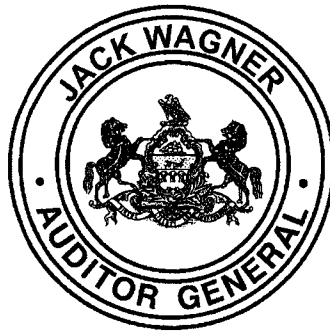


TESTIMONY ON STATE PROCUREMENT REFORM

**SENATE COMMUNICATIONS AND TECHNOLOGY
COMMITTEE**



Auditor General Jack Wagner

December 1, 2009

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TESTIMONY ON PROCUREMENT REFORM

Department of the Auditor General
Jack Wagner

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Good morning Chairman Folmer, Chairman Wozniak and committee members.

Thank you for the opportunity to discuss the issue of state government procurement reform. In this difficult economic climate, it's imperative that we in state government do everything we can to make every dollar count. That applies to every aspect of state government, from what we spend on programs and agencies to how we purchase goods and services.

Pennsylvania spends approximately \$4 billion yearly on goods and services. Under the Commonwealth Procurement Code, the Department of General Services has the responsibility for procuring, or obtaining, the goods and services necessary to keep our government operating efficiently and effectively. These goods and services are obtained by a variety of ways, most commonly through the competitive bidding of contracts. A sole source process may be utilized when services must be procured directly from one supplier. Emergency procurement is used when services are urgently needed for reasons such as public health or safety, and cannot be delayed by the use of the formal competitive procurement process.

During my 10-and-a-half years as a state senator, and, now, as auditor general, I have always believed that the taxpayer is best served when the contracting process is transparent and truly competitive; when the execution of contracts follows clear lines of accountability; and when the results of the contract meet performance benchmarks that are clear and measurable.

Competition is good for three reasons: It spurs innovation. It creates more jobs. And it saves taxpayer money. Innovation is the growth engine of capitalism, and it's why the United States has one of the highest standards of living in the world.

Innovation, in turn, leads to new jobs and new industries. For example, there are tens of thousands of people working every day to create new applications for the wildly popular iPhone. Wouldn't it be nice to harness this entrepreneurial spirit to reinvent state government?

Innovation and competition also lead to lower prices. Let's look, again, at the iPhone. To stave off increased competition, Apple has lowered the base price on its cheapest iPhone from \$199 to \$99. It's a victory for consumers everywhere.

Competition is the American way. And it should be the only way in state government. A competitive and open bidding process must ensure that all interested companies are afforded the opportunity to bid for state contracts.

My department recently completed a special performance audit of the Department of General Services' procurement of information technology contracts. Our audit examined the state's spending of \$592 million with Deloitte Consulting for information technology services, which I consider a textbook example of what happens when competition, transparency and accountability are absent in state government.

Our auditors determined that the commonwealth approved \$592 million worth of contracts with Deloitte from January 1, 2004 to December 31, 2007. The bulk of the spending -- almost two dollars out of every three -- went to the Department of Public Welfare.

DPW received the largest share of IT spending with Deloitte because it is the biggest and most complex agency in state government. The Department of the Auditor General has conducted numerous audits of DPW during my tenure, most recently with regard to the Low Income Home Energy Assistance Program, Medicaid, and special allowances. Each of those audits found errors related to lack of information and a failure to provide checks and balances necessary to minimize financial waste.

In the case of LIHEAP, we found the potential for taxpayer fraud through the use of fraudulent Social Security Numbers that DPW had failed to validate.

In Medicaid, our auditors found improper payments to health insurers due to DPW's failure to verify eligibility information for applicants, including such basic facts as age and income level.

In the special allowances program, our auditors found that DPW had approved hundreds of thousands of dollars in cash assistance to welfare recipients who were seeking jobs without requiring receipts or any other form of documentation to prove that the money was being spent on legitimate purchases.

As the state's independent fiscal watchdog, I would like to know: Where is the value to taxpayers if DPW is spending hundreds of millions of dollars with Deloitte for information management services and these errors are still occurring?

Our auditors found that DGS initially awarded Deloitte 59 contracts worth \$382 million. But of the 59 contracts, only 17 had multiple bidders. Deloitte was the only bidder for the majority of the 59 contracts. The lack of bidders for lucrative state contracts raises red flags about potential flaws in how these contracts were advertised and awarded in the first place.

We found that the value of these original contracts swelled by 55 percent, or \$210 million, over the next three years, due to Office of Administration-approved change orders, sole-source contracts and emergency contracts. The unusually high number of contract changes again points to a flawed bidding process. If requests for proposals are issued properly, then later amendments, such as change orders, are kept to a minimum or are not needed at all.

Besides potential flaws in the initial bidding process, our auditors also found shoddy monitoring and record-keeping, and they were thwarted by the Department of General Services' refusal to provide public documents, raising concerns about whether taxpayers overpaid for Deloitte's services.

DGS's failure to exercise proper oversight resulted in several potential conflicts of interest that raised questions about how well taxpayers' interests were served. For example, our auditors found that at least three Office of Administration managers who were involved in pre-approving IT contracts were, in fact, former Deloitte employees. Auditors also found that a former Deloitte employee participated in individual agencies' IT procurement process.

DGS did nothing to address these potential conflicts. DGS also has failed to enforce knowledge transfer provisions in the contracts that require Deloitte to train state workers so that they can eventually assume daily control of the state's computer systems. But according to agency managers and employees interviewed by our auditors, the knowledge transfers are not occurring due to insufficient staff levels at the respective state agencies. DPW, for example, has accounted for nearly two-thirds of the state's IT spending, yet the department has spent only \$24,520 on knowledge transfer training with Deloitte.

It's disturbing that Pennsylvania has spent more than a half-billion dollars for information technology services with only one vendor. What's even more disturbing is how much the contracts with Deloitte may cost taxpayers in future years, if the state fails to make sure that knowledge transfer training is occurring. If training does not occur, state employees will be unable to operate or repair the system, and Pennsylvania will be forced to rely indefinitely on Deloitte Consulting for computer services. Deloitte will be the state's de facto IT department.

This is an expensive proposition for taxpayers. According to records obtained by our auditors, Deloitte contractors are paid wages far in excess of what most state workers receive. Under the state contracts, some Deloitte workers are to be paid up to \$290 per hour.

Some of these salaries shock the senses with the Pennsylvania unemployment rate nudging 9 percent, the commonwealth grappling with multi-billion dollar deficits, and hundreds of state workers just laid off. We must reduce our reliance on outside contracts that never end.

Our audit had 6 findings, and it makes 37 recommendations on how DGS can restore accountability, transparency and competition to the procurement process. We recommend that:

- DGS ensure that agencies develop procedures to document preparation and approval of Requests for Proposals and that agencies' RFP evaluation committees follow procedures and document committee meetings.
- DGS and the Department of Community and Economic Development should coordinate to verify whether vendors seeking grants and tax credits already have state contracts.

- DGS should ensure that state agencies are enforcing the knowledge transfer provision of contracts to guarantee that state employees are being trained to operate all computer systems.
- DGS should develop and enforce ethical standards to prevent real or perceived conflicts of interest involving state employees approving procurement contracts.
- The procurement process should be centralized with all contracts coordinated through DGS.
- Legislation should be considered to tighten up and centralize the bidding process.

It is imperative that our state government earn the taxpayers' trust by being as transparent as possible. I hope the General Assembly exercises its constitutional authority and takes an active and vigorous role in overseeing the state's procurement process...to make sure that tax dollars are being spent efficiently, effectively, and in the public's interest.

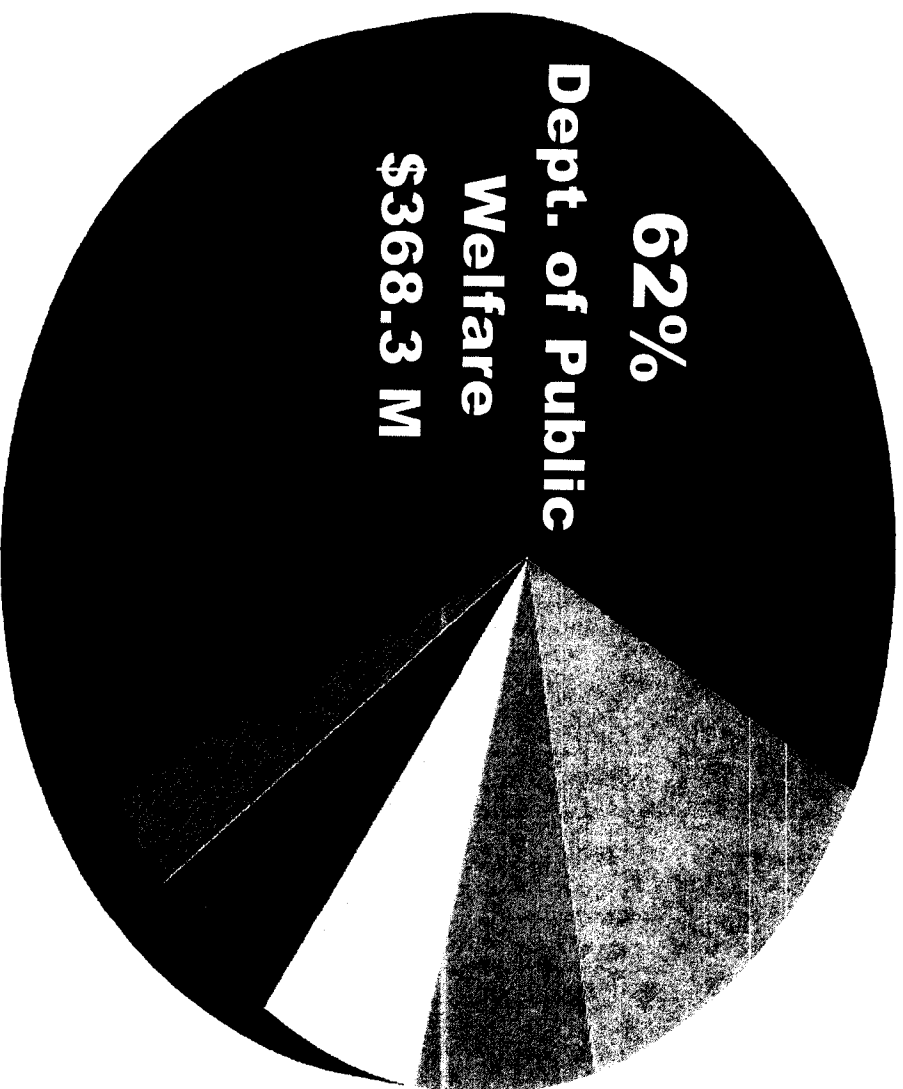
Thank you for the opportunity to discuss this important issue with your committee and I am happy to answer any questions you may have.

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How PA is Spending

\$592 Million with One Vendor

EFFECTIVE DURING PERIOD JAN. 1, 2004 - DEC. 31, 2007



Dept. of Labor & Industry
\$85.6 M



Dept. of Transportation
\$42.9 M



Dept. of Health
\$33.2 M



PLCB
\$28.2 M



Dept. of Insurance
\$20.1 M



9 other agencies

SPECIAL PERFORMANCE AUDIT OF THE DEPARTMENT OF GENERAL SERVICES

DELOITTE TECH CONTRACTS WITH STATE AGENCIES

EFFECTIVE DURING PERIOD JAN. 1, 2004 - DEC. 31, 2007

| COMMONWEALTH AGENCY | # | ORIGINAL BID CONTRACTS | # | SOLE SOURCE CONTRACTS | # | EMERGENCY CONTRACTS | 3 AGENCIES TESTED CHANGE ORDERS (#) | # | TOTAL CONTRACTS |
|---------------------|-----------|------------------------|----------|-----------------------|-----------|---------------------|-------------------------------------|-----------|----------------------|
| PUBLIC WELFARE | 34 | \$203,503,901 | 2 | \$9,249,689 | 14 | \$61,666,963 | \$93,889,587 (72) | 50 | \$368,310,140 |
| LABOR & INDUSTRY | 2 | 58,513,675 | 2 | 4,860,595 | | | 22,234,840 (10) | 4 | 85,609,110 |
| PENN DOT | 3 | 42,935,034 | | | | | | 3 | 42,935,034 |
| DEPT. OF HEALTH | 4 | 16,213,394 | 2 | 7,243,850 | 2 | 5,589,898 | 4,156,428 (2) | 8 | 33,203,570 |
| PLCB | 1 | 28,259,997 | | | | | | 1 | 28,259,997 |
| INSURANCE DEPT. | 4 | 19,513,505 | | | 1 | 599,999 | | 5 | 20,113,504 |
| DEPT. OF EDUCATION | 1 | 5,237,331 | 1 | 274,528 | | | | 2 | 5,511,859 |
| OFFICE OF ADMIN. | 3 | 3,665,386 | | | | | | 3 | 3,665,386 |
| DEPT. OF STATE | 1 | 1,381,926 | | | 1 | 171,823 | | 2 | 1,553,749 |
| CORRECTIONS DEPT. | 1 | 813,898 | | | | | | 1 | 813,898 |
| DGED (GRANT) | 1 | 750,000 | | | | | | 1 | 750,000 |
| DEPT. OF REVENUE | 1 | 595,000 | | | | | | 1 | 595,000 |
| SERS | 1 | 458,420 | | | | | | 1 | 458,420 |
| DEPT. OF BANKING | 1 | 250,000 | | | | | | 1 | 250,000 |
| PUC | 1 | 67,483 | | | | | | 1 | 67,483 |
| TOTAL | 59 | \$382,158,950 | 7 | \$21,628,662 | 18 | \$68,028,683 | \$120,280,855 | 84 | \$592,097,150 |

UP 55%

AUDITOR GENERAL JACK WAGNER

**\$592 MILLION IN CONTRACTS ASSIGNED
TO SINGLE-VENDOR DELOITTE CONSULTING**

◆ **Deloitte received \$2.25 million from the Department of
Community & Economic Development for job growth
and retention:**

- **\$ 750,000 grant used for furniture, office equipment**
- **\$ 1.5 million used to reduce state taxes**
↳ **(\$1 million in violation of the law)**

AUDITOR GENERAL JACK WAGNER