

An Audit Report on

# **The Department of Information Resources' TexasOnline Contract**

March 2002

Report No. 02-031



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# Key Points of Report

## An Audit of the Department of Information Resources' TexasOnline Contract

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March 2002

### Overall Conclusion

The Department of Information Resources (Department) should strengthen its efforts to protect the State's financial interest in TexasOnline, the e-government Web portal for the State of Texas. Implementing a formal contract monitoring process would enable the Department to ensure that the TexasOnline contractor makes necessary adjustments to its financial reports, provides accurate and useful financial and performance information, and complies with the terms of the contract. The TexasOnline contractor provided fiscal year 2000 and 2001 financial reports to the Department that contained inaccuracies and were not as useful as they could have been. This increases the risk that the contractor could overcharge the TexasOnline project. It also could unnecessarily delay the point when the contractor recovers its investment. On September 1, 2001, the State began receiving 10 percent of TexasOnline gross revenue.

The TexasOnline contractor currently bears the cost of developing TexasOnline, retains all TexasOnline revenue after expenses, and owns the system. When the contractor recovers its investment, the State will begin to receive half of TexasOnline revenue after expenses (expenses include the 10 percent currently paid to the State). The State would also assume ownership of the system (excluding the common payment system and the customer telephone support center).

### Key Facts and Findings

- Expenditures on the contractor's financial reports were overstated by at least \$202,935 and possibly by as much as \$436,000. Revenue was overstated by \$98,636. Before adjustments, TexasOnline state-related expenditures and revenue since inception total \$11,136,978 and \$1,538,360, respectively.
- The Department must implement a formal contract monitoring process to ensure that the TexasOnline contractor complies with the contract and the contract renewal agreement. On February 9, 2002, the Department executed a contract renewal agreement that addressed the contract weaknesses we identified during our audit.
- TexasOnline software (valued at \$1.1 million) may not be transferable to the State upon termination of the TexasOnline contract without additional cost. The contract renewal agreement gives the TexasOnline contractor an extension until August 31, 2002, to amend the TexasOnline software licenses.
- Tests of the TexasOnline revenue process at the Real Estate Commission indicated that revenues are processed accurately and transactions are completed successfully for that agency.

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*This audit was conducted in accordance with Government Code, Section 321.013.*

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# Executive Summary

The Department of Information Resources (Department) should strengthen its

## What Is TexasOnline And How Is It Funded?

(www.texasonline.com)

TexasOnline is the official e-government Web portal for the State of Texas. TexasOnline provides access to state, county, and city government services.

TexasOnline is a unique government/private sector partnership that allows the portal to be self-supporting while giving the State access to leading edge technologies. The partnership is based on a new model. Therefore, both parties should continually assess the strengths and weaknesses of the arrangement.

State agencies currently use TexasOnline to provide services such as driver's license renewal and vehicle registration. Users pay a convenience fee to conduct transactions online.

The TexasOnline contractor currently bears the cost of developing, operating, and maintaining TexasOnline; retains all TexasOnline revenue after expenses; and owns the system. Per the contract, on September 1, 2001, the State began receiving 10 percent of TexasOnline gross revenue. When the contractor recovers its investment, the State begins receiving half of TexasOnline net revenue and assumes ownership of parts of the system. (For more background, see Section 6.)

efforts to protect the State's financial interest in TexasOnline.

Implementing a formal contract monitoring process would enable the Department to ensure that the TexasOnline contractor makes necessary adjustments to its financial reports, maintains and provides accurate and useful financial and performance information, and complies with the terms of the contract.

The Department and the Texas Electronic Government Task Force (Task Force) began overseeing the development and implementation of TexasOnline beginning with its inception in May 2000. The TexasOnline Authority replaced the Task Force in November 2001.

The Department, the Task Force (until November 2001), and now the Authority, share responsibility for:

- Managing contractor performance.
- Developing TexasOnline operational policies.
- Ensuring that TexasOnline complies with the Department's financial requirements.
- Evaluating the efficiencies gained through TexasOnline.

The TexasOnline contractor provided fiscal year 2000 and 2001 financial reports to the Department that contained inaccuracies and were not as useful as they could have been.

This increases the risk that the contractor could overcharge the TexasOnline project. This condition could also unnecessarily delay the point at which the State begins receiving half of the revenue after expenses from TexasOnline and assumes ownership of parts of the system (excluding the common payment system and the customer telephone support center).

The original TexasOnline contract, which was in effect during our audit, contained ambiguous language regarding the contractor's process for recapturing expenditures and the State's revenue sharing options.

We provided the Department with a detailed list of the contract weaknesses we identified. On February 9, 2002, the Department executed a contract renewal agreement that incorporated our recommendations for strengthening the contract. The contract renewal agreement also requires the contractor to present financial reports in a format that conforms with generally accepted accounting principles. Because the contract renewal occurred after we completed our audit, we do not know whether problems we identified—other than ambiguous contract language—were corrected.

One contract weakness we identified that has not been resolved relates to the transferability of software licenses. At the Department's request, we reviewed whether TexasOnline software licenses were transferable to the State as required in the original contract. We determined that 99 percent of TexasOnline software (valued at \$1.1 million) may not be transferable to the State without additional cost upon termination of the TexasOnline contract. The contract renewal agreement gives the contractor an extension until August 31, 2002, to amend the software licenses with the software vendors, so that they will be transferable to the State at no additional cost.

# Executive Summary

## **Does The TexasOnline Contractor Provide Accurate and Useful Financial Reports?**

The TexasOnline contractor provided the Department with fiscal year 2000 and 2001 financial reports that contained inaccuracies.

TexasOnline expenditures on the contractor's financial reports were overstated by at least \$202,935. Statistical sampling of these expenditures indicated that as much as \$436,000 in expenditures was potentially overstated. Expenditure adjustments are required because of errors associated with vendor invoices and payroll charges. Since the inception of TexasOnline, state-related expenditures on the project have totaled \$11,136,978 (before proposed adjustments).

TexasOnline revenue identified in the contractor's financial reports was overstated by \$98,636. We identified these adjustments by reconciling all TexasOnline revenues for fiscal years 2000 and 2001. Revenue adjustments are required because the contractor did not recognize certain credit card processing expenses and the revenue necessary to cover them. The contractor also incorrectly included revenue from another project in its financial reports. Since its inception, TexasOnline has generated \$1,538,360 in total revenue (before proposed adjustments).

Approximately 50 percent of the financial report errors we identified occurred because the contractor used spreadsheets, rather than an automated accounting system, to prepare its financial reports. Although the contractor bought an automated accounting system to track TexasOnline financial information, it is not using this system to generate TexasOnline financial reports. (The cost of the \$17,422 automated accounting system was charged to TexasOnline.)

During our audit, the contractor was retroactively entering transaction data into its automated accounting system. Because this

process was not complete, the automated accounting system could not generate complete financial reports. The contract renewal agreement the Department executed on February 9, 2002, requires the contractor to use a double-entry accounting system to maintain TexasOnline financial records.

In addition to containing inaccuracies, the financial reports the contractor submitted to the Department were not as useful as they could have been. The reports were confusing and could cause the reader to draw the wrong conclusions. The contract renewal agreement addresses the following concerns identified about the financial reports during this audit:

- The contractor presented the financial reports in non-standard accounting formats and retroactively made numerous adjustments to the financial reports. This weakened the reliability of the reports because they were always subject to change.
- Comparative analysis was not possible because the format of the monthly financial reports differed from year to year.
- The financial reports the contractor presented to the Department were not clearly labeled as being cumulative or for the current period only, thus making them more difficult to interpret and analyze.
- The contractor did not always provide a comparison of budgeted to actual expenditures. Therefore, it was not easy to compare project expenditures with the approved budget.
- The budgets the contractor prepared for fiscal years 2000 and 2001 were not supported with detailed information. Therefore, it was not possible to trace particular expenditures on the contractor's financial reports to the approved budget.

# Executive Summary

## **Are There Opportunities to Strengthen the TexasOnline Contract?**

The Department's original contract with the TexasOnline contractor contained weaknesses that did not adequately protect the State's financial interests.

- The contract contained ambiguous terms regarding the contractor's process for recapturing expenditures and the State's revenue sharing options. Terms such as "gross revenue," "fees," "costs," "expense," and "net revenue" were not clearly defined. This ambiguity jeopardized the State's opportunity to maximize its share of TexasOnline revenue and could have delayed the point at which the State assumes ownership of certain parts of the system.
- The original contract did not specify when the TexasOnline contractor was required to submit updated budget information. It also did not specify whether expenditures in excess of the approved budget could be charged to the TexasOnline project.
- The original contract was unclear about the recovery of software development costs. It stated that all software development costs were to be considered recovered as of August 31, 2002. However, the definition of software development costs included only the initial TexasOnline pilot agency projects

The contract renewal agreement the Department executed on February 9, 2002, addressed these contract weaknesses.

## **Does the Department Monitor the TexasOnline Contractor's Performance to Ensure That TexasOnline Functions As Intended?**

While the Department informally monitors the TexasOnline contractor, it has not yet

established a formal contract monitoring process to ensure that the TexasOnline contractor carries out its responsibilities. The Department has few written contract monitoring policies and procedures, performs no reviews of its monitoring process, and has not yet provided contract monitoring personnel with training on contract monitoring best practices.

During our review, the contractor did not provide the Department with certain performance information the Department needed to monitor the contract. As a result, the Department was unable to monitor whether the TexasOnline contractor was meeting agreed-upon system availability and data transmission targets. The contract renewal agreement contains additional performance metrics for which the contractor must provide performance information. Therefore, it is important that the Department ensure that the contractor provides the information necessary to monitor the contractor's performance.

Although a provision in the original contract required the contractor to develop a disaster recovery plan for TexasOnline, the contractor has not complied with this provision. According to Department officials, they asked the contractor to develop a disaster recovery plan but had no sanctions available to penalize the contractor for noncompliance with this provision. The contract renewal agreement gives the contractor until August 31, 2002, to have a disaster recovery plan in place. The renewal agreement also contains sanctions for noncompliance.

## **Are TexasOnline Revenues and Transactions Processed Successfully and Reconciled Properly?**

Testing of the TexasOnline revenue process at the Real Estate Commission (Commission) indicated that revenues are processed accurately and transactions are completed successfully. Thus, although we identified

# Executive Summary

financial reporting and contract weakness issues, TexasOnline is functioning as intended for this agency.

## **Are TexasOnline Agencies Collecting Data to Demonstrate Improved Efficiencies and Customer Service?**

Out of 11 state agencies using or planning to use TexasOnline, one had conducted benchmarking studies and four others were beginning to conduct benchmarking studies. The Authority currently does not require agencies to conduct benchmarking studies to compare the cost and efficiency of providing services via TexasOnline versus other service delivery methods. However, the Authority is required by statute to provide benchmarking information for TexasOnline on even-number years. To assist agencies in developing benchmarks, the Department has contracted with a consultant to develop several benchmarking tools for agencies to use.

## **Summary of Management's Response**

The Department generally agrees with this report's findings and recommendations. The Department implemented or plans to implement all of the recommendations.

## **Summary of Objectives, Scope, and Methodology**

Our objectives were to determine whether:

- The Department protects the State's financial interests by adequately monitoring the TexasOnline contract to ensure that:
  - The contractor provides accurate and useful financial reports.
  - Opportunities to strengthen the contract are pursued during contract negotiations.
  - TexasOnline functions as intended at a selected agency.
- TexasOnline revenues and transactions are processed successfully and reconciled properly at a selected agency.
- TexasOnline agencies are collecting data to demonstrate improved efficiencies and customer service.

To achieve these objectives, we reviewed the controls over TexasOnline financial reports, tested expenditures and revenues, and examined the adequacy of the Department's monitoring of the contract. We also surveyed TexasOnline agencies and tested revenue at one agency. Our audit scope covered fiscal years 2000 and 2001.



## Overall Conclusion

The Department of Information Resources (Department) should strengthen its efforts to protect the State's financial interest in TexasOnline. Implementing a formal contract monitoring process would enable the Department to ensure that the TexasOnline contractor makes necessary adjustments to its financial reports, maintains and provides accurate and useful financial and performance information, and complies with the terms of the contract.

### What is TexasOnline?

(www.texasonline.com)

"TexasOnline is the official e-Government site of the state of Texas, providing seamless 'one stop shopping' access to many state, county and city government services, and allowing citizens to access government services on-line, not in line."

Source: Department of Information Resources

(See Section 6 of this report for more information about TexasOnline.)

The TexasOnline contractor provided fiscal year 2000 and 2001 financial reports to the Department that contained inaccuracies and were not as useful as they could have been. This increases the risk that the contractor could overcharge the TexasOnline project. This condition could also unnecessarily delay the point at which the State begins to receive half of the revenue (after expenses) from TexasOnline and assumes ownership of the system (excluding the common payment system and the customer telephone support center).

Beginning September 1, 2001, the State began receiving 10 percent of TexasOnline gross revenue. This 10 percent is based on all gross revenue earned and collected by the contractor from state agency activities. The contractor currently bears the financial burden of developing, operating, and maintaining TexasOnline; retains 100 percent of TexasOnline revenue after expenses (which includes the 10 percent paid to the State); and owns the system. When the contractor has recovered its investment, the State will begin to receive 50 percent of TexasOnline revenue (after expenses) and will assume ownership of parts of the system. The financial reports the contractor provides will be the primary basis for determining when the contractor has recovered its investment.

The original TexasOnline contract in effect during our audit contained ambiguous language regarding the contractor's process for recapturing expenditures and regarding the State's revenue sharing options. We provided the Department with a detailed list of the contract weaknesses we identified. On February 9, 2002, the Department executed a contract renewal agreement that incorporated most of our recommendations for strengthening the contract. The contract renewal agreement requires the contractor to present financial reports in a format that conforms with generally accepted accounting principles. Because the contract renewal occurred after we completed our audit, we do not know whether problems we identified—other than ambiguous contract language—were corrected.

One contract weakness regarding software transferability has not been resolved. At the Department's request, we reviewed whether TexasOnline software licenses were transferable to the State as required in the original contract. We found that TexasOnline software licenses (valued at \$1.1 million) were not transferable to the State without additional cost upon termination of the TexasOnline contract as required in the original contract. The contract renewal agreement gives the contractor an extension until August 31, 2002, to amend the license agreements with software vendors (see Section 2 for additional details).

Our review of the TexasOnline revenue reconciliation process at the Real Estate Commission indicated that revenues and transactions are processed successfully and reconciled properly at this agency. Thus, although we identified financial reporting and original contract weaknesses, TexasOnline is functioning as intended for this agency. We also determined that, at the Department's initiative, TexasOnline agencies are just beginning to perform benchmarking. This benchmarking is to compare the cost and efficiency of offering services through TexasOnline with the cost and efficiency of offering services through other means.

Section 1:

## **Does the TexasOnline Contractor Provide Accurate and Useful Financial Reports?**

The TexasOnline contractor provided the Department with fiscal year 2000 and 2001 financial reports that contained inaccuracies. The inaccuracies will require adjustments to TexasOnline expenditures and revenue. Expenditures were overstated by at least \$202,935 and possibly by as much as \$436,000. Revenues were overstated by \$98,636. The adjustments that must be made to the contractor's financial reports underscore the need for more accurate reporting. A high visibility project such as TexasOnline needs to strive for financial accuracy to maintain the confidence of the public. While the Department has been proactive in requesting that the contractor's financial records be audited, our audit and a review conducted by the Department's internal auditor highlight opportunities for improvement.

In addition, the contractor's financial reports were not as useful as they could have been. They were presented in various formats that could be confusing and cause the reader to draw the wrong conclusions. It is important to have useful financial reports because:

- Without accurate and useful TexasOnline financial reports, there is an increased risk that the contractor could overcharge the TexasOnline project. In addition, not having accurate and useful financial reports could unnecessarily delay the point at which the State assumes ownership of parts of TexasOnline and increases its revenue sharing opportunity.
- Part of the newly established TexasOnline Authority's (Authority) responsibilities will be to ensure that TexasOnline complies with the Department's financial requirements (see Section 6 for additional detail). This includes reviewing the financial reports the contractor provides. Therefore, the Authority must have accurate and useful financial reports in order to carry out its responsibilities.

**Expenditure information on the contractor's financial reports was overstated by at least \$202,935 and possibly by as much as \$436,000.**

The results of our expenditure transaction testing indicated that expenditures on the contractor's financial reports were overstated by \$202,935 and possibly by as much as

\$436,000. The errors are associated with various contractor payroll charges or errors related to vendor invoices that were incorrectly billed to TexasOnline. We identified \$202,935 in necessary adjustments as follows:

#### What is Statistical Sampling?

Statistical sampling is used to test part of the population in order to determine characteristics of the entire population. In this case, the population comprised the total expenditures reported on the contractor's financial reports.

- We identified \$70,935 in errors from our testing of a statistical sample of 98 expenditures from the contractor's fiscal year 2000 and 2001 financial reports.
- We identified an additional \$132,000 in errors outside of our statistical sample.

A projection of the errors we found in our statistical sample to the contractor's total recorded expenditures indicates that \$304,000 in expenditures were potentially overstated. Adding the \$132,000 in errors we identified outside of our statistical sample to the projected errors indicates that a total of \$436,000 in expenditures was potentially overstated. This amount represents the costs the contractor overcharged to the TexasOnline project. Since the inception of TexasOnline, state-related expenditures on the project have totaled \$11,136,978 (before proposed adjustments).

#### **Revenue information on the contractor's financial reports was overstated and should be decreased by \$98,636.**

We determined that revenue on the TexasOnline contractor's financial reports should be decreased by \$98,636. We determined this by reconciling all TexasOnline revenues for fiscal years 2000 and 2001. We calculated the following net adjustments (the revenue amount the contractor erroneously credited to the TexasOnline project):

- Adjustments increasing revenue by \$29,522 are required because the contractor did not recognize certain credit card processing expenses and the revenue necessary to cover these expenses.
- Adjustments decreasing revenue by \$128,158 are required because the contractor incorrectly included revenue associated with one non-TexasOnline contractor project in its financial reports.

Since its inception, TexasOnline has generated revenue totaling \$1,538,360 (before proposed adjustments).

#### **The contractor should complete its implementation of an accounting system to improve the accuracy of its financial reporting.**

Although the contractor purchased an accounting system to maintain financial records for TexasOnline, this system did not have complete data for fiscal years 2000 and 2001. The \$17,422 cost of this accounting system was included in the TexasOnline budget and the contractor reported it to the Department as an expenditure.

During our audit, the contractor was in the process of retroactively entering transactional data into this system for fiscal years 2000 and 2001. Because of this, the accounting system could not generate complete financial reports. Therefore, the contractor maintained financial data in a spreadsheet application and generated financial reports using those spreadsheets. Approximately 50 percent of the financial

report errors we identified can be attributed to the contractor's use of spreadsheets instead of an automated double-entry bookkeeping system.

An automated double-entry bookkeeping system is preferable to a spreadsheet application for many reasons. For example, an automated double-entry system can:

- Flag duplicate entries that have the same invoice number or dollar amount. (This provides a better monitoring mechanism.)
- Highlight accruals that have not been reversed. (This can allow for enhanced tracking of TexasOnline's financial position.)
- Provide a proper audit trail for transactions.

During our audit, the contractor provided numerous revised and adjusted financial reports. Reliance on spreadsheets makes the financial reports prone to error and does not allow for a proper audit trail of transactions. Subsequent to our audit, the

Department executed a contract renewal agreement that specifies that the contractor will use a double-entry accounting system to maintain, on a current basis, all financial activity related to TexasOnline.

**What is a Financial Statement Opinion Audit?**

A financial statement opinion audit is an audit that determines whether financial statements are presented fairly in accordance with generally accepted accounting principles.

The Department directed its internal auditor to perform a financial review of TexasOnline revenues and expenses for the period from March 1, 2000, through May 31, 2001. (The internal audit was not, however, a financial statement opinion audit of the contractor's accounting records.) In a report dated August 31, 2001, the internal

auditor did not make a conclusion regarding the overall status of the contractor's financial reports. However, the internal audit report did recommend the following:

- The contractor should use an accounting system instead of spreadsheets.
- Expenditures should be decreased by \$38,429 on the contractor's TexasOnline financial reports.
- The Department should obtain a financial statement opinion audit of the TexasOnline financial statements that the contractor prepares.

The contract renewal agreement the Department executed on February 9, 2002, specifies that an annual financial audit of the contractor's financial reports may be conducted by the Department or its representative.

**Specific aspects of the TexasOnline financial reports make them confusing.**

The fiscal year 2000 and 2001 TexasOnline financial reports the contractor prepared were not as useful as they could have been because:

- The contractor presented the financial reports in non-standard accounting formats with frequent changes in presentation and reported expenditure amounts. The reports were confusing because the contractor had to

retroactively make numerous prior-period adjustments to them. The financial reports were unreliable because they were always subject to change.

- The format of the monthly financial reports the contractor presented to the Department differed from year to year, so comparative analysis was not possible. Financial reports should be standardized using a generally accepted presentation format so that the information can be compared from year to year.
- The financial reports the contractor presented to the Department were not clearly labeled as being either cumulative or for the current period only. Financial reports should be clearly labeled so that individuals reviewing the information can clearly understand it.
- The contractor did not always provide a comparison of budgeted to actual expenditures. Therefore, it was not easy to determine where project expenditures stood in comparison to the approved budget. Financial reports should include variance analysis that compares budgeted and actual expenditures. Variances above a certain threshold (as determined by the Authority) should include accompanying explanatory text detailing the reason(s) for the variance.
- The budgets the contractor prepared for fiscal years 2000 and 2001 were not supported with detailed information. Therefore, it was not possible to trace particular expenditures that appeared on the contractor's financial reports to the approved budget. The budgets for those years categorized planned expenditures into broad areas, and the TexasOnline contractor was not able to provide detailed support for the budgeted amounts. Overall, expenditures for fiscal years 2000 and 2001 were within budget.

The contract renewal agreement the Department executed subsequent to our fieldwork specifies that the contractor must prepare monthly financial statements that conform with generally accepted accounting principles.

**Having a dedicated financial subcommittee to review TexasOnline financial reports could help reduce inaccuracies and confusion.**

The Texas Electronic Government Task Force (Task Force), the Authority's predecessor, did not have a finance subcommittee solely dedicated to reviewing the financial reports provided by the contractor. Although the Task Force established a subcommittee whose duties included reviewing the financial reports, a subcommittee whose only responsibility is reviewing the financial reports is preferable. If a dedicated finance subcommittee had been established at the inception of TexasOnline, the subcommittee might have been able to better monitor the accuracy and usefulness of the contractor's financial reports and, therefore, reduce the risks associated with inaccurate and confusing financial reports.

Recommendations:

The Department should:

- Determine the exact amount based on the proposed adjustments by which expenditures on the contractor's financial reports should be decreased, and adjust the financial reports by that amount.
- Ensure that the contractor makes the necessary adjustments to its financial reports by decreasing revenues by \$98,636.
- Obtain an annual financial opinion audit of the TexasOnline contractor's financial reports as permitted by the contract renewal agreement.
- Ensure that the TexasOnline contractor complies with the contract renewal agreement requirement to provide financial report formats generated from its automated accounting system. The formats should use standard accounting financial statement presentation that complies with generally accepted accounting principles (GAAP). The formats should include budget-to-actual analysis.
- Ensure that the contractor complies with the contract renewal agreement requirement to use a double-entry accounting system to maintain, on a current basis, all financial activity related to TexasOnline.
- Recommend that the Authority establish a finance subcommittee to review the contractor's financial reports. Members of the subcommittee should have a background in accounting or finance.

Management's Response:

*We agree with the need to present accurate and timely financial statements for the TexasOnline project.*

*We began enhancing and standardizing financial reporting during the fiscal 2002 budget process. The private partner was required to submit to DIR detailed data to support budget numbers along with narrative explaining the project and detailing revenue and expenditure assumptions. DIR requested and received support documentation which included such information as the number of hours by project by contract personnel by hourly rate and detail on subcontractor estimated expenditures.*

*In this unique relationship, the private partner assumes all risks and is responsible for full funding of operations and development. The State began receiving 10% of gross revenues in fiscal 2002. Profit sharing (50% of net revenues) is estimated to begin in fiscal 2006. DIR had the records audited by a contract internal auditor after the first full year of financial activity so that accounting errors that would impact the financial status of the project and the State's revenue sharing could be corrected before revenue sharing was effective. The audit began prior to the end of the first full year of financial activity. Annual financial statement opinion audits are planned and specified*

*in the contract amendment signed February 9, 2002. These audits will safeguard the State's financial interest in the project.*

*Regarding the individual recommendations:*

- *DIR's Chief Financial Officer (CFO) will review and research the recommended audit adjustments with the private partner by April 30, 2002. Following the review, the private partner will be notified in writing regarding adjustments that need to be made with a deadline of May 31, 2002, for completing the adjustments.*
- *The contract amendment states that DIR may engage an auditor annually to perform a financial statement opinion audit of the project.*
- *The private partner has completed changes requested by DIR to the financial report format. The improved financial statements prepared in accordance with Generally Accepted Accounting Principles (GAAP) were presented at the initial meeting of the TexasOnline Authority in January 2002. The contract amendment requires that financial statements be presented in compliance with GAAP.*
- *During the audits, the private partner had begun entering records in a double-entry accounting system. The private partner has advised DIR that the implementation is complete and that financial statements are being prepared from that system. By April 15, 2002, DIR's CFO will confirm that the system has been implemented.*
- *The newly appointed TexasOnline Authority established a Financial Services Subcommittee at the March 8, 2002, meeting.*

## Are There Opportunities to Strengthen the TexasOnline Contract?

### Overview of the TexasOnline Project

The Task Force directed the Department to establish a framework project to provide government services electronically. The parties to the contract are the Department and the TexasOnline contractor. The Department is responsible for overseeing the day-to-day operation of TexasOnline.

The TexasOnline contractor is responsible for developing, maintaining, and supporting TexasOnline. The contractor's responsibilities include, but are not limited to, establishment of a data center, customer relations management, help desk support, and providing an online payment system for agencies to use to interface with the Comptroller of Public Accounts.

The Department's original contract with the TexasOnline contractor contained weaknesses that did not adequately protect the State's financial interest in TexasOnline. We provided the Department with a detailed list of the contract weaknesses we identified. The contract renewal agreement that the Department executed with the contractor on February 9, 2002, incorporated our recommendations for strengthening the contract. As described below, however, one weakness we identified regarding the transferability of the TexasOnline software licenses still has not been resolved.

In addition, the Department needs to enforce certain existing contract provisions. TexasOnline provides valuable government services to citizens, state agencies, and city and county governments. Therefore, it is critical that the Department enforce the terms of the contract to ensure that the system provides accurate and reliable service.

As the partnership between the Department and the contractor matured, the need for clarification of certain contract terms was magnified. Additionally, practical experience with TexasOnline highlighted the fact that certain clarifications should be incorporated into the contract.

### The original contract contained certain financial terms that required clarification.

The original contract contained ambiguous terms regarding the State's revenue sharing options and the contractor's process for recapturing expenditures. For example, the definitions of key contract terms such as "gross revenue," "fees," and "costs" allowed for multiple interpretations. Other terms such as "expense," and "net revenue" also were not clearly defined, yet they were used frequently throughout the contract. This ambiguity jeopardized the State's opportunity for maximizing its share of TexasOnline revenue and could have delayed the point at which the State assumes ownership of parts of the system.

The original contract's definition of "net revenue" demonstrated why the Department needed to clarify financial terms. The contract stated that net revenue equaled gross revenue less the contractor's costs as *approved in the annual budget*. However, net revenue should be based on actual expenditures, not budgeted expenditures. Under this definition of net revenue, the contractor could have inappropriately or erroneously overestimated expenditures. This could have had a significant impact on revenue sharing and system ownership; the State receives 50 percent of net revenues and assumes ownership of certain parts of the system after the contractor has recovered its investment.

Additionally, the original contract did not specify when the TexasOnline contractor was required to submit revised or updated budget information. The original contract



also did not specify whether any expenditures in excess of the approved budget could be charged to the project.

The original contract also was unclear about the recovery of software development costs. The original contract stated that all software development costs were to be considered recovered as of August 31, 2002. However, the contract's definition of software development costs included only the initial TexasOnline pilot agency projects.

**The Department should enforce contract provisions requiring that hardware or software assets be transferable to the State at no additional cost.**

At the Department's request, we reviewed TexasOnline software licenses to determine if the contractor had complied with a contract requirement that allowed licenses to be transferred to the State at no additional cost. We found that 99 percent of TexasOnline software (valued at \$1,118,089) may not be transferable to the State without additional cost if the State terminates the relationship with the contractor.

The original contract stated that the contractor should notify the Department in writing of any hardware or software licenses in which the contractor did not have a transferable interest. However, the contractor did not comply with this requirement. The original contract also stated that the contractor would notify the Department in writing of situations in which assignable interest in the software depended on the payment of a license transfer fee.

If a software license is not transferable, the State may be forced to pay additional costs if it terminates its relationship with the contractor. Typically, the license associated with purchased software restricts usage of the software to the original purchaser only. The software manufacturer could levy penalties if a party other than the original licensee uses the software.

The TexasOnline software license agreements may not be transferable to the State because:

- The contractor has not executed or provided software agreements, or the agreements contain wording specifying that the software is not transferable.
- Software agreements are not in the name of the contractor because they were purchased by a subcontractor.
- Software agreements call for a sub-license, but the contractor has not executed sub-license agreements with the State.

The contract renewal agreement gives the contractor an extension until August 31, 2002, to amend the software licenses so that they will be transferable to the State at no additional cost upon termination of the contract. In addition, the contract renewal agreement specifies that future license agreements are not to be executed by the contractor without first receiving written agreement from the Department that the license is acceptable.

**The Department should ensure that the TexasOnline contractor executes formal contracts with all subcontractors.**

The TexasOnline contractor took approximately 20 months to execute a contract with the major subcontractor for TexasOnline. Although the subcontractor began performing work on TexasOnline around May 2000, according to the Department, a contract outlining the services to be provided by the subcontractor was not formally executed until December 2001. The subcontractor provides services such as facilities support (air conditioning, physical security, and monitoring), data backup, and recovery services. As of March 2001, the TexasOnline contractor had paid the subcontractor approximately \$1.7 million without a signed contract.

The Department's original contract with the TexasOnline contractor recognized that the contractor was in contract negotiations with the subcontractor. The original contract also absolved the contractor of any liability resulting from the subcontractor's failure to perform. However, it does not appear that the intention of this language was to allow the subcontractor to operate without a contract for a 20-month period.

In the absence of a signed contract, if the subcontractor fails to perform there are no sanctions that can be levied or cost recoupment clauses that can be exercised. If the subcontractor fails to perform its duties, this could have a significant impact on the citizens, state agencies, and city and county governments using TexasOnline services.

The contract renewal agreement specifies that all services to be provided by subcontractors must be in writing and that subcontractors must comply with all terms and conditions of the Department's contract with the TexasOnline contractor.

Recommendations:

The Department should:

- Enforce the terms of the contract renewal agreement regarding the State's revenue sharing options and the contractor's process for recapturing expenditures.
- Ensure that the contractor amend software licenses as soon as possible so that they will be transferable to the State at no additional cost upon termination of the TexasOnline contract. The Department also should ensure that the contractor complies with the contract renewal agreement requirement that future license agreements not be executed by the contractor without first receiving written agreement from the Department that the license is acceptable.
- Ensure that the contractor promptly execute formal contracts with all subcontractors. This will ensure that the subcontractors are obligated to comply with all terms and conditions of the contract and contract renewal agreement.

Management's Response:

*We agree with the need to strengthen the TexasOnline contract.*

*Regarding the individual recommendations:*

- *The February 9, 2002, contract amendment clarifies term definitions and specifies that any costs incurred in transferring license agreements to the state will be borne by the private partner. It includes formulas detailing the processes to be used for recovering expenditures and outlines in detail the State's revenue sharing options.*
- *DIR continues to work with the contractor on the license agreements. The contract amendment requires the contractor to obtain transferable license agreements at no additional cost to the State by August 31, 2002. The amendment also prohibits the private partner from entering into license agreements for TexasOnline which would require payment of license transfer fees without DIR's written consent.*
- *The contract amendment requires that all the private partner's subcontractor agreements be in writing.*

Section 3:

### **Does the Department Monitor the TexasOnline Contractor's Performance to Ensure That TexasOnline Functions As Intended?**

Sections 1 and 2 of this report highlight why it is important for the Department to monitor the TexasOnline contractor. While the Department informally monitors the contractor on a daily basis, there are opportunities for the Department to improve its monitoring of the contractor.

#### **The Department should formalize its monitoring of the TexasOnline contract.**

The Department's contract monitoring process should be strengthened because the Department:

- Has few written contract monitoring policies and procedures.
- Does not perform a review of its monitoring process.
- Has not yet provided contract monitoring personnel with training on contract monitoring best practices.

The Department has been working on improving its monitoring process. For example, the Department has been preparing monitoring checklists for its staff to use.

**The TexasOnline contractor did not provide the Department with the information the Department needed to monitor the contract.**

Because the TexasOnline contractor did not provide the Department with required information, the Department did not monitor specific contract performance targets intended to ensure TexasOnline availability while minimizing loss of data. The Department's original contract with the contractor contained at least five performance metrics for TexasOnline. We judgmentally selected two of these metrics to determine if the Department was monitoring them. These metrics were:

- *The contractor will ensure that TexasOnline up-time and availability is 99.5 percent.* Monitoring this metric is crucial to ensuring that TexasOnline is available to users.
- *Data packet loss must be less than 1.5 percent.* (A data packet refers to one frame in a computer data communication. Computer data communications are divided into frames when messages are transmitted across networks.) Monitoring this metric is critical to ensuring that all user-entered transaction information is appropriately routed so that transactions can be successfully processed.

The Department was not monitoring these two metrics because the contractor was not providing necessary information. Although Department officials said they requested the information, the contractor did not provide it. The contract did not contain sanctioning provisions that the Department could use if the contractor failed to provide the information.

The contract renewal agreement removed the performance metric regarding data packet loss but added additional performance metrics for which the contractor must provide performance information. The contract renewal agreement allows for noncompliance sanctions. Because the agreement was signed after we completed our audit, we did not determine if the Department is now receiving the information necessary to monitor the contractor's performance.

**The Department should ensure that the TexasOnline contractor prepares a disaster recovery plan.**

The original contract required the contractor to prepare a disaster recovery plan for TexasOnline. However, the contractor has not complied with this requirement. A disaster recovery plan provides documented procedures, approved by senior management, to ensure that interrupted business processes are handled appropriately and that information assets are adequately protected.

The Department unsuccessfully attempted to enforce this requirement, but it had no sanctions available to penalize the contractor for noncompliance. The contract renewal agreement signed February 2002 gives the contractor an extension until August 31, 2002 to have a disaster recovery plan in place. The renewal agreement also contains sanctions for noncompliance.

Recommendations:

The Department should:

- Implement a formal contract monitoring process that is driven by the requirements set forth in the contract.
- Develop written contract monitoring policies and procedures. The Department should establish policies and procedures for:
  - Maintaining contract monitoring documentation.
  - Formalizing the contract monitoring review process.
  - Requiring applicable personnel to receive contract monitoring training.
- Ensure that the contractor complies with the contract requirement to provide information by which to monitor performance metrics.
- Ensure that the contractor prepare a disaster recovery plan for TexasOnline as soon as possible. Both the contractor and the Department should review and approve the plan. The plan should ensure that the contractor follows the Department's standards for testing, updating, and periodically reviewing the plan.

Management's Response:

*DIR agrees written contract monitoring policies and procedures would further enhance its contract monitoring process. DIR and the TexasOnline Task Force (currently the TexasOnline Authority) have monitored the private partner and project on a continual basis since its inception to assure the contract is being adhered to and that contractor performance meets acceptable standards. The revised contract now includes a comprehensive set of performance requirements with associated monetary penalties. These contractual requirements should further enhance both DIR and the Authority's ability to monitor contractor performance. These performance metrics will be closely monitored and enforced by DIR, as will all other provisions of the contract, as amended. In addition, when available, DIR will use the contract management guide to be developed and periodically updated by the Office of the Attorney General pursuant to Section 2262.051, Government Code, in monitoring and enforcing the contract.*

*Regarding the recommendations:*

- *Written contract monitoring policies and procedures will be completed by June 30, 2002, under the direction of the TexasOnline Division Director. DIR is currently developing written policies, standards and procedures and will provide staff training in contract monitoring best practices. DIR will continue to review its monitoring processes on an ongoing basis to further enhance them.*

- *The contract amendment includes detailed performance metrics and penalties for non-performance. DIR will ensure that the contractor meets their requirements as detailed in the metrics.*
- *The contract amendment requires a disaster recovery plan be implemented by August 2002 to continue the contract past that date.*

Section 4:

## Are TexasOnline Revenues and Transactions Processed Successfully and Reconciled Properly?

Testing of the TexasOnline revenue process at the Real Estate Commission (Commission) indicated that, for this agency, revenues are processed accurately, transactions are completed successfully, and revenues and transactions are reconciled. The transactions we tested included real estate agent and broker license renewals completed through TexasOnline. The Commission's TexasOnline transaction revenue for fiscal years 2000 and 2001 represented 1.5 percent of all TexasOnline revenue during those years and 29 percent of TexasOnline transaction revenue.

### What Are the Two Types of TexasOnline Revenue?

**Transaction Revenue.** Revenue generated from convenience fees charged to members of the public who use TexasOnline to obtain information or conduct transactions.

**Service Revenue.** Revenue generated from fees charged to state agencies by the TexasOnline contractor for application development or operation services.

At the time of our audit, there were nine agencies that had TexasOnline applications involving the purchase of or payment for services or products (see Table 1 in Section 6 for additional detail). Our testing of TexasOnline revenues and transactions was limited to transactions occurring between October 2000 and September 2001 at the Commission. We selected the Commission for testing of TexasOnline revenues and transactions because it was one of the TexasOnline pilot agencies and, therefore, had been using TexasOnline for a relatively significant period of time.

The Commission's reconciliation process is a model that existing and future TexasOnline agencies could emulate. As one of the TexasOnline pilot agencies, the Commission has worked well with the Comptroller of Public Accounts to obtain the reports it needs to monitor revenues.

### Recommendation:

The Department should consider using the Commission's revenue reconciliation process as a model when current or future TexasOnline agencies seek assistance in establishing or improving their own revenue reconciliation procedures.

Management's Response:

*We agree that the Real Estate Commission's revenue reconciliation process should be used as a model for other agencies using TexasOnline. That information will be made available to existing and new customers.*

Section 5:

## **Are TexasOnline Agencies Collecting Data to Demonstrate Improved Efficiencies and Customer Service?**

Our survey results indicated that agencies' benchmarking efforts are in their infancy, because the Authority currently does not require agencies to conduct benchmarking studies. The Department is proactively addressing the need to perform benchmarking by working with TexasOnline agencies and engaging a consultant to develop benchmarking tools for agencies to use. The templates developed by the Department have standardized the benchmarking information agencies should gather. Additionally, the Department is contacting TexasOnline agencies to offer benchmarking presentation and discussion meetings, provide assistance, and generally guide agencies through the benchmarking process.

### **What is Benchmarking?**

Benchmarking is the act of collecting and documenting cost, time, and production data about an existing process for comparison with the same information about a new or modified process.

While the Department is encouraging agencies participating in TexasOnline to collect benchmarking data, our survey of 11 agencies using or planning to use TexasOnline indicated that:

- One agency has conducted benchmarking studies to compare the cost and efficiency of its existing service delivery methods with the cost and efficiency of offering services through TexasOnline.
- Four agencies were beginning to conduct benchmarking studies.
- Four agencies did not plan to conduct benchmarking.
- Two agencies were undecided about whether they would conduct benchmarking.

The TexasOnline Authority needs to gather benchmarking information from agencies to comply with Texas Government Code, Section 2054.051. This statute requires the Authority to report to the Legislature regarding the status, progress, benefits, and efficiency gains from TexasOnline. Without benchmarking, changes in cost, effectiveness, and efficiency cannot be measured against past performance. In addition, there is a risk that both successes and failures will go unrecognized and reports to management may be inaccurate.

Recommendation:

The Department should work with the TexasOnline Authority to require that TexasOnline agencies gather and report the appropriate benchmarking information. This will provide the information the Authority needs to prepare the reports mandated by the Legislature.

Management's Response:

*DIR agrees that the benchmarking process is a valuable tool and will continue working with the agencies to refine and utilize it. DIR had researched the nation for quantifiable results on the benefits of electronic government. Failing to find empirical studies, in April 2001, DIR initiated a voluntary benchmarking project to determine both the quantitative and qualitative benefits of TexasOnline. As part of the project, DIR developed a benchmarking tool to assist agencies in performing a quantitative and qualitative assessment of their e-government efforts. Currently, 7 of 9 state agencies using TexasOnline are participating in the voluntary benchmarking process.*

*Regarding the recommendation:*

- We agree that benchmarking e-government projects that participate in TexasOnline information would provide useful information to the agencies and legislature. DIR will encourage the TexasOnline Authority to require, where feasible, benchmarking of agency projects brought on TexasOnline. This information should also be useful to them in the mandated reports to the Legislature.*

Section 6:

## Background Information

In August 2000, the State of Texas launched its official e-government Web portal for state and local government business. The Web site, [www.texasonline.com](http://www.texasonline.com), serves as a portal through which both state agencies and local governments can offer a comprehensive network of services that citizens can access without leaving their homes and businesses. Currently, citizens can perform a variety of tasks through TexasOnline. Examples of these tasks include driver's license renewals, insurance agent license renewals, and sales tax filing and payments.

Texas Government Code, Section 2054.062, established the Texas Electronic Government Task Force (Task Force). The Department was tasked with establishing the Task Force with representatives from the following entities:

- Secretary of State
- Comptroller of Public Accounts
- Texas Department of Economic Development



- General Services Commission (now the Texas Building and Procurement Commission)
- Natural Resource Conservation Commission
- Department of Insurance
- Public Utility Commission of Texas
- Department of Information Resources

In addition, the Task Force included the following individuals appointed by the Governor:

- Representatives of local government
- Three public members
- Three representatives of businesses that are regulated by local government or a state agency

The Task Force was required to study the feasibility of conducting government transactions via the Internet. The Task Force developed the TexasOnline concept to facilitate on-line government service delivery and issued a request for offer to secure a vendor to assist in the development of TexasOnline. The governing board was established as a subcommittee of the Task Force. The governing board was responsible for approving the annual budget for TexasOnline and establishing policies and procedures governing the use of TexasOnline.

TexasOnline is self-supported through transaction convenience fees paid by users of the system and through service revenue paid by state agencies that use the TexasOnline contractor's services. Convenience fees are then used to reimburse the contractor for its capital investment and to offset variable expenses such as credit card fees and other costs associated with the acceptance of electronic payments. Service revenue is paid by state agencies that use the contractor for application development or operation services.

In May 2001, Senate Bill 187 (77th Legislature, Regular Session), established the 15-member TexasOnline Authority (Authority)<sup>1</sup>. The Authority provides vision, leadership, and operational oversight for TexasOnline. The Authority replaced the Task Force on November 1, 2001. Members of the Authority include the following fifteen members, many of whom are appointed by the Governor:

- Representative from the Comptroller of Public Accounts
- Representative from the Department of Information Resources
- Three representatives of local government
- Three representatives from businesses regulated by a state agency or local government
- Four representatives from state agencies

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<sup>1</sup> Senate Bill 187 became effective May 26, 2001, as Texas Government Code, Section 2054.051.

- Three public members

A representative from the State Auditor’s Office also advises the Authority.

The duties of the Authority include:

- Developing policies related to the operation of TexasOnline
- Considering services to be provided by TexasOnline
- Operating and promoting TexasOnline
- Managing the contract performance of TexasOnline
- Complying with the Department’s financial requirements for TexasOnline
- Overseeing money generated from the operation and expansion of TexasOnline
- Developing pricing policies
- Evaluating whether improved efficiencies are being gained from participation in TexasOnline
- Coordinating with the Department to receive periodic security audits of the TexasOnline operational facilities
- Advising the Department about TexasOnline

The Authority held its first official meeting on January 11, 2002.

Table 1 below lists the state agencies offering services through TexasOnline.

Table 1

<b>State Agencies Offering Services Via TexasOnline</b>	
<b>Agency</b>	<b>Service</b>
Comptroller of Public Accounts	Sales tax return filing and Texas Tomorrow Fund application
Department of Insurance	Subscription renewal
Department of Licensing and Regulation	Contractor's license renewal
Natural Resource Conservation Commission	Event registration
Real Estate Commission	Agent and broker license renewal
Department of Public Safety	Driver's license renewal
Workers' Compensation Commission	Employer insurance coverage search and attorney fee processing
Texas Education Agency	Application to Texas public university
Department of Transportation	Vehicle registration

Source: TexasOnline ([www.texasonline.com](http://www.texasonline.com))

## Objectives, Scope, And Methodology

### Objectives

Our objectives were to:

- Determine whether the Department of Information Resources (Department) protects the State's financial interests by adequately monitoring the TexasOnline contract to ensure that:
  - The contractor provides accurate and useful financial reports.
  - Opportunities to strengthen the contract are pursued during contract negotiations.
  - TexasOnline functions as intended at a selected agency.
- Determine whether TexasOnline revenues and transactions are processed successfully and reconciled properly at a selected agency.
- Determine whether TexasOnline agencies are collecting data to demonstrate improved efficiencies and customer service.

While our objectives did not include issuing a formal opinion on the TexasOnline financial statements, our objectives did include testing the accuracy and usefulness of the financial reports the TexasOnline contractor submitted to the Department.

### Scope

The scope of this audit was limited to reviewing financial reports provided by the contractor for fiscal years 2000 and 2001. Our audit also included analysis of TexasOnline revenue data provided from the Comptroller of Public Accounts (Comptroller). Our review of revenues was limited to the Real Estate Commission's (Commission) transaction revenue.

### Methodology

The audit methodology consisted of gaining an understanding of controls over financial reports. We also tested the controls and the accuracy of the financial reports by reviewing the financial reports, expenditures, and revenues.

Information collected to accomplish our objectives included the following:

- Interviews with staff from the Department, the Comptroller, and the Commission, and with contractor staff
- Documentary evidence such as:
  - TexasOnline Task Force financial reports
  - Commission revenue reconciliation reports
  - TexasOnline third-party invoices

Procedures, tests, and analysis performed included the following:

- Review of the contractor's financial presentations to the Task Force
- Review of the contractor's TexasOnline financial records, including invoices and payroll records
- Review of Department documentation related to TexasOnline benchmarking
- Review of Commission documentation related to its TexasOnline revenue reconciliation process
- Surveying TexasOnline agencies related to TexasOnline benchmarking activities

Information resources reviewed included the following:

- Requirements in Texas statutes
- Requirements in the TexasOnline request for offer
- Comptroller service revenue data

Criteria included the following:

- TexasOnline contract
- Comptroller TexasOnline revenue procedures
- Department TexasOnline procedures

### **Other Information**

We conducted fieldwork between September and November 2001 and tested transactions that occurred from March 1, 2000, through July 31, 2001. This audit was conducted in accordance with generally accepted government auditing standards.

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

- Rodney Almaraz, CPA, MBA (Project Manager)
- Sonya Etheridge, CIA, CISA (Assistant Project Manager)
- Tom Hill
- Lee Laubach
- Adrian Martinez
- Leslie Ashton, CPA (Quality Control Reviewer)
- Sandra Vice, MPAff (Audit Manager)
- Frank Vito, CPA (Audit Director)

## Management's Response



### DEPARTMENT OF INFORMATION RESOURCES

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March 20, 2002

CAROLYN PURCELL  
*Chief Information Officer*  
*State of Texas*

— ♦ —  
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Mr. Lawrence F. Alwin, CPA, State Auditor  
State Auditor's Office  
1501 North Congress, Suite 4.224  
Austin, Texas 78701

Dear Mr. Alwin:

Thank you for your review of the TexasOnline project. We appreciate the professionalism and cooperation demonstrated by your staff during this audit.

The TexasOnline project is a unique public/private partnership that allows TexasOnline to be self-supporting while giving state and local governments access to leading edge technologies. The partnership is based on a new model for development and funding of electronic government initiatives. This model requires the private partner (contractor) to acquire the necessary resources and pay for all costs associated with the development, implementation and operation of TexasOnline. The private partner then may recover those costs through a variety of methods, with convenience fees (charges to the user of the service) and subscription fees (charges to the provider of the service) being the primary methods of recovery to date. Based on the contract negotiated between the State and the private partner, the partner assumes all financial risk for the project.

Additionally, the private partner is required to share any revenues recovered through TexasOnline with the State. Under this revenue sharing approach the State will receive 10% of the Gross Revenues and 50% of the Net Revenues after break even. The State began receiving its 10% of gross revenues in fiscal 2002. Current estimates forecast that the State will begin profit sharing (50% of net revenues) in fiscal 2006. TexasOnline financial activity recorded by the private partner in fiscal year 2001 was significant. The private partner invested approximately \$13 million in TexasOnline from inception of the project in May 2000 through August 2001.

In June 2001, DIR engaged a contract internal auditor to review the project. The scope of the audit included vendor compliance with contract terms and conditions related to accounting and financial reporting and adequacy of the accounting records and supporting documentation.

In August 2001 prior to completion of the internal audit, the State Auditor's Office notified DIR that they would be performing an audit of TexasOnline.

Mr. Lawrence F. Alwin

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Both audits identified private partner accounting processes and reporting that need to be improved and bookkeeping errors that needed to be corrected to accurately reflect the financial status of TexasOnline. DIR has worked with the private partner to implement financial reporting in accordance with Generally Accepted Accounting Principles and those statements are being submitted monthly to the TexasOnline Authority. A detailed FY 2002 proposed budget with full supporting documentation was provided by the private partner to DIR in April 2001. A contract amendment was signed on February 9, 2002, that further addresses and clarifies financial reporting issues and requires an annual financial statement opinion audit. Bookkeeping errors will be researched and corrected.

We agree with the recommendations for strengthening the TexasOnline contract. A comprehensive amendment was executed February 9, 2002, with our private partner. Section 4 of the amendment clarifies revenue and expense issues in the May 5, 2000, TexasOnline contract that were identified by both the State Auditor's Office (SAO) and DIR's internal auditor. Section 5 of the amendment requires monthly financial statements and reports, including fixed assets and depreciation schedules; requires that the private partner use American Institute of Certified Public Accountants Statement of Position 98-1 in accounting for software development costs; specifies depreciation rates; allows DIR or its representative to conduct annual financial statement opinion audits of the private partner; requires that the private partner utilize a double entry bookkeeping system for the TexasOnline Project; and imposes service level requirements and penalties on the private partner for non-performance.

Section 7 of the February 9, 2002, amendment requires the private partner's subcontracting agreements to be written and to be auditable by the State for two years after termination of the subcontract.

We agree that it is critical to the State's interest that the transferability of software licenses be resolved.

DIR agrees that written contract monitoring policies and procedures would further enhance its contract monitoring process. The revised contract requires a comprehensive set of performance requirements with associated monetary penalties to enhance both DIR and the Authority's ability to monitor contractor performance. The revised contract also requires a disaster recovery plan be implemented by August 2002 to continue the contract past that date.

DIR agrees that the benchmarking process is a valuable tool and will continue working with the agencies to refine and utilize it. DIR researched the nation for quantifiable results on the benefits of electronic government. Failing to find empirical studies, DIR developed a benchmarking tool to assist agencies in performing a quantitative and

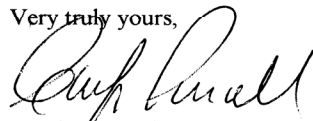
Mr. Lawrence F. Alwin  
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qualitative assessment of their e-government efforts. Currently, 7 of 9 state agencies using TexasOnline are participating in the voluntary benchmarking process.

Additional details related to DIR's response to the audit findings can be found at the end of each audit finding.

We appreciate the SAO's assistance in reviewing the contract amendment to ensure that all issues had been adequately addressed.

Very truly yours,



Carolyn Purcell  
Executive Director

CP:LAF:laf

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