



An Audit Report on

A Selected Contract at the Department of State Health Services

June 2016
Report No. 16-031



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Overall Conclusion

The Department of State Health Services (Department) should strengthen its management of its contract with Morris & Dickson Company, a pharmaceutical wholesaler, to help ensure compliance with statutes, Office of Comptroller of **Public Accounts (Comptroller's Office)** requirements, Department policies and procedures, and the **contract's statement of work**.

The Department did not sufficiently manage and monitor the pharmaceutical wholesaler contract to verify that Morris & Dickson Company performed according to the terms of the contract. The Department verified that it received the goods that it purchased before it paid for those goods; however, the Department should improve its review of certain contract deliverables and consistently verify that prices and discounts are accurate. Specifically, the Department did not verify the accuracy of the prices for \$7,610,851 (67 percent) of the \$11,344,023 in payments tested. In addition, the Department provided auditors a report that the contractor prepared asserting that it paid service charges on payments made late totaling \$43,363, even though its contract with Morris & Dickson Company did not contain a provision allowing for such charges. The Department should also ensure that it pays interest when it does not make payments within the established time frames required by Texas Government Code, Section 2251.025.

In addition, the Department did not require one of its Contract Management Units to oversee the contract with Morris & Dickson Company because it does not require contracts that are primarily for the purchase of goods to be administered by its Contract Management Units. As a result, the Department had not assigned a contract manager to oversee the contract, as required by statute.

The Department and the Health and Human Services Commission (Commission) **generally planned, procured, and formed the Department's contract with Morris & Dickson Company** in accordance with applicable requirements. However, the

Background Information

The scope of this audit covered the **Department of State Health Services'** (Department) pharmaceutical wholesaler contract with Morris & Dickson Company.

The Department awarded the pharmaceutical wholesaler contract to Morris & Dickson Company on September 1, 2013, for an estimated \$140 million per year with up to four additional one-year-period contract renewals (through the end of fiscal year 2018). Expenditures for the contract totaled \$308,085,610 between September 1, 2013, and December 31, 2015.

The Department is responsible for most contract planning activities and for contract oversight. The Health and Human Services Commission is responsible for contract procurement activities and contract formation.

Sources: **The Department's contract** with Morris & Dickson Company, Uniform Statewide Accounting System data, and the Commission's *Contracting Processes and Procedures Manual*.

This audit was conducted in accordance with Texas Government Code, Sections 321.0131, 321.0132, and 2262.052.

For more information regarding this report, please contact **Audrey O'Neill**, Audit Manager, or **Lisa Collier**, First Assistant State Auditor, at (512) 936-9500.

Commission did not ensure that all appropriate personnel completed the required disclosure and nondisclosure statements. **The Department's** nondisclosure form also did not include all assertions required by the *State of Texas Contract Management Guide*.

Auditors communicated other, less significant issues **related to the contract's function, procurement, formation, and oversight** to the Department and Commission separately in writing.

Table 1 presents a summary of the findings in this report and the related issue ratings. (See Appendix 2 for more information about the issue rating classifications and descriptions.)

Contract Management Framework

Plan - Identify contracting objectives and contracting strategy.

Procurement - Fairly and objectively select the most qualified contractor(s).

Contract Formation/Rate/Price Establishment - Ensure that the contract contains provisions that hold the contractor(s) accountable for producing desired results, including all relevant terms and conditions as well as establish processes that are cost-effective and aligned with the cost of providing goods and services.

Contract Oversight - Monitor and enforce the terms of the contract.

Source: *State of Texas Contract Management Guide*, version 1.9.

Table 1

Summary of Chapters and Related Issue Ratings		
Chapter	Title	Issue Rating ^a
1	The Department Did Not Sufficiently Manage and Monitor the Pharmaceutical Wholesaler Contract to Verify That Morris & Dickson Company Performed According to the Terms of the Contract	High
2	The Commission and Department Generally Complied with Statutes and Requirements for Contract Planning	Low
3	The Commission Generally Procured and Formed the Contract with Morris & Dickson Company in Accordance with Requirements; However, It Should Strengthen Its Proposal Evaluation Process	Medium

^a A chapter is rated Priority if the issues identified present risks or effects that if not addressed could critically affect the audited **entity's ability to effectively administer the program(s)/function(s) audited**. Immediate action is required to address the noted concern and reduce risks to the audited entity.

A chapter is rated High **if the issues identified present risks or effects that if not addressed could substantially affect the audited entity's ability to effectively administer the program(s)/function(s) audited**. Prompt action is essential to address the noted concern and reduce risks to the audited entity.

A chapter is rated Medium if the issues identified present risks or effects that if not addressed could moderately affect the audited **entity's ability to effectively administer program(s)/function(s) audited**. Action is needed to address the noted concern and reduce risks to a more desirable level.

A chapter is rated Low **if the audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited**.

Summary of Management's Response

At the end of each chapter in this report, auditors made recommendations to address the issues identified during this audit. The Commission and the Department agreed with the recommendations in this report.

Audit Objective and Scope

The objective of the audit was to determine whether the Department has administered certain contract management functions for the selected contract in accordance with applicable requirements.

The scope of the audit covered the Department's pharmaceutical wholesaler contract with Morris & Dickson Company. Auditors tested transactions from the inception of the current contract on September 1, 2013, through December 31, 2015.

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Detailed Results

Chapter 1

The Department Did Not Sufficiently Manage and Monitor the Pharmaceutical Wholesaler Contract to Verify That Morris & Dickson Company Performed According to the Terms of the Contract

Chapter 1
Rating:
High ¹

The Department of State Health Services (Department) did not sufficiently manage and monitor its pharmaceutical wholesaler contract with Morris & Dickson Company to verify that the contractor performed according to the terms of the contract.

The Department verified that it received the pharmaceutical drugs that it ordered and that those pharmaceutical drugs were supported by an invoice prior to payment. However, the Department should improve its review of certain contract deliverables, consistently verify that prices and discounts are accurate, make payments in a timely manner, pay interest on late payments, and not pay service charges that are not specified in the contract.

In addition, the Department did not require one of its Contract Management Units to administer contracts that are primarily for goods. As a result, the Department had not assigned a contract manager to oversee the contract as required by statute.

The Department also did not have documented contract management policies and procedures for governing certain aspects of vendor contracts that are mainly for goods.²

The Department should sufficiently design payment processing controls for payments to Morris & Dickson Company for the contract audited.

The Department did not exceed the total annual contract amount or make duplicate payments to Morris & Dickson Company for the contract audited. User access related to purchasing also was properly segregated in the Department's internal accounting system, the Health and Human Services Administrative System (HHSAS). However, the Department did not have a process in place to consistently verify that the prices paid were correct and complied with the contract's pricing, terms, and conditions.

¹ Chapter 1 is rated as High because it identifies risks or effects that if not addressed could substantially affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Prompt action is essential to address the noted concerns and reduce risks to the audited entity.

² The Department has contracts for services and contracts for goods and services. The contract with Morris & Dickson Company is primarily for the purchase of goods, which are pharmaceutical drugs.

Auditors tested 48 payments totaling \$11,344,023 made from September 1, 2013, through December 31, 2015, and determined that the Department verified that it received the pharmaceutical drugs, and that it approved the invoices for those drugs prior to payment. However, the Department did not always verify whether the invoices were correct as required by the *State of Texas Contract Management Guide*.³ For all 48 payments tested, the Department did not independently verify the pharmaceutical drug prices for certain types of drugs purchased. Specifically:

- Within 48 of the payments tested, the Department did not verify the accuracy of the prices for \$7,610,851 (67 percent) of the \$11,344,023 in payments tested. As a result, auditors were unable to determine whether the prices that the Department paid for certain types of drugs were accurate.
- For all 48 payments tested, the Department did not obtain documentation to verify whether the contractor correctly applied the early payment discount specified in the contract, or whether additional fees were included in the payments.
- For the two largest payments tested, the Department accurately verified the prices totaling \$3,733,172 for certain types of pharmaceutical drugs⁴ included on those invoices. However, the Department's review process did not accurately verify drug prices for 10 (34 percent) of the 29 drugs it received. Those errors occurred because the Department did not have a secondary review and approval process for the pharmaceutical drug prices that it reviewed.

Without a process to verify that prices are correct and comply with the contract, the Department could overpay for the goods it receives.

The Department did not make payments within the time lines set by the contract or pay interest, and it paid service charges that were not included in the contract as a result of those late payments.

The Department's contract with Morris & Dickson Company contained provisions establishing an early payment period. Under the terms of the contract, the Department can receive a pricing discount for invoices paid

³ The *State of Texas Contract Management Guide* requires invoices to comply with the pricing, terms, and conditions of each contract. The audited contract's statement of work requires that (1) product pricing be in accordance with the public health services pricing for eligible programs or the contractor's negotiated price and (2) the contractor use less expensive products for invoicing and not add any fee, percentage, or other cost to the products purchased unless the fee, percentage, or cost is defined and approved in writing by the Department.

⁴ The types of pharmaceutical drugs the Department verifies are for the Texas HIV Medication Program, which provides medications for the treatment of HIV and its related complications for low-income Texans.

within 15 or 20 days from the date the invoice was received.⁵ Auditors analyzed all 1,412 payments the Department made to Morris & Dickson Company from September 1, 2013, through December 31, 2015. Of those 1,412 payments, 54 (4 percent) were not made by the contract's early payment due date, as required by Texas Government Code, Section 2251.030. Furthermore, 19 of those payments were made more than 30 days after the invoices were received.

Texas Government Code, Section 2251.030, requires agencies that have entered into contracts with early payment discounts to pay by the established due dates to obtain the discount. By not paying by the early payment due date, the Department could potentially owe the contractor interest for days past due and may not receive the maximum discount allowed by the contract.

Interest Due

Texas Government Code, Section 2251.025, states that interest is due to a vendor on overdue payments, and that payments begin to accrue interest on the date that a payment becomes overdue.

For the 54 late payments, auditors estimated that the Department did not pay interest to the contractor ranging from \$3,551 to \$10,947 as required by statute (see text box).⁶ A Department facility employee stated that the interest was manually waived in the Department's internal accounting system because the Department was already paying service charges for those late payments.

For the 54 payments made after the early payment due date, the Department paid Morris & Dickson Company an 18 percent service charge.⁷ However, the contract did not include provisions allowing such service charges. The Department did not have a process to verify that Morris & Dickson Company (1) invoiced only for goods or services specified in the contract and (2) did not include unallowable fees or unauthorized charges in the invoices. In addition, the Department did not ensure that all employees processing the invoices and payments were aware that the contract did not allow Morris & Dickson Company to bill for service charges. The Department provided auditors a report that the contractor prepared asserting that the Department paid a total of \$43,363 in service charges for those 54 payments.

⁵ According to the contract, this is the negotiated early payment date for Department facilities and the pharmacy branch warehouse. The early payment date for (1) Department facilities is 10 days plus a 5-day grace period and (2) the Department's pharmacy branch warehouse is 15 days plus a 5 day grace period.

⁶ Auditors calculated an estimated range for interest due to the contractor because there was a lack of clarity in the contract about the due date from which interest payments should be calculated to ensure compliance with Texas Government Code, Section 2251.025. Specifically, it was unclear in the contract whether the due date was the early payment due date (15 days for facilities and 20 days for pharmacy branch warehouse) or 30 days after an invoice had been received, as specified in Texas Government Code, Section 2251.021.

⁷ Morris & Dickson Company calculated the service charge as follows: (gross invoice amount multiplied by 18 percent) multiplied by (business days invoice late divided by 365).

Auditors reviewed 10 of those payments and verified that the Department paid the amounts in the contractor's report.

The Department did not have a contract manager assigned to the Morris & Dickson Company contract to oversee compliance with contract terms, and it did not always conduct and document certain monitoring activities.

For contracts that are primarily for goods, the Department did not require one of its Contract Management Units to oversee contractor compliance with contract terms and document that it evaluated compliance. Instead, each program division within the Department informally monitors invoices for compliance with terms or other sections of a contract. The Department's agency-wide contract policies require that every contract have an assigned contract manager from contract planning through contract close-out. However, the Department's Pharmacy Branch did not have a contract manager to oversee the contract with Morris & Dickson Company as required by Texas Government Code, Section 2262.053. In addition, the Department's Pharmacy Branch did not have any employees with the contract manager training and certification required by statute. Without ensuring that a contract manager is assigned to monitor the contract, there is an increased risk that the Department may not identify and address potential contractor noncompliance with the terms of the contract.

Adjusted Service Level

The adjusted service level is the acceptable quality level that the Department uses to measure contractor compliance with requirements to provide goods according to the terms of the contract. It is calculated as the total number of goods the Department received as a percentage of the number of goods ordered (excluding items not available to Morris & Dickson Company for certain reasons, such as discontinued products, as established by the contract).

The Department did not (1) verify the data in the adjusted service level performance reports it received from the contractor or (2) document the contractor's compliance with the 97 percent adjusted service level performance measure as required by the contract (see text box for more information on the adjusted service level). Because the Department does not verify the performance reports the contractor provides, there is a risk that those reports are not accurate or that the contractor may not be fully complying with the agreed-upon service levels.

In addition, the contract did not specify the required frequency for evaluations of the service level performance measure. The Department asserted that it monitors the service level performance measure annually; however, it could not provide evidence of those evaluations for fiscal years 2014 and 2015. The *State of Texas Contract Management Guide* states that a contract's statement of work should include the content, frequency, and audience of each report noted in the contract.

The Department did not have any documentation showing that it completed a monitoring risk assessment, which would help the Department identify high-risk areas, such as noncompliance with the adjusted service level performance measure, on which to focus its monitoring efforts (see Chapter

2 for more information about the requirement to conduct a preliminary risk assessment). Department-wide contract policies and procedures specify that it is the contract manager's primary responsibility to continually monitor a contractor's performance to ensure compliance with contract terms and conditions.⁸

The Department did not have documented contract management policies and procedures for governing certain aspects of vendor contracts that are primarily for goods.

For contracts that are primarily for goods, the Department did not have policies and procedures or other documentation identifying the management positions responsible for approving (1) a purchase requisition prior to the original solicitation and (2) renewals of contracts that are primarily for goods. Having policies and procedures governing certain aspects of approvals for major vendor contracts primarily for goods would help the Department to ensure that contracts are properly initiated and contract renewals include only changes that are appropriately approved.

Recommendations

The Department should:

- Develop a process to verify the accuracy of all types of pharmaceutical drug prices and contractor discounts, and to verify that unauthorized charges are not paid.
- Establish a process to ensure that it makes payments within established time frames and it receives the maximum discount established in its contracts.
- Pay interest for payments made after the established due date, as required by Texas Government Code, Section 2251.025.
- Assign a qualified contract manager to oversee all contracts, including contracts that are primarily for goods.
- Verify the data in the adjusted service level performance measure reports it receives from the contractor and document reviews of the contractor's compliance with contract terms, including the adjusted service level performance measure.

⁸ The *State of Texas Contract Management Guide* also requires that a contract manager consider methods to verify that the contractor performs as specified in a contract's statement of work.

- Complete and document a monitoring risk assessment for large contracts.
- Develop and implement contracting policies and procedures that identify management responsible for (1) approving purchase requisitions for solicitations and (2) renewals of contracts that are primarily for goods.

Management's Response

The Department of State Health Services (DSHS) accepts the findings and recommendations and will take steps to address these issues particularly for this contract but also for similar contracts managed by the department.

DSHS will establish a single contract manager for the department for this contract. This individual will be responsible for ensuring that all contract management functions relating to the department's use of this Health and Human Services (HHS) system-wide contract are carried out in accordance with Comptroller guidelines and HHS and DSHS contracting policies and guidelines. This includes assessing risk, verifying contractor performance in accordance with the contract, reviewing and approving billing, maintaining contract related documentation, and monitoring the contract. This contract manager will coordinate across the department divisions and develop procedures to ensure all contract management functions are addressed and that activities are carried out consistent with the contract. The contract manager will be designated by July 1, 2016.

The HHS System established a Contract Management Handbook in September 2015 to guide contracting and procurement activities of all HHS agencies in line with Senate Bill 20 (84th Texas Legislature, 2015). This document delineates contract management functions, and roles and responsibilities of HHS agencies. It also establishes policy and procedure on approving purchase requisitions for solicitations and the process and approvals for contract renewals. Additionally, DSHS published the 2016 DSHS Contract Management Handbook effective June 1, 2016. The handbook is consistent with Comptroller Guidelines and the HHS System Contract Management Handbook. The handbook includes details on specific DSHS procedures for elements of the contracting process, contract guidance and procedures for vendor and recipient/sub-recipient contracts including a tool for vendor risk assessment, and other tools and forms to promote good contract management. Full implementation of the revised handbook for vendor contracts will occur through December 31, 2016.

In addition to the handbook, specific procedures to ensure cross department coordination will be fully implemented by December 31, 2016.

DSHS will review vendor contracts across the department, particularly those that are used across multiple areas of the department, to ensure a similar process and structure are in place for these contracts. This action will occur by March 31, 2017.

On the issue of ensuring maximum discounts as well as prompt payment, the Central Office Claims Unit will meet with Central Office and State Hospital Accounting to ensure understanding of processing timelines and prompt payment and provide any technical assistance as needed. This will be completed by August 31, 2016.

Finally, DSHS will develop policies and procedures to verify accuracy of pharmaceutical prices, contractor discounts, and that unauthorized charges are not paid as well as ensuring payments are made within established timeframes to receive the maximum discount and that interest is paid for untimely payments according to statute. These policies and procedures will be updated or completed by March 31, 2017.

Implementation Date:

Various dates July 1, 2016 through March 31, 2017 as noted within the response

Responsible Person:

Assistant Commissioner, Division for Disease Control and Prevention Services

Chief Financial Officer

The Commission and Department Generally Complied with Statutes and Requirements for Contract Planning

Chapter 2
Rating:
Low⁹

Both the Health and Human Services Commission (Commission) and the Department established contracting policies and procedures that provide a standard entity-wide contracting process. Additionally, the Commission ensured that purchasers involved with the Morris & Dickson Company contract complied with training and certification requirements.

The *Commission's Contracting Processes and Procedures Manual* states that the Department is responsible for most contract planning activities, such as performing a needs assessment and creating an initial purchase requisition to send to the Commission's Procurement and Contracting Service Division. After receiving the Department's planning documentation, the Commission administers other contract planning and procurement activities. The Commission is also responsible for verifying that the Department complies with applicable statutes, Commission rules, and Office of the Comptroller of Public Accounts (Comptroller's Office) requirements.

For its contract with Morris & Dickson Company, the Department performed most required planning activities, including completing an informal needs assessment, identifying the appropriate sponsors for the procurement, selecting the appropriate procurement method, and preparing a cost estimate with historical pricing and usage. In addition, the Department ensured that the request for proposals included the required statement of work components.

However, the Department did not perform a preliminary risk assessment, as required by the *State of Texas Contract Management Guide*, to determine the level, type, and amount of management, oversight, and resources needed to plan and implement the contract. The Department's agency-wide contracting policies also state that to manage contract risk, the assigned contract manager should ensure that risk is assessed and evaluated prior to a contract's execution and continues to be assessed and evaluated throughout the life of the contract. Without identifying and evaluating the risks associated with a contract, the Department might not know whether the contract requires an executive sponsor's involvement, and it might not identify the activities and resources required to effectively monitor the contract.

⁹ Chapter 2 is rated as Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

Recommendation

The Department should perform a preliminary risk assessment during the contract planning phase for all large contracts to assess and evaluate the risks associated with the contracts to identify the appropriate level of sponsorship, monitoring, and oversight needed.

Management's Response

The HHS System established a Contract Management Handbook in September 2015 to guide contracting and procurement activities of all HHS agencies in line with Senate Bill 20 (84th Texas Legislature, 2015). This document delineates contract management functions, and roles and responsibilities of HHS agencies. The handbook contemplates a preliminary assessment of risk during the contract planning phase, risk assessment by the contract manager as well as ongoing contract monitoring. DSHS will ensure that it follows the policy and procedure required by the handbook for all large contracts.

Implementation Date:

December 31, 2016

Responsible Person:

Assistant Commissioner, Division for Disease Control and Prevention Services

The Commission Generally Procured and Formed the Contract with Morris & Dickson Company in Accordance with Requirements; However, It Should Strengthen Its Proposal Evaluation Process

Chapter 3
Rating:
Medium ¹⁰

The Commission generally procured and formed the Morris & Dickson Company contract in accordance with applicable statutes, rules, Comptroller's Office requirements (requirements), and Commission policies and procedures. However, the Commission should ensure that vendor proposals include all required documentation, appropriate personnel complete required disclosure and non-disclosure forms, and proposal evaluations are accurate and complete.

The Commission generally procured and formed the contract audited according **to applicable requirements. However, the contractor's proposal** did not include important documents that the solicitation required.

To help ensure compliance with applicable state laws, rules, requirements, and Commission policies and procedures, the Commission sufficiently completed the following contract procurement and formation requirements:

- Properly advertised the solicitation on the appropriate Web site.
- Ensured that the evaluation criteria for the proposal were reasonable and reflected the essential qualities and performance requirements for the contract objectives.
- Documented its negotiation and notification of the award to Morris & Dickson Company.
- Ensured that the appropriate management and legal personnel reviewed and approved the contract.
- Ensured that the contract included all applicable essential and recommended clauses and provisions, as well as four other additional terms and provisions, in the *State of Texas Contract Management Guide*.

Morris & Dickson Company submitted its proposal by the due date, and that proposal included a majority of the required documentation identified in the solicitation. However, the Commission did not ensure that Morris & Dickson Company's proposal included audited financial statements from the current and previous two years, as required in the solicitation. Audited financial statements help to demonstrate the financial stability and solvency of a

¹⁰ Chapter 3 is rated as Medium because it presents risks or effects that if not addressed could moderately affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Action is essential to address the noted concerns and reduce risks to a more desirable level.

vendor over a period of time. In addition, the audited financial statements were a component in the scoring matrix the Commission used in its proposal evaluation process. The Commission asserted that it accepted Morris & Dickson Company's current year balance sheet as a demonstration of the company's stability and solvency; however, the Commission did not have documentation showing how it determined that the current year balance sheet was acceptable. Those errors occurred because the checklist that the Commission used to determine vendor responsiveness did not clearly identify all of the documents that the solicitation required.

Both the *State of Texas Contract Management Guide* and the *Commission's Contracting Processes and Procedures Manual* states that the evaluation of the responsiveness of proposals must include the required documentation stipulated in the solicitation.

The Commission did not ensure that the appropriate personnel completed the required disclosure and nondisclosure statements.

Three of the four proposal evaluators, including the initial contract manager,

Disclosure and Nondisclosure Statements

The *State of Texas Contract Management Guide*, version 1.9, outlines two statements that state entity management and staff involved in a contract procurement should complete:

A disclosure statement - Texas Government Code, Section 2262.004, requires purchasing personnel to disclose and identify any personal or financial relationships with any party associated with a contract award prior to the award of that contract.

A nondisclosure statement - A statement intended for an individual to certify that there are no conflicts of interest that may impair or influence his or her judgment. In addition, the individual agrees to maintain the confidentiality of the information related to the procurement process. The statement should be completed by individuals who participate in the development and/or award of a request for proposals.

for the contract audited fully completed the required disclosure statements. The remaining evaluator had an incomplete form; while the form was signed, it did not indicate whether that individual had a conflict of interest. Texas Government Code, Section 2262.004, and the *Health and Human Services Procurement Manual* require that before a state agency can award a major contract, appropriate personnel must disclose in writing any personal or financial relationships with any party associated with a contract award (see text box for details).

In addition, 1 (25 percent) of the 4 evaluators did not complete the Commission's procurement integrity form, which is the Commission's version of the nondisclosure form that the *Health and Human Services Procurement Manual* requires evaluators to complete. The procurement integrity form also did not contain three of the six assertions required by the *State of Texas Contract Management Guide* related to potential conflicts of interest. As a result, none of the individuals on the bid evaluation team completed the

nondisclosure statement prescribed in the *State of Texas Contract Management Guide*.

Auditors did not identify conflicts of interests among the evaluators. However, if the Commission does not ensure that contract managers and all evaluators properly complete disclosure forms, there is an increased risk that evaluators or contract managers may have undisclosed conflicts of interest.

The Commission did not ensure that the proposal evaluation forms were complete and accurate for the Morris & Dickson Company contract.

Auditors identified a total of seven discrepancies between the four individual evaluation score sheets and the combined evaluation matrix provided to the Commission's executive commissioner. Specifically:

- Three criteria on two of the individual evaluator score sheets did not contain ratings. Although those three criteria were blank on the individual score sheets, the combined evaluation matrix listed the scores for those criteria as "10," which was the highest rating. For those three errors, one was for the pricing criterion and the other two were for the vendor reference check criteria. In addition, a Commission employee notified auditors that the Commission did not complete vendor reference checks until after the individual evaluations were completed. However, two evaluators still assigned scores to the vendor reference check criteria.
- Four scores on the individual evaluator score sheets were lower than the scores listed on the combined evaluation matrix. For example, one individual evaluator score sheet listed an "8" for criteria related to pricing, but when that individual's score was added to the combined evaluation matrix, that matrix listed a score of "10" for that criteria.

The Commission could not provide any evidence that it performed a secondary review comparing the individual and combined evaluation scores to verify the accuracy and completeness of the combined evaluation matrix. The discrepancies identified did not affect the selection of the contractor because the Commission received only one bid. However, if evaluations are not accurate and complete for all criteria, there is a risk that the Department, with the Commission's assistance, could inappropriately select a contractor using an inaccurate evaluation tool for future contracts. The *State of Texas Contract Management Guide* and the *Commission's Contracting Processes and Procedures Manual* requires proposals to be evaluated using the selected criteria set forth in the solicitation.

Recommendations

The Commission should:

- Tailor the bid responsive checklist to include all documentation required by the solicitation and ensure that procurement employees understand what is sufficient to meet responsiveness requirements.
- Verify the completeness of disclosure statements that bid evaluators and contract managers complete.
- Verify that all appropriate staff working on a solicitation complete the Commission's procurement integrity form as required by the *Health and Human Services Procurement Manual*.
- Include in its procurement integrity form all assertions required in the *State of Texas Contract Management Guide*, or use the nondisclosure form prescribed by the *State of Texas Contract Management Guide*.
- Ensure that each member of the evaluation team provides an evaluation score for each solicitation criterion.
- Conduct and document a secondary review of individual evaluations and the combined evaluation matrix to verify completeness and accuracy.

Management's Response

The Health and Human Services Commission (HHSC) is in agreement with the HHSC portion of the findings and associated recommendations and offer the following responses.

The Health and Human Services (HHS) system started including checklists for vendors to use in assembling their proposals in February 2016. Purchasers have been trained to flag any proposal that doesn't appear to include all of the required documents and information. PCS then works with Legal to determine if the vendor's proposal should be disqualified as "non-responsive." PCS staff is also ensuring that all forms required of HHS staff are completed, signed, and saved with the procurement file. The evaluation process has been dissected and guidelines established for purchasers to ensure that all steps are completed properly, including verifying the completeness and accuracy of the evaluation matrix. Lastly, the non-disclosure form has been updated to account for the new items in S.B. 20.

Implementation Date:

March 30, 2016 - complete.

Responsible Person:

Deputy Executive Commissioner, Procurement and Contracting Services

Appendices

Appendix 1

Objective, Scope, and Methodology

Objective

The objective of this audit was to determine whether the Department of State Health Services (Department) has administered certain contract management functions for the selected contract in accordance with applicable requirements.

Scope

The scope of this audit covered the Department's pharmaceutical wholesaler contract with Morris & Dickson Company. Auditors tested transactions from the inception of the current contract on September 1, 2013, through December 31, 2015. The audit reviewed all phases (planning, procurement, formation, and contract oversight) of the contracting process for the contract audited through December 2015.

Methodology

The audit methodology consisted of collecting and reviewing planning, procurement, and contract formation documentation, including the pharmaceutical wholesaler contract; conducting interviews with Health and Human Services Commission (Commission) and Department staff; reviewing statutes and rules, Office of the Comptroller of Public Accounts requirements, and Commission and Department policies and procedures; and performing selected tests and other procedures. The selection methodology for the contract was based on contract dollar amount, type of contract, and recent audit coverage.

Data Reliability and Completeness

Auditors used expenditure information in the Uniform Statewide Accounting System (USAS) and relied on previous State Auditor's Office audit work to determine whether that data was sufficiently reliable for the purposes of this audit. Additionally, auditors relied on prior State Auditor's Office audit work to test user access and segregation of duties for the Department's Health and Human Services Administrative System (HHSAS) accounting system. Auditors did not perform any additional information technology work at the Department.

Sampling Methodology

For the samples discussed below, auditors applied a non-statistical sampling methodology using professional judgement. The sample items were not representative of the entire population and, therefore, it would not be appropriate to extrapolate results to the population. Auditors selected the following samples:

- To test the accuracy and contract compliance of contractor expenditure transactions that the Department processed, auditors used professional judgement to select a risk-based sample of 48 contractor expenditures made during the scope of the audit. The sample was selected using analytical procedures that identified expenditures with risk factors, such as charges that appeared to be duplicated, expenditures that appeared to be late, and payments that were significantly larger than the average amount that seemed reasonable for each program and facility. In addition, auditors used professional judgment to select key deliverables in the contract that related to expenditure testing to test whether the 48 contractor expenditures complied with contract terms.
- To test compliance with the Texas Government Code, Section 2251, and contract payment terms, auditors used analytical procedures to identify all contractor expenditures made during the scope of the audit that were paid after the due date. Department management confirmed that all identified expenditures were paid after the due date.
- To test duplicate payment controls, auditors used professional judgment to select an additional non-statistical sample of 62 expenditure transactions exceeding \$1,000 that occurred during the scope of the audit.

In addition, auditors used professional judgment to select contract deliverable requirements related to key goals and performance measures of the contract. Auditor selected all fiscal years in the audit scope for the requirements selected; therefore, it would be appropriate to project the test results to the population.

Information collected and reviewed included the following:

- Contract between the Department and Morris & Dickson Company.
- Department and Commission policies and procedures, including procurement manuals and contracting manuals.
- Department and Commission personnel training and certification records, disclosure forms, and nondisclosure forms.

- Department and Commission planning and procurement files, including solicitation documentation, evaluation criteria and documentation, and other related supporting documentation.
- Department expenditure data from USAS.
- Department payment documentation, including contractor invoices, approvals, and other support documentation.
- Adjusted service level performance reports for fiscal years 2014 and 2015 from Morris & Dickson Company.
- Legislative Budget Board contracts database.
- Prior State Auditor's Office information technology work.

Procedures and tests conducted included the following:

- Interviewed employees at the Department and the Commission about contract management.
- Reviewed the Department's and the Commission's contracting policies and procedures to determine whether they aligned with the *State of Texas Contract Management Guide* and included management responsible for contract approvals.
- Tested whether the Commission's purchasing staff and Department's contract managers met the training and certification requirements outlined in the *State of Texas Procurement Manual*; Texas Government Code, Sections 2262.053 and 2155.078; and the *Commission's Procurement Manual*.
- Reviewed planning documentation to determine (1) whether the Department performed a needs assessment that identified risks, constraints, and objectives; (2) whether a preliminary risk assessment was performed; (3) whether the cost estimate was reasonable; and (4) the level of research that the Commission and the Department performed for the procurement.
- Tested whether the Commission properly documented bid evaluation criteria and evaluation scores and whether the Commission verified the mathematical accuracy of the scoring matrix.
- Reviewed the Morris & Dickson Company contract and related supporting documentation to determine whether it contained approvals, payment methodology, essential and recommended terms in the *State of Texas Contract Management Guide*, and other requirements.

- Tested a sample of contract expenditures for accuracy and compliance with contract terms; the *State of Texas Contract Management Guide*; and Texas Government Code, Chapter 2251.
- Analyzed contractor expenditures for late payments per Texas Government Code, Chapter 2251, and contract payment requirements.
- Reviewed and/or tested the Department’s monitoring activities for compliance with contract terms, including contract deliverables.
- Reviewed prior State Auditor’s Office information technology work on USAS and segregation of duty controls related to purchasing in HHSAS.
- Reviewed controls for double billing and tested potential duplicate contractor payments.

Criteria used included the following:

- Texas Government Code, Chapters 322, 2155, 2156, 2251, 2261, and 2262.
- Title 34, Texas Administrative Code, Chapter 20.
- *State of Texas Contract Management Guide*, versions 1.9, 1.10, and 1.11.
- *State of Texas Procurement Manual*, version released in 2012.
- The Department’s contract policies.
- The *Commission’s Contracting Processes and Procedures Manual*, dated December 2012.
- The *Health and Human Services Procurement Manual*, dated June 2010.
- Terms in the audited contract.

Project Information

Audit fieldwork was conducted from February 2016 through April 2016. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The following members of the State Auditor's staff performed the audit:

- Kelley Ngaide, CIA, CFE (Project Manager)
- Jacqueline M. Thompson, CFE (Assistant Project Manager)
- Shaun Alvis
- Cameron Scanlon
- Nakeesa Shahparasti, CPA
- Michelle Ann Duncan Feller, CPA, CIA (Quality Control Reviewer)
- Audrey O'Neill, CIA, CFE, CGAP (Audit Manager)

Issue Rating Classifications and Descriptions

Auditors used professional judgement and rated the audit findings identified in this report. Those issue ratings are summarized in the report chapters/sub-chapters. The issue ratings were determined based on the degree of risk or effect of the findings in relation to the audit objective(s).

In determining the ratings of audit findings, auditors considered factors such as financial impact; potential failure to meet program/function objectives; violation of state statute(s), rules, regulations, and other requirements or criteria; and the inadequacy of the design and/or operating effectiveness of internal controls. In addition, evidence of potential fraud, waste, or abuse; significant control environment issues; and little to no corrective action for issues previously identified could increase the ratings for audit findings. Auditors also identified and considered other factors when appropriate.

Table 2 provides a description of the issue ratings presented in this report.

Table 2

Summary of Issue Ratings	
Issue Rating	Description of Rating
Low	The audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited <u>or</u> the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.
Medium	Issues identified present risks or effects that if not addressed could <u>moderately affect</u> the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern(s) and reduce risks to a more desirable level.
High	Issues identified present risks or effects that if not addressed could <u>substantially affect</u> the audited entity's ability to effectively administer the program(s)/function(s) audited. Prompt action is essential to address the noted concern(s) and reduce risks to the audited entity.
Priority	Issues identified present risks or effects that if not addressed could <u>critically affect</u> the audited entity's ability to effectively administer the program(s)/function(s) audited. Immediate action is required to address the noted concern(s) and reduce risks to the audited entity.

Related State Auditor's Office Work

Related State Auditor's Office Work		
Number	Product Name	Release Date
15-030	An Audit Report on Procurement for Terrell State Hospital Operations at the Health and Human Services Commission and the Department of State Health Services	March 2015
15-017	An Audit Report on the Telecommunications Managed Services Contract at the Health and Human Services Commission	December 2014
14-035	An Audit Report on Selected Contracts at the Health and Human Services Commission	June 2014

Copies of this report have been distributed to the following:

Legislative Audit Committee

The Honorable Dan Patrick, Lieutenant Governor, Joint Chair

The Honorable Joe Straus III, Speaker of the House, Joint Chair

The Honorable Jane Nelson, Senate Finance Committee

The Honorable Robert Nichols, Member, Texas Senate

The Honorable John Otto, House Appropriations Committee

The Honorable Dennis Bonnen, House Ways and Means Committee

Office of the Governor

The Honorable Greg Abbott, Governor

Department of State Health Services

Dr. John Hellerstedt, Commissioner

Health and Human Services Commission

Mr. Charles Smith, Executive Commissioner



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