or clearly understand the operation of the Executive Order, the report fails to explain how the checks and balances and policies within the Commonwealth are designed to work.

*AG Report, Page 18, "We requested that the Agencies with Deloitte contracts provide us with a list of their accounting of Deloitte contracts. It took L&I over three months to compile a list of contracts and change orders."*

Commonwealth Response: There were a number of issues with the information requests made by the auditors. First, many of the requests were made informally, not in writing, and without a deadline for a response.

Further, it must be noted that while the report indicates that L&I took three months to compile the list, L&I had previously provided the auditors with copies of the contract documents and change orders. Consequently, the auditors already possessed the information at issue in this statement, even though it wasn't in "list" form. L&I attempted to cooperate with the audit, so there is no reason to make a finding that information was slow to be produced when the information had already been provided.

*AG Report, Page 18, "The Office of Administration denied having a contract with Deloitte."*

Commonwealth Response: The Office of Administration (OA) never denied having a contract with Deloitte. In fact, OA was never asked to provide information for its one contract with Deloitte, the Business Solutions Center of Excellence project.



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*AG Report, Page 18, "Control weaknesses in approving expenditures" The audit findings document states: During our initial meeting with DOH, the individual who signed several of the invoices as approved, as well as the other management attending the meeting could not recall their procedures.*

**Commonwealth Response:** This statement is misleading and must be corrected. During the audit interviews, the auditors asked DOH staff about procedures on a time and materials contract that occurred over four years ago. DOH provided a general statement of how this was handled and noted that it could provide additional detail if needed. However, the Auditor General's Office never followed up. For the report to now state that actions were not documented is disingenuous.

*AG Report, Page 19, "No written policies and procedures for the review and approval of IT invoices."*

**Commonwealth Response:** This statement is inaccurate and must be revised. PennDOT met with the auditors and explained how the invoices are routed and who reviews and approves them. PennDOT walked the auditors through the process: 1) invoice received, logged and tracked, 2) forwarded to multiple people for approval of hours worked and proper contracted rates, 3) reviewed to ensure that deliverables have been received, and finally, 4) process for payment or rejected. This process includes a very detailed review of all Deloitte invoices before any payment is made to them. Therefore, it is inaccurate to state there are no written policies and procedures for the review of IT invoices.

Likewise, DPW employs a significant number of employees who are dedicated to the approval of IT deliverables. These employees have written procedures for the acceptance of contract deliverables and it is the deliverables that effectively drive the invoicing process. As a result, DPW also disagrees with this finding and believes it to be without merit.

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*AG Report, Page 20, "Potential over billing of facility costs."*

Commonwealth Response: The report erroneously assumes that Deloitte is misusing the resources provided in its contracts. This simply is not the case.

With respect to the facility charges associated with the L&I CWDS contract, DGS reviewed square footage costs to determine the reasonableness of the charges in connection with the location. Additionally, the square footage charge encompasses all facility services. Since the cost was pre-negotiated at a flat rate for the life of the contract, Deloitte bears the costs if service fees increase due to inflation or other factors. This is standard contracting practice.

Additionally, the report's suggestion that Deloitte may be utilizing the facility for other work unrelated to the contract is unfounded. The CWDS contract has specific time sensitive deliverables. Use of the facility for other projects would jeopardize Deloitte's ability to meet these deliverables. There is no evidence to support that this is the case and accordingly this statement should be removed from the report.

*AG Report, Page 20, "DCED's \$750,000 grant to Deloitte to hire/retain 2000 jobs is questionable."*

Commonwealth Response: There are significant errors and/or misunderstandings in the report regarding DCED's \$750,000 Opportunity Grant (OGP) to Deloitte for job retention/creation in Pennsylvania.

Specifically, on Page 20, the report states, "Because the grant does not specify what contracts would pay for these retained/new employees, Deloitte could be hiring/retaining 2,000 jobs from existing 'Commonwealth-funded' contracts rather than private 'non-Commonwealth-funded' contracts. "

This statement is misleading and jumps to the most damaging of many possible conclusions. The statement implies that Deloitte's projected new jobs and current employment of over 2,000 people in Pennsylvania is directly attributable to Commonwealth contracts. Deloitte's Pennsylvania operations serve a wide range of clients in multiple states and their expansions were a result of growth of their overall client base. There is no basis for concluding the growth is the result of Commonwealth contracts.

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Deloitte made clear to DCED in January 2005 that it was planning to consolidate multiple Deloitte offices in the Philadelphia area into one location and add new jobs. At that time, multiple locations both in Pennsylvania and outside of Pennsylvania were under consideration for the consolidated operations. Pennsylvania was at risk to lose 1001 jobs or could gain 252 jobs. DCED chose to aggressively pursue the project and retain the existing jobs and add new jobs.

Deloitte informed DCED of a second expansion project in late 2005 for a new “technology center”. The multi-client center was to perform work for other states, the federal government and private sector. The proposed center would focus on custom software development for both public and private sector clients. Deloitte was considering a number of locations for this technology center including: Baltimore, MD; Tulsa, Ok; Atlanta, GA; Austin, TX; Tallahassee, FL; and Camp Hill, PA. This was a multi-state, competitive project and Pennsylvania had the opportunity to gain 250 new jobs as a result of this project. DCED chose to aggressively pursue the new jobs.

While it is possible that some of the new jobs created by Deloitte in Pennsylvania may be related to Commonwealth contracts, the vast majority of work performed by Deloitte’s Pennsylvania operations is not specific to Commonwealth contracts.

Additionally, the report states, “we question DCED’s logic in allowing Deloitte to retroactively calculate the number of retained/new jobs back to 2005 when the grant was awarded on September 2007. “

Deloitte accepted an offer of assistance from the Commonwealth of Pennsylvania in January 2005 to retain 1001 jobs and create 252 new jobs in Philadelphia. Deloitte was in the process of applying for the OGP under this offer when the “technology center” project was introduced which impacted both the Harrisburg and Pittsburgh Deloitte offices by retaining 537 additional jobs and adding an additional 250 jobs to these locations. In order to streamline the application process and allow DCED to better track Deloitte’s overall employment impact in the Commonwealth, the two projects to occur at three locations were combined under one contract starting April 2005 that required Deloitte to retain 1,538 jobs and create 502 jobs over four years.

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Deloitte and DCED clearly entered into the contract process in January 2005 well before the award in September 2007. Because the contract process was already underway for the expansion/retention of Deloitte's Philadelphia operations, jobs created from that point forward were considered towards Deloitte meeting its overall job creation/retention commitment for the combined projects, and there is nothing improper about doing so.

*AG Report, Page 20: "DPW management stated that they do not verify the reasonableness of the costs or perform any review to ensure that costs for use of the same facilities over multiple contracts are not overlapping and potentially being double billed to the Commonwealth. We were unable to validate if any over billing occurred due to lack of supporting documentation. In addition, DPW could not validate for the same reason."*

Commonwealth Response: We strongly disagree with this statement. DPW validates the reasonableness of facility related costs. In fact, Deloitte's facility costs for the largest two contracts covered by the audit are in line with that of other competitive offers. To that point, every competitive cost proposal submitted during the RFP process that resulted in the two largest DPW-Deloitte contracts examined for this audit, contained pricing for facilities by other vendors that were higher than the cost submittals of Deloitte, in some cases 150 to 300 percent higher.

The audit report also claims on page 21 that, "Facility costs are established by the negotiation process at the beginning of the contract and are a fixed monthly rate. According to DPW management, the reasonableness of the costs is not verified due to the immaterial dollar amount of the facilities costs compared to the total contract amount. However, facility costs over four years totaled \$3.6 million. DPW's Director of the Bureau of Financial Operations stated during the negotiation process the facilities charges are of little concern to him and he does not micromanage every line item in the contract as long as the overall price is reduced to an acceptable amount. Additionally, DPW does not request any documentation from Deloitte to verify reasonableness and the accuracy of the facility costs during the invoice review process."

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To state, as above, that DPW did not validate facility costs and considered reviewing these costs as “micromanaging” is incorrect. DPW clearly stated to the auditors that its negotiation approach comprehensively examines all contract components – including facility costs – and validates these costs against competitors’ costs and against other external sources.

In addition, the statement referenced above referred to overall contract negotiations, and referenced the fact that these facility costs represent less than 1 percent of the total contract value. In order to realize the best overall value for the Commonwealth, the Department focused on all components of the contract. Although omitted from the report, this approach resulted in a 13 percent reduction in the price of the two largest contracts reviewed for this audit alone – an annual savings of approximately \$6.3 million.

*AG Report, Page 21, The audit report states that “both DPW and PennDOT management stated that the size and complexity of the Deloitte contracts made it impractical to enter contract information into the SAP Procurement Module, thus properly utilizing the three-way match controls. We disagree. The accounting system was designed to maximize automated controls and the control environment by subjecting its contract payments to the three-way match feature.”*

**Commonwealth Response:** The above statement discloses a lack of understanding of the limitations of the SAP Procurement module and accepted Commonwealth accounting practices. The report casually disagrees with our opinion of the functionality of the SAP Procurement Module without offering any basis in fact for the disagreement. The Public Health and Human Services Comptroller, DGS, and the Integrated Enterprise System (IES) have all agreed that there are instances in which the SAP system, which does not have the capability to encumber funds, is unable to meet certain contracting needs and, therefore, a funds commitment must be utilized. The PennDOT and DPW contracts are prime examples of those exceptions.

Even though complex services are very difficult to configure in the procurement module of SAP, agencies are encouraged to use the procurement module wherever and whenever feasible. There has been a significant decline in past few years of use of funds commitments for service procurements and we welcome advice from your office on how we could increase use.

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*AG Report, Page 22, "Ensure that agencies enter all contracts and related change order/amendment information into the SAP procurement module to ensure complete accountability of all contracts. In addition, this will ensure that all payments are subject to proper controls of the SAP three-way match procedures."*

**Commonwealth Response:** DGS has instructed Commonwealth agencies to move toward entering all procurements into the procurement module of SAP. Entering complex procurements, such as RFPs and RFQs, can have unique issues and be challenging to enter. For example, while deliverables based contracts can be tracked, reviewed and received with the SAP system, time and materials based contracts are not as adaptable to the SAP system.

The Commonwealth, including PennDOT, is moving towards more deliverable-based IT contracts and away from time and materials contracts for a number of reasons. With deliverables based IT contracts the selected vendors assumes much of the risk of providing the required products within their project budget, reduces administrative tracking, and provides tangible products at prescribed prices and times. This type of contract works well within the SAP system and deliverables can be tracked, reviewed and received effectively. A deliverable-based contract keeps both the vendor and the Commonwealth project manager focused on the defined project scope.

On occasion, time and materials contracts are necessary. These contracts provide a great deal of flexibility when solutions to problems cannot be defined to the last detail prior to a procurement. Time and materials contracts do not work well within SAP Procurement. The need to move monies from line item to line item creates significant transactional work.

**Auditors' Conclusion:** We commend DGS for moving agencies toward entering all procurements into the SAP Procurement Module, as stated in Recommendation 18 identified in the finding. Additionally, we acknowledge the Commonwealth's efforts to move toward more deliverable-based IT contracts and away from time-and-materials-based contracts.

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DGS's statement that the auditors never attempted to discuss the role of OA in the procurement process is incorrect. The auditors did request a meeting with OA-OIT by contacting OA's Audit Coordinator, who is also OA's Chief Counsel. OA's Audit Coordinator questioned the auditors, first through a telephone call and then through e-mail, why the interview with OA-OIT was required and how the information we intended to discuss was covered by the scope of our audit. OA's Audit Coordinator agreed that OA-OIT's role in the procurement process is within the scope of our audit, but never ultimately scheduled the meeting the auditors were requesting over a two-month period. As stated in Finding No. 1, the Commonwealth permitted us to interview management from OA-OIT after our original draft report was submitted to DGS. As a result of our interviews with OA-OIT and review of documentation from OA-OIT, we reported weaknesses in OA-OIT's procurement review process, including the appearance of, and potential for, conflicts of interest in Finding No. 5.

Additionally, all documentation or information requests were made in writing according to the protocols issued by the Governor's Office. A written memo or e-mail was sent to the respective agencies' audit coordinators for all documentation and information requested.

Furthermore, DGS claims that OA never denied having a contract with Deloitte. However, we have an e-mail from OA's Audit Coordinator and Chief Counsel stating that OA had no contracts with Deloitte during the period January 1, 2004 to December 31, 2007. Similarly, the Executive Deputy General Counsel in the Governor's Office of General Counsel also stated in an e-mail to the Department of the Auditor General's Chief Counsel that OA had no contracts with Deloitte during this period. The OA contract with Deloitte was provided to the auditors at the audit exit conference, after the original draft findings were given to DGS for response.

With regard to DOH not being able to recall procedures for the review and approval of time and materials contract invoices, we interviewed the individual who signed the invoices as approved. He could not recall his procedures.

With regard to PennDOT's and DPW's invoice review and approval procedures, PennDOT did verbally explain its procedures to the auditors; however, PennDOT stated it did not have written procedures. DPW does have written procedures for the acceptance of contract deliverables; however, DPW does not have written procedures for the review and approval of invoices. While the deliverable acceptance is one important part of the invoice review, the review should also include, but not be limited to, ensuring accuracy of invoice, price agrees to the contract, funds are available, and approval by supervisor. Also, DPW had invoices for time and materials contracts that do not include an acceptance of fixed-price deliverables. To ensure invoice procedures are performed properly and consistently, procedures should be written.

With regard to facility costs, we do not state that Deloitte is overbilling facility costs. We state that the potential exists because neither DPW or L&I has verified that Deloitte is performing work for only the contract in question and not other work for Deloitte unrelated to the respective contracts with the Commonwealth. In addition, statements were made by DPW management in a meeting with three auditors present regarding not verifying the reasonableness of facility costs when contracts are being negotiated. DGS's response to the finding contradicts the statements that DPW management previously stated to the three auditors.

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With regard to DCED's grant to Deloitte to create 502 new jobs and retain 1,538 existing jobs, attempts were made by the auditors to discuss this grant with DCED. The auditors initially contacted DCED's Audit Coordinator and Chief Counsel through e-mail in order to verify that DCED made this grant to Deloitte. DCED failed to respond to the e-mail. Subsequently, the auditors attempted on two occasions to call DCED's Audit Coordinator and leave a detailed voice-mail to set up an interview with DCED regarding this grant; however, the phone calls were not returned. Our attempts to contact DCED's audit coordinator were in accordance with the Governor's Office's protocols. As stated in Finding No. 1, the Commonwealth permitted us to interview management from DCED after our original draft report was submitted to DGS. As a result of our interviews with DCED and review of documentation from DCED, we reported weaknesses in DCED's Opportunity Grant and Job Creation Tax Credit procedures. We continue to recommend that DGS monitor contracts by vendor to ensure an awareness of situations such as Deloitte receiving a \$750,000 grant and \$1.5 million in tax credits in addition to receiving \$592.1 million in Commonwealth contracts, as well as to ensure that the Commonwealth obtains the benefits/services intended. DCED should ensure that future grants and tax credits be for hiring/retaining jobs from non-Commonwealth funded contracts. We also made additional recommendations to improve DCED's procedures.



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### *Finding 5 - DGS Needs to Improve its Oversight and Monitoring of Agencies IT Procurement Practices*

Commonwealth Response: We disagree with the findings in this section. The auditors never sought to discuss generally the role of OA in the IT procurement process and never specifically sought to discuss Executive Order 2004-8 and the supporting policies. The Executive Order provides the very framework for appropriate and adequate independent review of IT procurement that the report finds lacking. Since the auditors did not seek to discuss the operation of the Executive Order, the report fails to understand how the checks and balances provided in the Executive Order are designed to work.

Further, in this Finding, as in Finding No. 1, the report casually, without any support or detail makes allegations of conflicts of interest between Deloitte and employees of the OA and other Commonwealth agencies. As we point out in our cover letter, the reliance on these assertions as if they were facts to support the conclusion that OA and DGS did not exercise appropriate scrutiny over Deloitte procurements amounts to a disregard for the truth. We would argue this demonstrates that the auditors failed to collect facts and properly analyze them.

The comments in this finding show a clear lack of understanding of the existing policies and practices in place. Below we provide a significant amount of information regarding the Commonwealth's IT procurement structure. Before finalizing any recommendations related to this finding, we ask that you understand how these policies and practices put in place the checks and balances your auditors failed to discover.

The IT procurement process has more oversight or scrutiny than any other area of procurement.

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### Executive Order 2004–8 (issued April 29<sup>th</sup>, 2004)

- The original Executive Order 2004–8 established a Commonwealth–wide IT governance structure to oversee the investment and performance of information solutions across the Commonwealth’s agencies and to advise and counsel the Governor on the development, operation, and management of the Commonwealth’s IT investments, resources, and systems. In particular the Executive Order:
  - Established the powers and duties of the governance board which is to define a strategic vision for Commonwealth IT operations, establish program priorities, approve IT planning, direct the consolidation of IT support services, direct IT investments and participate in IT purchasing and policy.
  - Established four Communities of Practice (CoP) to bring together agencies that share program and policy objectives. The CoP process was designed to focus on enterprise IT planning and project prioritization ensuring that IT projects / technologies are shared across multiple agencies in a collaborative, non–redundant manner.
  - Further defined OA/OIT responsibilities as follows:
    - Implementing policy, planning and budget directives adopted by the Board
    - Recommending IT related budget requests, monitoring enterprise–wide IT spending, reviewing and approving (prior to submission to DGS), all sole source requests, RFP, RFQ and IT emergency contracts.
    - Managing the CoP process for project prioritization
    - Reviewing and approving all IT senior management appointments through the Deputy Secretary for IT
    - Established Enterprise Architecture (EA) to establish technology policy and deploy enterprise–wide technology, including processes, product standards, and performing technical reviews of agency systems.

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### Executive Order 2004-8 (as amended – May 9, 2007)

- Established Deputy CIO organizations that report to the Deputy Secretary for Information Technology within the Governor's Office of Administration to oversee four Community of Practice areas, which are HHS, PS, Environment and GGO.
- Established direct reporting relationship with the Agency CIO reporting to the Deputy CIO for a respective Community of Practice.
- Further defined governance and strategic planning through the Communities of Practice (CoP) process for annual enterprise IT strategic planning and project prioritization and regular management of IT procurement, spending and performance.
- Defined program management and business process integration/
  - Implementing IT policy, planning, and budget directives across the CoP and within individual agencies.
  - Managing a Portfolio Management process within each Deputy CIO CoP for overall monitoring of program objectives, project alignment, budgets and expenditures.
- Established standards for project management and delivery, expanding the use and implementation of project management methodologies and principles on all technology projects.
  - Providing Project Management resources as directed by the Board to manage agency IT projects.
- Established IT Procurement and Contract Management within the Office of Administration comprised of Office of General counsel staff that will review, approve and negotiate all IT contracts. This includes reviewing and approving scopes of work greater than an amount specified by the Board, providing pre-issuance approval for all agency Requests for Proposal (RFPs), Request for Quotations (RFQs) from the IT-ITQ contract, IT sole source requests and IT Emergency Contracts.

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- Reviewing and approving all IT project contract changes including amendments, renewals, work orders, and change orders greater than an amount specified by the Board.
- Defined and directed IT consolidation and related services recommending and conducting the consolidation of agency IT services including: infrastructure, applications, operations and support services.

In addition, as pointed out in the report, ITB EPM003 establishes an enterprise-wide policy for IT procurement reviews according to specific dollar thresholds and is issued in accordance with Executive Order 2004-8, As Amended. This policy has evolved over time to include the following:

The agency Chief Information Officer (CIO)/IT Manager is to e-mail the documentation specified below to the agency's OA/OIT CoP Planner who will in turn review with DCIO for approval or denial. Required reviews are highlighted below:

- Review of all RFPs, RFQs, Sole Source requests, SW/HW procurements, IFBs in excess of \$100,000
- Review of all DPH Change orders regardless of dollar value
- Review of Contract extensions, Advice of Change or Change orders in excess of \$100,000.
- Review of all Waiver requests that deviate from enterprise IT standards or contracts.
- Review of all agencies requests for facilities hardening.
- Review of all Staff aug requests.

Technical architecture reviews were also established in April 2006. The Architecture Review (TAR) board, comprised of various subject matter experts and IT practitioners, review the technical and architectural components of projects and planned procurements (greater than \$100,000). TAR will review the architectural direction proposed for new applications, major changes to existing applications and plans for infrastructure upgrades. This ensures alignment to Commonwealth standards and the best use of funding.

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An important part of this review board is discussion over whether the application should be developed in house or externally (expertise required and project size / resources available). This is done as a normal course of action in conjunction with the agencies and DGS.

Project Management: In an effort to develop and mature the Commonwealth's project management expertise, OA/OIT also established an Enterprise Project Management Office in 2007. The primary objectives include:

- People: Recruitment, selection and placement of Enterprise PMs and training and certification of all Commonwealth Project Managers
- Process: Development and establishment of standards– Enterprise PM methodology
- Over the last fiscal year, EPMO delivered over 30 instances of 8 classroom courses for Project Management, gaining an average participant evaluation of over 3.6 out of 4.0, and earning credits for those seeking or maintaining PMI certification. Over 300 Commonwealth staff were trained.
- EPMO also established the Enterprise Project Management University (EPMU) providing professional development programs in training and mentoring for all project managers.

**Auditors' Conclusion:** We disagree with DGS's response to the finding. The Commonwealth Procurement Code states that DGS has the duty to procure or supervise the procurement of all supplies, services, and construction needed by executive agencies and those independent agencies for which the DGS acts as the purchasing agency. The Code further gives DGS the authority to audit and monitor the implementation of its regulations.

In addition, after our original draft report was submitted to DGS, the Commonwealth permitted us to interview OA-OIT management. Based on the results of our interviews and review of OA-OIT documentation, we identified serious deficiencies with OA-OIT's IT procurement review procedures. As such, these deficiencies have been incorporated in the finding. Furthermore, while we are not aware of any violations of the law regarding conflicts of interest with respect to Deloitte contracts, OA-OIT did have the appearance of, and potential for, conflicts of interest.

Therefore, our recommendations for DGS remain as stated. In addition, we have made additional recommendations to OA-OIT.

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### *Finding 6 - PA's Existing Procurement Organizational Structure Failed to Provide Centralized and Independent Oversight and Monitoring, Including Conflict of Interest Concerns*

Commonwealth Response: The report fails to acknowledge that for the first five years of the audit scope, January, 2000 through December, 2005, procurement was highly decentralized, a structure that had existed for decades before Governor Rendell's major reform on the operation in 2006. Under the prior structure every agency controlled the execution and management of its own contracts.

Under Governor Rendell, the procurement and IT structures have been dramatically reorganized to reflect a more centralized, shared services model utilized by leading private sector companies. Under this model, more than 100 procurement positions from the agencies were centralized into DGS in 2006, 135 IT agency positions were centralized into OA-OIT, and 13 Agency Chief Information Officers now report directly to OA-OIT. Through this new shared services model, OA and DGS are able to provide greater oversight and monitoring of all agency contracts and have also saved taxpayers more than \$300 million a year through efforts such as Strategic Sourcing.

In 2008, 97% of all IT contracts over \$250,000 were DGS led contracts, and many of these were led in partnership with OA-OIT. We should be clear, however, that the agency in which the contract is embedded will manage the day-to-day administration of the contract, including approval of change orders. For large, statewide contracts, OA-OIT will manage the contract upon execution.

During the audit period 2000-2007, the agencies cited in this report awarded and managed Deloitte contracts at issue. Even today, under the new shared services model, DGS will, on occasion, delegate the award and management of a contract back to the agencies when deemed appropriate.

## *APPENDIX C*

Further, we strongly object to your use of a quote from over two years ago by the former Deputy Secretary for Safety Administration at PennDOT taken from a *newsletter* as evidence of favoritism towards Deloitte. It is not appropriate to use a quote from the Deputy stating that Commonwealth and Deloitte employees have enjoyed a “good partnership” on the .centric project as proof of favoritism or bias.

Evaluation committee members are selected based upon their expertise. Relevant expertise includes business process understanding and technical expertise. For example, the committee that evaluated the L&I CWDS RFP proposals was made up of a team of fifteen individuals: seven were voting members and eight were non-voting members. The evaluation committee had representatives from the following entities: L&I/OIT, DPW/BIS, each of the three Workforce Partner Agencies (L&I/BWDP, L&I/OVR, DPW/BETP), OA/OIT, L&I Comptroller’s Office, L&I Chief Counsel’s Office, and DGS Purchasing Office. It is wrong to suggest that evaluation committees are not independent or fail to contain appropriate knowledge of the project and contracting processes.

The audit report also ignores multiple steps that DPW takes to provide central oversight and monitoring of the procurement process, including conflicts of interest procedures.

DPW clearly explained to the auditors that all evaluation teams involved in RFP processes that resulted in awards to Deloitte did not include any evaluation team members with any historical working relationship with Deloitte. While the auditors recognize some efforts to separate DPW and Deloitte, DPW wants to stress that it has gone to great lengths to separate the DPW staff from Deloitte’s as much as is feasible (including not allowing DPW staff to participate in Deloitte office events and physical separation within the building).

## *APPENDIX C*

In addition, we would like to reiterate some facts about the procurement process that this finding chose to omit. For example, DPW's internal procurement processes include:

- Review of RFP documents, associated evaluation criteria and evaluation results by the Department's Bureau of Financial Operations;
- Review by the Department's Procurement Review Board and Internal Audit Committee which includes representation from DPW's Executive Management, the PHHS Comptroller, DPW Legal Office, and our internal auditors (these auditors are in the process of reviewing the largest contract Deloitte has with DPW at this time); and
- Review of the RFP and final contract by the Federal Government (including the Food and Nutrition Service (US Department of Agriculture) and the U.S. Department of Health and Human Services.

DGS has also put in place a number of reforms to address contractor responsibility and conflict of interest issues. We hope that you will recognize these in your final report.

- Through a rigorous evaluation and review process, Governor Rendell has cut in half the number of sole source contracts awarded.
- In February, 2009, DGS launched a new sole source page to their website, which posts all important sole source award information for public viewing. We are aware of no other state in the nation that provides greater transparency to their sole source process.
- In partnership with the Department of State, DGS has tightened the campaign finance reporting requirements for vendors awarded sole source contracts. DGS now sends the Department of State (DOS) instant email notification each time a vendor has been awarded a sole source contract, allowing DOS to follow-up with the vendor if no campaign finance report is filed with their Agency by the required date. DGS has also included a link to the campaign finance report on their sole source page.



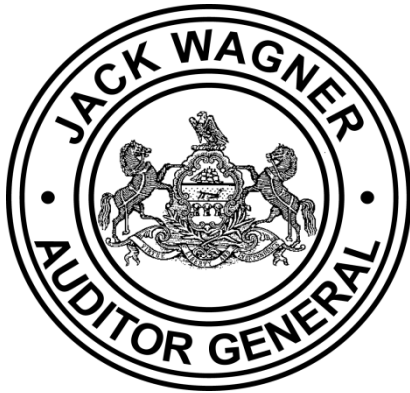
## *APPENDIX C*

- DGS also conducts regular ethics training for its procurement officers and senior officials. The ethics training, conducted by DGS' Office of Chief Counsel, is a half-day session covering a wide range of topics.
- DGS requires evaluation committee members to sign a form confirming that neither they nor their immediate family members have a conflict of interest with any of the vendors competing for the RFP for which they are scoring. Our Office of Chief Counsel reviews the committee process and is responsible to report and potential problems or conflicts.
- DGS' Bureau of Procurement will soon form a new Quality Assurance team to work with its agency customers to ensure the procurement process is being followed and to assist in improving efficiencies.

**Auditors' Conclusion:** Based on our review of the Commonwealth's current IT procurement structure, including the serious deficiencies noted in DGS's and OA-OIT's IT procurement review process, such as the appearance of, and potential for, conflicts of interest of key OA-OIT management significantly involved in the IT procurement process as noted in Finding No. 5, we continue to make our recommendations to DGS to improve the Commonwealth's organizational structure of procurement.

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*APPENDIX D*



## *APPENDIX D*

Appendix D details the combined verbatim response of the Department of General Services (DGS) and various Commonwealth agencies to the Department of the Auditor General's modifications of its original draft findings and recommendations, which had been contained in the draft audit report provided to DGS on January 23, 2009. The revised draft findings and recommendations were submitted for management's review on July 6, 2009. The special performance audit examined procurement of contracts between state agencies and Deloitte Consulting LLP that were in effect during the period January 1, 2004 to December 31, 2007. Appendix D also contains our auditors' conclusion to each combined verbatim response. The revised findings and recommendations contained in this final report are the result of DGS and audited agencies belatedly agreeing to provide our auditors with previously requested documentation and interviews, subsequent to the completion and the forwarding of our original draft findings and recommendations to management on January 23, 2009.

Because the residents of Pennsylvania entrust their state government with the responsibility to ensure that it spends taxpayer dollars both appropriately and effectively, it is incumbent upon our state government to earn that trust through transparency. Such transparency should allow the public to remain knowledgeable by providing full access to information relevant to the spending of the aforementioned tax dollars. Taxpayers will ultimately shoulder any financial burden stemming from poor procurement practices. Alarming, as our audit discloses, the procurement of goods and services by state agencies of the Commonwealth is an area in which management too frequently demonstrates a wanton disregard for the taxpayers of Pennsylvania. Unfortunately, we found this mindset to be prevalent in many of the agencies involved in our audit.

Despite our best efforts to ensure a timely completion of this audit, management's protocols and inadequate responses continually delayed the release of our report. In certain instances, nine months passed before management finally provided information requested by our auditors. In addition, management's continued refusal to provide our auditors with specific requested information further heightened our concerns about transparency and proper oversight. Specifically, throughout the audit period, management verbally and in written correspondence from DGS and the Office of General Counsel routinely denied or hindered our auditors' repeated requests for pertinent information under the veil of avoiding undue scrutiny, pressure, or challenge from outside entities. In the letter accompanying its formal response to our revised findings and recommendations, management further claims that it "provided the Auditor General with all documents still in our possession over the seven-year audit period." However, key documents from at least 19 of the 33 contracts provided to our auditors should have been available for review under the Commonwealth's current retention schedule, but were unable to be located.

## *APPENDIX D*

Management also asserts, “We are pleased that the Auditor General has acknowledged that no laws were broken, as had been portrayed by the draft audit.” In our original draft audit report, we could not conclude that conflicts of interest laws were, in fact, violated, and we do not do so in this final report. Nevertheless, we do raise legitimate concerns about conflicts of interest and the potential for improprieties in the procurement process because of a lack of transparency. We put forth numerous recommendations in the report to address these weaknesses and others. Regrettably, management continues to attempt to minimize our recommendations and avoid the seriousness of the matter, as demonstrated by its formal response. Despite its protracted response, management chose to reply to only 10 of our recommendations, ignoring the other 27 recommendations offered in our report. Moreover, further evidence that agencies have failed to comprehend the gravity of our concerns is the response of management to our recommendation that it scrutinize all vendors to ensure that they are not improperly benefitting from state economic development programs. According to management, “Such a task would be unduly burdensome and unrealistic.” In essence, management has abdicated its oversight duties, which demonstrates a willingness to simply rely on vendors who are receiving the taxpayer-funded grants or tax credits to act in good faith and scrutinize themselves.

Additionally, management asserts that we failed to acknowledge in our revised findings particular reforms that the audited agencies have implemented to strengthen the procurement process. However, our auditors have not substantiated these reforms because they were not in place during the audit period, although we reserve the right to validate any reforms in a follow-up review and future audits. The need for confirmation is important, especially in the wake of management’s contention that it participated in our audit in the spirit of full disclosure, followed by its warning, “Please do not interpret this decision [to provide information] as consent to be provided with all documentation requested by you and your auditors on all future audits. We will continue to consider your document requests on a case by case basis.”

Management disregards our recommendations and attempts to refute our findings by avoiding the foundation of our evidence. Similar to its initial response, management intimates that evidence used to compile our findings is not proper and we should examine other information. As mentioned previously, while our auditors review all information that management provides, we will not rely on the audited agency to determine the relevance of requested audit evidence.

Furthermore, management states that “the auditors could only find one instance where a former Deloitte employee served as a voting member of an evaluations committee.” It is important to note that the Commonwealth did not provide original detailed scoring sheets prepared by the evaluators for 13 of 58 contracts with Deloitte awarded through the RFP and RFQ methods. Therefore, we could not verify the evaluators for these contracts. In addition, we found significant potential for, or appearance of, conflicts of interest within OA-OIT regarding individuals who were significantly involved in the IT procurement review process, as detailed in Finding No. 5.

## ***APPENDIX D***

We made several changes to our original draft findings and recommendations following our interviews and examination of the additional documentation that management ultimately decided to permit. Based on this new information, Finding No. 1 is a new finding in its entirety. Findings No. 3, No. 4, and No. 5 contain significant changes from the findings contained in our original draft report. Furthermore, the aforementioned findings include additional recommendations.

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COMMONWEALTH OF PENNSYLVANIA

July 17, 2009

Mr. Randall R. Marchi  
Director  
Bureau of Departmental Audits  
225-D Finance Building  
Harrisburg, PA 17120

Dear Mr. Marchi:

We received your July 6, 2009 revised findings and recommendations relating to procurements undertaken with Deloitte Consulting LLP during the period July 1, 2000 to December 31, 2007.

We acknowledge that our initial reluctance to share with the Auditor General confidential documents, or documents that we argued were not relevant to the scope of the audit, could have led to the perception that we were not fully transparent in our procurement practices. However, Secretary Creedon contacted the Auditor General on February 10, 2009, before a *Patriot News* article that wrote of your office's criticism of the Administration for its failure to share documents, to inform him that Governor Rendell had directed us to release all documents requested by the Auditor General. Ultimately, we provided the Auditor General with all documents still in our possession over the seven-year audit period. This amounted to thousands of pages of documents.

We are pleased that the Auditor General has acknowledged that no laws were broken, as had been portrayed by the draft audit and conveyed to the media, and

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## APPENDIX D

only concluded that allowing former Deloitte employees to participate on a contract evaluation committee could lead to the "appearance of conflict." The auditors could only find one instance where a former Deloitte employee served as a voting member of an evaluation committee and could not point to any wrongdoing by this employee. This current report reaffirms our original contention that there is no evidence to support the accusation that procurements were awarded based on ties between Commonwealth employees and Deloitte.

We agree the Commonwealth's procurement process can always be improved, including greater education and training for the Agencies on Commonwealth retention policies. Yet there is no acknowledgement in your revised draft of the many reforms undertaken by our Agencies to strengthen procurement practices. For example, there is no discussion of the:

- centralization of procurement;
- \$320 million in savings generated as a result of centralization and strategic sourcing;
- improved transparency in the procurement process;
- centralization, consolidation and development of IT support processes, including IT procurement review, by the Office of Administration, Office of Information Technology;
- new procurement audit unit;
- increased ethics standards, including a new conflict of interest form for evaluation committee members;
- significant decrease in the number of sole sources awarded because of a more rigorous review process.

Many of our reforms were detailed in our February 20, 2009 response to the Auditor General's first draft report, but very little of our response was addressed in your revised draft. Among the many issues that we outlined in our original response is that your auditors omitted our reforms to date, criticized established and nationally recognized industry best practices, concluded analysis or oversight did not occur when it did, and took employee statements out of context.

In the hope that the Auditor General will address these issues in the final report, we've attached a copy of our February 20, 2009 response and would request that you attach it, as well as today's appendix, to your final audit report. We also ask that you include it in all distributions of the audit report to ensure that the taxpayers can make as accurate an assessment as possible. We believe this step



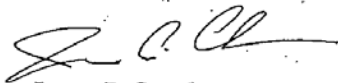
**APPENDIX D**

would be evidence of your commitment to a fair and open process and that it should be done to ensure compliance with the Generally Accepted Government Auditing Standards published by the U.S. Government Accountability Office.

We recognize that some of the points suggested by your office could add value and improvement to our procurement process, and we look forward to evaluating them and using them in the future.

We have attached an appendix with specific comments on your revised draft audit.

Sincerely,



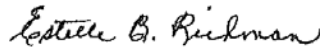
James P. Creedon  
Secretary, General Services



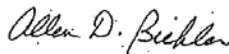
Naomi Wyatt  
Secretary, Office of Administration



Sandi L. Vito  
Secretary, Labor & Industry



Estelle B. Richman  
Secretary, Public Welfare



Allen D. Biehler  
Secretary, Transportation



Everette James  
Secretary, Health



George E. Cornelius  
Acting Secretary, Community & Economic Development



Joe Conti  
Chief Executive Officer, Liquor Control Board

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COMMONWEALTH OF PENNSYLVANIA

**Response to**

**“July 6, 2009 Revised Special Performance Audit relating to the procurement of contracts with Deloitte Consulting LLP during the period July 1, 2000 to December 31, 2007.”**

*Finding 1 – Although Public Pressure from the Appearance of a Lack of Transparency Led Various State Agencies to Provide all Deloitte Documentation to the Auditors, Review of the Provided Documentation Disclosed Deficiencies and Control Weaknesses*

**Commonwealth Response:** This is not an audit finding. It is an opinion that is untrue, unnecessary and irrelevant to this audit. Public pressure did not lead the agencies to provide additional documentation. This is a perception of your agency and the auditors do not provide a factual basis for that belief nor do they explain why such a statement is relevant to the audit. It would appear the auditors have forgotten that the Secretary of the Department of General Services (DGS) contacted the Auditor General Wagner a week before any media reports to inform him that agencies would provide additional documentation to his auditors, including the names of evaluation committee members. The Secretary of DGS later followed up with a February 10, 2009 letter to the Auditor General reiterating his commitment, again, before any media reports. In the end, Governor Rendell directed the documents to be released because he felt it was in the best interest of the public to have a full and complete understanding of the procurement process, which they would not have received by reading the auditor’s first draft of the Deloitte audit.

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Further, the allegation of lack of cooperation simply rehashes an old story that is misleading and irrelevant to the audit. The consistent position of this administration and past administrations has been that the identity of evaluation committee members and their individual scoring sheets, committee scoring sheets, disadvantaged business participation submittals and scores, losing proposals and other documents are considered confidential information access to which by the Department of the Auditor General is prohibited. The Office of the Budget (current and past) has also maintained that these documents are not within the scope of a financial statement audit. With the passage of the Right to Know Law and Governor Rendell's efforts to create greater transparency in state government, agencies can now provide more information in regard to RFPs, proposals and scoring. This inflammatory language should be removed as it has nothing to do with the audit.

*AG Report: Page [17], "More importantly, this lack of cooperation gave the perception of secrecy through a lack of transparency."*

**Commonwealth Response:** This is a circular argument unworthy of legal or audit significance. Your report does not find any evidence of vendor favoritism or inappropriate behavior by Commonwealth employees.

*AG Report: Page [18], "After media reports regarding the results of our draft report criticizing the Commonwealth on a lack of transparency, the Department of General Services was instructed to release additional documents to us."*

**Commonwealth Response:** As stated above, this is incorrect. The decision to release additional documents was communicated to Auditor General Wagner by the Secretary of DGS before media reports about the Auditor General's draft report.

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The auditor's assertion that DGS "was instructed to release additional documents to us," implies that DGS would have the ability to provide these documents, but declined to do so. As we have repeatedly stated to the auditors, DGS did not possess any contract documents within our Agency relating to contracts awarded to Deloitte, as the RFP's and RFQ's audited were awarded and managed by the agencies. DGS has never awarded a contract to Deloitte. Therefore we would not have had the ability to deny or provide these documents.

*AG Report: Page [18], "Of the 58 Deloitte RFQ/RFP contracts in effect during the period January 1, 2004 through December 31, 2007, totaling \$474 million, we were only provided complete documentation necessary to audit 25 contracts totaling \$173 million."*

*And*

*AG Report: Page [20], "Without receiving all procurement documentation, we could not verify that agencies adhered to Commonwealth procurement laws or exercised due diligence in awarding 33 Deloitte contracts through the RFP and RFQ method totaling \$311 million."*

Commonwealth Response: Although the auditors make allegations of impropriety relating to the release of contract documents, it seems to view the Commonwealth's retention practice as improper simply because more than half the contracts they selected to review were completed more than three years ago – past the Commonwealth's three year retention law for procurement documents.

The Commonwealth's Procurement Code ("Procurement Code") establishes that all procurement records shall be retained for a minimum of three years from the date of final payment under the contract and disposed of in accordance with record retention guidelines and schedules as provided by law. The Commonwealth has further established that losing proposals need only be retained for six months after award.

For the auditors to allege that that the Commonwealth has "deficiencies," or "lacked transparency" because it was not able to review all documents, it must eliminate from the equation documents that agencies properly and lawfully disposed of according to the Procurement Code and before the audit began.

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Of the 50 Deloitte RFQ/RFP contracts reviewed by the auditors (several were duplicate contracts with different purchase order numbers) 20 of those contracts, or 40%, had their date of final payment three years before the Auditor General began his audit. Consistent with the Procurement Code, documents relating to these older contracts were properly disposed of by the agencies. The auditors should have only reasonably expected the Commonwealth to have documents relating to 30 of the contracts.

Further, nearly one quarter of the documents requested by the auditors were not applicable to the contract under review. For example, the Auditors requested copies of losing proposals when Deloitte was the only bidder, or they requested a procurement review form for a contract that was under the dollar limit required for review.

Ultimately, the Commonwealth produced 73% of the documents requested that were within the three year retention policy and were applicable to that specific contract.

The majority of the documents agencies were unable to provide the auditors were two documents immaterial to this audit. The first form was STD 21, submitted by the winning vendor *after* award of a contract to show the winning vendor's workforce breakdown by gender and race. We are confused by this document request from the auditors and unable to understand how information about a winning vendor's workforce breakdown is relevant to an audit clearly focused on the award of contracts. The other document frequently missing from agency files relates to disadvantaged business (DB) participation. However no one on an evaluation committee scores the DB component of a proposal and would be able to impact this part of the process.

Despite their irrelevance to this audit, STD-21 and DB documentation must be better retained by our agencies. As a result of this audit, DGS has begun outreach and education to the agencies about the process and retention policies for both DB documents and STD-21.

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However, with 73% of the documents made available to the auditors, we are uncertain as to why the auditors allege this is a “deficiency” that prevented them from completing their due diligence.

*AG Report: Page [19], “Six agencies admitted that they had discarded the contract documentation for eight of the 19 contracts within the three year retention requirement, including the Department of Education, which indicated that the original detailed scoring sheets and losing vendor proposals for one contract were discarded at the end of 2008.”*

Commonwealth Response. Agencies improperly disposed of the majority of their RFP/RFQ documents in only three instances – out of the 30 contracts that were executed recently enough that agencies should have kept the documents according to retention policies.

The auditors cite as an egregious example of failure to comply with the retention policy the Department of Education, which was not able to provide losing proposals or detailed scoring sheets for a Request for Proposal (RFP). The auditors fail to explain that the Department of Education provided 10 of the 12 requested documents relating to the RFP, including the overall scoring sheets.

Again, we are uncertain as to why the auditors cannot audit the Department of Education’s RFP with 10 of the 12 requested documents made available to them.

*AG Report: Page [20], “We disagree with DGS’ position that losing proposals should only be retained for six months.”*

Commonwealth Response. As a result of this audit, the Department of General Services and the Office of Administration intend to propose a modification to the retention policy that losing proposals should be kept for four years after completion of the contract, as well as all procurement-related documents.

*AG Report: Page [20], “We recommend that Commonwealth agencies retain procurement documentation, including losing proposals and detailed scoring sheets, until the information has been subject to audit.”*

## APPENDIX D

Commonwealth Response. The auditors misread the Commonwealth Procurement Code and General Administrative Retention Schedule to require that all procurement records (as so defined in the Code and/or Schedule) must be maintained “until they are subject to audit.” This is not only clearly erroneous as a legal matter, but also nonsensical in fact. What these provisions plainly and actually mean is that the records must be maintained for the period stated, unless an audit of them has been started *during the retention period*, not that the records are to be maintained until an audit is actually conducted of them, if ever (which would obviously make the stated period completely meaningless). The Commonwealth executes approximately 10,000 contracts a year. Not only is this suggestion nonsensical, it is entirely impractical to implement.

*AG Report: Page [20], “As part of all audits, we recommend that DGS and other Commonwealth agencies provide all procurement records to the Department of the Auditor General upon request, including, but not limited to, the names of the proposal evaluation committee members, copies of losing proposals, and detailed scoring sheets by each member of the proposal evaluation committee.”*

Commonwealth Response. The Commonwealth has already done so with this audit and we will review future requests on a case by case basis.

*AG Report: Page [17], “Our requests to schedule certain interviews were refused, including with key management at the Office of Administration Office of Information Technology (OA-OIT), who review and approved scopes of work greater than \$100,000 for pre-issuance approval for all agencies’ information technology (IT) contracts (See Finding 5 for more details).”*

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**Commonwealth Response:** This statement is inaccurate and misleading. Every interview that the Auditor General's office requested of OA/OIT was granted and scheduled –most within the very short notice provided by the Auditor General's Office. In fact, OA–OIT suggested to the Auditor General's Office that it be interviewed after the first draft report was released and no contact had been made with OA–OIT. OA–OIT fully cooperated with all meeting requests, but to be clear there were scheduling and availability issues with the Auditor General's Office. All of these facts belie the conclusion that there is a “perception of secrecy through a lack of transparency.” Moreover, it is wholly improper to suggest that scheduling delays evidence “vendor favoritism.” To the contrary, after many hours of interviews and the review of hundreds of pages of documents, the investigation by the Auditor General's Office has revealed that no laws were violated regarding conflicts of interest.

**Auditors' Conclusion:** We are in total disagreement with the Commonwealth's response that documentation previously denied to the auditors was going to be provided prior to media reports regarding the original draft of the audit report. DGS and the various Commonwealth agencies were uncooperative from the onset of the audit, not providing requested documentation. In fact, the Chief Counsel from the Department of the Auditor General contacted the Governor's Office of General Counsel and wrote a letter in an attempt to obtain the requested documentation for the auditors; however, the documentation originally requested on June 12, 2008 was not provided until after February 23, 2009, subsequent to media reports regarding the results of our original draft report criticizing the Commonwealth on lack of transparency.

Government Auditing Standards require the auditors to assess inherent risk, control risk, and risk of fraud or abuse when developing the nature, timing, and extent of our audit testwork. Lack of cooperation is a factor which increases audit risk, and, therefore, is definitely relevant to the audit. We disagree that the identity of evaluation committee members and their individual scoring sheets, committee scoring sheets, disadvantaged business participation submittals and scores, and losing vendor proposals are not within the scope of our audit. To the contrary, our first audit objective is to determine that contracts were awarded in compliance with Commonwealth procurement law, which requires us to evaluate each one of these procurement documents.

We also disagree with the Commonwealth's response that DGS does not have the ability to deny or provide the requested procurement documentation related to Commonwealth contracts with Deloitte. To the contrary, we received a letter from the DGS Deputy Secretary for Administration and Procurement on June 18, 2008, in which DGS denied us certain procurement documentation, including lists identifying the members of the proposal evaluation committees; copies of losing vendors' proposals; detailed scoring sheets by each member of the proposal evaluation committee; and documentation regarding the overall scoring and selection process, including maximum point values assigned to each major criterion and evaluation committee member recommendations for vendor selection. Therefore, the Commonwealth's response is inaccurate.



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With regard to the Commonwealth's response related to the fact that the auditors could not verify that agencies adhered to Commonwealth procurement laws or exercised due diligence in awarding 33 Deloitte contracts through the RFP and RFQ methods, we clearly state in the Condition section of Finding No. 1 that, based on the three-year retention requirement established by the Commonwealth Procurement Code, documentation for at least 19 of the 33 contracts should have been available to the auditors. We disagree that losing vendor proposals should only be retained for six months after the award because this documentation is part of the procurement records. For the remaining 14 contracts, the three-year retention period would have expired before our audit began; however, it would be reasonable for the Commonwealth to retain this procurement documentation until an audit has been completed because, for several years, the Department of the Auditor General has sought access to key procurement contract documentation during the annual GAAP and Single Audits. Therefore, the Commonwealth is well aware of our position that this documentation remains subject to an audit and should be retained until it is made available to the auditors. Consequently, we disagree with the Commonwealth's assertion that auditors misread the Commonwealth Procurement Code and the *General Administrative Retention Schedule*. Findings regarding the denied documentation were reported in these audits, and, therefore, this procurement documentation should have been retained. Furthermore, key procurement documents for contracts at the Office of Administration and Department of Education were admittedly destroyed during our audit, in direct violation of the *General Administrative Records Retention and Disposition Schedule*.

Additionally, we initially requested procurement documentation, including losing vendor proposals, for all Commonwealth contracts with Deloitte in effect during the period January 1, 2004 through December 31, 2007. If DGS or the respective Commonwealth agencies responded that Deloitte was the only bidder, then we did not expect to receive losing vendor proposals, nor did we fault the agencies for this fact.

Furthermore, the Commonwealth cited that it produced 73 percent of the documents requested that were within the three-year retention policy. This figure is irrelevant. The fact is that, if the Commonwealth did not provide all applicable key procurement documents for certain contracts (which include original detailed scoring sheets prepared by each evaluator; RFPs/RFQs, including portions of RFPs/RFQs; purchase order/contract; statements of work; Deloitte proposal; and/or losing vendor proposals), then we could not determine that contracts were awarded in compliance with Commonwealth procurement law and in an unbiased manner. For the 33 contracts cited in Finding No. 1, the Commonwealth did not provide one or more of these key documents and 19 of these 33 contracts were within the three-year retention requirement. Examples of key documents not provided include losing vendor proposals for 14 contracts and original detailed scoring sheets prepared by each evaluator for 13 contracts.

With regard to the STD-21 and Disadvantaged Business Participation Evaluations not provided to the auditors, while it is true that, in many instances, this documentation was not provided by DGS or the respective Commonwealth agencies, we did not consider these documents key documents necessary to be reviewed in order to satisfy our audit objectives. We state in the Condition section to Finding No. 1 that we were unable to audit 33 of the contracts due to one or more of the following documents not being provided: original detailed scoring sheets signed by the evaluators; RFPs/RFQs, including portions of RFPs/RFQs; purchase order/contract; statements of work; Deloitte proposal; and/or losing vendor proposals.

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Using the three-year retention requirement established by the Commonwealth Procurement Code, six agencies admitted that they had purged the contract documentation for 8 of the 19 contracts within the three-year retention requirement. Again, we disagree with the Commonwealth's policy to retain losing vendor proposals for only six months after the award.

We acknowledge that the Department of General Services and Office of Administration intend to propose a modification to the retention policy that losing vendor proposals should be kept for four years after completion of the contract, as well as all procurement-related documents.

With regard to the Department of Education providing 10 of 12 documents requested for a Deloitte contract and the Commonwealth's uncertainty as to why the auditors cannot audit the procurement with 10 of the 12 requested documents provided, the fact is that the two documents not provided (losing vendor proposals and detailed scoring sheets completed by each evaluation committee member) are key documents that must be reviewed in order to ensure that contracts were awarded in compliance with Commonwealth procurement law and in an unbiased manner. This was clearly explained to DGS and the Commonwealth agencies at the audit exit meeting on February 23, 2009. Additionally, it is important to note that the Department of Education purged these two documents at the end of 2008, during our audit, which is especially concerning and in noncompliance with the *General Administrative Records Retention and Disposition Schedule*, which states that once an audit begins, relevant records may not be destroyed until the audit is concluded.

Interviews with OA-OIT were only granted and scheduled after the audit exit meeting on February 23, 2009. The Commonwealth's response that "every interview that the Auditor General's office requested of OA-OIT was granted and scheduled" is only true after the date of the exit meeting. We attempted to schedule interviews with OA-OIT between November 3, 2008 and December 9, 2008 through several e-mails and phone calls. OA's Audit Coordinator and Chief Counsel repeatedly questioned the relevance of the requested meetings to our audit objectives, and ultimately never provided any available dates to schedule a meeting until after the audit exit meeting on February 23, 2009. Again, Government Auditing Standards require auditors to assess risk of fraud or abuse when developing the nature, timing, and extent of our audit testwork. Lack of cooperation is a factor which increases our assessment of the risk for fraud or abuse.

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### *Finding 2 – Agencies Rely Too Heavily on Deloitte Due to a Lack of IT Expertise and a Reluctance to Train Information Technology Staff on Newly Developed Systems*

*AG Report, Page [22], “Additionally, management indicated that current IT staff is proficient with DPW’s older systems and believes that it would be difficult for the current IT staff to learn and be trained on the newer systems or technology. Furthermore, DPW management stated that some staff have no desire to learn newer systems, while others do not have the capability of understanding certain IT topics regardless of how much training is provided to them.”*

**Commonwealth Response:** Given the auditors have not removed or modified this allegation, we would like to reiterate our comments from the February 20, 2009 response.

DPW did not make any statements implying that their IT staff was unable or unwilling to learn new systems and software languages. IT staff within DPW are hard working and dedicated employees and, unfortunately, they too often do not get the credit they deserve. DPW takes exception to the audit’s attempt to demean their efforts.

For example, the draft audit report misrepresents a reference DPW made to a research study by the Gartner Group (a research/consulting firm) that notes that efforts to retrain COBOL programmers to .net technology have failed at a rate of approximately 70 percent nationwide. At the time, DPW made clear that this reference was made as part of an overall discussion concerning potential management challenges that DPW faces in maintaining systems written in multiple languages and that it was not directed at DPW employees.

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Also, the report incorrectly cites DPW's current complement for IT positions at 410 when it is actually 360 and mistakenly cites a number of vacancies in some information technology positions with our use of private contractors for other functions. As was pointed out to audit staff, many of these vacancies are not in the application development portion of our IT staff but rather in positions that are budgeted for other functions such as maintenance of other existing systems. The ability of DPW to keep these applications running despite some of these vacancies is actually a testament to the level of professionalism and hard work of our staff.

The final report should not include these inaccurate statements regarding DPW employees. It is especially disappointing that, subsequent to the issuance of the draft audit and the provision of information showing this assertion to be inaccurate and misleading, audit staff did not make any effort to correct the record in its final report.

**Auditors' Conclusion:** We want to emphasize that we are not demeaning the efforts of DPW's IT staff. To the contrary, we are recommending that DPW ensure that knowledge transfer occurs and maximize the use of in-house IT staff to perform maintenance and upgrades on the systems to reduce the need for maintenance contracts with Deloitte. Our interviews with DPW management revolved around use of DPW IT staff to develop, upgrade, and/or maintain its own systems. DPW management may have been using the study performed by the Gartner Group, which was mentioned in the response, to generalize about its IT staff, but at our interviews with DPW management, we were specifically discussing DPW IT staff in relation to work performed under Deloitte contracts. This study was not mentioned during our interview with DPW management. DPW management did provide auditors with documentation on February 23, 2009 at the audit exit meeting, which had been originally requested on October 28, 2008, supporting 360 vacant IT positions. The revised draft audit report was modified accordingly to state that DPW had 360 vacant IT positions.

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### *Finding 3 – RFP/RFQ Process Needs to be Improved and Sole Source, Emergency, and Change Order Procurements Lacked Adequate Justification and Approvals*

*AG Report: Page [26], Section Discussing Weaknesses in the LCB RFP/RFQ Process.*

Commonwealth Response: DGS, and not PLCB (an independent agency), has the power to establish procurement policy. DGS has established guidelines for agencies to follow in selecting evaluation committee members in Chapter 6 of Part I of the DGS Handbook.

The PLCB has begun to take steps to improve documentation and develop policy and procurement related to:

- The establishment of a methodology related to the development, review and approval of RFPs.
- Formalize the process and requirements related to selection of a RFP evaluation committee, including committee meetings, instruction on scoring/evaluating proposals and overall documentation requirements.
- Define documentation requirements for (dis)approval processes and other decision making that may occur if there is any deviation from standard protocols.
- Establish requirements for the development of a single, comprehensive procurement file for each RFP and consistent with the Commonwealth's record retention schedule.

*AG Report: Page [26], Section Discussing Weaknesses in the DPW RFP/RFQ Process.*

Commonwealth Response: DPW policy meets or exceeds all requirements of the procurement code. While in some cases, the audit report notes errors in administrative record keeping which we acknowledge and will correct (please note that several of the procurements in question are more than five years old), we do not agree that there are material weaknesses in the RFP and RFQ process. This section of the audit report does not distinguish between requirements in the procurement code and practices that the Auditor General believes to be sound contracting policies that are not required in either statute or regulation.

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DPW believes that a more balanced assessment of whether or not DPW or the Commonwealth have procedures that can provide a “reasonable assurance” regarding the integrity of our RFP/RFQ processes should have included areas where a processes exceed the requirements of the procurement code. These steps, which were shared with audit staff but omitted from the final audit report, include:

- Creation of a “evaluation workbook” for all evaluation committee members that helps evaluators provide a framework for evaluating large and technically complex proposals;
- Distribution to DPW management of a procurement announcement form that affords management the opportunity to management across the Department the opportunity to review and critique the proposed procurement strategy prior to issuance of the RFP or RFQ; and
- Creation of a selected vendor form that documents the committees selection and the rationale of selection of the vendor and is distributed to multiple parties including DPW Executive Management, DPW Legal, PHHS Comptroller and other reviewers.

*AG Report: Page [26], “We found scoring sheets were inadequate in documenting pertinent scoring information. For instance, 67 of the 69 scoring sheets were missing signatures.”*

*And*

*AG Report: Page [26], “Committee meetings were not formally documented within the procurement file.”*

Commonwealth Response: Signatures on scoring sheets and formal documentation of meetings is not required by law or policy. We question the auditor’s conclusion that these represent a “weakness” in the system. Each scoring sheet contains the evaluator’s name at the top of the sheet and agencies keep a list of evaluation committee members. Moreover, each RFP/RFQ has a timeline that clearly shows when meetings occurred.

It is interesting that a 15 month audit into allegations that Deloitte contracts were improperly awarded has resulted in findings that our agencies lack meeting minutes and signatures, neither of which is required by law.

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*AG Report: Page [27], "Inadequate and unrealistic justification for emergency procurements."*

**Commonwealth Response:** Many of the emergency contract were awarded pursuant to one of the other methods of procurement such as the competitive sealed proposals method. The agency requested an emergency in order to authorize the selected offeror to begin work (for which it would be paid) before a contract was fully executed. Without the emergency authorization, the offeror could not be paid for any work done before full execution of the contract.

*AG Report: Page [34], "DPW believes that new initiatives may require additional work that was not included in the original work statement, thus requiring a change order. Yet management also indicated that initiatives cannot be added to the original work statement of a contract until the funds become available."*

**And**

*AG Report, Page [34], "The failure to award service contracts through a competitive bidding method, rather than through the sole source or emergency method, could result in the Commonwealth paying an excessive amount for a service and may not receive the best quality of service."*

**Commonwealth Response:** The audit report's characterization of this statement is of particular concern to DPW as it conveys a lack of understanding of the scope of the procurement at issue as well as of the annual scoping process. To be clear, at no time did DPW procure services outside the scope of work of the contract, nor could it under the existing contract terms as the draft audit implies.

The scopes of work for the contracts noted in the audit report are to perform maintenance and modification work to some large IT systems in DPW at various competitively procured rates. These systems help manage benefits and track information for approximately two million Pennsylvanians and are highly integrated into the work that many DPW employees perform every day. Understandably, these systems require a great deal of effort to maintain and also require many modifications to keep current with changes in policy and in law. While some of the changes to these systems are planned over multiple years, some by their very nature are not.

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The contract administratively describes all work under the contract after the first year as a “change order” and DPW must technically execute a change order to authorize the work regardless of whether it is planned or not. The annual scoping sessions defined under the contract provide the vehicle for DPW to determine what work, within the scope of the contract, it would like the vendor to perform during the course of that contract year.

It is this administrative term (“change order”) that is the source of the misunderstanding by audit staff. A great deal of the change orders cited in the audit report are not change orders in the traditional sense in that they do not represent a new or different scope of work in the contract. Rather, they represent the administrative process required under the terms of the contract to authorize work after the first year of the contract. For example, the formal initiation of the next step of a planned multi-year project and modification of our existing IT infrastructure to comply with changes in law and regulations both require a change order, but are both within the scope of work of the contract. The rates charged for this work were competitively procured and are dictated by the contract so they do not allow any opportunity for favoritism.

The following examples will help illustrate the difference:

- Multi-Phase Large IT Projects: Large IT projects usually contain multiple phases of work and span a number of years. When a large IT project is procured, the entire scope of the project is part of the RFP. However, the RFP also will make clear that different portions of the project may or may not be completed depending on a number of factors, including available funding and agency priorities. For example, under the terms of the contract, DPW must technically execute a change order for each phase of its multi-year \$37 million overhaul of its Client Information System (CIS). Each phase varies in size (from a low of \$2 million to a high of \$12 million) and funding in any particular phase or year can vary significantly.



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- Implementation of Changes in Law: Some of the change orders associated with the contract are the result of changes in federal or state law that occurred after the time of the initial procurement – two examples being the implementation of the federal Deficit Reduction Act (DRA) and the transition to state direct payment of vendors in DPWs Office of Developmental Programs mandated by the federal government. The latter, which mandated DPW to switch from essentially a county-based system to direct payment of vendors who provide services to individuals living with mental retardation, required DPW to make changes to several of our existing systems such as HCSIS included under the IT Bundling contract. These changes totaled \$6 million over the term of the contract and, since the contract required all maintenance and modifications to these systems be performed by Deloitte, all of these changes necessarily resulted in change orders to the contract.

Finally, the statement “when funding becomes available” was made in reference to the annual budget process and the reality that funds for any given project may not be fully funded each fiscal year. Further, the procurement code allows all contracts, including this one, to have change orders executed for work within the scope of the contract. This is particularly applicable for larger and technically complex projects. Not only is this process entirely appropriate, it is necessary to allow projects to respond to changing needs and funding over the life of a multiple year under taking. This is an IT contracting best practice followed by public and private sector IT purchasers.

*AG Report: Page [31], “Additionally, the current governance of IT procurements, established by the Governor in April 2004 through Executive Order 2004-8 and Information Technology Bulletin ITB-EPM003, requires OA-OIT to review and approve scopes of work greater than \$100,000 for pre-issuance approval for all agencies’ IT contracts. In addition, OA-OIT must review and approve all IT project contract changes, including amendments, renewals, work orders, and change orders greater than \$100,000 ...”*

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**Commonwealth Response:** As we stated to the auditors repeatedly during our meetings, Executive Order 2004-8 which was signed in 2004 began the centralization of some IT services. Further centralization, consolidation and development of support processes, including procurement review, were put into place with the amendment of Executive Order 2004-8 in May of 2007. These processes continue to evolve. Therefore it is inaccurate to suggest that OIT had the above obligations throughout the entire time period of your investigation (2004-2008).

**Auditors' Conclusion:** We acknowledge that DPW states that it will correct errors in administrative record keeping, which partially relates to our Recommendation 11.

It is important to note that the Commonwealth's response related to weaknesses in the RFP/RFQ process at DPW does not fully address our Recommendations 7 through 11. These recommendations are significant and will improve the RFP/RFQ process at DPW and other Commonwealth agencies.

With regard to Commonwealth agencies questioning the auditors' conclusion that the lack of signatures on scoring sheets and the formal documentation of evaluation committee meetings are weaknesses in the system due to the fact that these are not required by law, Government Auditing Standards require that we obtain an understanding of and assess management's controls as they relate to the audit objectives. Signatures on scoring sheets and documentation of committee meetings are examples of good management controls related to the process to evaluate and select a vendor for procurement of services. Signatures on the scoring sheets ensure that the scoring is the actual unaltered scoring performed by the respective evaluators and documentation of committee meetings provides a record of discussions held and decisions made during the evaluation and selection of the vendor to further ensure that the selection was reasonable and unbiased. Our audit report included a total of 37 recommendations to DGS to improve the Commonwealth's IT procurement process. We requested that DGS respond to these recommendations; however, DGS and the other Commonwealth agencies did not address 27 of these recommendations in their response.

With regard to the Commonwealth's response related to contract change orders, we agree that change orders are at times necessary and appropriate; however, we question the excessive use of change orders. For example, one contract at DPW totaling approximately \$23.0 million at its onset at January 1, 2007 had 34 change orders, adding \$72.6 million to the original contract through December 31, 2007. Change orders continued to be made to this contract through the current date. In addition, of the 10 change orders that we selected for testing at DPW, five had deficiencies, including lack of various approvals (all five change orders), lack of justification (three of the five change orders), and one was issued after the contract expired. Due to the excessive use of change orders combined with the deficiencies found during our testwork, we strongly suggest that DGS implement our recommendations to ensure that change orders are properly justified, the justification is properly documented, and the change orders are properly approved, thus improving the procurement process.

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We disagree that OA-OIT did not have obligations to review IT procurements throughout the period of our audit. The Commonwealth responded that centralization of IT procurement review by OA-OIT was put into place when Executive Order 2004-8 was amended on May 9, 2007; however, Executive Order 2004-8, as it was originally signed on April 29, 2004, defined one of OA-OIT's responsibilities as reviewing and approving all RFPs, RFQs, sole source requests, and emergency contracts for IT procurements prior to submission to DGS. Therefore, OA-OIT's obligation to review and approve IT procurements began in April 2004, not May 2007 as the Commonwealth's response suggests.

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### *Finding 4 – Poor Accountability and Control Weaknesses found for IT Contracts and Expenditures*

Commonwealth Response. We recognize that our agency record-keeping and adherence to known, written IT, ethics and procurement policies are not as consistent as we would like or cannot be improved. Indeed, we appreciate that your audit has pointed out many areas in which we can improve and we intend to do so. In fact, we have taken our own identified measures and will share them with you moving forward.

We cannot forget, however, that your auditors commenced this audit to investigate allegations of conflicts of interest and procurement improprieties concerning the many contracts the Commonwealth has with Deloitte. While your auditors disagree with the exercise of our discretion and judgment in entering into and our administration of some of these contracts, they failed to find any individual instances of wrongdoing. Nevertheless, your auditors have spent considerable time and resources from your own agency and those of the Administration to prepare a massive report itemizing all the instances where t's were not crossed and i's not dotted.

We would suggest though, given the genesis of your investigation, that an overall Finding be stated at the top of your final report: "We found no conflicts of interest or instances of wrongdoing by the Commonwealth agency employees involved in the procurement or administration of the Deloitte contracts."

*AG Report: Page [37], "DGS stated that it could only provide a list of contracts which have been entered into the SAP procurement module, which is the Commonwealth's main accounting system of procurement, however, we learned that not all agencies entered Deloitte contract information into the SAP procurement module."*

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**Commonwealth Response.** You again state that you disagree with the assertion by DPW and PennDOT that the size and complexity of the Deloitte contracts made it impractical to enter them into the SAP Procurement Module, stating that the accounting system was designed to maximize automated controls and the three-way match feature. You miss the point. We agree that it is desirable to take advantage of the three-way match, and DGS along with Budget have been striving ever since the implementation of SAP to enter as many contracts as possible into the procurement module. Unfortunately many complex service contracts do not lend themselves well to the procurement module which is optimized for discrete line item, fixed-rate contracts where the work effort is definitive and known in advance. Please inform us of how you would enter the referenced Deloitte contracts, as they were necessarily structured, into the SAP Procurement Module and we will gladly do so.

*AG Report: Page [38], "The Office of Administration (OA) denied having a contract with Deloitte on several occasions and did not explain what the payments to Deloitte were for after we questioned this discrepancy. We verified through our own investigation that OA had made payments to Deloitte related to three contracts or purchase orders, including one contract totaling more than \$3.5 million. This contract relates to OA's Business Solution Center of Excellence project. We are concerned that OA denied having this contract considering the various potential conflicts of interest OA had with Deloitte during this contract period, which we note in Finding [5]."*

**Commonwealth Response.** This statement completely misrepresents the facts. On March 9 OA-OIT provided to you the BSCOE details including a summary explanation, pricing submittals, RFQ team names, and the vendor proposal submitted. OA never denied having this contract and did not refuse to provide information related to it. Indeed, as the Auditor General's Office has determined, there were no conflicts of interest related to this or other procurements and OA-OIT had no reason to withhold any information from the auditors

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Also, as previously explained, in addition to the BSCOE documentation provided, OA-OIT also provided information related to PO 4500168988 (HIPPA Project) for the Bureau of Management Consulting. This procurement occurred in the fall of 2003, the project was successfully completed in April/May of 2004, and related documents were purged in the fall of 2007 following the retention schedule in effect at that time. The PO in the SAP system has the statement of work and the Deloitte response proposal attached. The auditors also requested details on PO 4500105255 which we already explained was cancelled due to an incorrect vendor number and was recreated as PO 4500168988 (HIPPA Project). Copies of all of these details were provided to the Auditor General's Office in March.

*AG Report: Page [40], "DPW management stated that they do not verify the reasonableness of the costs or perform any review to ensure that costs for use of the same facilities over multiple contracts are not overlapping and potentially being double billed to the Commonwealth. We were unable to validate if any over billing occurred due to lack of supporting documentation. In addition, DPW could not validate for the same reason."*

**Commonwealth Response:** It is especially disappointing that, subsequent to the issuance of the draft audit and the provision of information showing this assertion to be inaccurate and misleading, audit staff did not make any effort to correct the record in its final report. In this case, DPW provided audit staff with comparison pricing from competitors and a line item cost verification analysis – both of which are not referenced in the final audit report.

As we stated in our February 20, 2009 response, we strongly disagree with this statement. DPW validates the reasonableness of facility related costs. In fact, Deloitte's facility costs for the largest two contracts covered by the audit are in line with that of other competitive offers. To that point, every competitive cost proposal submitted during the RFP process that resulted in the two largest DPW-Deloitte contracts examined for this audit, contained pricing for facilities by other vendors that were higher than the cost submittals of Deloitte, in some cases 150 to 300 percent higher.

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The audit report also claims on page [43] that, “Facility costs are established by the negotiation process at the beginning of the contract and are a fixed monthly rate. According to DPW management, the reasonableness of the costs is not verified due to the immaterial dollar amount of the facilities costs compared to the total contract amount. However, facility costs over four years totaled \$3.6 million. DPW’s Director of the Bureau of Financial Operations stated during the negotiation process the facilities charges are of little concern to him and he does not micromanage every line item in the contract as long as the overall price is reduced to an acceptable amount. Additionally, DPW does not request any documentation from Deloitte to verify reasonableness and the accuracy of the facility costs during the invoice review process.”

To state, as above, that DPW did not validate facility costs and considered reviewing these costs as “micromanaging” is incorrect. DPW clearly stated to the auditors that its negotiation approach comprehensively examines all contract components – including facility costs – and validates these costs against competitors’ costs and against other external sources.

In addition, the statement referenced above referred to overall contract negotiations, and referenced the fact that these facility costs represent less than 1 percent of the total contract value. In order to realize the best overall value for the Commonwealth, the Department focused on all components of the contract. Although omitted from the report, this approach resulted in a 13 percent reduction in the price of the two largest contracts reviewed for this audit alone – an annual savings of approximately \$6.3 million.

*AG Report: Page [44], “The (DCED) Director of the Grant Division stated that, with regard to review of invoices, there is a general procedural manual, but because no two projects are the same, the manual is not specifically utilized. She stated that DCED’s analysts ‘know what to look for’ but do not document their review.”*

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Commonwealth Response. The Auditor General's representatives were provided with a copy of the Opportunity Grant Program (OGP) procedures manual and a copy of the invoicing documentation for the Deloitte OGP prior to May 6, 2009. It is true that no two OGP projects are exactly the same. However, with regard to review of invoices, the manual is utilized as detailed in the Commonwealth Response on pages 25 and 26, and each analyst has also personalized their own manuals to address differences in OGP projects. It is also true that the seasoned analysts that process OGP applications, contracts, and invoices do know what to look for, but **all** OGP project files are documented exactly as they should be according to both the procedures manual and management direction. To be clear, not only do the analysts review and keep on file the documentation provided by the Grantee, but the supervisor also reviews both the documentation and the analysts' review of same prior to signing off on the Payment Request Form, which is only then submitted to the Comptroller's office for disbursement.

*AG Report: Page [45], "Adhere to Act 23 and the Job Creation Tax Credit Program Guidelines and award a vendor no more than \$1,000 tax credit per new job over the award period."*

**Commonwealth Response:** DCED respectfully disagrees with the Auditor General's legal conclusions and contends that the tax credit award to Deloitte was consistent with Act 23.

Section 8804-B(a) of the Act provides that "a company may claim a tax credit of \$1,000 per new job created up to the maximum job creation tax credit amount specified in the commitment letter."

Section 8804-B(d) specifically authorizes DCED to award these tax credits "for a period determined by the department but not to exceed five years". This section would not have been necessary if the position of the Auditor General were correct. That is, inclusion of the multi-year provisions in Act 23 indicates legislative intent that DCED is authorized to award credits on a multi-year basis and not be limited to the single-year award argument advanced by the Auditor General.



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The Auditor General further cites the Job Creation Tax Credit Guidelines as indicating that credits are limited to a one-time credit of no more than \$1,000 per job. DCED, in drafting the Guidelines, had no intent to indicate such limitations and further, does not believe that the Guidelines can be reasonably read to state such limitations.

The interpretation by DCED is consistent with practice since the Ridge administration. Further, the Job Creation Tax Credit award to Deloitte was consistent with this long-standing interpretation and administration of the program. Deloitte was treated no differently than any other beneficiary of this program.

Further, it is the position of DCED that its administration of the program is consistent with legislative intent in that the legislature, although clearly familiar with the program and its administration, has made no effort to amend the Act.

Based on the above, DCED disagrees with the findings and recommendations of the Auditor General with respect to the administration of the Job Creation Tax Credit Program and the award made to Deloitte under the program.

*AG Report: Page [45], "DGS scrutinize all vendors to ensure that they are not improperly benefiting from DCED grant programs."*

Commonwealth Response. Such a task would be unduly burdensome and is unrealistic.

*AG Report: Page [46], "Communicate with other agencies to determine the magnitude of existing Commonwealth contracts with a vendor before awarding grants and tax credits."*

Commonwealth Response. The Governor's Action Team (GAT) does consider existing Commonwealth contracts as a factor in determining what, if any, economic development incentives it might recommend for a company that is undertaking a job creation/retention project in the Commonwealth.

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It is GAT/DCED policy not to extend offers of financial assistance to companies for projects where the principal source of the company's business is derived from Commonwealth contracts. In cases where there is doubt regarding the volume of a company's business being derived from the Commonwealth, we may consult the Treasury Department's contract database to verify the extent of a company's Commonwealth contracts.

*AG Report: Page [46], "Develop written standard operating procedures for review and approval of the grant and Job Creation Tax Credit process."*

Commonwealth Response. The Governor's Action Team (GAT) will develop written standard operating procedures for review and approval of the grant and Job Creation Tax Credit process.

*AG Report: Page [46], "Verify by reviewing source documentation that vendors actually hire and retain the number of employees agreed upon."*

Commonwealth Response. Following the Auditor General's audit of the Opportunity Grant Program in 2007, several changes have been made to the OGP monitoring process. Grantees are advised in writing at the time of OGP approval that they may be asked to submit payroll documents verifying employment. As a result of the audit, there is a procedures manual detailing all changes to the administration and monitoring of the Opportunity Grant Program. The Department's OGP monitoring database has been programmed to request payroll records from every 10th OGP grantee being monitored. This procedure was discussed and affirmed by the Auditor General's office during the OGP audit. In addition, all grantees (including vendors) are visited at the project site within 24 months of OGP contract completion. All grantees are monitored on an annual basis, prior to the official monitoring date, to evaluate the likelihood of their meeting job creation and capital investment projections. If, at the end of the monitoring period the grantee has not met projections, a clawback of the grant occurs, which is based on the company's actual performance and determined by the Secretary of DCED.

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*AG Report: Page [42], "DCED management stated that there are no work papers or documented procedures supporting DCED's review of invoices submitted by Deloitte to ensure compliance with the grant agreement,"*

And

*AG Report: Page [46], "(DCED) document its review of grant expenditures, including using work papers and documented procedures performed."*

**Commonwealth Response.** All analysts in DCED's Grants Division are provided with an Opportunity Grant Program (OGP) procedures manual, and the Auditor General's representatives were provided a copy of same prior to May 6, 2009. Section 16 of the procedures manual outlines the process to be followed for review of documentation submitted by a Grantee for disbursement, also referred to as "invoicing." The documentation in the Deloitte OGP project file for invoicing is complete, procedures from the manual were followed, and the Auditor General's representatives were also provided a copy of the invoicing documentation prior to May 6, 2009.

Specifically, the analysts are directed, in their procedures manual, to review requests for disbursement/payment, and the documentation is highlighted in the file to confirm that the process was followed for this project as follows:

- a. Eligible uses of the funds as outlined in the commitment letter?
- b. Costs incurred within the contract activity period?
- c. Did the Grantee incur the costs?
- d. Were the funds used at the project site?
- e. Does the backup documentation match the PRV (Payment Request Form)?
- f. Is a vendor justification provided for every vendor?

In the Deloitte OGP project, the commitment letter, which is an appendix to the OGP contract, states, in part, that funds would be used toward the purchase of furniture and fixtures at 1700 Market Street, Philadelphia. The activity period of the OGP contract was between January 1, 2006 and June 30, 2008. The Grantee on the contract was Deloitte Services, LP.

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Documentation received from the Grantee, reviewed by both the assigned analyst and her supervisor, and located in the Deloitte OGP project file, specifically followed the procedures stated above. The documentation shows that the Grantee, Deloitte Services, LP, used the OGP funds toward the purchase of furniture and fixtures. Invoices are in the file from the vendor, AFD Contract Furniture, Inc., to the Grantee, dated within the activity period of the OGP contract, and showing that the furniture and fixtures purchased were delivered to one of the project site locations (in this case, 1700 Market Street, Philadelphia, PA.) This documentation matches the Payment Request Form submitted to the Comptroller's office for disbursement, and a vendor justification is in the Deloitte OGP project file.

The Payment Request Form is provided to the Grantee once the contract is fully executed, is completed by the Grantee, and is then submitted to DCED along with all of the documentation necessary for the previously noted review. Once the analyst reviews and verifies the documentation submitted, all of the same is reviewed by the supervisor, and the Payment Request Form is executed by the supervisor acknowledging review and approval. The supervisor-executed Payment Request Form is then sent to the Comptroller's office for disbursement, and the copy of same kept in the OGP project file can then be considered the "work paper" verifying all proper procedures were followed.

**Auditors' Conclusion:** Based on the documentation provided by DGS and the other Commonwealth agencies, we are not aware of any violations of the law related to conflicts of interest; however, it is important to note that key procurement documentation was not provided for 33 of 58 RFP/RFQ contracts as stated in Finding No. 1. Therefore, we could not determine whether these procurements were awarded in compliance with Commonwealth procurement law and in an unbiased manner. However, we did find instances of potential or perceived conflicts of interest within OA-OIT in which two different CIOs and a Deputy CIO had former relationships with Deloitte and had significant responsibilities to review and approve IT procurements as reported in Finding No. 5. OA-OIT does not have policies or procedures in place to address potential or perceived conflicts of interest within their organization. We consider this a significant weakness which should be corrected. Unfortunately, DGS and OA-OIT have chosen not to address this issue and instead attempt to reduce our audit to "a report itemizing all the instances where t's were not crossed and i's not dotted," as stated in their response.

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Additionally, while it is true that as part of our audit we reviewed allegations of conflicts of interest and procurement improprieties concerning the contracts that the Commonwealth has with Deloitte, Government Audit Standards state that we must obtain an understanding and evaluate management controls as they relate to the audit objectives. Therefore, the Commonwealth's response stating that we prepared a report "itemizing all instances where t's were not crossed and i's not dotted," in reality refers to instances in which we found weaknesses in management's controls related to IT procurements and have made recommendations accordingly to improve their controls and improve their process. As previously stated, our audit report included 37 recommendations to improve the Commonwealth's IT procurement process, and DGS has not responded to 27, or 73 percent, of these recommendations. We strongly suggest that the Commonwealth agencies implement our recommendations to improve their IT procurement process.

We recommend that DGS continue to move agencies toward entering all procurements into the SAP Procurement Module, as stated in Recommendation 18 of Finding No. 4, as DGS previously stated it was doing in response to our first draft audit report at Appendix C.

The Commonwealth claims that OA never denied having a contract with Deloitte. However, on September 8, 2008, we received an e-mail from OA's Audit Coordinator and Chief Counsel stating that OA had no contracts with Deloitte during the period January 1, 2004 to December 31, 2007. Similarly, on September 16, 2008, the Executive Deputy General Counsel in the Governor's Office of General Counsel also stated in two e-mails to the Department of the Auditor General's Chief Counsel that OA had no contracts with Deloitte during this period. An OA contract with Deloitte was finally provided to the auditors at the audit exit conference held on February 23, 2009, after the original draft findings were given to DGS for response. DGS also provided additional information for a second OA contract with Deloitte on March 9, 2009, including written documentation stating that OA purged the original detail scoring sheets prepared by each evaluator and losing vendor proposals in fall 2008 during our audit, not fall 2007 as stated in the Commonwealth's response. In fact, fall 2008 would have been around the same time as when we were requesting documentation in which OA and the Governor's Office claimed to have no contracts with Deloitte.

With regard to facility costs, while cost verification worksheets which include facility costs are required to be submitted by the vendors as part of their proposals, there is no evidence that DPW specifically reviewed and verified these costs for reasonableness. In addition, there is no evidence that DPW ensured that the proposed facility costs did not overlap with facility costs already being paid on other Deloitte contracts. Furthermore, statements were made by DPW management in a meeting with three auditors present regarding not verifying the reasonableness of facility costs when contracts are being negotiated. The Commonwealth's response to the finding contradicts the statements that DPW management previously stated to the three auditors.

We disagree with DCED's legal conclusions regarding the Job Creation Tax Credit award to Deloitte. Based on our department's legal analysis, a vendor should not be awarded more than \$1,000 tax credit per new job created over the award period. Act 23 does not state or imply that the same new job can provide the basis for tax credits in more than one year. Furthermore, it is clear from DCED's own program guidelines that Section 8804-B(d), cited in the management response, refers to the time period in which a company must take action to claim the tax credit, not the time period for which the company may receive the tax credit.

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We recommend that DGS scrutinize all vendors who receive contracts from the Commonwealth to ensure that such vendors are not improperly benefitting from DCED grant programs. DGS states that such a task would be unduly burdensome. However, we feel that without DGS monitoring and a lack of communication between DCED and other Commonwealth agencies, there is a real possibility that vendors could be improperly benefitting from state economic development programs. Incentive dollars provided to vendors under that Opportunity Grant Program and Job Creation Tax Credits are significant. Based on documentation provided by DCED management, DCED approved Opportunity Grants to vendors totaling of \$177.2 million during the period January 1, 2004 to April 30, 2009. Additionally, DCED approved Job Creation Tax Credits to vendors totaling \$156.1 million during the period January 1, 2004 to May 4, 2009. Therefore, this risk should be minimized by DGS and DCED by implementing our recommendations. DCED stated that it does consider whether vendors have existing Commonwealth contracts and may review the Treasury Departments contract database, but we also recommend that DCED should communicate with agencies which have contracts with the vendor before awarding grants or tax credits in order to ensure the vendor is not improperly benefitting and that the awards are in the best interest of the Commonwealth.

We acknowledge that the Governor's Action Team will develop written standard operating procedures for review and approval of the grant and Job Creation Tax Credit process.

DCED management stated that no visit was made to Deloitte's project sites. In addition, DCED performed no independent verification of the jobs retained/created, furniture/equipment purchased, and private investment made by Deloitte in order to comply with the grant and tax credit requirements. DCED relied solely on information provided by Deloitte. We exclusively reviewed only Commonwealth contracts with Deloitte during this audit, and, therefore, performed no analysis as to procedures DCED performed for other vendors awarded Opportunity Grants or Job Creation Tax Credits.

Regarding DCED's response related to its procedures to review invoices, the manual referred to by DCED that summarizes the process to be followed for review of documentation is only a general outline. The manual does not include detail procedures followed by the analysts in order to perform their review and verifications. Additionally, while the Payment Request Form was signed by the supervisor, the supporting invoice in the project file showed no evidence of review and what steps or procedures the analysts actually performed during the review. We continue to recommend that DCED document its review of grant expenditures, including using workpapers and documented procedures performed.

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### ***Finding 5 – DGS Needs to Improve its Oversight and Monitoring of Agencies' IT Procurement Practices***

*AG Report: Page [47], "Although management acknowledged that it was aware of the conflicts of interest allegations regarding Deloitte contracts, DGS management stated that it took no investigative action and performed no monitoring or auditing regarding the validity of the purchasing agencies' procurement of these contracts."*

**Commonwealth Response.** The Commonwealth acknowledged that it was aware of the *Auditor General's* allegation of conflict of interest. DGS has in fact taken several steps, outlined in our February 20, 2009 response, to address the potential for conflict of interest and agency compliance with procurement policies and law.

Prior to receiving this recommendation, we have developed a no conflict of interest certification and disclosure section to be incorporated within the existing confidentiality form that all evaluation committee members must complete and sign.

Also, DGS has created a new audit function the Bureau of Procurement to review agency procurement practices and procedures to ensure they are compliant with the Procurement Code and DGS policies. We have completed two audits to date and we would be pleased to share those reports with the auditors.

We are pleased that after conducting a comprehensive audit spanning seven agencies, 50 contracts and nearly two years of review, the Auditor General's report concludes that no laws were violated.

*AG Report: Page [48], "As part of our audit, we interviewed OA-OIT's Chief Information Officer and Deputy Chief Information Officer regarding how OA-OIT reviews and approves IT procurements and contract changes. For IT procurements and contract changes over \$100,000, OA-OIT stated that, beginning around mid-2006, the agency CIO or designee submits to their respective Community of Practice (COP) Planner within OA-OIT an IT Procurement Review Form along with the respective RFP, RFQ, sole source request, emergency contract, or change order documentation. The Technical Architecture Review Board (TAR), comprised of various subject matter experts, performs a technical review of the documentation provided by the agency with the Chief Technology Officer providing approval or denial based on TAR's comments. In addition, the Deputy CIO of the respective Community of Practice performs a business review and provides final approval or denial. From 2004 to implementation of this review process in mid-2006, OA OIT's respective Community of Practice performed the review with the COP*

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*Planner providing approval or denial to the agency. From 2000 to 2004, there was no centralized review of procurements and contract changes."*

**Commonwealth Response.** The following clarification was already provided to you in April but it is missing from your comments:

OA/OIT in conjunction with agency CIOs, conduct annual Community of Practice (COP) project reviews with the IT Governance Board. On an ongoing basis, OA/OIT reviews and approves all procurements over \$100,000 (this includes review of draft RFP, RFQ, sole source reviews, emergency procurements and change order documents). The procurement review consists of review / approval of draft procurement documents by the Deputy CIO, which may also include the Technical Architecture Review (TAR) depending on the content of the procurement. What we stated specific to large, complex procurements (particularly large RFPs) is that it is not unusual to go through several iterations / versions with multiple reviews being conducted by the DCIOs, the subject matter experts and our IT Contracting Office (which is part of the Office of Chief Counsel and which has been in place since December, 2007) before RFP documents are posted for bid by DGS. As we explained during our meeting further review depends on the procurement. For example, as we discussed at the meeting, for software procurements we will review the quote submitted by the vendor and ensure that it is aligned with our standards and there is generally no need for further reviews. The DCIOs conduct regular wellness checks and reviews of all large agency projects through regular review, interaction and supervision of agency CIOs. In addition, for large projects like Workforce Development, Financial Transformation, IOCMS, OIT participates in regular project steering committee meetings

From 2000 to 2004 OA–OIT was not responsible for centralized IT procurement review. In June 2004, a centralized review process was put into place with the Community of Practice Planners for procurements greater than \$100,000 (for agencies under the Governor’s jurisdiction). During this time frame, large IT initiatives were also reviewed by the CIO.



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On numerous occasions throughout the interviews with the Auditor General's Office it was clearly articulated that from 2004–2006 the IT procurement review process was changing, maturing and evolving to meet new technology demands, agency consolidations and shared service delivery of IT to the Commonwealth. In addition in October of 2005, OIT was reorganized formalizing the Deputy CIO structure and improved procurement review process which included the implementation of the Technical Architecture review Board and process in April 2006.

As we repeatedly explained, there was no formal centralization of IT or direct agency accountability to OA–OIT until the Executive Order was modified in May 2007.

*AG Report: Page [48], "OA-OIT has no written stated operating procedures for its review of IT procurements. OA-OIT did provide various Executive Orders/Bulletins and Training Manuals; however, this documentation does not address the day-to-day operation of key documents and detail review procedures."*

Commonwealth Response. This statement is incorrect and misleading. OA–OIT provided the auditors with the policy documents, training manuals, process documents, work flows and roles and responsibilities that document procedures and processes. On numerous occasions we also explained and re–explained our on–line system is used to track workflow and approvals.

*AG Report: Page [48], "IT Procurement Review Form is the only evidence of OA-OIT's review. The review evidence on this form is comprised of a single check box approval for the TAR Board and Deputy CIO. OA-OIT has no detail documentation or working papers supporting the review performed by each of the TAR members or the Deputy CIO."*

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Commonwealth Response. This statement fails to include important facts that were conveyed repeatedly to auditors. As we explained on numerous occasions and covered at length during our meeting in April, the Procurement Forms are part of an on-line system that contains work flow. Much like a manager approves a person's leave slip on-line using the SAP system, technical experts and managers (with security rights) can review the procurement forms on-line and approve them. All documentation is kept on-line with supporting detail. In addition, we have now ensured that commonwealth comptrollers will not approve any orders unless the COP approval is provided and documents are attached to the order within SAP.

*AG Report: Page [48], "OA-OIT cannot conclusively determine which individuals actually performed the review. Approvals by reviewers are done during TAR meetings and conference calls that are not documented and no minutes are kept for the meetings."*

Commonwealth Response. As previously mentioned, all documentation is kept on-line with supporting detail. Given the type of review that is necessary, there is no need or requirement for formal minutes. In addition, TAR meetings are often face to face meetings and if the right subject matter expert is not present, the procurement does not move forward until that expert's review is complete. Finally, any conditions or issues are noted with the procurement form and maintained within the on-line system.

*AG Report: Page [49], "OA-OIT's record keeping needs improved. When the auditors requested copies of the one-to-two page IT Procurement Review Form for all Deloitte contracts and contract changes over \$100,000 during the period January 1, 2004 to December 31, 2007, and provided OA-OIT with a list of the contract numbers and change order numbers, OA-OIT management stated that it would take weeks to go through thousands of documents and be very costly for its staff to produce these forms."*

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Commonwealth Response. This conclusion assumes too much and is therefore, inaccurate. As OA-OIT explained to the auditors on numerous occasions between 2004 and 2006 the procurement review process changed drastically and it has been a maturing and evolving process. As a consequence, to be sure we produced every single responsive document from that period – so as to not be accused of lacking transparency – we explained that we would have to do a thorough records search. In addition, because the documents requested date back beyond many document retention periods, searching for any that still would be in files would naturally take time. We also explained repeatedly that the procurement review process and TAR review were not in place until April 2006. Therefore it would be much more time consuming to investigate and produce documentation on procurements that predated the process and policy that we have in place today. Understandably its time consuming for OA-OIT staff that have full-time jobs to also search through years worth of procurement documents. The fact that we spent over 96 resource hours to provide complete, thorough, accurate responses to your requests is not evidence of poor record keeping, rather it evidences our commitment to be as transparent and forthcoming with information as possible. Your suggestions to the contrary are inflammatory and inaccurate.

*AG Report: Page [49], “There were a total of 60 contracts and changes to contracts with Deloitte over \$100,000 from the date of Executive Order 2004-8 of April 29, 2004 that required OA-OIT to provide review/approval until the end of our audit period of December 31, 2007. Of these 60 contracts and contract changes, OA-OIT could not provide evidence of review/approval for 26, including 5 RFPs/RFQs, 2 Sole Source Contracts, 5 emergency contracts, and 14 contract changes.”*

Commonwealth Response. As we previously stated, from 2000 to 2004 OA-OIT was not responsible for centralized IT procurement review. In June 2004, a centralized review process was put into place with the Community of Practice Planners for procurements greater than \$100,000 (for agencies under the Governor’s jurisdiction). During this time frame, large IT initiatives were also reviewed by the CIO.

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On numerous occasions throughout the interviews with the Auditor General's Office it was clearly articulated that from 2004–2006 the IT procurement review process was changing, maturing and evolving to meet new technology demands, agency consolidations and shared service delivery of IT to the Commonwealth. In addition in October of 2005, the Deputy CIO organization was formalized within OIT improving the oversight of the procurement review process which included the implementation of the Technical Architecture Review Board process in April 2006.

As we repeatedly explained, there was no formal centralization of IT or direct agency accountability to OA–OIT until the Executive Order was modified in May 2007.

*AG Report: Page [49], "OA-OIT does not perform reviews of the purchasing agencies' selection of evaluation committee members, scoring by the committee members, or selection of the vendor to ensure that selection of the vendor is reasonable and unbiased."*

Commonwealth Response. This is not an accurate statement. As we stated during our meetings, OA–OIT has members on the RFP teams as non-voting members to provide consulting and oversight.

*AG Report: Page [49], references to "conflict of interest."*

Commonwealth Response. With respect to the comments about conflicts of interest and/or "bias", the comments are unwarranted and not based in fact. As you previously acknowledged, the commonwealth has laws and policies governing conflicts of interest. And the auditors' numerous interviews and reviews of documents have produced no evidence of any bias. In the face of those facts it is irresponsible for you to continue to make allegations and accusations that conflicts of interest or apparent conflicts of interest between Deloitte and commonwealth employees existed.

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AG Report: Page [50], “OA-OIT management indicated that it does not have policies or procedures of its own to address the appearance of conflicts of interest related to review process for IT procurements and contract changes. OA-OIT stated that it adheres to various laws and policies that address ethical issues in procurement, including the Governor’s Code of Conduct (4 Pa Code Chapter 7), the Public Official and Employees Ethics Act (65 Pa. C.S. § 1101 *et seq.*), the Procurement Code (Chapter 23, “Ethics in Public Contracting”, 62 Pa. C.S.A. § 2301), and the Procurement Handbook (Part 1 Chapter 60). However, these laws and policies address actual conflicts of interest, but not the appearance of conflicts of interest.”

Commonwealth Response. Current policies ensure to the extent possible that evaluations are not conducted by individuals with a real, perceived or apparent conflicts of interest. Please refer to attached link. <http://www.dgsweb.state.pa.us/comod/RFPPlaybook/ConfidentialityStatementandNoConflict.doc>

AG Report: Page [50], “Additionally, due to the deficiencies in OA-OIT’s controls note above related to inadequate documentation of review and approval, OA-OIT could not give us a list of IT procurements and contract changes related to Deloitte contracts that were reviewed and approved by the individuals with the perceived conflicts of interest noted above. Therefore, we could not conclusively determine what reviews and approvals these individuals performed during our audit period. However, based on the responsibilities of their job position, it is clear that these individuals were significantly involved in reviewing and approving the IT procurements and contract changes during the period January 1, 2004 to December 31, 2007. Based on the limited information that we were able to obtain, we are not aware of any violations of law; however, there was clearly an appearance of conflict of interest that could have been avoided by excluding the former Deloitte employees from involvement with Deloitte contracts.”

Commonwealth Response. Your conclusions assume too much and are, therefore, invalid. As previously stated Executive Order 2004–8 as amended and ITB EPM003 set out the OA/OIT review requirements for IT procurements. Those documents require that OA/OIT review IT procurements with a dollar value in excess of certain thresholds. They do not require that the commonwealth CIO specifically review or approve any procurement. Generally, the commonwealth CIO is not involved in the review of draft procurement documents. In most instances the commonwealth Deputy CIO reviews and approves final procurement documents after review by the Technology Architecture Review (TAR) Board. Approval or disapproval is communicated to the agency CIO/IT Manager through the Community of Practice Planner based on the recommendation of the TAR Board and Deputy CIO. That communication is the official approval or disapproval and is the record that is maintained. We have provided the information regarding known reviews

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and approvals related to the Deloitte procurements in the scope of this audit. As we have repeatedly documented and explained, current and former commonwealth CIOs could not and did not manipulate or bias any Deloitte procurement because they did not participate on any procurement committee that selected Deloitte as a vendor. To now suggest that because OA-OIT cannot produce every single review and approval made by commonwealth CIOs from 2000–2007 (a period of time during which OA-OIT was not formally responsible for centralized IT procurement review) evidences a conflict or appearance of a conflict is irresponsible. Moreover, such unsubstantiated accusations suggest improper behavior by former employees who in fact provided exemplary service to the Commonwealth.

*AG Report: Page [52], “With regard to OA-OIT’s record keeping system, OA-OIT’s CIO and Deputy CIO stated that their reviews are performed prior to the awarding of the contract and, therefore, have no associated contract number. OA-OIT’s staff must manually match the contract number to the RFP or RFQ, which has a different number, by manually looking through thousands of pages of documents.”*

Commonwealth Response. As previously stated, on an ongoing basis, OA/OIT reviews and approves all procurements over \$100,000 (this includes review of draft RFP, RFQ, sole source reviews, emergency procurements and change order documents). The procurement review consists of review / approval of draft procurement documents by the Deputy CIO, which may also include the Technical Architecture Review (TAR) depending on the content of the procurement.

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What we stated specific to large, complex procurements (particularly large RFPs) is that it is not unusual to go through several iterations / versions with multiple reviews being conducted by the DCIOs, the subject matter experts and our IT Contracting Office before RFP documents are posted for bid by DGS (hence no contract numbers are available). As we explained during our meeting further review depends on the procurement. For example, as we discussed at the meeting, for software procurements we will review the quote submitted by the vendor and ensure that it is aligned with our standards and there is generally no need for further reviews. The DCIOs conduct regular wellness checks and reviews of all large agency projects through regular review, interaction and supervision of agency CIOs. In addition, for large projects like Workforce Development, Financial Transformation, IOCMS, OIT participates in regular project steering committee meetings. After contract award, all legal documents are kept as part of the contract and PO as part of SAP. There is no tie between SAP and the procurement review system at present.

*AG Report: Page [50], "Furthermore, OA-OIT management indicated that it works together with the Office of Administration's Human Resources Office to define the minimum education, training, and experience requirements for the agency CIO positions. Management indicated that OA-OIT monitors and ensures that these positions are filled in compliance with the established job requirements. However, when the auditors made inquiry to OA-OIT regarding an allegation that was received by the auditors stating that an agency CIO was taking college courses paid by the Commonwealth to fulfill the minimum job requirements after being hired and requested Out-Service-Training/Travel Authorization Request forms, OA-OIT stated that it does not approve professional training for agency IT staff. OA-OIT management stated that training request would be handled by the agencies."*

Commonwealth Response. There is a significant misunderstanding regarding the information that was provided on the issue of CIO hiring and training. Specifically related to the hiring process, it is indeed true that since May 2007, OA-OIT working together with HR, monitors and ensures that CIO positions are filled in compliance with the established job requirements. In fact, from the beginning of 2008, OA-OIT has a clearly defined the CIO selection process. Documents reflecting that process were provided to the auditors but those details are not included in your report. This process is the direct result of the CIO reporting relationship change that took place in May 2007.

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In addition, we explained that as part of IT consolidation and the subsequent updates to the Executive Order (May 2007) agency CIOs were categorized in one of three categories (depending on agency size and complexity): CIO1, CIO2 or CIO3. The classifications took effect August 2007 and the reporting relationships changed to OA/OIT at that time. OA/OIT and OA/HR worked together to define these classifications and the qualifications. As we previously advised, no agency CIOs were removed or displaced because of the August 2007 re-classifications. Therefore, any agency CIOs who held the position prior to August 2007 was grandfathered in to the position as is the normal practice when reclassifications of non-civil service positions are made.

We are unable to address the particulars of your new allegations regarding agency CIO training and qualifications as you have not revealed which CIO(s) you believe did not have the minimum job requirements. But we can clarify the fact that since August 2007 OA-OIT participates in the CIO hiring process and ensures CIOs hired meet the newly revised qualifications. Also, as previously stated OA-OIT does annual performance reviews with each CIO as well as establishes performance expectations annually. Part of this is a review of strengths and weaknesses and training plan. Since August 2007, OA-OIT has provided CIO training sessions. If any agency wants to provide additional professional training to its CIO or any other employee, that is at the discretion of the agency.

*AG Report: Page [52], "With regard to the serious deficiencies noted with OA-OIT's IT procurement review procedures, the OA-OIT CIO stated that the IT Procurement Review Form is automated and transmitted electronically to the appropriate individuals for review and approval based on roles set up in OA-OIT's system. She concluded that auditors think of documentation only as paper and that, although she does not have paper evidencing who performed the review, it does not mean that the review was not performed. In addition, she stated that she knows and tracks all of the persons performing the reviews and there has not been much change in these personnel over the years."*



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Commonwealth Response. This statement is another mischaracterization. On numerous occasions we attempted to explain our on-line system which contains not only the procurement review form, but supporting documentation (since April 2006). As we explained on numerous occasions and covered at length during our meeting in April, the OA-OIT Procurement Forms are part of an on-line system which contains work flow. Much like a manager approves a person's leave slip on line with the SAP system, technical experts and managers (with security rights) can review the procurement forms on line and approve them. All documentation is kept on-line with supporting detail.

In addition, the TAR review is often a face to face meeting and if the right subject matter expert is not present, the procurement does not move forward until that expert's review is complete. Any conditions or issues are noted with the procurement form. Also, as we stated and provide copies to your office, the procurement review forms are signed off by the Deputy CIOs and Chief Technology Office. Those forms "conclusively determine" who signed off on the procurement.

Your comment that there are no working papers or documentation of review by the TAR Board and Deputy CIO is incorrect. While there are no formal minutes, there is documentation on-line to support the on-line approvals provided by the DCIO and CTO as appropriate.

*AG Report: Page [52], "With regard to lack of OA-OIT reviews for sole source and emergency contracts greater than \$100,000, OA-OIT management stated that there was confusion early in the process when the Deputy CIO organizations were first being established within OA-OIT as to whether OA-OIT would review sole source and emergency procurements. OA-OIT stated that this policy has been clarified since that time and sole source and emergency procurements over \$100,000 are to be reviewed by OA-OIT. No explanation was provided for the lack of review/approval for the RFPs/RFQs and contract changes."*

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Commonwealth Response. What we have said repeatedly is that since April 2006 when the formal system was put in place, the process has matured and evolved. This coupled with the fact that since August 2007 agency CIOs have a direct reporting relationship to OA-OIT helps strengthen our policies and procedures. OA/OIT does review RFQ/RFP, change orders, emergency procurements, etc. as outlined in numerous conversations and as outlined in the EMP 003 policy and your records should accurately reflect that. The last statement in the above quotation, therefore, should be deleted.

*AG Report: Page [53], "With regard to potential conflict of interest situations, OA-OIT management does not feel that it is necessary to have its own policies beyond the Governor's Code of Conduct, the Public Officials and Employees Ethics Act, the Procurement Code and the Procurement Handbook."*

Commonwealth Response. You note that the ethics laws and policies to which the Administration cited and adheres only address actual conflicts of interest, and not the "appearance of" conflicts of interest, and that policies and procedures should be in place for potential, perceived and appearance of conflicts of interest. You further recommend that we exclude employees with the potential, perceived or appearance of conflicts of interest from participating on contract evaluation committees. Please be advised that prior to receiving this recommendation, we have developed a new conflict of interest certification and disclosure section to be incorporated within the existing confidentiality form that all evaluation committee members must complete and sign. However please share with us any standards that you have identified which could be used to define the terms "potential" "perceived" and "appearance" so that we may include them in our policies; otherwise we see no way to reasonably guard against these situations without completely halting our procurement and business decisions or preventing the hiring of former contractor employees to oversee business areas in which they have natural expertise. With respect to former contractor employees who come to the Commonwealth as permanent employees, we must agree to disagree that where no ties (financial, ownership or familial) to the former employer exist such a Commonwealth employee cannot participate as an evaluator in a competitive procurement process along with other evaluators. Again, if you are aware of any legal precedent defining a time-out period or prohibiting such involvement, please share it with us.

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*AG Report: Page [54, Recommendation 26.], DGS should ensure that OA-OIT take specific measures."*

**Commonwealth Response.** This is outside DGS' level of authority for measures not directly related to procurement. Notwithstanding the detailed timeline which we previously provided your office, it is also apparent from your revised report that you remain confused about the timing and application of Executive Order 2004-8 which provides OA-OIT with certain authority over IT procurements - many of the provisions which you state were not performed according to this directive did not come into effect until the Executive Order was amended on May 9, 2007, well after the time the audited contracts would have been subject to those procedures.

**Auditors' Conclusion:** We must make clear that the allegations of conflicts of interest regarding Commonwealth contracts with Deloitte were not our allegations. The allegations were reported in newspapers and by several individuals who contacted the Department of the Auditor General. The Department of the Auditor General fulfilled its responsibilities by reviewing the allegations received.

It is important to note that, prior to submitting the Commonwealth's response dated February 20, 2009 to our original draft report, neither DGS nor any other Commonwealth agency provided to us or mentioned a new confidentiality form to include a no conflict of interest certification or a DGS audit function. Prior to the exit meeting, we confirmed there were no conflict of interest forms required to be signed and no DGS audit function through documentation review and interviews. These are new procedures which were implemented by DGS and communicated to us in its response to our original draft audit report.

Executive Order 2004-8, signed by the Governor on April 29, 2004, required OA-OIT to review and approve all RFPs, RFQs, sole source requests, and emergency contracts for IT procurements greater than \$100,000 prior to submission to DGS. This review process evolved between 2004 and 2006 until the Executive Order was amended on May 9, 2007 to provide the review structure and process which is in place at the current time.

We reiterate that OA-OIT provided us with various Executive Orders/Bulletins and Training Manuals; however, per our review, these policies and manuals did not address the day-to-day operation of key documents and detail review procedures to be performed. We continue to recommend that DGS ensure that OA-OIT develops standard operating procedures for review and approval of IT procurements and contract changes.

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With regard to OA-OIT's response that all of its review documentation is maintained online, we did discuss this issue at length with OA-OIT. In fact, we requested, both in writing and verbally at our meetings on April 6, 2009 and May 5, 2009, all review documentation, including screen printouts of online documentation. The only document that OA-OIT could produce was the IT Procurement Review Form, which consisted of a single check box approval for the TAR Board and the Deputy CIO. OA-OIT had no detailed documentation or working papers, whether online or hard copy, supporting the review performed by each of the TAR members or the Deputy CIO that could be produced for the auditors. Additionally, we requested that OA-OIT provide its online documentation or screen printouts evidencing the persons actually performing the review and approval from the Technical Architecture Review Board, Community of Practice, and Deputy CIO; however, OA-OIT stated that it could not produce such information. While OA-OIT claims to have an online system which contains workflow of review and approvals and maintains documentation online with supporting detail, OA-OIT was not able to produce any evidence of this documentation besides the IT Procurement Review Form. Good management and system controls should include evidence of an audit trail by documenting the detail review performed and the person performing the review and approval. OA-OIT could not provide this audit trail, documentation, or other evidence.

Regarding the Commonwealth's response to timing issues OA-OIT had providing the IT Procurement Review Forms to the auditors, OA-OIT states that the long timeframe required to provide these documents was due to the necessity of performing a thorough records search. However, OA-OIT management stated to the auditors at our May 5, 2009 meeting that this records search would take considerably more time due to the fact that OA-OIT does not link the RFP/RFQ reviewed to the actual contract awarded. Therefore, it becomes more difficult to retrieve OA-OIT's IT Procurement Review Forms related to a certain contract. We recommend that OA-OIT improve its record keeping so that the records can be thoroughly searched and retrieved in a more timely manner.

Executive Order 2004-8, signed by the Governor on April 29, 2004, required that OA-OIT provide IT procurement review and approval. Based on documentation prepared and provided by OA-OIT, there were a total of 60 Deloitte contracts and contract changes during the period April 29, 2004 through December 31, 2007 which required OA-OIT review and approval. OA-OIT could not provide evidence of review/approval for 26, or 44 percent, of these contracts and contract changes as stated in the Condition Section of Finding No. 5. OA-OIT states that this was due to the fact that its review process was in a state of change and evolution during the years 2004 through 2006 until the Executive Order was amended on May 9, 2007; however, this does not negate the fact the OA-OIT was given the responsibility to perform IT procurement reviews beginning on April 29, 2004, but either did not perform or could not provide evidence of all the reviews required.

OA-OIT provided no evidence that it reviews the purchasing agencies' selection of evaluation committee members, scoring by the committee members, or selection of the vendor to ensure that selection of the vendor is reasonable and unbiased. Also, while OA-OIT stated it has members on the RFP committee as non-voting members to provide consulting and oversight, this is not a requirement. We found that only some RFP committees included non-voting members from OA-OIT, according to the RFP committee member information provided by DGS and the respective Commonwealth agencies.

## *APPENDIX D*

Regarding OA-OIT's references to conflicts of interest, the Commonwealth employees referred to in Finding No. 5 had confirmed relationships with Deloitte. It does not appear that any laws were violated with regard to conflicts of interest; however, these individuals clearly had an appearance of, and potential for, conflicts of interest due to the fact that they were significantly involved in OA-OIT's IT procurement review and approval process. Additionally, OA-OIT could not provide detailed documentation supporting the reviews performed or who performed the reviews, and, therefore, we could not determine whether there was any bias or actual conflicts of interest. Again, what we do know is that there was a definite potential for bias and conflicts of interest, as well as the appearance of conflicts. Contrary to the Commonwealth's response, we would be irresponsible to not bring this to the Commonwealth's and taxpayers' attention. We recommend that policies and procedures should be in place to prevent both actual conflict of interest situations, as well as potential/appearance of conflict of interest situations. These policies and procedures should not only be in place for the RFP evaluation committee members, but also for any other Commonwealth employees, including OA-OIT, involved in the selection of vendors or the review/approval of IT procurements.

We disagree with the Commonwealth's response regarding training of agency CIOs. Because agency CIOs report directly to OA-OIT, we requested Out-Service-Training/Travel Authorization Request forms for CIOs taking college courses paid by the Commonwealth to fulfill minimum job requirements in order to be hired for the position. OA-OIT stated that approving this training is the responsibility of the respective Commonwealth agencies. However, we disagree. OA-OIT has the responsibility to monitor and ensure that the agency CIOs, who report directly to the OA-OIT Deputy CIO for the respective Community of Practice, meet minimum education and training job requirements. Therefore, OA-OIT should review and scrutinize out-service-training requests for college/university courses in order for an agency CIO to meet minimum job requirements.

Additionally, while there may not be any laws defining a "time-out" period prohibiting former Commonwealth contractor employees who become Commonwealth employees from being involved in the procurement process where the former contractor may be awarded the contract, we recommend that the Commonwealth develop its own policies to prevent this or other potential/appearance of conflict of interest situations.

The Commonwealth responded that Recommendation 26 is outside of DGS's level of authority. However, we disagree. This recommendation included six bulleted items in which we recommend that DGS ensure OA-OIT implements to improve the IT procurement process. The Commonwealth Procurement Code states that DGS has the responsibility to procure or supervise the procurement of all supplies, services and construction needed by executive agencies and those independent agencies for which the department acts as the purchasing agency, and, therefore, this responsibility does fall under DGS's authority.

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