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Key Points of Report

An Audit Report on Purchasing and Contract Administration at the Texas Department of Criminal Justice

October 1996

Overall Conclusion

Deficiencies in the design and implementation of controls over the Texas Department of Criminal Justice's (TDCJ) purchasing and contracting functions have prevented TDCJ from ensuring that it spends funds according to state law or on the most effective, efficient services. In fiscal year 1995, TDCJ purchased \$602.5 million of goods and services, and contracted for at least an additional \$300 million of purchased services. While TDCJ has recently begun to address many of the weaknesses noted, the historic lack of sound controls over purchasing and some divisions' contract administration increases the risk that these funds could be misused or spent on ineffective programs.

Key Facts and Findings

- TDCJ's purchasing process is missing many of the basic controls needed to ensure that the proper method of purchasing is used, that all eligible bidders have an opportunity to participate, or that the best price is obtained. A sample of fiscal year 1995 purchases revealed that almost 19 percent of purchases made during the year did not comply with one or more of the tested requirements.
- The effectiveness of TDCJ's contract administration varies among divisions and programs. Administration of some programs, such as the new substance abuse programs administered by the Programs and Services Division and the Pardons and Parole Division, includes fairly strong controls over contractor selection, contractor reimbursement, contract development, and contractor oversight. However, some divisions have weaknesses in their systems of contract administration:
 - The Community Justice Assistance Division annually allocates \$230 million to Community Supervision and Corrections Departments for probation services and, beginning in fiscal year 1996, also distributes another \$10 million for the *Treatment Alternatives to Incarceration Program (TAIP)*. Management of these funds is impaired by poor allocation methods and data, the absence of contractual provisions needed to ensure accountability, and a general lack of oversight.
 - The process used by TDCJ to develop the seven privately operated state jails (known as the Mode II state jails) did not ensure that the State selected the best proposal for jail construction and operation or negotiated the best rate. Weaknesses in the following areas increased the risk that TDCJ did not spend contracting dollars in the most effective and efficient way:
 - Site and vendor selection did not ensure that the best proposal was objectively selected.
 - Per diem rate negotiations did not include sufficient analysis of proposed costs.
 - Contracts are inconsistent and some do not include key provisions necessary to ensure accountability.

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This audit was conducted in accordance with Government Code, § 321.015(a) and (b)(1).

Executive Summary

Deficiencies in the design and implementation of controls over the Texas Department of Criminal Justice's (TDCJ) purchasing and contracting functions have prevented TDCJ from ensuring that it spends funds according to state law or on the most effective, efficient services. Weaknesses in purchasing controls have resulted in numerous purchases that do not comply with state purchasing requirements. In addition, weaknesses in some divisions' administration of purchased service contracts prevent these divisions from ensuring that:

- The best contractor is objectively selected
- Contract rates are reasonable
- Contracts include the provisions needed to hold contractors accountable
- Services provided are effective and conform to contract requirements

TDCJ Is Taking Steps to Address Purchasing Deficiencies

TDCJ's Board and management have already begun to address many of the significant weaknesses in TDCJ's purchasing process. Specifically:

- The Executive Director requested that TDCJ's Internal Audit Department and our Office audit the existing purchasing process.
- The Board of Criminal Justice adopted a 12-point plan which instituted Board approval of all purchases greater than \$1 million, directed staff to consolidate purchasing functions, and appointed a special committee to assist staff in revising purchasing guidelines.
- The use of the TDCJ's "direct" purchasing authority has been suspended.
- A comprehensive policy and procedure manual for purchasing has been drafted.
- The number of staff members with purchasing authority has been reduced.
- Implementation of an automated purchasing and inventory control system has begun.

TDCJ's Purchasing Process Has Not Ensured That Purchasing Requirements Are Met

TDCJ's purchasing process is missing many of the basic controls needed to ensure that the proper method of purchasing is used, that all eligible bidders have an opportunity to participate, or that the best price is obtained. TDCJ lacks complete purchasing policies, has not exercised sufficient oversight of employees with purchasing authority, and has not ensured that purchasers have had sufficient training or experience with purchasing requirements. In fact, people with experience and training in different methods of purchasing have not historically been involved in purchases until after items have been ordered, received, and sometimes, used.

As a result, competition is not used or is not used effectively to ensure TDCJ pays a reasonable price for its goods and services. We found that:

- Competitive bidding has been avoided through the use of inappropriate purchasing methods.
- Controls over informal bidding do not ensure qualified bidders are contacted or competitive bids are obtained.
- Purchases have been divided (or "split") to avoid competitive bidding requirements.
- Emergency purchases have sometimes been used as a substitute for planning.

These conditions limit TDCJ's ability to ensure the prices it pays are reasonable, and have also allowed many purchases to be made which do not comply with state purchasing requirements. Of the 315 fiscal year 1995

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delegated purchases (greater than \$1,000) tested, only 255, or 81 percent, complied with all applicable requirements. For some types of purchases, the compliance rate was much lower. Only 11 percent of “direct” purchases and 22 percent of “emergency” purchases complied with requirements.

TDCJ Has Not Consistently Implemented an Effective Contract Administration Model

The effectiveness of TDCJ’s contract administration varies among divisions and programs. Administration of some programs, such as the new substance abuse programs administered by the Programs and Services Division and the Parole Division, includes fairly strong controls over contractor selection, contractor reimbursement, contract development, and contractor oversight.

Figure 1

Material Contract Administration Weaknesses				
Divisions/ Programs	Contractor Selection	Contract Payment Methodology	Contract Provisions	Contractor Oversight
Community Justice Assistance Division (CJAD)	Some funds allocated based on untested and inaccurate data. Other funds distributed based on historical funding allocations without consideration of past performance or efficiency.		<ul style="list-style-type: none"> No contracts with CSCDs Minimum requirements for CSCD subcontracts inadequate 	<ul style="list-style-type: none"> No monitoring for 18 months Current efforts compliance-focused New performance audits may not achieve intended objectives because of reductions to plans.
CJAD-Treatment Alternatives to Incarceration Program (TAIP)	RFP used but improvements in process needed	Amount subjectively determined	No contracts with CSCDs	Monitoring plans just under development
Mode II State Jails	Initial process was subjective. Final process was more objective but not always consistent.	Per diem rates negotiated without sufficient analysis of cost components.	Mode II contracts inconsistent and do not include all provisions necessary to ensure accountability	Process should be formalized.
Parole Division	No major weaknesses. Apply system developed for substance abuse contracts to all future contract awards and renewals.			
Substance Abuse Treatment	No major weaknesses. Better analysis of indirect costs and limits could result in lower rates.			
Pre-Release Centers	<ul style="list-style-type: none"> No major weaknesses Analysis of component costs could lower negotiated rates 		Contracts do not include all provisions necessary to ensure accountability.	Monitoring has been insufficient.

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However, some divisions have weaknesses in their systems of contract administration. Figure 1 summarizes the major weaknesses in TDCJ's contract administration.

CJAD'S Contract Administration Cannot Ensure That State Funds Are Spent Effectively or Efficiently

The Community Justice Assistance Division's (CJAD) current system of contract management does not ensure that local Community Supervision and Corrections Departments (CSCDs) spend state dollars efficiently or on programs that reduce recidivism. CJAD annually allocates \$230 million to CSCDs for probation services and, beginning in fiscal year 1996, also distributes another \$10 million for the *Treatment Alternatives to Incarceration Program (TAIP)*. Management of these funds is impaired by poor allocation methods and data, the absence of contractual provisions needed to ensure accountability, and a general lack of oversight.

CJAD's fund allocation process differs for each of its appropriation line items, but we found weaknesses in all of the methods used:

- CJAD allocates \$132 million of state funds for basic supervision services based on self-reported data from the CSCDs. We found errors in this data at three of the five CSCDs visited (with error rates up to 9 percent).
- Another \$97 million of "grant funds" for residential and other programs is allocated based mainly on historical distributions. This process does not consider past performance or program efficiency.
- Lastly, CJAD distributed almost \$10 million of *TAIP* funds to CSCDs using a request for proposal. Weaknesses such as unclear evaluation criteria limited the

effectiveness of this process and prevent CJAD from ensuring that the most effective programs were objectively selected.

In addition, CJAD has not developed guidelines to ensure CSCD subcontractors are objectively selected or that amounts paid to subcontractors are reasonable. CSCDs planned to spend approximately \$36 million of the funds allocated to them by CJAD on subcontractors in fiscal year 1995.

CJAD does not have and does not require CSCDs to have contracts which adequately protect state funds from the risk of financial loss. CJAD's current combination of community justice plans, notice of grant awards, and financial standards are not adequate to hold CSCDs programmatically accountable. In addition, CJAD has not set adequate minimum standards for CSCDs' subcontracts. For example, standards do not require CSCD contracts to include performance measures or provisions for financial audits, recovery of misspent funds, contract modification, or contract close-out.

CJAD basically stopped monitoring CSCDs between June 1994 and December 1995. Beginning in December 1995, CJAD resumed field audits, but most of the planned visits will once again address only basic compliance issues. Performance-based reviews have also begun, but these audits may not achieve their intended objectives because some components of these reviews have been eliminated. In addition, CJAD has not provided guidance to CSCDs to ensure the effectiveness of their oversight of subcontractors.

Executive Summary

Weaknesses in the Development of the Contracted State Jails and in Current Contract Monitoring Increase the Risk That State Funds Are Not Being Spent Efficiently and Effectively

The process used by TDCJ to develop the seven privately operated state jails (known as the Mode II state jails) did not ensure that the State selected the best proposal for jail construction and operation or negotiated the best rate. Weaknesses in the following areas increased the risk that TDCJ did not spend contracting dollars in the most effective and efficient way:

- Site and vendor selection did not ensure that the best proposal was objectively selected.
- Per diem rate negotiations did not include sufficient analysis of proposed costs.
- Contracts are inconsistent and some do not include key provisions necessary to ensure accountability.

The process used by CJAD during the initial stages of Mode II state jail development did not ensure that the best proposals were selected or that the State would receive the best value for its contracting dollars. In addition, while the final selection process was more structured, there were inconsistencies in the approach used to evaluate the proposals and select the final sites and vendors. As a result, TDCJ does not have adequate assurances that the best proposals were objectively selected.

Negotiations of operating per diem rates were not structured to ensure that TDCJ was paying the lowest rate possible. TDCJ staff negotiated rates based on their calculations of TDCJ's own cost to operate similar facilities and the

amount of funds available to operate the jails. But because TDCJ did not negotiate rates based on a detailed analysis of operators' estimated cost to operate a facility, TDCJ may be paying per diem rates which do not reasonably align with the cost to operate the Mode II state jails.

Mode II state jail contracts for the same services were often not consistent in content or form, and did not include all the necessary provisions to ensure contractor accountability. In addition, contract provisions regarding inmate phone system revenue may not comply with the requirements of the General Appropriations Act. As a result, revenues that have been received by operators or developers could instead be due to TDCJ.

Other Divisions Have Better Systems of Contract Management

Beginning in fiscal year 1996, TDCJ assumed responsibility for several substance abuse treatment programs formerly administered by the Texas Commission on Alcohol and Drug Abuse. In implementing these programs, both the Parole Division and the Programs and Services Division significantly strengthened their management controls over contracts.

These areas can further improve their contract administration by conducting more detailed analysis of providers' proposed indirect costs and by developing methods to determine the effectiveness of these programs.

Summary of Management's Response

TDCJ concurs with the recommendations included in the report and has begun to implement many of them to improve its contracting and purchasing processes.

Overall Assessment

Weaknesses in both the Texas Department of Criminal Justice's (TDCJ) purchasing and contracting functions prevent TDCJ from ensuring that it spends funds according to state law or on the most effective, efficient services. In fiscal year 1995, TDCJ purchased approximately \$602.5 million of goods and services and contracted for at least an additional \$300 million of purchased services. (TDCJ actually purchased \$815.2 million of goods and services, but only approximately \$602.5 million were "delegated" purchases made by TDCJ.) While TDCJ has begun to address many of the weaknesses noted, the lack of sound controls over purchasing and some divisions' contract administration increases the risk that these funds could be misused or spent on ineffective programs.

TDCJ's purchasing process is not structured to ensure the agency's compliance with state purchasing requirements. TDCJ:

- Lacks complete purchasing policies
- Has not exercised sufficient oversight of employees with purchasing authority
- Has not ensured that purchasers have had sufficient training or experience with purchasing requirements

These conditions, coupled with management's lack of information needed to manage the purchasing function, have created an environment in which numerous purchases have been made that do not comply with state requirements. A sample of fiscal year 1995 purchases revealed that almost 19 percent of purchases made during the year did not comply with one or more tested requirements. For example, of the 33 emergency purchases tested, justification letters for 24 were inadequate. We also found that three of 315 purchases tested were received before the date of the purchase order.

In addition to compliance problems, TDCJ has also not developed effective processes to ensure the prices it pays are reasonable. Competition is not always used (even when required), and other mechanisms to assess the reasonableness of prices have not been developed. This applies to contracts as well as to purchases.

For example, TDCJ cannot determine if the indirect costs charged to its contracts are reasonable because it does not analyze the amount or composition of providers' indirect costs, and also because not all divisions require providers to submit such cost details. One provider reviewed had seven contracts with TDCJ for a variety of services. Reported indirect costs associated with the contracts totaled \$3.2 million. Because TDCJ did not require the provider to report detailed costs for the contracts, TDCJ could not know if the provider overallocated indirect costs, or if the costs were reasonable and necessary for providing contracted services.

The effectiveness of TDCJ's contract administration varies greatly among divisions and programs. TDCJ contracts for a variety of services such as substance abuse treatment (residential and outpatient), halfway house services, and operation of its pre-release centers. Administration of some programs, such as the new substance abuse

programs administered by the Programs and Services Division and the Pardons and Parole Division, includes fairly strong controls over contractor selection, contractor reimbursement, contract development, and contractor oversight. However, other divisions have weaknesses in their systems of contract administration. Until these weaknesses are addressed, these divisions cannot ensure the reasonableness of contract prices or the quality of services provided.

Section 1 of this report provides information on our review of TDCJ's purchasing process. Sections 2 through 7 provide detailed information on our review of purchased service contract administration at several divisions.

Section 1:

TDCJ's Purchasing Process Has Not Ensured That Purchasing Requirements Are Met

Purchases Processed by TDCJ's Austin Purchasing Department Generally Comply with Applicable Requirements

Our comments on TDCJ's purchasing function do not relate to purchases made by TDCJ's Austin Purchasing Department. This department was responsible for only two percent of the dollars TDCJ expended on purchases in fiscal year 1995.

Purchasing for the Community Justice Assistance Division, the Pardons and Parole Division, the State Jails Division, the Texas Council on Offenders with Mental Impairments, and the Executive Administration Austin Office is done in Austin. The Austin Purchasing Department initiated 6,981 purchase orders, worth \$17,297,212 in fiscal year 1995. The Austin Purchasing Department uses a consolidated purchasing system that limits purchasing authority and requires that users requisition needed items.

Our tests of 17 delegated purchases handled by the Austin Purchasing Department found that all but one had appropriate budget authorization and a signed receiving report, and all had solicited bids when appropriate. We also reviewed another 41 Austin purchases, and found that, in all cases, there was appropriate authorization before a purchase was made. Also, in all cases where it was appropriate, there was a signed receiving report dated before payment.

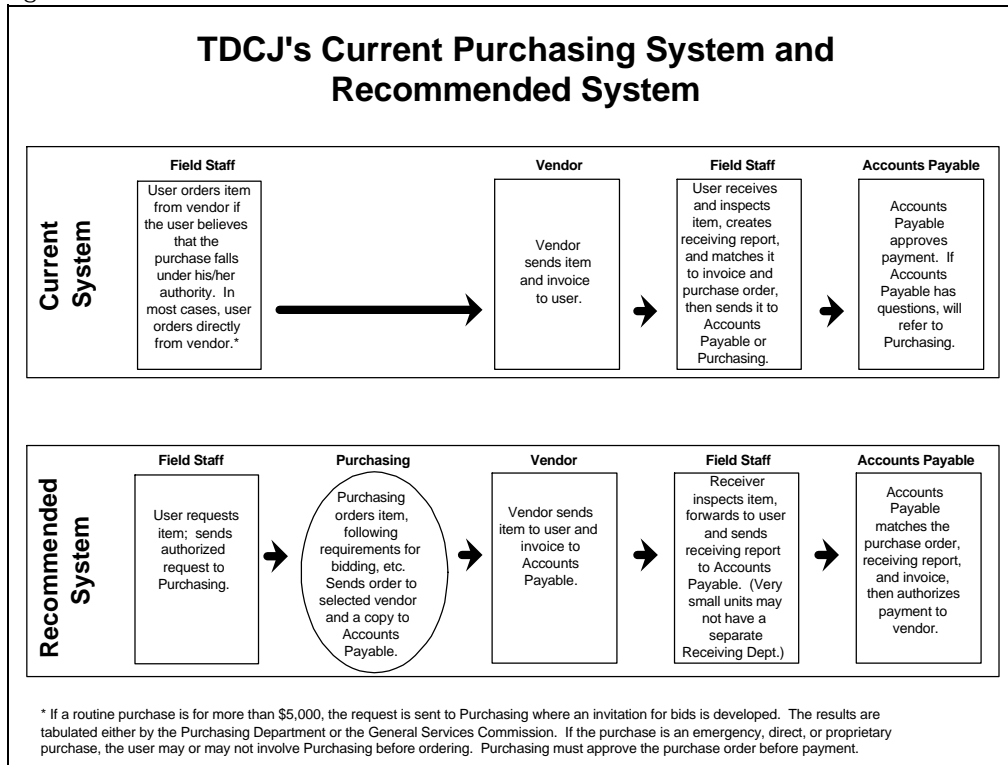
The Texas Department of Criminal Justice's (TDCJ) purchasing process cannot ensure compliance with competitive bidding requirements or other legislative mandates. The absence of sound controls prevents TDCJ from ensuring that it buys its goods and services at the right price and in the best way. In addition, TDCJ management has not developed or used information to effectively manage or track purchases. We found many deviations from prudent purchasing practices by TDCJ's Huntsville Purchasing Department and TDCJ field staff with purchasing authority. The Huntsville Purchasing Department processes purchases for the Institutional Division and other departments such as Texas Correctional Industries, Food Services, and Facilities.

Our review focused on TDCJ's compliance with competitive bidding requirements and other statutes and regulations related to purchasing. During fiscal year 1995, TDCJ spent a total of \$815.2 million on almost

69,000 purchase orders. Of these, approximately 87 percent, or 60,299 purchase orders (totaling \$602.5 million), were "delegated" purchases. That is, TDCJ was delegated the authority to process these orders without the assistance of the General Services Commission (GSC).

TDCJ's purchasing process has not changed significantly since before the period of rapid prison expansion of the early 1990s. At TDCJ, people with experience and training in different methods of purchasing have not historically been involved in purchases until after items have been ordered, received, and sometimes, used. Purchases originate when a user orders an item and creates a purchase order. The item is sent to the user, who signs for it and awaits receipt of the vendor's invoice. In some cases, the purchase order, invoice, and receiving reports are then sent to the Purchasing Department for approval; in most cases they are sent directly to Accounts Payable for payment. The first part of Figure 2 illustrates how TDCJ's purchasing system has operated.

Figure 2



An effective purchasing system should ensure that:

- The proper method is used for the purchase.
- All eligible bidders have an opportunity to participate.
- The best price is obtained.

- Progress is made toward achieving state initiatives (such as participation by Historically Underutilized Businesses [HUB], preference for recycled materials, and compliance with child support requirements).

Staff with training in procurement should decide whether an urgent need translates into an emergency purchase order, if an item is available on a state contract, and the method for obtaining the best price.

The second part of Figure 2 describes a requisitioning system that would help to alleviate many of the problems TDCJ has encountered. In a requisitioning system, the end-user requests an item and sends a requisition to a purchaser. The purchaser then determines the appropriate mechanism for filling the requisition. If the item is not in

stock, the purchaser would determine the appropriate purchasing method, obtain bids if needed, and issue a purchase order.

TDCJ has begun to address many of the significant weaknesses noted in this report. Specifically:

- The Executive Director requested that TDCJ's Internal Audit Department and our Office audit the existing purchasing process.
- The Board of Criminal Justice adopted a 12-point plan which instituted Board approval of all purchases greater than \$1 million, directed staff to consolidate purchasing functions, and appointed a special committee to assist staff in revising purchasing guidelines.
- The use of TDCJ's "direct" purchasing authority has been suspended.
- A comprehensive policy and procedure manual for purchasing has been drafted.
- The number of staff members with purchasing authority has been reduced and purchasing for the Institutional Division has been consolidated within the Huntsville Purchasing Department.
- Implementation of an automated purchasing and inventory control system has begun.

Section 1-A:

TDCJ's Purchasing System Is Not Adequately Controlled and Cannot Ensure Compliance With Purchasing Statutes

TDCJ's purchasing process does not include adequate controls to ensure that purchases comply with state law. We found that:

- TDCJ's purchasing policies are incomplete.
- There has been little or no oversight of purchasers, and no mechanism to ensure compliance with policy.
- Purchasing decisions are sometimes made by staff members who do not have sufficient training and experience with purchasing requirements.
- Management has not collected or used information to manage the purchasing function.

As a result, of 315 delegated purchases greater than \$1,000 made in fiscal year 1995, only 255, or 81 percent, complied with all applicable requirements. For some types of purchases, the compliance rate was much lower. For example, only 11 percent of

“direct” purchases and 22 percent of “emergency” purchases complied with requirements. Requirements tested include:

- Was the item ordered before it was received?
- Did someone sign for the item’s receipt?
- Was there appropriate and adequate justification for an exemption from competitive bidding?
- Was the proper procurement method used?
- Was the purchase appropriately approved?
- Was there evidence of appropriate bidding?

Figure 3 summarizes the results of this test of compliance.

Many staff members are authorized to make purchases for the agency. Since January 1996, TDCJ has reduced the number of authorized purchasers—from 236 in January 1996 to 163 as of June 1996. In order to ensure that this many people—stationed in all different parts of the State— execute purchases properly, TDCJ must have clear and up-to-date procedures, adequate monitoring and oversight, and training in those areas with low compliance levels.

TDCJ does not have complete policies for purchasing. Good purchasing policies ensure that assets are conserved, purchasing data is fed into a system that provides reliable information, and goals are achieved. However, TDCJ’s purchasing policies were not complete or up-to-date at the time of this audit.

There has been little oversight of purchasers, and no mechanism to ensure

compliance with policy. The Purchasing Department has not monitored field staff for compliance with purchasing requirements. As a result, the Purchasing Department has not identified problem areas, and TDCJ has not provided needed training or taken other corrective action to ensure that good purchasing procedures are followed.

Purchasing decisions are sometimes made by staff members who do not have sufficient training and experience with purchasing requirements. Historically, field staff made decisions on the appropriate purchasing

Figure 3

Compliance with Purchasing Requirements Delegated Purchases				
Type of Purchase	In Compliance - All Tested Requirements	Not in Compliance - One or More Tested Requirements	Total Tested	Compliance Percentage
Direct	2	16	18	11.1%
Emergency	6	27	33	22.2%
Proprietary	12	1	13	92.3%
Other Delegated	235	16	251	93.6%
Total	255	60	315	
Overall Compliance Percentage				81%

method and gave selected vendors the opportunity to make telephone bids. Field staff made these purchases without sufficient training or support from the Purchasing Department. Consequently, they made purchases that exceeded their delegated authority or that were not in compliance with purchasing requirements.

Some purchases were made incorrectly by field staff. For others, the purchasing method was changed retroactively by the Purchasing Department so the transaction could proceed even though decisions about whether to seek bids had already been made. For example:

- The Facilities Department purchased a metal repair system as a proprietary purchase when the purchase should have been bid. A proprietary purchase is allowed when equivalent product competition is not available. In this case, however, even though a specific brand was required, it was available from multiple vendors.
- When W-2 forms were ordered for 1995, informal bids were obtained instead of formal bids. A letter in the Accounts Payable file states, "I ordered the W-2 forms and just took phone bids. The dollar amount for this purchase order is \$7,010.69. I realize now that formal bids should have been made by Purchasing. Please help." This purchase was approved as an emergency purchase order.

Management has not collected or used information to manage the purchasing function. Information is another control that helps ensure purchases are properly executed. We found that management was not tracking purchases or collecting and using information that would prevent or detect problems. Section 1-C discusses this in more detail.

Consolidation of the purchasing function is a start. TDCJ has recently begun to consolidate its purchasing. In March 1996 the new Consolidated Purchasing Department was created. This division within the Huntsville Purchasing Department is to handle most of the purchasing for the Institutional Division. Fourteen purchasers and three support staff members have been transferred to the Consolidated Purchasing Department, and staff members whose responsibilities include purchasing for units will begin to report to the Consolidated Purchasing Department. We believe that this will be the beginning of a significant improvement in TDCJ's purchasing process if these purchasers:

- Are given appropriate training
- Have a good set of procedures on which to rely
- Are monitored to ensure that problems are either prevented or detected

and if the planned information system provides meaningful information that is used by management.

Section 1-B:

TDCJ Has Not Developed an Effective Process to Ensure That Prices Are Reasonable

TDCJ has not developed effective ways to ensure that purchases are reasonably priced. Competitive bidding is the typical control that ensures an agency is paying a fair price for its goods and services. However, TDCJ purchases many items that are not required to be competitively bid. Figure 4 details bid requirements for purchases exempt from formal competitive bidding.

Figure 4

Requirements For Purchases Exempt from Formal Bidding Requirements			
Type of Purchase	Requirements	Estimated Number of FY 95 Purchase Orders	Approximate Dollars
Emergency Purchase	<p><u>Defined</u>: "A purchase of goods or services so badly needed that an agency will suffer financial or operational damage unless they are secured immediately." Requires a letter of justification explaining the reason for the emergency purchase, the damage that will occur without this purchase, and why the needs were not anticipated.</p> <p><u>Bid requirements</u>: "Attempt three informal bids when possible." (<i>GSC Procurement Manual</i>)</p>	430	\$10.1 Million

Figure 4, concluded

Requirements For Purchases Exempt from Formal Bidding Requirements, concluded			
Type of Purchase	Requirements	Estimated Number of FY 95 Purchase Orders	Approximate Dollars
Direct Purchase	<p><u>Defined</u>: Exemption from GSC rules for Agriculture or Industry to "purchase directly or at public auction . . . [items] . . . if the division determines that the purchase is economically feasible and advantageous to the division." (<i>Texas Government Code, §496.051</i>)</p> <p><u>Bid requirements</u>: Bids not required. Justification of economic feasibility required.</p>	328 (<i>Estimated by TDCJ</i> ¹)	\$12.9 Million (<i>Estimated by TDCJ</i> ¹)
Any purchase for less than \$1,000	No bid requirements (<i>GSC Procurement Manual</i>)	48,374	\$11.9 Million
Spot purchases between \$1,000 and \$5,000	<p><u>Defined</u>: Purchases of supplies, materials, or equipment, with certain exceptions.</p> <p><u>Bid requirements</u>: For spot purchases between \$1,000 and \$5,000, three informal bids from the Centralized Master Bidder's List (<i>GSC Procurement Manual</i>)</p>	Not more than 4,500 ²	Not more than \$10.4 Million ²
<p>¹ TDCJ estimate based on manual review of records.</p> <p>² These figures include other purchase types between \$1,000 and \$5,000, such as direct publications, emergencies, and others.</p>			

As shown in Figure 4, neither emergency nor direct purchases require formal competitive bids. However, in both areas, the lack of other compensating controls has resulted in items purchased at prices that TDCJ cannot justify as reasonable. For both of these purchasing methods, as well as for purchases of supplies, materials, or equipment ("spot purchases") under \$5,000, informal bidding is frequently used. However, the informal bid process at TDCJ does not ensure that vendors who are likely to provide a competitive bid have that opportunity. In addition, TDCJ has not kept field staff from dividing purchases that should have been competitively bid into multiple purchases to avoid competitive bidding requirements.

TDCJ has not used competition effectively to ensure that prices are reasonable. We found that:

- Competitive bidding has been avoided through the use of inappropriate purchasing methods.
- Controls over the informal bidding process are inadequate.

- Purchases have been divided (or “split”) to avoid competitive bidding requirements.
- Emergency purchases have sometimes been used as a substitute for planning.
- Use of “blanket” justifications diminishes their effectiveness as a control.

Formal competitive bidding has been avoided through the use of inappropriate purchasing methods. We noted instances in which purchasing methods that did not require formal competitive bidding seemed to have been used inappropriately. As a result, purchases were made as emergency purchases or direct purchases when they should have been bid. Therefore, there is no assurance that the best price was paid for materials TDCJ bought. For example:

- TDCJ's direct purchasing authority was used to purchase a \$476,000 Geographical Information System for one of the Texas Correctional Industries. No attempt was made to bid it competitively. The purchase was originally prepared as a proprietary purchase, but the GSC would not approve the proprietary nature of the purchase because similar systems were available through its catalogue. The vendor tried to qualify for GSC's catalogue but could not. TDCJ later purchased the system from the same vendor using its direct purchase authority, without making any attempt to obtain the equipment from other vendors.
- A certain brand of metal repair kits were purchased as a proprietary purchase because, according to the accompanying letter, it was the only brand that had been approved by the FDA and USDA for use around food. Even though the letter did not indicate that a company in Lufkin was the only supplier for this specific brand, there was no attempt to obtain bids from other vendors.
- TDCJ purchased approximately \$4.5 million of herbicides and pesticides between fiscal year 1994 and the first half of fiscal year 1996. Approximately \$2.8 million (or 63 percent) of this was through emergency purchase orders. The justification letters for all of the emergency purchase orders reviewed cited the lack of approved storage space as a reason for the emergency. This was done even though the GSC had asked to work with the purchaser on the development of an open market purchase order with just-in-time delivery as an alternative.

TDCJ did not obtain its informal bids from the most frequently used vendors in the State, or from those with the highest satisfaction ratings from the GSC. Of the 24 unsuccessful bids from 11 purchase orders sampled, 11 did not provide a completed bid, 7 bidders had not been approved by the GSC, and none were the on the GSC's list of the most-used vendors in the State for this commodity. TDCJ bought most of its herbicides and pesticides from vendors with low ratings on performance in the GSC's database of vendor performance.

- TDCJ purchased a taut wire intrusion detection system for \$648,000 and wrote the specifications in a proprietary manner. Two other vendors submitted proposals for the project, asking that their systems be considered as equal alternatives to the specified system. There is no evidence that TDCJ adequately considered the merits of the claims. Later, TDCJ purchased an additional \$6.4 million in fencing from this same vendor as an emergency, explaining the lack of competition as a result of the "proven performance and reliability of the system."
- Texas Correctional Industries purchased \$33.7 million of VitaPro, a soy-based protein product, for sale to TDCJ Food Services and other states' correctional agencies. TDCJ used its direct purchasing authority to exempt this purchase from competitive bidding even though the purchase should have been bid.

Controls over informal bidding do not ensure that reasonable prices are obtained. TDCJ has not effectively used informal bids to ensure it pays the best price. Users typically obtain informal bids by calling several vendors and recording the quoted prices on the purchase order. Unit purchasers are encouraged to call at least two historically underutilized businesses. However, there is no process to ensure that those who are offered the opportunity to bid are vendors who are likely to provide a competitive bid. For instance, successful low bidders on past purchases are not necessarily contacted for informal bids on subsequent purchases.

In addition, purchasing methods that require bidding appear to have been avoided in favor of other purchasing methods that do not have such requirements. Because the informal bidding process is not controlled, there is no assurance that qualified vendors bid, that the best price is obtained, or that there is progress toward achieving statewide initiatives. In addition, there is the opportunity to provide favored vendors with business not made available to other vendors.

- **Bids were not always obtained when necessary.** In each case in our random sample where informal bids were required, staff members contacted vendors for informal bids. However, in one third of the purchases tested, one or more of the contacted vendors did not provide bids. Staff members placing these orders did not continue to seek bids until they received three bids. In our random sample of fiscal year 1995 purchase orders, 148 items should have received three informal bids. Only 99 (67 percent) of these purchase orders actually received bids from three vendors (one of whom was successful). On 16 (11 percent) of the orders, both of the other vendors contacted had chosen not to submit a bid; on 33 (22 percent) of the orders, one of the vendors contacted did not provide a bid.
- **Vendors who had consistently chosen not to provide bids in the past were asked for informal bids anyway.** We contacted 15 bidders who were not awarded purchase orders to determine whether they had been asked for

bids on specific items. In one case a vendor stated that he had not done business with TDCJ since 1993, but is still being called for bids.

- **Specifications for some bids appear to be too specific.** For example, carpeting was ordered from a Huntsville merchant for use in Big Springs. The emergency justification letter indicated that the carpet was needed to cover an asphalt floor to avoid having to perform asbestos removal procedures. However, the specifications were very specific in terms of color and brand names. In addition, the successful bidder was a Huntsville vendor that had received orders from TDCJ in the past. The unsuccessful bidders (both HUBs) were in the Valley and in Houston. We found that there were numerous HUB vendors for carpeting in the Big Springs area, and these vendors were not given the opportunity to submit bids.

Purchases have been divided (or “split”) to avoid competitive bidding requirements. We found examples of “split” purchases in the Facilities Department, the Transportation Department, the Food Services and Laundry Department, and in several of the Texas Correctional Industries factories. We considered a purchase to be

“split” only when identical items were ordered on separate purchase orders on the same or very close dates by the same department from the same vendor, and when each of the resulting purchase orders was just under the dollar threshold that requires competitive bidding. This is a stringent definition—for example, we did not consider it to be a “split” purchase if “upper housings” and “lower housings” were ordered on separate purchase orders. Even so, we found examples of “splits” in many different departments.

Bids are not required for individual purchases of less than \$1,000, and only informal bids are required for bids less than \$5,000. However, purchasers have split orders to come in under these thresholds. For example:

Figure 5

Purchases of Item No. 58097			
Order Date	Units ordered		Purchase order total (includes other items)
	Number	Price	
Sept. 8	30	\$ 772.20	\$ 873.14
Sept. 8	20	\$ 514.80	\$ 897.33
Sept. 8	10	\$ 257.40	\$ 873.71
Sept. 27	35	\$ 900.90	\$ 904.22
Total	95	\$ 2,445.30	

- We reviewed 25 separate purchase orders issued between September 8 and September 27, 1995, by the Food Services and Laundry Department to one vendor for barber shop supplies. We found eight separate items that had been ordered on more than one purchase order. For example, 95 units of item number 58097 (armature assemblies) were ordered on four different purchase orders within two weeks. (See Figure 5.) None of these purchase orders exceeded the \$1,000 threshold that triggered the need for competitive bidding. If all 95 units had been ordered at the same time, the resulting order would have required competitive informal bids.

- We also reviewed four purchase orders placed between October 25 and November 1, 1995, for a total of 176 sets of clippers. Each purchase order was for just under \$5,000, the threshold figure that triggers the need for formal bidding. All four orders were shipped by the vendor on the same date. If these four orders had been combined, the total for the 176 sets would have been required to be competitively bid on the open market.
- The Facilities Department ordered eight sheets of Lexan plastic from the same vendor on two separate purchase orders, one dated March 25, 1996, and the other dated March 26, 1996. Each purchase order came to \$999.96, just below the \$1000 threshold.

When purchases are divided, TDCJ not only loses the assurance that competitive bidding will provide a good price for the item, but also incurs the risk that some vendors may receive preferential treatment. Splitting purchases to avoid bidding requirements is prohibited by Government Code, Subchapter C, Section 2155.132(f).

Emergency purchases have sometimes been used as a substitute for adequate planning. Bidding requirements are much less stringent for emergency purchase

orders than for other types of purchases. In some instances, TDCJ has paid more for items purchased as an emergency than it would have had the items been purchased competitively. For example, during the first part of fiscal year 1996, TDCJ awarded four separate emergency purchase orders totaling almost \$280,000 to one vendor for razor blades. The

Figure 6

If purchased at this price . . .	4.5 million blades would cost . . .	Price paid to selected vendor (\$0.0625 each)	Loss
\$0.054 each (as awarded for March 1996 to August 1996 open market purchase order)	\$ 242,892	\$ 279,563	\$ 36,571
\$0.059 each (as offered by one vendor, for shipment in three to four weeks)	\$ 265,382	\$ 279,563	\$ 14,181
\$0.0615 each (as offered by another vendor, for shipment on the following day)	\$ 276,627	\$ 279,563	\$ 2,936

justifications for these purchases varied from the vendor being able to ship the razor blades on the same day the order was received (even though TDCJ had a three month supply of razor blades on hand) to this vendor being “low bidder” (even though other vendors contacted did not provide bid information). By using this particular vendor for these four purchases, TDCJ spent as much as \$36,000 more than it would have had other vendors been used. This savings could have supplied the entire prison system with razor blades for more than a full month. (See Figure 6.)

By using “blanket” justifications for purchases exempt from formal competition, TDCJ has diminished the effectiveness of the justification process. Emergency

purchases require a justification letter that states the reason for the purchase, what damage will occur if the purchase is not made immediately, and why the emergency was not anticipated. Direct purchases also require a justification letter that explains why the use of this purchasing exemption is economically advantageous to the agency. These justifications could serve as a control that would at least ensure that each purchase was authorized. However, at TDCJ, these justification letters do not always refer to a single purchase, or even a certain number of purchases. Instead, there may be several purchases which use the same justification letter. For example:

- One justification letter that was attached to at least 12 emergency purchase orders reviewed stated, “The material for the following projects should be emergency purchased in order to provide a riot resistant environment ASAP.” The 12 purchase orders totaled \$185,000; there is no way to know how many other purchase orders this justification letter was attached to, or if it was inappropriately attached to purchases that had nothing to do with these projects.
- The direct purchase of approximately \$370,000 in farm equipment to farm 1,600 acres in Dalhart received a single decision memorandum authorizing the multiple purchases. One of the items on the list was four tractors, totaling an estimated \$240,000. However, this memo did not document the expected price for each tractor. At least two tractors were purchased under this memo, one for \$82,000 and another for \$76,500. Therefore, two thirds of the money was used but only half of the tractors were purchased. Without a clear decision memorandum, there is no way to know what purchases were authorized.
- The Agriculture Department traditionally receives only one decision memorandum per year for each type of direct purchase and uses that authorization for multiple purchases. For example, the decision memo attached to a direct purchase order for swine stated that it was for three purchases of up to 96 boars and 70 gilts, with an expected total expenditure of approximately \$91,600. Although there is no way to systematically tie this decision memorandum to specific purchases, the Agriculture Department was able to identify 20 separate purchases that used it. (These 20 purchase orders did not exceed the authorized amount.) Although the departmental budget analyst stated that the expenditures did not exceed the authorized limit, this could not be verified because the purchases were not tied to the authorization.

Section 1-C:

Information to Manage Purchases Has Been Unavailable or Inaccurate

At TDCJ, information is not developed or used internally, and has not always been reported to external users accurately. A primary control to ensure that purchasing works well is the development and use of information. Looking at differences between one year and another, and one unit and another, can help identify potential problems, abuses, or even areas that are working well.

TDCJ has little information available internally to manage purchasing. As noted in Figure 4 (pages 11-12), TDCJ has not collected certain kinds of information. For example:

- TDCJ had no information on the number or types of purchases made in fiscal year 1995 or 1996. In order to test purchases, we had to develop estimates of these figures. We were unable to develop an accurate count of delegated purchase orders or an accurate assessment of the associated dollars. As a result, the total number and amount of purchase orders cited in this report are only estimates.

Figure 7

Direct Purchases in Fiscal Year 1995		
	Number of Direct Purchases	Dollars in Direct Purchases
On the Direct Purchase Log	173	\$2.5 Million
Added by TDCJ after manual count	155	\$10.4 Million
Revised Total	328	\$12.9 Million

- To calculate the number of direct and emergency purchases, TDCJ had to pull files and count these purchases manually. The logs of such purchases kept in the Purchasing Department are not accurate, and it is not unusual for these types of purchases to be made without adding them to the log. For example, the direct purchase log for fiscal year 1995 only listed 173 purchase orders, for a total of about \$2.5 million. TDCJ's subsequent estimates, after a manual count, included 155 more purchases, at an additional \$10.4 million. (See Figure 7.)

TDCJ is now developing a new system for purchasing. To ensure that this system addresses past weaknesses, TDCJ will need to develop baseline information about the numbers and types of past purchases.

TDCJ has also submitted inaccurate information to the Legislature and other external users. Semiannually, state agencies report each non-resident bidder to whom the agency has awarded contracts of more than \$25,000 [as required by Government Code, Article 601(b), Section 2152.064(b)]. The *Report on Purchases with Non-Resident Bidders for \$25,000 or More* covering July through December 1995 included material misstatements. For example, \$18,794,471 was erroneously included in the report, and another \$83,216,397 was omitted but should have been included. In

preparing this report, TDCJ listed payments made instead of obligations incurred. For example, the report stated that one contract with VitaPro was valued at \$501,561. However, the purchase order was for more than \$33.7 million. \$501,561 was the amount paid to the vendor by TDCJ during this period—not the amount of the contract.

TDCJ has now corrected its process for preparing this report and has also corrected past reports to ensure accurate information is available on non-resident contracts.

In addition, we were unable to determine whether the annual report on purchases of recycled materials has been submitted as required by Texas Government Code, Article 601(b). The two receiving agencies contacted had no record of having received this report from TDCJ.

Information that will be available through the new purchasing system will make it possible for TDCJ to start monitoring the purchasing process, but the automated system will not require that analysis or monitoring occur. In our May 1993 report, *Tough Choices: Finding Ways to Balance Criminal Justice Policy and Criminal Justice Dollars—A Review of Management Controls at the Texas Department of Criminal Justice*, SAO Report No. 93-124, we noted that TDCJ's accounting system would also provide an opportunity to develop and analyze management information, but no such analysis occurred.

Recommendations:

To ensure that TDCJ complies with purchasing requirements, it must improve both its system of internal controls and its oversight of purchases. Specifically:

- Management should prepare a TDCJ policy and procedure manual for the Purchasing Department. In addition, there should be a process for reviewing and keeping procedures up to date. Management should:
 - Define every class of purchase order (consistent with GSC guidelines) and define the appropriate application for each class of purchase.
 - Develop procedures for processing each type of order with flow charts which detail processes and controls.
 - Distribute this manual to all individuals with purchasing authority.
- Divisions and units should be responsible for identifying purchasing needs.
 - Documentation of planning and justification for requisition should be completed and approved at the division level, including budget review and adjustment.

- The division or unit should complete a requisition with appropriate signatures.
- A minimum threshold should be considered for approval by the Executive Director or his/her designee (except when specifically required by statute, as in the case of proprietary purchases).
- Procurement should be restricted to the Purchasing Department. Purchases of all divisions and departments should be processed by the Purchasing Department. Once users identify their needs, the Purchasing Department should confirm that the item is not available from TDCJ's warehouses, and if necessary, determine how to procure the goods to meet the users' needs and comply with purchasing rules and statutes.
- To ensure that purchasers have adequate training:
 - Management should continue its policy of training purchasers and encouraging certification by the National Institute of Governmental Purchasers (NIGP).
 - Management should give greater emphasis to the amount of purchaser training offered by the GSC and specialized training specific to TDCJ.
 - Management should enhance training on how to work with users to write competitive specifications to meet their needs.
 - Users should be trained on how and when to requisition goods and services, including how to estimate lead times.
- Exemptions from competition should be granted on a case-by-case basis.
- Management should develop and implement a single information system that includes all TDCJ divisions, and which will provide timely, reliable, and useful information. This information should be used to analyze and review purchasing operations. For example, the system should be capable of:
 - Preparing trend analyses of numbers and types of orders (such as direct orders, emergency orders, open purchase orders, orders of specific commodities, and orders by vendor)
 - Comparing units or facilities
 - Determining the status of encumbrances against open purchase orders

- Generating external reports to the GSC, the Legislature, and other users
- The Purchasing Department should develop an internal monitoring system. Trained personnel should perform periodic, risk-based reviews of purchases and review a checklist of compliance issues. Purchasers making noncomplying purchases should be counseled as to the proper methodology; recurrent errors should be dealt with appropriately.

Section 2:

CJAD's Contract Administration Has Not Ensured That State Funds Are Spent Effectively or Efficiently

The Community Justice Assistance Division's (CJAD) system of contract administration has not ensured that local Community Supervision and Corrections Departments (CSCD) spend state dollars efficiently or on programs that reduce recidivism. \$132 million of state funds is allocated based on self-reported data. We found errors in this data at three of five CSCDs visited (with error rates up to 9 percent). Another \$97 million is allocated based on historical distributions. This process does not consider past performance or program efficiency. In addition, CJAD has not ensured state funds are protected by strong contracts and has not adequately monitored CSCDs' use of funds or program effectiveness.

Compensating controls at the CSCD level (such as County Auditor Departments' processing of and accounting for CSCD funds) have reduced the risk of fraud and misuse of state funds at the CSCD level. However, we also found that CSCDs lack sufficient controls over how subcontractors spend state funds or ensure quality program delivery. CJAD has not provided guidance to CSCDs that would ensure good contracts or effective oversight of contractors. CSCDs budgeted approximately \$36 million to be spent on subcontractors in fiscal year 1995.

Our work at CJAD included a review of contract administration at both the state and local levels. CJAD provides financial and technical assistance to local probation departments. In turn, the local probation departments, or CSCDs, actually supervise probationers and provide a range of community-based programs such as substance abuse treatment, job training, and education assistance. These programs are either provided directly by the CSCD or by CSCD subcontractors.

CSCDs are neither wholly state nor county agencies, but instead are managed by a panel of local judges. As a result, local probation departments must be responsive to the judiciary as well as to the State. This structure puts the Community Justice Assistance Division in a unique position. While it provides funds and approves local plans and programs, it has not historically included enforcement in its role. Thus, to fully implement some of this section's recommendations, CJAD will need to reevaluate its role in terms of ensuring accountability of state funds spent on community corrections.

Section 2-A:

Weaknesses in CJAD's Funding Allocation Methods and Program Approval Process Prevent it From Ensuring Funds Are Distributed Equitably or Are Awarded to the Most Effective Programs

The methods used by CJAD to annually allocate approximately \$230 million of state funds to CSCDs cannot ensure that funds are distributed equitably or are spent on programs that reduce recidivism. Funds are distributed differently for each of CJAD's appropriation line items. (See text box below.)

\$132 million of state funds is allocated based on formulas. Source data for the funding allocation formulas is self-reported and has not been verified or tested. We found errors in the numbers reported at three of the five CSCDs reviewed. Errors in these reported numbers mean that funds have not been distributed appropriately. Our random sample revealed over-reporting of the number of probationers on direct supervision by as much as nine percent.

Allocating State Funds for Community Corrections

CJAD provides funds to any CSCD which has an approved community justice plan and is in compliance with CJAD standards. CJAD distributes state funds from three appropriation line items.

Two appropriation line items (basic supervision and community corrections) are allocated using funding formulas. CSCDs receive fixed amounts of funds from these line items. In fiscal year 1995, these appropriations totaled approximately \$132 million.

One line item (diversion target) is distributed through a grant review process. Payment amounts are set by an approved grant budget. In fiscal year 1995, this line item was approximately \$97 million.

\$97 million of additional state funds is allocated based on CJAD's review of program proposals. Diversion target funds are awarded to CSCDs based on grant applications. While CJAD reports awarding these grants "competitively," actual allocations are generally determined based only on past funding levels. As a result:

- Program results are not considered.
- Expenditure levels approved in prior years are reapproved, regardless of program efficiency.
- New programs are not funded.

All funds are subject to CJAD's review and acceptance of CSCDs' proposed budgets. This budget review process is not designed to ensure that proposed expenses are reasonable and necessary or that programs are effective. Instead, budget reviews tend to focus on ensuring expense information is properly classified and reported. Also, because CJAD has not developed minimum program standards for some programs, it does not have criteria against which to measure proposed programs or assist in assessing the reasonableness of proposed expenditures (including staffing patterns, etc.).

For example, one CSCD requested \$2.59 million of grant funding to build a new restitution center. CJAD reviewed supporting documentation that included the following line items:

- \$2.1 million for “Design and Construction of New Facility”
- \$150,000 for “Sewer and Water Construction for New Facility”
- \$3,000 for “Program Consulting”
- \$1,000 for “Fuel”

Because there was insufficient detail to support these figures, CJAD had no way to determine whether items specified by the CSCD were reasonable and necessary for constructing the new center. Nevertheless, the amounts were all approved as proposed.

In addition, CJAD has not developed guidelines to ensure CSCD subcontractors are objectively selected or that amounts paid to subcontractors are reasonable. Approximately \$36 million of the funds allocated to CSCDs were planned to be spent by CSCDs on subcontractors in fiscal year 1995. CJAD does not review subcontractors’ proposed costs or necessarily even know with whom CSCDs subcontract.

CJAD relies on the CSCDs to ensure the best value for any dollars spent on subcontractors. The Local Government Code identifies CSCDs as specialized local entities which must purchase items in accordance with the same procedures applicable to a county and sets dollar limits above which some purchases should be competitively bid. Professional services are exempt from this requirement as are purchases for which the commissioner’s court grants an exemption. So, although CSCDs are not required to competitively bid purchased services, they should still have some mechanism to ensure the best provider is objectively selected and that the price paid is reasonable.

However, none of the five CSCDs reviewed used competitive bidding to select providers of purchased services. (Some CSCDs did competitively award contracts for electronic monitoring, urinalysis testing, linen services, and computer hardware maintenance.) Instead, providers were typically selected based on CSCD managements’ knowledge of the provider. Quite often, CSCDs believed certain providers to be the only ones capable of supplying a given service. None of the CSCDs reviewed issued requests for proposals to ensure that no other potential vendors existed. In addition, once contracts were in place, we found that CSCDs typically renewed these contracts (unless funds were no longer available).

None of the CSCDs reviewed had good systems to assess providers’ rates. Rates were typically set based only on providers’ proposals or the amount of funds available to the CSCD with which to contract for services. As a result, CSCDs cannot determine if contract rates reasonably align with the cost of providing services. When contracts cannot or are not awarded competitively, CSCDs should use alternative mechanisms to ensure that the rate paid to the selected providers is reasonable.

CJAD Does Not Have Contracts With the CSCDs and Does Not Ensure That CSCD Subcontracts Adequately Protect State Funds From Waste or Abuse

CJAD Standards for CSCD Contracts

Beginning in fiscal year 1996, CJAD Financial Management Standards require that CSCDs' contracts include the following:

- If the contract is not competitively bid, a statement that the value of the contract is less than \$15,000 or that the purchase is exempt from competitive bidding requirements
- Specification that the CSCD is a political entity of the judicial district
- Cost breakdown per offender (or statement why such as cost breakdown is not possible)
- Clause requiring vendor to provide itemized invoice before payment will be made
- If contract is for direct client services, a clause specifying the vendor's responsibility to comply with provisions of Senate Bill 959 regarding the implementation and adoption of HIV guidelines
- Provision allowing TDCJ-CJAD and/or funding recipient to audit the vendor
- Statement that employees of CSCD may not receive privileges, gifts, or favors from vendor and vendor may not make any payments to employees of CSCD
- Statement that venue will be the primary county of the judicial district
- Provision that the contract shall be governed by and in accordance with Texas laws

In addition:

- All parties to the contract must be identified.
- All services must be clearly identified.
- The contract should end with signature line binding all parties to the contract.
- Contracts greater than \$25,000 must comply with the McGregor Act.
- No funds may be expended on a contract which has been awarded to an individual or company that also served as a consultant for the development of the program.

For fiscal year 1995, some of these requirements were mandated by various CJAD memos, but were not specifically stated in the standards.

CJAD does not have and does not require CSCDs to have contracts which adequately protect state funds from the risk of financial loss.

CJAD's current combination of community justice plans, notice of grant awards, and financial standards are not adequate to hold CSCDs programmatically accountable. In addition, CJAD has not set adequate minimum standards for CSCDs' subcontracts.

The relationship between CJAD and the CSCDs is not contractual; it is defined by statute. CSCDs must submit an approved community justice plan to be eligible to receive CJAD funding. In addition, CJAD has developed minimum financial and operating standards to guide CSCDs' use of state funds. However, even taken together, these items do not include all provisions necessary to hold CSCDs accountable for the use of state funds. For example:

- Community justice plans' descriptions of programs are broad. These plans are designed to include all programs a particular CSCD wants to offer, not just the programs they can financially or realistically offer. CJAD does not require CSCDs to operate programs according to the proposal. Therefore, even if the program proposal were more detailed, the

CSCD could use the program's funds to operate the program in any manner it wished.

- Program plans are required to include outcome and output measures. CJAD briefly reviews proposed output and outcome measures included in the plans for appropriateness, but does not ensure consistency among similar programs. Moreover, CJAD does not compare actual and proposed performance results at the end of the fiscal year.

CJAD has set some basic standards for CSCDs to follow when drafting contracts with service providers, but these standards are insufficient to ensure that CSCD contracts will adequately protect state dollars from waste or misuse. (See text box on page 24 listing CJAD's standards for CSCD contracts.) For example, standards do not require CSCD contracts to include performance measures or provisions for financial audits, recovery of misspent funds, contract modification, or contract close-out.

None of the contracts reviewed at the CSCD level included all of the CJAD-required provisions, and all left the CSCD open to some degree of risk. For instance, one CSCD reviewed had 13 contracts and leases, and every contract was deficient in some way:

- None had statements that the contract was less than \$15,000 or was exempted from competitive bidding procedures.
- Four did not clearly identify the services to be provided.
- Eight did not include a provision specifically allowing TDCJ-CJAD and/or funding recipient to audit the vendor.
- One contract did not have the CJAD-required provision which prevents providers from spending funds on a contract which has been awarded to an individual or company that also served as a consultant for the development of the program. The CSCD has a contract for substance abuse treatment services with a provider who then subcontracts with the individual who developed the program. This individual received over \$25,000 during the first three months of 1996, and over \$251,000 during 1995 from the provider. The CSCD's contract with the provider does not include the CJAD-required provision, and therefore, does not prohibit this type of relationship.
- Five contracts were unsigned, or the signed contracts were not on file at the CSCD. In addition, we found one contract that was signed by a provider employee but was between the CSCD and an outside vendor (that is, the contract was not signed by the CSCD, but only by the subcontracted provider and the vendor).

CJAD standards also require that certain CSCD contracts be reviewed by CJAD prior to being awarded. Only the following contracts require CJAD approval:

- Leases of building space
- Contracts for construction and/or renovation
- Any contract in which the term exceeds one year or is for an indefinite period of time

As a result, not all contracts are subject to CJAD's review. CJAD does not have a system in place to ensure that it reviews required contracts. During our reviews of CSCDs, we found contracts which should have been reviewed by CJAD but were not. For example, at one CSCD 3 of the 12 contracts and leases in place were subject to CJAD approval, but only 2 received it. At another, 5 of the 13 contracts and leases should have been approved by CJAD, but only 3 were submitted for approval. We also found some contracts that had been approved by CJAD, but did not have all provisions required by CJAD.

Section 2-C:

Oversight of CSCDs and Their Subcontractors Has Been Ineffective

CJAD's oversight of the CSCDs has been insufficient to ensure program and fiscal accountability. CJAD's past reviews focused mainly on compliance with probation officer certification, continuing education requirements, and case management standards. There were no reviews of program efficiency or effectiveness. In addition, CJAD has not provided guidance to CSCDs to ensure the effectiveness of their oversight of subcontractors.

CJAD Monitoring - CJAD basically stopped monitoring CSCDs between June 1994 and December 1995. During this 18-month period, only six field visits were conducted, and two of these visits were limited to providing technical assistance. Moreover, programs which had come to CJAD management's attention as high-risk for fraud or misappropriation of funds during this period were not monitored.

Beginning in December 1995, CJAD resumed field audits, but most of the planned visits address only basic compliance issues. CJAD is in the process of developing a new outcome-based performance evaluation system, and some of the planned reviews will collect information for this effort. However, reductions to the program's scope (such as elimination of plans for efficiency reviews) make it unlikely that these reviews will accomplish their intended objectives.

In addition to the reviews conducted by CJAD, CJAD requires CSCDs to have an annual independent audit. These audits are intended to ensure that:

- CJAD financial standards, which define allowable and unallowable costs, are followed
- Refunds are identified and returned
- Internal controls are sufficient
- Accounting systems are capable of accurately reporting financial transactions

However, the timing of these audits does not allow CJAD to review the reports in time to affect funding decisions. For example, at the beginning of each biennium, CJAD approves CSCD budgets for two years. So funding decisions for fiscal years 1996-1997 were made before audit reports were fully reviewed. As of February of this year, the fiscal year 1994 reports had not been reviewed although the fiscal year 1995 reports were due the next month.

Additionally, problems identified and reported in these audits are not tracked to ensure resolution or to affect the level and frequency of division monitoring. The independent audits are designed only to determine whether the CSCD accurately reported the use of state funds, not whether the funds were used appropriately.

TDCJ's Internal Audit Department recently reviewed the quality of CJAD's audit review process. Their review questioned CJAD's ability to ensure that independent CPAs provided quality work and provided recommendations to improve the usefulness of this process. In our review of five CSCDs, we found numerous instances of misclassification of expenditures, internal control weaknesses, and other problems such as billing inaccuracies. For example:

- At one CSCD's substance abuse treatment center, over-the-counter medications were sold to clients at a fixed price instead of at cost (as currently required by CJAD financial standards).
- One CSCD did not routinely verify the accuracy of all billings. Services provided by the county to the CSCD were billed directly to the County Auditor. The CSCD did not review and approve these bills prior to payment. In addition, other bills for services such as drug tests and psychological counseling were not verified to ensure that the CSCD was not over-billed for these services.
- One CSCD did not identify fixed assets purchased with state funds separate from fixed assets purchased with county funds. As a result, the CSCD will not easily be able to identify whether the proceeds from the sale of obsolete assets should be considered state or county revenue.
- One CSCD's contracts with psychologists includes a provision requiring the CSCD to pay 10 percent of the amount billed for no-show patients. While the CSCD's management interpreted this to mean that only 10 percent of the total that would have been collected for no-show patients was to be paid, the County Auditor's Office actually paid 10 percent of the total bill to compensate the psychologist for no-show patients. (Bills were approved by CSCD staff prior to payment.) As a result, we found instances where psychologists actually received more compensation for no-show patients than they would have if all of these patients had arrived for their appointments.

We also found a few instances in which CSCDs made expenditures specifically disallowed by CJAD's financial standards. For example:

- CJAD requires all expenditures to be fully supported by documentation to support the expense. Although not pervasive, at one CSCD we found over \$4,200 of travel expenditures for which there was not adequate documentation.
- CJAD standards also require that furniture items to be purchased with state funds be approved by CJAD prior to purchase. One CSCD purchased \$5,700 of furniture without such approval.

CSCD Monitoring - CJAD has not developed minimum standards for CSCD monitoring of providers. None of the CSCDs reviewed had a formal system for ensuring that subcontractors provided the quality of purchased contract services contracted for in the most efficient manner. CSCDs typically rely on probation officers and probationers for feedback on the quality of services, but the CSCDs reviewed did not actively solicit this information.

CJAD also does not require that CSCDs hold their subcontractors to the same financial standards the CSCDs are required to follow (that is, CJAD does not require CSCD contracts limit subcontractors' expenditures to the allowable cost categories CSCDs are limited to). As a result, our review of five CSCD subcontractors found numerous examples of expenditures that were unreasonable, unnecessary, or unsupported. The subcontractors reviewed spent approximately \$13 million on services to probationers. Our review included only a small sample of transactions from various expenditure accounts (such as travel or advertising expenses). Using this methodology, questionable costs at the five providers reviewed totaled approximately \$299,000. Examples of questionable expenditures include:

- **Related Party Transactions** - At one provider, the executive director and chief financial officer are married to each other and are officers in a company that leased office space to the provider. This same provider leases additional building space from one of its counselors. The provider has not disclosed these relationships to the CSCD or included them in its financial statements. At this same provider, a facility director hired his brother for some construction work without obtaining bids to ensure the reasonableness of the \$1,470 expense.
- **Double Billing** - One provider bills both the Texas Commission on Alcohol and Drug Abuse and the CSCD (or sometimes the County and the CSCD) for services provided to probationers. Neither funding source calculated its unit rate using cost-based data or knew specifically what services the other was paying for. Therefore, neither agency can determine if they are paying the provider for services already paid for. (We also found one instance of triple-billing at this provider.)
- **High-Dollar Management Fees** - Two non-profit providers paid a parent/management company up to 13 percent of revenues for financial, legal, and other management services. While we did not review the specific expenditures of the parent/management company, we did find:

- One parent company used these revenues to pay for lobbying activities and billed the provider for many of the expenses that appear to be associated with providing services called for in the management agreement (expenses such as travel to review programs, legal fees, etc.). Fiscal year 1995 expenses, in addition to the 13 percent of revenue charged as management fees, totaled over \$13,500. This provider is no longer associated with its parent company and is seeking reimbursement of some of its management fees and other expenses.
- Another provider paid over \$250,000 per year for management services to the consultant who helped establish the program and obtain the contract with the CSCD. This provider would not give copies of the management agreement to either us or the CSCD, and therefore, we were unable to determine the reasonableness of many of the consultant's billing and related expenses.
- **Use of State Funds for Purposes Typically Disallowed by State Statutes -** Providers used contract funds to pay for staff parties and other entertainment, flowers, donations to charities or other associations, and travel reimbursements above state rates. For example, providers spent:
 - \$1,200 to frame prints which were given to judges as Christmas presents
 - \$1,000 for a donation to the National Foundation for Women Legislators
 - \$176 for dinner between provider board members/management and various public officials
 - \$337 for flowers for employees
 - \$620 for coffee services
- **Unreasonable Expenditures -** (expenses incurred which are not reasonable and necessary for implementing the contracted program)
 - One provider paid over \$2,600 in legal fees for resolution of Occupational Safety and Health Administration (OSHA) violations. (Contracts require compliance with applicable statutes including OSHA. Therefore, contract funds should not be used for fines resulting from noncompliance.) The same provider paid an additional \$2,000 as an OSHA settlement to an individual; we could not find evidence to show that this person was either a former or current employee.
 - One provider charged its CSCD contract program for over \$7,400 of expenses incurred for other programs.

- One provider paid over \$2,100 in property taxes, although the provider was non-profit and should have been exempt from paying these taxes.

Because none of the CSCDs' contracts specifically allow recovery of these types of expenditures, neither CJAD nor the CSCD has clear recourse to recover these funds.

Recommendations:

To better ensure state funds are spent appropriately and on effective programs, CJAD must improve its methods for allocating state funds, its contracts with CSCDs, and its monitoring of CSCDs' use of state funds and program effectiveness. CJAD also must provide more assistance to CSCDs in developing good processes for selecting subcontractors, setting rates, developing contracts, and ensuring the delivery of quality services. Specifically:

Selection/Rate-Setting

- Grant funds should be distributed based on criteria such as a CSCD's past performance or demonstrated need for the service within the geographic area, not on historical distributions. Proposed costs should be analyzed for reasonableness and should be compared to other CSCDs' costs for providing similar services.
- Data for funding formulas should be verified. In its monitoring, CJAD should review the processes used by CSCDs to collect and calculate reported data. Once CSCDs have good processes in place, CJAD's review should be limited to testing data to ensure its continued accuracy.
- Minimum program standards for residential requirements should be developed to aid in the analysis of costs and to ensure that similar programs provide a minimum level of services to all clients.
- CJAD should consider developing ceiling rates for different purchased services. Rates should be based on the reasonable and necessary costs of providing services and should consider any geographical differences in salaries, utility costs, or other expenses. The methodology for developing such rates should be developed in conjunction with CSCDs, well documented, and periodically updated.
- CJAD should provide CSCDs assistance in developing good methodologies for analyzing the reasonableness of providers' proposed costs.

Contracts

- CJAD should strengthen its agreements with CSCDs. Plans (or other documents intended to define services to be delivered and the results of those services) should clearly define the services CSCDs are to provide and should also clearly define the outcomes of those services. Proposed outcomes should be compared to actual results and assistance should be given to help those CSCDs that do not meet their goals improve.
- CJAD should develop standard contracts for CSCDs to use when subcontracting. CSCDs should be allowed to tailor these contracts to fit their needs and the specifics of the contracted services.
- CJAD should develop a process to review CSCD subcontracts to ensure they include necessary (and mandated) clauses. Such a review should be designed to ensure that CJAD's review does not interfere with CSCDs' time frames for awarding the contracts. On the other hand, CSCDs must submit contracts to CJAD to allow sufficient time for review prior to contract award. Standard contracts would shorten the time frames (and, perhaps eventually, necessity) of this review.

Monitoring

- Field Services staff should use a risk-based approach to select CSCDs for review and to determine procedures to conduct during visits. Possible areas of review should include:
 - The CSCD's process for accumulating and reporting statistical information to CJAD, such as the number of probationers on direct supervision and performance measures data
 - The resolution of internal control weaknesses identified in independent audits or past CJAD reviews
 - How the CSCD selects and negotiates rates with subcontractors
 - How well CSCD contracts protect state funds from fraud or misuse
 - How the CSCD ensures quality services from subcontractors
 - How the CSCD determines its success in delivering quality services

Risk factors to consider in selecting CSCDs for review can include:

- Program success rates (according to program performance measures included in the community justice plan and according to residential/non-residential discharge data)
- Level of state funds carried over from prior years
- Level of collections from community supervision payments
- Dollar amount and type of contracted services or professional fees
- Percentage of funds spent on facilities/utilities/equipment or supplies
- State dollars per felon or probationer

- State dollars excluding grant residential projects per felon or probationer
 - Percentage of revenue from “other revenue”
 - Results of previous CJAD and independent auditor reviews
 - Length of time since last CJAD review
 - How long programs have been in operation
- Field Services staff should conduct field audits and document both their analysis and results so that deficiencies can be tracked and corrective action monitored.

In addition, CJAD should consider developing an integrated management system to enable staff to better analyze and compare proposed program components, budgets, reported expenditures, program results, etc.

Section 3:

CJAD's Administration of the *Treatment Alternatives to Incarceration Program* Has Not Ensured State Funds Are Used Effectively

Management of the *Treatment Alternatives to Incarceration Program (TAIP)* has not ensured that contracting dollars are maximized or spent on the most effective, efficient programs. While CJAD’s management controls over *TAIP* are stronger than controls over other CJAD programs, weaknesses in CJAD’s request for proposals (RFP) process and the absence of sound methodologies to determine fair and reasonable contract rates prevent CJAD from ensuring it funds the best programs or objectively selects contractors. In addition, weaknesses in CJAD’s contracts and a lack of oversight increase the risk that providers cannot be held programmatically or fiscally accountable.

TAIP was previously administered by the Texas Commission on Alcohol and Drug Abuse (TCADA). Effective September 1, 1995, oversight responsibilities transferred to TDCJ-CJAD. CJAD issued a request for proposals in September 1995 but did not have a full-time program manager until January 1996. The TCADA contracts and rates were extended for the first quarter of fiscal year 1996 to allow CJAD time to select *TAIP* programs, determine funding allocations, and award new contracts.

TAIP is a program to screen and assess offenders for substance abuse, and then to refer them to treatment. For fiscal year 1996, CJAD distributed \$9.8 million of *TAIP* funds to CSCDs for *TAIP*-related salaries, travel, supplies, and treatment services. CSCDs typically subcontract with community-based providers for outpatient counseling and residential substance abuse services.

Section 3-A:

Weaknesses in CJAD's *TAIP* RFP Prevent it from Ensuring the Best Programs Were Funded

The RFP process used to select CSCDs for *TAIP* contract awards did not provide adequate assurance that the most qualified contractors were fairly and objectively selected. CJAD used an RFP to determine which CSCDs would receive a contract, but not to determine the amount of each contract. Weaknesses in this process severely limited its effectiveness and prevented CJAD from ensuring that the most effective programs were objectively selected.

CJAD's RFP for *TAIP* outlined the criteria to be used in reviewing proposals, and CJAD used a point system to evaluate these criteria. However, the point distribution for the various criteria may not have been appropriate to ensure that the best program was selected. For example, the allocation did not adequately address the effectiveness or efficiency of proposed services:

- The "program description" criteria had a total point distribution of 15 points. This category included such information as program capacity, community support, and follow-up procedures. On the other hand, "program process/implementation" was allocated only 10 points. This category appears to be more important to a program's success than the "program description" criteria.
- The "budget" criteria (which includes such information as cost of services, cost effectiveness, and cost of treatment) received only 5 points. While cost should not be the only criterion used in selecting proposals, the quality and effectiveness of services must be weighed according to their cost. Without adequately considering cost, CJAD does not have adequate assurance that the most cost-effective proposal was selected.

In addition, during our review of rejected proposals, we noted that the proposal review forms completed by the staff reviewers were not complete or consistent. CJAD did not develop clear definitions of rating criteria. The lack of clear evaluation criteria, coupled with the lack of experience of the CJAD staff with this program, increases the risk that similar proposals were scored differently or that unqualified proposers were rated as qualified. For example:

- The "target population" section of one proposal was given a score of three of five points, but the only justification was that the proposal was "too broad." In the same proposal, the "program process/implementation" section was given a score of eight of ten points without any justification for the score.
- The reviewers' scores were not shown in a consistent manner on the review forms. Some reviewers listed their individual scores and the final score negotiated among the raters, while others only listed the negotiated scores.

The effectiveness of CJAD's RFP process was further limited by:

- The RFP issued by CJAD was in draft form, and had not been reviewed by staff experienced or trained in developing RFPs to ensure it included all information needed to select the best proposers for contract award.
- The RFP did not require proposers to analyze or submit detailed provider cost information to review the reasonableness of proposed unit rates.
- Some proposals were reevaluated after initial scoring based on a subjective review of final scores.

These conditions prevent CJAD from ensuring that the best contractors received *TAIP* funds.

In addition, our analysis of the scores for proposals that were accepted and funded compared to the scores for proposals that were rejected and not funded showed that CJAD went through the process of soliciting program proposals for *TAIP*, reviewing the proposals, and evaluating the proposals. However, CJAD did not necessarily use the scores as a basis for allocating funds to the CSCDs. For example, one CSCD received a review score of 30 points for its proposal and received *TAIP* funds. However, six other CSCDs all received a review score on their proposals of 30 or higher, but did not receive any *TAIP* funds.

Section 3-B:

The Amount of *TAIP* Funds Allocated to Successful Proposals Was Subjectively Determined

CJAD's allocation of *TAIP* funds to contractors/providers was a subjective process. Part of each CSCD's total *TAIP* allocation was determined by multiplying CJAD-developed unit rates for assessments and treatment services by the number of expected units of each service to be provided. However, the rate-setting methodology used by CJAD did not ensure that the *TAIP* rates reasonably aligned with providers' cost for service provision. In addition to this allocation, funds for expenses such as travel were allocated based on staff members' review of requested amounts. Again, the lack of criteria and analysis of these costs prevent CJAD from ensuring that final allocations were necessary and reasonable for providing *TAIP* services.

Once CJAD determined which CSCDs would receive *TAIP* funds (through its RFP process), it allocated available *TAIP* funds among successful CSCDs. Due to the limited amount of *TAIP* funds, CJAD had to reduce the total amount of CSCDs' requested expenditures. For example, one county requested \$7 million for its *TAIP* program, but CJAD had only \$8 million available to fund all counties' proposals (for the last three quarters of fiscal year 1996).

Determining *TAIP* Funding Amounts

CJAD's allocation of funds differed for large and small counties. To determine the amount of funds to be awarded to the large counties, CJAD calculated a 2 ½ year average of the monthly number of screening and assessments made by the six largest counties when TCADA administered the program. This average was multiplied by CJAD's new rates and totaled. Added to this amount was the cost of one coordinator's salary and other "reasonable" expenses associated with the coordinator's position (such as travel, training, supplies, etc.). Other administrative costs were evaluated on a case by case basis relative to the mission of the *TAIP*.

CJAD did not have historical figures for screening, assessments, and other administrative costs for the small counties. Therefore, CJAD used the projected outputs listed in the proposals for funding purposes. For example, one county's proposal projected that they would screen 200 people and provide 90 people with group/individual counseling. These figures were multiplied by the administrative cost rates established by CJAD to determine the amount of administrative costs to be funded.

CJAD allocated funds based on each CSCD's estimated workload, CJAD's calculated unit rates for service costs, and the staff's subjective review of other proposed expenses. (See the text box at left for a more detailed discussion of the allocation process.) Allocation percentages were also developed to divide funds between administrative, screening, and assessment expenditures, and treatment expenditures. Weaknesses in CJAD's rate-setting methodology, in the staff's method of reviewing other expenditures, and in the method used to determine the administrative cost caps/percentages prevent CJAD from ensuring each CSCD's funding allocation is reasonable for the services provided.

Rate Calculations - CJAD cannot ensure that its *TAIP* rates (which were used as ceilings) are reasonable because CJAD did not conduct any cost-based analysis in developing its rates. While there is no documentation on how CJAD's rates were determined, staff members report that rates were calculated considering:

- TCADA rates
- CJAD "continuation" rates
- CSCD proposed rates

None of the rates considered by CJAD had been developed by analyzing provider cost data. For example, the "continuation" rates, or extension rates, used by CJAD for the first quarter *TAIP* funding were based on rates developed by the Pardons and Parole Division (Parole) for similar services. However, because Parole did not routinely analyze detailed costs at the time, Parole's rates were largely based on provider proposed rates. In addition, the rates included in CSCDs' proposals were developed without obtaining true cost estimates from service providers. Therefore, there are no assurances that these rates reflect reasonable costs.

Review of Other Expenditure Types - The budget cuts made to expenditure line items, such as travel, professional fees, and equipment were subjective. There were no criteria or methodologies used to make these budget cuts. For example, one county requested \$4,800 for travel expenses, but received \$2,400. CJAD staff simply looked at how large the area or region was to determine the funding amount. There was no analysis of the number of trips planned or the need for these trips. In addition, this county requested \$700 for other professional fees, but received \$300. Finally, they requested \$750 for office supplies and received the total amount requested.

CJAD staff responsible for cutting budgets were not experienced or familiar with the *TAIP* program, and there was no one at CJAD who knew enough about the program to provide guidance or direction to the budget analysts in making the budget cuts. Consequently, staff did not know if they were cutting funds that were vital to the program.

Allocation Percentages - CJAD capped administrative, screening, and assessment costs at 20 percent of total costs (leaving 80 percent for treatment costs). However, there was no analysis conducted to determine if these allocation percentages were reasonable. The *TAIP* Advisory Committee felt that the objective of the program was to provide treatment. They considered a range from 16 to 32 percent for administrative and screening/assessment costs. However, the only analysis conducted prior to deciding the final allocation percentage was a comparison of six counties' budgets and the percentages of their screening/assessment budget to their total budget.

Section 3-C:

CJAD Does Not Have Formal Contracts for *TAIP* Services

CJAD does not have actual contracts with the CSCDs for *TAIP* services. *TAIP* allocations to CSCDs for administrative costs, such as the coordinator's salary, are governed by CJAD's grant award statement; approved *TAIP* budgets; *TAIP* standard conditions, guidelines, and policies for operation of *TAIP* budgets; and the financial management manual.

However, these standards, guidelines, and policies do not apply and are not required of funds paid to providers by the CSCDs. CJAD did develop a standard contract for CSCDs to use when contracting with providers for *TAIP* services. But this contract does not:

- Require regular contractor financial reporting
- Require an annual independent audit by a CPA
- Define reasonable and allowable expenses
- Include a provision for cost accounting
- Include a provision for outcome measures, only output or process measures
- Include a provision for contract modification or close-out provisions

In addition, the *TAIP* standard contract did not include all of the provisions CJAD requires other CSCD contracts with subcontractors to include. For example, the contract does not include a statement that the contract is either exempt from competitive bidding requirements or is less than \$15,000. (See Section 2-C for more information on CJAD's requirements for CSCD contracts.)

Section 3-D:

CJAD Is Beginning to Plan for Monitoring *TAIPs* and *TAIP* Providers

CJAD has not conducted any monitoring of *TAIP* programs and has not developed standards for CSCD oversight of providers. In April 1996, CJAD visited the majority of large providers to obtain basic information about services and practices in order to begin defining monitoring activities.

Some of the current plans and procedures for *TAIP* oversight include:

- The *TAIP* coordinator is to be responsible for verifying the billings from the provider. CJAD-*TAIP* personnel will verify a sample of the people receiving service against the CSCD files, provider files, probation officers files, etc. This verification will be conducted by contract monitors that CJAD will be hiring.
- *TAIP* policies and procedures state that the coordinator will be responsible for oversight of the referral process and must conduct on-site inspections of each treatment provider quarterly.
- The guidelines and policies for operation of *TAIP* budgets state that *TAIP* activities will be monitored monthly to ensure that treatment activities are in accordance with the approved budgets.

Recommendations:

To improve its contract management of *TAIP*, CJAD should:

- Refine its RFP process by:
 - Developing a point system for evaluating proposals to ensure that the best programs and contractors are selected. The points should be distributed so that the most relevant sections of the proposal receive the most weight or points.
 - Developing clear review criteria for the rating process conducted by staff reviewers so that they know what an effective program should consist of. The criteria developed should ensure consistency in the review process by the various reviewers.
 - Having the RFP reviewed by legal counsel prior to solicitation to ensure that all needed information is included.
 - Requiring CSCDs to either conduct a cost analysis of providers' rates or submit detailed cost information to CJAD in order to determine the reasonableness of proposed unit rates.

- Establish a rate-setting methodology based on the reasonable cost of providing services. As part of this methodology, CJAD should develop guidelines to aid budget analysts in making budget cuts for *TAIP*. In addition, budget analysts should receive training and information on *TAIP* prior to making budget cuts. An analysis should be conducted to determine the reasonable allocation percentages for *TAIP* funding of screening/assessment and treatment costs.
- Develop contracts or other mechanisms to ensure that CJAD can hold CSCDs programmatically and fiscally accountable for their use of *TAIP* funds.
- Revise the standard *TAIP* contract to include sufficient provisions (such as close-out, annual audits, etc.) to ensure the protection of state funds.
- Give providers a list or manual that defines and outlines, in detail, reasonable and allowable expenditures such as those provided in CJAD's Financial Management Manual.
- Develop monitoring processes that look at program and financial records and information of the CSCDs and the providers.
- Require outcome measures for *TAIP* in addition to the output measures to aid not only in monitoring, but future funding.

Section 4:

Weaknesses in the Development of the Contracted State Jails and in Current Contract Monitoring Increase the Risk That State Funds Are Not Being Spent Efficiently and Effectively

The process used by TDCJ to develop the seven privately operated state jails (known as the Mode II state jails) did not ensure that the State selected the best proposal for jail construction and operation or negotiated the best rate. Weaknesses in the following areas increased the risk that TDCJ did not spend contracting dollars in the most effective and efficient way:

- Site and vendor selection did not ensure that the best proposal was objectively selected.
- Per diem rate negotiations did not include sufficient analysis of proposed costs.

Mode II State Jails

Of the 22,000 state jail felony beds authorized by Senate Bill 532, 73rd Legislature, the Community Justice Assistance Division (CJAD) was responsible for developing 6,000 beds. These state jails are referred to as "Mode II" state jails. To construct these beds, CJAD was authorized to contract with Community Service and Corrections Departments (CSCDs) or with counties to build, operate, or manage state jail felony facilities. CSCDs could, in turn, subcontract with a private vendor or commissioner's court for any or all of the above services. Currently, all operational Mode II state jails are managed and operated by private vendors.

The State Jail Division (SJD) was responsible for constructing the remaining 16,000 beds. These beds are managed and operated by TDCJ and are referred to as "Mode I" state jails.

- Contracts are inconsistent and some do not include key provisions necessary to ensure accountability.

Current weaknesses in TDCJ's contract monitoring function continue to increase that risk. Construction of TDCJ's Mode II state jails is now virtually complete with TDCJ investing approximately \$159 million to build the privately operated Mode II jails. (Approximately 8,000 privately-operated beds were actually built.) During fiscal year 1995, TDCJ paid approximately \$4.6 million to operate the Mode II state jails. We

estimate that once all Mode II state jails are open and at full capacity, it will cost at least \$91 million annually to operate the jails.

Several factors helped shape the selection and contract award process used by TDCJ for the Mode II state jails:

- Planning and implementation of the Mode II state jail program was conducted within relatively short time frames. Approximately one year elapsed from the passage of the state jail enabling legislation to the construction of the first facility.
- The state jail enabling legislation was structured to allow local communities latitude and flexibility in developing the Mode II jails.
- TDCJ had to contend with pressure from communities, counties, contractors, and others who were interested in participating in the program, and who attempted to influence TDCJ's decision-making process.

Section 4-A:

TDCJ's Selection of Mode II Sites and Vendors Did Not Necessarily Ensure That the Best Proposals Were Chosen

The process used by CJAD during the initial stages of Mode II state jail development did not ensure that the best proposals were selected or that the State would receive the best value for its contracting dollars. In addition, while the final selection process was more structured, there were inconsistencies in the approach used to evaluate the proposals and select the final sites and vendors. As a result, TDCJ does not have adequate assurances that the best proposals were objectively selected.

Implementation of the Mode II state jails included the selection of sites and vendors for the development, construction, operation, and management of the jails. As Figure 8 shows, the selection process involved several phases, occurred over several months, and included many different groups.

Figure 8

Mode II State Jail Selection Time Line		
Date	Group Involved	Activity
PHASE I: Initial Selection of Potential Sites for Mode II State Jails		
September 1993	Texas Board of Criminal Justice	Approved Mode II state jail program
	CJAD	Solicited CSCDs/counties for interest in developing Mode II state jail program
October 1993	CJAD	Issued RFP for initial site selection
November 1993	CJAD	<ul style="list-style-type: none"> • Received 28 proposals¹ • Conducted site visits of viable sites • Prepared evaluation summary for Board consideration • Presented site recommendations to the Board subcommittee
	Texas Board of Criminal Justice	Selected 14 specific regional sites for Phase II consideration
PHASE II: Selection of Final Sites		
December 1993	CJAD/TDCJ Engineering Directorate	<ul style="list-style-type: none"> • Met with 14 proposers and distributed additional criteria for Phase II site selection • Requested selected counties provide a completed Facilities Agreement and geotechnical and environmental reports
January 1994	TDCJ Engineering Directorate	<ul style="list-style-type: none"> • Hired construction manager to assist in remaining site selection process • Issued RFP for the location, design construction and/or renovation, operation, and management of a 1,500-bed state jail facility²
<p>¹ In response to CJAD's initial RFP (October 1993), some communities submitted several proposals. For example, one CSCD submitted four proposals, each with different sites and community incentives.</p> <p>² This Mode II facility differs from other Mode II facilities in both its funding and contract structure.</p>		

Figure 8, concluded

Date	Group Involved	Activity
PHASE II: Selection of Final Sites (concluded)		
February 1994	Construction Manager	Conducted preliminary site evaluations of 13 potential sites (one site was not inspected pending local site selection)
	TDCJ Staff (from various divisions)	Reviewed proposals submitted in response to January RFP. Developed evaluation report for presentation to the Board of Criminal Justice.
March 1994	Texas Board of Criminal Justice	<ul style="list-style-type: none"> • Authorized TDCJ to proceed with contract negotiations with one operator to develop a 1,500-bed facility • Approved seven other sites contingent upon successful completion and negotiation of design, construction, operating plans, and negotiation of contracts within available funding levels (six primary sites and one alternate). Staff was to negotiate final contracts on three sites and was to provide assistance to the other sites in developing an RFP.³
PHASE III: Selection of Regional Proposals for Design, Construction, Operation and Management of Jails		
March 1994	CSCDs/ Counties	Issued RFP for design, construction, operation, and management of a 1,000-bed Mode II state jail facility. The format of the RFP was supplied by CJAD and its construction manager.
April 1994	Texas Board of Criminal Justice	Authorized TDCJ to negotiate with two proposers
May 1994		Authorized TDCJ to proceed with final contract negotiations with four other proposers
³ Some sites and contracts were approved and finalized ahead of other sites. For example, two jails in large metropolitan areas were developed ahead of the rest of the Mode II state jails. The Board was approving final contract details for these jails at the same time it was considering sites and vendors for the other Mode II state jails.		

The Initial Selection Process - Because the information requested in CJAD’s October 1993 RFP was general, CJAD conducted visits of potential sites to gather additional information. These visits were conducted by CJAD’s former Division Director and one staff person from TDCJ’s Engineering Directorate. While there were some criteria for information to be gathered during these visits, CJAD’s evaluation and development of site recommendations for the Board of Criminal Justice (Board) was largely subjective.

At a November 1993 Board meeting, CJAD provided the Board with a narrative description of each proposer’s site, utilities, program administration, incentives, and implementation strategies (or development time line). These descriptions were sometimes vague and did not provide sufficient, objective information for the Board to consider in making site selections. For example, some of CJAD’s comments included:

- “Recent excavation work indicates that the soil may be highly stable, workable cliche. However, only a geotechnician investigation can verify this. Foundation costs could be below average.”

- “No specific site was identified in the proposal. However, the applicant asserts that several potential sites have been identified.”
- “The soil appears to be a mix of sandy loam and clay but the substrate is unknown at this time. It is difficult to determine potential foundation costs without further study.”
- “Programs will be developed and based on local resources and the risk/needs of the offenders. Basic programming will include, but not be limited to: education/vocational programs, work, rehabilitation and recreation programs.”

At this meeting, the former Division Director told the Board that the type and depth of information compiled by CJAD in evaluating the proposed sites differed, saying, “You will see a lot of variation, and there is not really a lot of consistency with regard to specifics.” Some of this inconsistency was a result of the intentional flexibility built into the Mode II state jail program. For example, the enabling legislation for this program was designed to allow local jurisdictions the latitude to develop programs tailored to their needs and to place the facilities in areas that they felt were suitable. Because the program encouraged differences in proposals, it was imperative that CJAD develop sound criteria against which to judge the proposals and make objective assessments of the overall quality and cost-effectiveness of proposals. The process used did not allow this.

After discussing various factors related to the potential sites, the Board selected 14 proposals for further consideration. (These 14 proposals included potential sites in 11 different counties with each site ranked as primary or secondary.) The following conditions increase the risk that CJAD’s selection process did not result in the best proposals being selected for further consideration:

- CJAD had not detailed its proposed selection process, documented the criteria to be used to evaluate sites and proposals, or developed definitions of good and bad performance for each rating criterion.
- Insufficient documentation exists to show that CJAD’s evaluation of the initial 28 proposals was based on clear criteria, complete data, or was consistently conducted.
- The RFP format used by CJAD was general. The RFP did not require responders to answer many construction-related questions, and did not address such important issues as soil tests, environmental studies, and site evaluations.
- CJAD officials responsible for overseeing the Mode II development were not experienced with preparing RFPs for site location or evaluating responses.

The subjective nature of the initial screening was recognized by the then Chairman of the Board of Criminal Justice. In a letter to a state senator (dated after the Board’s November 1993 meeting), the Chairman stated:

. . . As to your wish for some precise or exact formula for site selection, there is none . . . While we do have criteria—such as proximity to a major urban area, regional dispersion, costs of site preparation, offsetting absorption of costs by the locality, availability and cost of utilities, and community acceptance—we have not reached the point of applying scores and weights to that criteria to arrive at the site decision.

Final Site Selection - While the final site and vendor selection process appears to have been more structured, there were some inconsistencies in the approach used to evaluate the proposals and select the vendors. In March 1994, CJAD and its construction manager presented the Board with evaluations and rankings from numerous proposals from three counties. Each county had by this time recommended the particular proposal it favored. CJAD and its construction manager, in turn, were to evaluate and rank all proposals from each county for the Board's final selections.

- In May 1994, the Board selected one county's recommended proposal even though it was ranked fifth out of six overall by CJAD's construction manager. The rankings included facilities cost, per diem cost for three years, and an assessment of programs proposed. The proposal selected had a total cost of \$39.5 million. The top-ranked proposal had a total cost of \$35.3 million.
- The Board approved the recommendation made by another county for its jail operator even though it was ranked second overall by CJAD's construction manager. The total cost for the top-ranked proposal was \$36.5 million. The selected proposal had a total cost of \$40.2 million. Also, CJAD's analysis appears to have resulted from only a review of summary information submitted by the county about the county's proposed site. Excerpts from a Board meeting in May 1994 indicated that some Board members debated the merits of choosing a vendor based primarily on the county's recommendation.

Selection of the 1,500-Bed Site - In January 1994, TDCJ issued a RFP for a 1,500-bed state jail facility. TDCJ staff developed some rating criteria for evaluating these proposals, but when they presented proposed sites to the Board in March 1994 they had not completed their evaluation and did not offer a specific recommendation. According to the then Executive Director's March memo to the Board (prepared prior to the board meeting), several factors prevented staff from completing their evaluation and recommending one proposal:

- Each proposal had "areas or issues in need of further clarification or negotiation."
- TDCJ had received an "unsolicited proposal" which could affect the Board's decision.
- Staff could not agree on the criteria to use when making their recommendation. The Executive Director stated that staff would like "some

general direction from the Board on the relative priority” that should be applied to each criteria.

- Funds for the project had not yet been identified or allocated.

Nevertheless, at the March 1994 board meeting, the Board selected a site and instructed staff to begin contract negotiations with the operator. Because the proposals had not been fully reviewed, TDCJ does not have adequate assurance that the best proposal was selected or the process was objective.

Overall, the bid process used to develop the Mode II state jails was difficult to administer. It did not allow TDCJ to pick a location for a jail independent of the vendors selected by the county for the location. According to several TDCJ officials, this method of selecting sites and vendors made it difficult for TDCJ to effectively negotiate costs and contract terms. It appears that TDCJ’s interpretation of state jail legislation compelled TDCJ to accept county preference whether or not it was the best deal for the State.

Section 4-B:

TDCJ Cannot Ensure the Reasonableness of Mode II State Jail Operating Per Diem Rates

Negotiations of operating per diem rates were not structured to ensure that TDCJ was paying the lowest rate possible. TDCJ staff negotiated rates based on their calculations of TDCJ’s own cost to operate similar facilities and the amount of funds available to operate the jails. (TDCJ calculated the maximum rate it would pay based on TDCJ’s cost to operate similar facilities with an allowance for fringe benefits which are normally budgeted elsewhere in the State’s accounting system.) But because TDCJ did not negotiate rates based on a detailed analysis of operators’ estimated cost to operate a facility, the Department may be paying per diem rates which do not reasonably align with the cost to operate the Mode II state jails.

TDCJ Finance personnel negotiated per diem rates after the Board approved the vendors’ proposals (which included proposed rates). Rates were submitted based on budget data in the proposals. However, four vendors proposed rates which matched the maximum rate TDCJ was prepared to pay (\$32.17 per day per confinee). It appears that TDCJ’s maximum rate was widely known to the vendors.

Negotiations resulted in some decreases in per diem rates, but contracted rates for four of the seven jails equaled vendors’ proposed rates for at least two of the three operating years. Figure 9 shows proposed and negotiated per diem rates for each facility.

Figure 9
Proposed and Negotiated Per Diem Rates

State Jail	Year 1		Year 2		Year 3	
	Proposed	Negotiated	Proposed	Negotiated	Proposed	Negotiated
1	\$32.17	\$30.94	\$32.17	\$32.17	\$32.17	\$32.17
2	\$32.17	\$32.17	\$32.17	\$32.17	\$32.17	\$32.17
3	\$32.17	\$32.17	\$32.17	\$32.17	\$32.17	\$32.17
4 ¹	\$26.63	\$27.85	\$27.66	\$28.94	\$28.89	\$30.24
5 ²	\$32.17	\$29.94	\$32.17	\$30.50	\$32.17	\$31.15
6 ²	\$30.87	\$29.94	\$27.99	\$30.50	\$28.89	\$31.15
7 ³	\$23.91	\$23.91	\$25.32	\$25.32	\$26.25	\$26.25

¹ Salary adjustment requested and approved for this facility to bring salary levels in line with the local market. However, there was no salary survey or other documentation to support this increase.
² Because these two jails had the same operator, rates for these two facilities were negotiated together.
³ The contract for this facility was awarded under a separate RFP.

By negotiating rates down from a “maximum rate” (versus reviewing detailed cost components and building up to a cost-based rate), TDCJ does not have assurances that the rates negotiated align with the reasonable and necessary costs of operating a Mode II state jail.

In addition, two state jail operating contracts specifically include provisions for start-up funds. (Another three facilities included some start-up costs in their proposed annual operating budgets, but there is no documentation of what items are or are not included in these amounts.) Start-up funds provide operators with capital to purchase necessary equipment and pay salaries for staff before a facility receives inmates or confinees. When operators receive start-up funds from the State, the amount of start-up funds should lower operating per diem rates.

Because TDCJ did not require operators to submit detailed cost data, TDCJ could not determine if the expenses covered by start-up funds were already included in contractors’ budgets or if the amount of start-up funds reduced proposed per diem rates. Only one of the operators whose contracts included provisions for start-up funds appeared to lower their proposed per diem rates to compensate for the receipt of those funds. The other operator’s proposed per diem matched the maximum per diem rate TDCJ was prepared to pay (\$32.17).

Section 4-C:

Contracts are Inconsistent and Do Not Include Some Provisions Necessary to Ensure Accountability

Mode II state jail contracts for the same services were often not consistent in content or form, and did not include all the necessary provisions to ensure contractor accountability. In addition, contract provisions regarding inmate phone system revenue may not comply with the requirements of the General Appropriations Act. As a result, revenues that have been received by operators or developers could instead be due to TDCJ.

Development of each Mode II state jail typically resulted in at least four contracts (see text box at left). Examples of weaknesses and inconsistencies in the contracts associated with TDCJ's seven Mode II state jails include:

Types of Contracts

The development and operation of each Mode II state jail included up to four different contracts. These contracts include:

Development Agreement - An overall document between TDCJ/CJAD, the CSCD or county, and the private developer. It arranges for design and construction of the jail, often via subcontracts with third parties. It also names the manager/operator of the facility who is not a party to this contract. (See management and operations agreement below.)

Design/Build Contract - Between the county or CSCD and the construction contractor for the design and construction of the facility.

Operations and Management Services Agreement - Between TDCJ and the CSCD or county. Contract identifies the rights and responsibilities of each party to operate and manage the jail. It also identifies the rights of the CSCD or county to contract with a private vendor to manage and operate the jail.

Operations and Management Services Agreement - Between the CSCD or county and a private manager/operator, if the CSCD or county decides to subcontract for these services.

One of the seven Mode II state jails is somewhat different from the other Mode II jails. Instead of the operations contract for this jail being between a CSCD or county and private operator, the contract is between TDCJ and the private operator.

- One management and operation contract was very brief, and either did not contain some key provisions or only cursorily addressed requirements. For example, the contract did not include:
 - A provision for indemnification and insurance. Such a clause would require the operator to purchase insurance and name TDCJ as an additional insured.
 - A prohibition against removing bond-funded equipment from the premises
 - A requirement to provide financial statements (either past or future operating years)
 - Specific billing procedures

- This county's management and operation agreement is only 14 pages long. Other contracts, completed before this county's contract, are up to 57 pages long and include more requirements to ensure accountability.
- Only one jail's management and operation agreement requires the operator to annually submit audited financial statements to TDCJ.
- Four of the jails' management and operations contracts had a provision for a contract monitor to be employed by the county or CSCD. The other three had no such provision. Therefore, TDCJ's State Jail Division is solely responsible for monitoring compliance with state jail division standards and contractual terms at these facilities.
- Default provisions for two development agreements were not specific as to what constitutes default and how to remedy deficiencies short of canceling the contract.

In addition to inconsistencies among contracts, key provisions were left out of contracts altogether or were insufficient to ensure accountability. For example, none of the contracts defined allowable and unallowable costs, even contracts that included provisions for start-up funds. As a result, we found start-up funds spent on items not typically allowed to be purchased with state funds:

- Relocation costs, including shipment of a personal vehicle for \$810, and commercial moving expenses of \$7,539 for two employees
- Various instances of per diem and mileage in excess of state rates. One employee was paid \$46 per day for meals for four days. Another was paid \$34 per day for five days. The state maximum allowable rate is \$25 per day.
- Meals for all attendees at one meeting. The total of two invoices was \$161.

Further examples of contract weaknesses include:

- Contract provisions require conformance to the contractor operating plan and state jail standards, but monthly payments are tied only to a daily census. There are generally no sanctions for noncompliance with standards other than termination of the contract. Monthly payments to a 1,000-bed state jail with a per diem rate of \$32.17 total nearly \$1 million per month (\$11.7 million per year). Therefore, the lack of recourse puts substantial state dollars at risk.
- Provisions governing inmate phone system revenue may not comply with the General Appropriations Act. A draft TDCJ Internal Audit report indicates that Board approval was not obtained for inmate phones, thereby violating Article IX, Section 98 of the General Appropriations Act, 74th Legislature. This section requires revenues of this type to be accounted for as state revenue unless otherwise approved by an agency's governing board. Neither we nor

TDCJ's Internal Audit Department could find documentation that the Board of Criminal Justice specifically authorized phone revenue to be retained by Mode II developers or operators.

Both developers and operators of Mode II state jails have entered into agreements with telephone service providers to install and operate inmate telephone systems. According to a draft report by TDCJ's Internal Audit Department, the phone service providers:

. . . have agreed in some cases to provide inmate and administrative telephone equipment gratis in exchange for the right to operate the inmate telephone system and receive revenue from inmate use of the system. The service providers in turn will share a portion of the telephone commission with the state jail facility operators or developers.

Contract arrangements currently call for phone service providers to make payments to three state jail operators and one state jail developer. (See Figure 10.)

Figure 10
Summary of Agreements With Telephone Service Providers

	Monthly (or annual) payment	Advances or Signing Bonus	Commission Percentage (to Operator or Developer)
Operator 1	\$25,000/mo. (\$300,000/yr)	N/A	49.7%
Operator 2	\$25,000/mo. (\$300,000/yr)	N/A	49.7%
Operator 3	N/A	\$535,000 in lieu of 24 months of future commissions/ \$266,667 bonus	44.0%
Developer	"\$10.00 and other good and valuable consideration"	N/A	Not disclosed

CJAD and the State Jail Division wrote letters giving the authority to install the inmate phone systems, but did not grant the authority for the developers or operators to keep the revenues. TDCJ does not know exactly how much revenue has or has not been collected by Mode II jail operators or developers.

- Similar issues may have to be addressed with vending machines in the state jails, although the revenue may be far less significant. According to a TDCJ Internal Audit Department draft report, the placement of vending machines which were being operated at one state jail had not (as late as February 1996) received Board approval. The Board did approve the placement of vending machines and use of revenues in Mode I state jails.

Current Monitoring Processes Should Be Formalized and Structured to Focus on Areas of High Risk

The State Jail Division's contract monitoring efforts focus on state jails' conformance with applicable State Jail Standards and TDCJ policies and procedures. Because current monitoring efforts are not formalized or documented, there is increased risk that TDCJ will not have the information it needs to determine if the jails are complying with operating plans submitted by private contractors with their proposals or if they are providing effective services.

Current weaknesses include:

- A formal risk assessment is not used as a basis to plan the timing and scope of monitoring reviews of state jails. A risk assessment helps to ensure limited resources are focused on the most critical issues and on the riskiest jails. For 1997-1998, the State Jail Division is scheduling its compliance reviews to coincide with the Institutional Division's annual operational reviews. The Institutional Division's reviews focus on facilities' compliance with its operational policies and procedures, applicable laws, and court orders. By using the Institutional Division's schedule instead of selecting jails for review based on documented risk, the State Jail Division may not provide timely coverage of issues.
- There is no formal training in the State Jail Division for performing monitoring duties, nor are qualifications of assigned monitors systematically documented before a review is performed. Although monitors may be experienced in the program area they will be reviewing, they have not been trained in such areas as gathering evidence, formulating findings, and writing logically supported conclusions. This type of training is important particularly when gathering evidence to support a finding of nonperformance by an operator. This evidence could be particularly crucial if nonperformance is the basis for potential cancellation of the contract.
- Formal policies and procedures do not exist. Monitoring tools have not been formally developed. Formal checklists which incorporate State Jail Division standards and other relevant standards have not been fully developed. Written procedures have not been developed to guide its monitoring team in tailoring this checklist to the jail being reviewed. Currently, each team member develops his/her own checklist.
- No follow-up audits have been performed to date. Audits are planned on an annual basis for all state jails after the initial 90-day preliminary review is done. In addition, there is no formal process for ensuring corrective action is taken on noted deficiencies.

- The State Jail Division is currently focusing on compliance with standards and policies and procedures. However, it should also be concerned with such issues as quality of programming and the conformance of the operator to its submitted operating plan along with its operate proposal. Reports from monitoring reviews of four state jails cited many deficiencies, but they were mainly compliance related. No significant quality or fiscal issues were cited.
- The State Jail Division does not have a formal methodology for planning its monitoring visits, documenting fieldwork, or reporting results. As a result, coverage for several standards were not planned at several of the jails. For example, Health Care (#157.49) and Health Screening and Examinations (#157.51) standards were not covered at three facilities. Also, Information Systems and Research (#157.61) and Citizen Involvement and Volunteers (#157.63) were not covered at another facility.
- Four Mode II contracts have provisions that require a CSCD monitor. No written procedures have been developed to define the tools, procedures, and objectives for their monitoring.
- Formal responses by the wardens for findings are now required. They had not been until April 1996. Formal responses increase the level of accountability jail officials can be held to regarding specific actions plans to remedy noted deficiencies.

Recommendations:

The State Jail Division should strengthen its contract administration to ensure that state funds are spent efficiently and effectively. To this end, it should:

- Fully plan and document future site and contractor selection processes. The approach should ensure that decisions are based on objective information.
- Analyze proposed costs in future renewals or renegotiations to ensure that all components are reasonable and necessary for providing the contracted service.
- Review all proposed contracts to ensure that necessary provisions are included and to ensure consistency, completeness, and legality. Provisions which allow the State Jail Division sanctions other than contract termination should be included in new contracts.

The State Jail Division should also take steps to improve its oversight of the Mode II state jails. Among the steps it should include are:

- Establish written procedures and policies for planning, conducting field work, and reporting. These procedures should be shared with the CSCD field staff responsible for monitoring the private state jail contractors.

- Conduct and use a formal risk assessment process to risk-rank facilities and issues, and use the assessment as the basis for a monitoring plan. A quality plan ensures that SJD limited resources are focused where risk is highest.
- Expand coverage to include fiscal and programming issues. Close coordination with the Programs and Services Division for these and other monitoring issues will be needed to ensure coverage is complete but does not overlap.

Section 5:

Recent Improvements in Parole's Contract Administration Should Enable the Division to Better Manage its Contracts

In fiscal year 1996, the Pardons and Parole Division (Parole) significantly strengthened its management controls over contracts. For those contracts awarded under this new process, these improvements should address past weaknesses and provide Parole with better assurance that vendors are providing contracted services at a fair price. However, Parole still needs to expand its new process to include renegotiated contracts (and future contracts awarded using an RFP) and enhance its oversight of contractors.

The Pardons and Parole Division handles its own contracting process, from selecting contractors to developing the contract and monitoring performance. Parole contracts directly with approximately 161 contractors, and during fiscal year 1995, expended approximately \$42.3 million on contracted services such as halfway houses and sex offender therapy. Our review of Parole's contracting process included a review of existing controls at Parole as well as a review of the financial operations at two Parole providers. Contract expenditures at these two contractors totaled \$10.5 million during fiscal year 1995.

Section 5-A:

Parole's New Selection and Rate-Setting Processes Provide Better Assurance That the Best Contractor is Selected and Reasonable Rates Are Set; However, Contract Renewals Are Not Yet Subject to These New Processes

The new processes used by Parole to award its substance abuse contracts and negotiate contract rates appear to ensure that the best contractor is selected and that rates are reasonable. Parole assumed responsibility for these substance abuse treatment contracts beginning in fiscal year 1996. Prior to that, Parole generally contracted with the same vendors for several years. Initial contracts were awarded using an RFP, and contract renewals were negotiated. These renewals have not yet been subject to the same level of scrutiny and analysis as were the new substance abuse contracts.

Parole uses both RFPs and invitations for bids. Invitations for bids are used for services such as electronic monitoring. RFPs are used for services such as residential and substance abuse services. Because the services procured with an invitation for bids are easier to define, and other mechanisms exist with which to ensure the reasonableness of rates (such as extensive open market competition), Parole's invitation for bids process has adequately ensured the selection of the best vendor and the soundness of contracted rates.

However, Parole's former RFP process had some weaknesses. For example:

- Parole's analysis and justification of contract awards was poorly documented.
- Evaluation criteria were vague.
- Factors such as vendors' past experience and program quality were not documented and/or were not considered.

In addition, initial rates for these contracts were generally based on providers' proposed rates instead of on an analysis of the cost components of those rates.

As these contracts have expired, Parole has attempted to negotiate lower rates with providers. But Parole has not yet required providers to submit detailed cost data to assess the reasonableness of renegotiated rates. As a result, even if providers decrease their initial rates, Parole does not have adequate assurance that the new rates reasonably align with providers' cost to provide services.

In our review of two large providers, we found numerous expenditures which state agencies are precluded from making and which indicate that the negotiated rates might be unreasonable. Both of these providers' current contracts with Parole were renegotiated without benefit of detailed cost information and analysis. Examples of questionable expenditures include:

- \$1,287 for Christmas party expenses
- \$529 for softball and bowling expenses
- \$570 in donations and fees to local organizations such as the Chamber of Commerce, Rotary Club, and Sheriff's Posse
- \$2,490 for contingent legal reserves
- \$200 for political contributions

We also found that providers allocate indirect expenditures to their Parole contracts. For example, during fiscal year 1995, one provider reviewed charged its Parole contract over \$740,000 for "general and administrative" expenses. The providers' annual report states that these costs consist of "salaries of officers and other corporate headquarters personnel, legal, accounting and other professional fees, travel expenses, executive office rental, and promotional and marketing expenses." According to provider staff, lobbying expenses are also included in the indirect cost pool.

While we did not review the detailed expenditures that make up this cost pool, we question whether all such expenses should have been charged to the Parole contract or

should be considered by Parole in negotiating its rate. As Parole renegotiates these contracts, it should ensure that only reasonable and necessary expenses are included in the indirect costs allocated to the program budget used to develop contract rates.

In addition to not reviewing cost information when renegotiating contracts, Parole currently does not have a systematic way to incorporate all information on contractors' past performance into the decision to renew a contract. This situation exposes Parole to the risk of extending contracts to providers with poor performance records.

With its award of the substance abuse contracts, Parole improved its RFP and rate-setting processes. Parole's review of proposals included a detailed evaluation instrument, detailed instructions to reviewers, written justifications, and documented approvals and award decisions. Rates for the substance abuse contracts were negotiated after extensive review and analysis of provider cost information. Parole required providers to submit detailed budgets with their proposals. Typically unallowable costs were excluded from consideration, and other sources of revenue (such as food stamp revenue) were considered. Parole compared costs by category among providers to identify other areas in which proposed costs were excessive.

Section 5-B:

Parole's Revised Standard Contracts Include Many of the Provisions Necessary to Ensure Accountability

Parole's standard contract was revised at the start of fiscal year 1996 and now includes many of the provisions necessary to ensure contractor accountability. Areas which require further improvement include:

- Prior to fiscal year 1996, contracts did not include performance standards. Performance measures have been added to the fiscal year 1996 contracts, but the measures focus more on expected program outputs than program outcomes.
- Although contracts state that funds not spent in accordance with the program budget are unallowable, Parole has not provided more specific information on types of unallowable expenditures within these budget categories.

Section 5-C:

Parole Is Restructuring its Monitoring to Focus on Areas of High-Risk

Parole's past monitoring was insufficient to ensure that contractors provided quality services and complied with contract terms. Parole has recently restructured its monitoring section and is developing new monitoring procedures. During the time of our review, Parole's plans for monitoring were not formally documented, and so our analysis is based largely on discussions with staff. It appears, however, that Parole is aware of its past weaknesses and its new monitoring effort will address these areas.

Past weaknesses include:

- Parole did not have a system with which to schedule monitoring visits or ensure that higher-risk providers were reviewed more often. Only residential programs received regular monitoring reviews. Parole policy called for quarterly visits, but not all providers were monitored according to this schedule. Parole did not maintain a schedule of its visits and, therefore, could not track compliance with policy.
- Visits focused heavily on building safety. Financial monitoring focused on verifying the accuracy of billings and ensuring clients' funds were adequately protected. By limiting monitoring to these areas, Parole has not been able to determine if contractors have operated efficiently or have provided quality services.
- Deficiencies identified in the quarterly inspection reports were not well supported by documentation and analyses. Monitors' working papers consisted mainly of informal notes, and analyses and procedures were incomplete and inconsistent among monitors. As a result, there is no assurance that problems identified in the past have been fully corrected or that refunds due Parole were recouped.
- Results of monitoring reviews and investigations were not systematically tracked to ensure corrective action had been taken or to allow analysis of problematic areas.

Parole is revising its monitoring procedures and practices. It suspended most of its monitoring function from the Fall of 1995 through April 1996 while new procedures were developed. However, Parole has recently hired two new financial monitors, and revamping its systems for:

- Selecting providers for review based on risk
- Determining the procedures to conduct during each review
- Documenting these procedures
- Tracking monitoring results and corrective actions

To ensure that its new monitoring process achieves its intended objectives, Parole plans to assign several monitors to do initial reviews of audit reports. Procedures and sites will be selected based on risk, and more monitors will be hired to oversee the substance abuse treatment contracts.

One area for which Parole still needs to define procedures is its review of providers' annual financial reports. Plans for reviewing and tracking issues identified in these audits have not yet been developed. (Fiscal year 1996 was the first year these audits have been required.) Information from these reports can identify areas of risk for Parole monitors.

Recommendations:

- Parole has significantly improved its system of selecting vendors and negotiating rates. This system should be employed when awarding new contracts or renegotiating new rates for continued contracts. When providers include indirect or general and administrative expenses in their proposals, sufficient analysis should be conducted to ensure that allocated costs are reasonable and necessary for providing the contracted services.
- Parole should continue with efforts to develop good measures of program success.
- Parole should formalize its basic plan for monitoring and improve and update the plan as needed.

Section 6:

TDCJ Could Enhance its Management of the Substance Abuse Treatment Contracts Through More Detailed Analysis of Vendor Proposals and by Developing Guidelines for External Audits of Providers

Contract management of TDCJ's substance abuse treatment programs provides adequate assurance that contractors are objectively selected, and that rates negotiated for services are reasonable. Contracts for these programs were competitively awarded, and rates were developed based on detailed cost information from providers' proposals. However, analysis of proposed indirect costs and tighter restrictions on proposed direct costs would provide more information with which to potentially negotiate lower rates. In addition, better guidelines for the required financial audit would help ensure that the audits provide the type and quality of information needed to maintain financial accountability.

Administration of TDCJ's substance abuse treatment programs is a new responsibility for TDCJ. Prior to fiscal year 1996, these programs were administered by the Texas

Commission on Alcohol and Drug Abuse. There are currently nine substance abuse treatment contracts. At current treatment capacity, projected program costs for the Substance Abuse Felony Punishment Facilities and In-Prison Therapeutic Community contracts will total approximately \$24.9 million for fiscal years 1996 and 1997. The facilities' cost for housing these programs is separate and above these projections.

Section 6-A:

Analysis of Indirect Costs and Restrictions on Allowable Direct Costs Would Provide Better Information to Negotiate Rates

TDCJ's process for awarding substance abuse treatment contracts appears to provide for objective selection of vendors and negotiation of reasonable rates for services. The substance abuse treatment contracts were competitively awarded with per diem rates negotiated from detailed cost information submitted by providers. For each location, spreadsheets were created, showing the unit cost by budget category. Staff reviewed unit cost components for reasonableness and comparability.

In developing these rates, however, TDCJ did not adequately analyze indirect cost components or examine how indirect costs were allocated by vendors. Therefore, while the rates negotiated generally appear reasonable, the rates might have been lower had additional effort been spent analyzing the reasonableness of all costs, including indirect costs.

The RFPs required potential contractors to submit a detailed cost budget using pre-defined cost categories such as personnel salaries, travel, equipment, office supplies, and indirect cost rate. Examples of the types of expense to be included were provided for some cost categories, but for indirect costs the RFP only required that the approved cost rate (and any supporting documentation) be submitted.

Almost all program budgets listed only one line item for total indirect costs, with no disclosure of the type of expenditures included in the indirect cost pool. In addition, the dollar amount of proposed indirect costs varied considerably. For example, our analysis of the five proposals submitted for one unit found that indirect costs ranged from 5 to 15 percent of total direct costs (or from \$51,192 to \$163,936). Because total projected indirect costs for the nine contracts awarded are material (for fiscal year 1996, indirect cost expenditures are projected to total \$1.1 million), TDCJ could possibly negotiate lower rates if more analysis of the type and allocation of indirect costs were examined.

In addition, unallowable costs such as the ones prohibited by the contract were not specified in the RFP. Because these expenditures were not defined until after the rate had been set, TDCJ does not know if unallowable costs were considered in the rate

Potential Unallowable Expenditures

The substance abuse treatment contract includes a list of "potentially unallowable costs." The contract states that expenditures for any of the following items may be considered unallowable:

- Alcoholic beverages
- Bad debts
- Cash payments to clients
- Expenses reimbursed by other funds
- Fundraising
- Legislative or lobbying expenses
- Related party transactions (unless specifically approved)
- Tobacco products
- Any other item deemed unallowable by state statute, policy or procedure

The contract allows TDCJ to suspend placements, withhold funds, or require the return of funds in the case of noncompliance with TDCJ policies.

negotiation process either as part of the indirect costs or as part of their program budget for direct costs.

Section 6-B:

The Substance Abuse Treatment Contracts Contain Many of the Provisions Necessary to Hold Contractors Fiscally and Programmatically Accountable

Overall, the provisions of the standard contract for the substance abuse treatment services include many of the provisions necessary to hold contractors accountable for delivering quality services. The contract includes provisions for:

- Remedies for noncompliance
- Unallowable expenditure types
- Performance measures
- Minimum staffing ratios
- Financial audits

However, the performance measures included in the contract do not adequately address program outcomes. TDCJ has recognized this shortcoming and is working to develop better measures of program success.

In addition to requiring an annual financial audit of providers' consolidated operations, the contract also requires "program specific audits." Currently, however, no guidelines exist to define what procedures external auditors are expected to perform as part of these program specific audits. As a result, TDCJ may not get the financial information it needs to monitor vendors' performance and compliance with contract provisions.

Section 6-C:

When Fully Implemented, TDCJ's Monitoring of the Substance Abuse Treatment Programs Will Promote Higher Quality Services From Contracted Providers

Although not well documented, TDCJ's plans for monitoring its substance abuse treatment contractors will promote the delivery of quality services when fully implemented. The Programs and Services Division has identified important aspects for monitoring, including those aspects that should be monitored by vendors. Monitoring will focus on program delivery and staffing levels (salaries make up 80-plus percent of total budget). TDCJ's first contracts for these programs were not effective until

January 1996. Therefore, much of TDCJ's plans for monitoring have yet to be implemented.

The Programs and Services Division (Programs and Services) is currently conducting "limited scope" audits at all locations. These audits are to obtain a preliminary understanding of TDCJ contractors and assess contractor compliance with certain key contract provisions. As of June 1996, monitors have visited four locations, with five more audits scheduled for the coming months.

Once these audits are complete, Programs and Services will implement a more comprehensive audit program. These audits will include the high-risk areas identified in the limited scope audits and will focus on vendor performance. Comprehensive audits are currently planned to be conducted annually. Quality assurance checklists are also being developed for program directors to use for self-monitoring.

Recommendations:

- TDCJ should analyze indirect cost components, and how indirect costs are allocated in reviewing vendor submissions. TDCJ should also define the allowable components of direct cost in the RFPs. If these added steps were performed, the result might be a reduction in the negotiated rates.
- TDCJ should define audit elements that external auditors must perform in auditing the contracted providers.

Based on feedback from vendors, CPAs, and other sources, TDCJ may need to revise the contract to provide the CPA more guidance or some specific reference to audit standards to follow. Also, given the cost benefit of performing a program specific audit, Programs and Services should consider requiring a reconciliation of budget to actual cost instead of a full program audit (with limited expenditure testing, particularly of indirect costs). With 90 percent of the budget made up of salaries, fringes, and indirect costs, the other 10 percent of the budget may not be material to warrant more extensive testing.

- Because Programs and Services is a new division, much of the monitoring function is still in the planning phase. Plans are mostly shared through discussion and are not formally documented. It should formalize a basic plan for contract monitoring and improve and update the plan as needed.

Section 7:

Analysis of Proposed Costs, Improved Contract Provisions, and Effective Oversight of Pre-Release Centers Would Enhance TDCJ's Ability to Ensure the Effective Use of State Funds

TDCJ developed and used a sound system for selecting operating vendors for its pre-release centers (PRCs). However, limited analysis of providers' proposed cost for reasonableness, the absence of certain key contract provisions, and limited oversight of operations increases the risk that:

- Contractor compensation is not reasonably aligned with the cost to provide services.
- Deficient contractors cannot be held accountable.
- Substandard services or contractor inefficiencies will not be detected.

There are currently eight PRCs operated by three different vendors. TDCJ opened the first four PRCs in 1988 and, in November 1992, issued an RFP for the construction of up to 2,000 additional beds. As a result of this RFP two new centers were constructed and one of the first four centers was expanded.

In 1995, TDCJ requested proposals for the operation of three of its first four PRCs. The contract for the fourth center's operation was not rebid but, instead, its contract was renegotiated to align the contract term with the contract term of the new facility that had been built adjacent to it in 1993. In fiscal year 1995, TDCJ expended \$41.4 million for the debt service and operation expenses associated with the PRCs.

Because there are no current plans to construct new facilities, our work focused on TDCJ's process to select and negotiate operating contracts. Our work was limited to a review of the RFP issued in 1995, the resulting contracts, and current monitoring efforts.

Section 7-A:

While TDCJ Objectively Selected PRC Vendors, Analysis of Proposed Rates' Component Costs Could Have Provided Better Assurance That Rates Are Reasonable

TDCJ's process for awarding the pre-release center operating contracts appears to provide for the objective selection of vendors. For the 1995 RFP, the three vendors whose proposals received the highest evaluations were awarded contracts. These bidders also had the lowest per diem rates. However, because TDCJ did not adequately analyze the cost components of those rates, it does not know if the final rates could have been lower or are aligned with the reasonable cost of operating the facilities.

TDCJ evaluated the PRC proposals against four criteria. Each of these criteria had several subcategories. For example, the "cost" category included a comparison of

The PRC Selection Process

TDCJ issued a RFP in May 1995 for the rebid of the operating contracts for three PRCs. Five vendors submitted proposals. These proposals were scored using a weighted evaluation instrument for rating proposals' cost, operating aspects, use of historically underutilized businesses, and compliance with legal requirements.

Staff from TDCJ departments with expertise in each area to be evaluated were asked to score the proposals for their particular categories. The methodology and rating scales were well documented. When more than one department reviewed a particular category, their scores were combined and a rough average score was used on the scoring sheets.

Once TDCJ determined which proposals had the highest scores, it began contract and rate negotiations with successful vendors.

proposed per diem rates to other proposed per diem rates, a review of whether the proposed rates were reasonably escalated over the five-year operating term, and an analysis of whether proposed costs fell within the expected TDCJ budget for the PRCs.

While TDCJ evaluated different aspects of the providers' proposed costs, it did not review the reasonableness of individual proposed expenditures. The budgets submitted by the vendors were not reviewed by line item to see if any questionable expenses had been included.

In negotiations of final per diem rates, TDCJ cut 40 cents off each vendor's proposed rates. There is no documentation of how this figure was determined. The

rates were later increased by 8 cents to compensate for vendors' additional expenses associated with the payment of "bond remarketing fees." The rates were also increased by an additional 4 cents after further negotiation. As a result, final rates were 28 cents less than initial proposed rates. While final rates were less than proposed rates, because TDCJ did not analyze the reasonableness of proposed rates, it cannot know if the final rates could have been even lower or if these rates represent efficient service delivery.

Section 7-B:

The PRC Contracts Do Not Contain Several Provisions Necessary to Hold Contractors Fiscally and Programmatically Accountable

Overall, the provisions of the standard contract for the PRCs are inadequate to hold the contractor accountable for delivering quality services. The contract does not include provisions for:

- Unallowable expenditure types
- Program-specific audits by independent CPAs
- Performance measures

Unallowable costs such as bad debts, lobbying expenses, and fundraising should be defined in the contract and the RFP and considered during the rate negotiation process.

Section 7-C:

Current Monitoring of the PRCs Cannot Ensure the Delivery of Quality Services

Monitoring of the PRCs has been insufficient to ensure that all centers comply with contract and other requirements or that centers are delivering quality services. The monitoring has been compliance focused. In addition, with the opening of two new facilities in 1995, monitoring at the other five facilities has been minimal or nonexistent. As a result, risk is increased that instances of noncompliance or substandard services could be provided and go undetected.

Monitoring typically includes:

- Quarterly reviews of contract compliance with provisions such as training, staffing, and food service by PRC monitors.
- Annual reviews by various TDCJ departments to determine the pre-release center's compliance with TDCJ's *Unit Operational Review Manual*. This manual was designed by TDCJ to measure operational compliance of its prison units with policies/procedures, court orders, etc.

TDCJ has focused its PRC monitoring resources on reviewing contract compliance at the two facilities that became operational in June 1995. Since that date, TDCJ has conducted only limited scope reviews at three facilities and no reviews at two others.

Besides focusing on compliance and providing only limited oversight of facilities' operations since June 1995, other weaknesses include:

- There is no risk assessment process to decide which center or what areas within each center will be reviewed. There is currently only one monitor for the seven centers. TDCJ has approved an additional position and is trying to replace a monitor who recently resigned. Using a risk-based approach to scheduling and conducting reviews would help ensure that these limited resources are used in the most efficient manner.
- PRC monitors are not involved with the financial aspects of the contract. The individual TDCJ departments that perform the annual audit of the centers are responsible for any financial aspects such as commissary sales. The contracts require that Securities and Exchange Commission financial reports be sent to the PRC Administrator, but we were unable to determine if any analysis is done with this information.
- There is no system to keep track of identified problems. The monitoring section also lacks a system that can efficiently track what monitors have audited each quarter.

PRC monitoring staff is currently developing a manual that will pertain only to the monitoring of the pre-release centers.

Recommendations:

- TDCJ should analyze the cost components of proposed rates to determine the reasonableness of individual proposed expenditures. TDCJ should also define the unallowable components of cost in the RFPs. If these added steps were performed, the result might be a reduction in the negotiated rates.
- The contracts should require program specific audits performed by independent CPAs. Performance measures that adequately address program outcomes should be included in the contracts. TDCJ should also define the audit elements that external auditors must perform in auditing the contractors.
- TDCJ should develop a risk assessment process to decide which center or what areas within each center will be reviewed. A risk-based approach to scheduling and conducting reviews would ensure that resources are used in the most efficient manner. TDCJ should also develop a system to track identified problems and the areas that have been reviewed each quarter.
- Although contract compliance is important, TDCJ's monitoring of the pre-release centers should also focus on the delivery of quality services by the contractors.

NOTE: There is a discrepancy between the section numbers referenced in Management's Response and the section numbers in the body of the report. When the report was reviewed in draft form by TDCJ, it contained 8 sections because the Overall Assessment was listed as Section 1. In the final version of the report, the Overall Assessment is not listed as a numbered section.

Management's Response to Report



TEXAS DEPARTMENT OF CRIMINAL JUSTICE

P.O. Box 99 • Huntsville, Texas 77342-0099

Wayne Scott
Executive Director

September 19, 1996

Ms. Julie Cleveland
State Auditor's Office
Post Office Box 12067
Austin, Texas 78711-2067

Dear Julie:

Enclosed are our replies to the audit recommendations. We appreciate the time you have devoted in working with our staff.

If you need anything else, please call David McNutt (409-294-2102) or Celeste Byrne (409-294-6876).

Sincerely,

Wayne Scott
Executive Director

Encl.

xc: David McNutt
Raymond Pyeatt

SECTION 2: TDCJ'S PURCHASING PROCESS HAS NOT ENSURED THE PURCHASING REQUIREMENTS ARE MET

GENERAL RECOMMENDATION:

To ensure that TDCJ complies with purchasing requirements it must improve both its system of internal controls and its oversight of purchases.

RECOMMENDATION 2-A

Management should prepare a TDCJ Policy and Procedures manual for the purchasing department. In addition there should be a process for reviewing and keeping procedures up to date.

ORESPONSE 2-A: TDCJ CONCURS.

July 1, 1996 responsibility for the Administrative Services Division function was transferred to the Deputy Director of Administrative Services. In addition to oversight of the Budget Office, the Deputy Director of Administrative Services assumed responsibility for the areas of Financial Operations, Local Funds, Communications, and Purchasing and Leases. Also on July 1, responsibility for creation of the Purchasing policies and procedures manual was transferred to the Budget Office.

In the month of July, the Budget Office prepared planning document that detailed contents of the manual, the audience, factors that would impact production of the manual, coordination of contact persons, timelines and more. Several other large agencies were contacted for copies of their purchasing manuals for use as reference. The basis of the Purchasing manual was the General Services Commission (GSC) Manual, the old Purchasing Manual (1988), the newly drafted Administrative Directive that dealt with Purchasing and preliminary audit findings. Chapter assignments were made to Purchasing Department staff. Meetings were held. Forms were redesigned.

On August 1, draft manuals were routed to the Board of Criminal Justice, the General Services Commission, the State Auditor's Office, TDCJ Internal Audit, Purchasing and Executive Management. Comments were due back August 23. Input received will be incorporated into the manual.

On October 15, the finalized purchasing policies and procedures manual will be presented to the Special Committee on Purchasing and routed appropriately. The manual will be distributed to all TDCJ purchasers and used as a basis for training. Updates are planned quarterly.

RECOMMENDATION 2-B

Divisions and Units should be responsible for identifying purchasing needs

ORESPONSE 2-B : TDCJ CONCURS

Creation of a standardized Requisition Form that will be used throughout TDCJ is underway. Utilization of the new Requisition Form will provide departments with a means of identifying their own purchasing

Management's Response (continued)

needs and a means of communicating those needs to the designated purchaser within the Purchasing Department. The standardized form will contain spaces for information such as the PCA, user unit, lead times, quantity and specifications and contact person(s). Also included will be a numbering system that will be used for reference and appropriate spaces for budgetary approval (user level and TDCJ level), division director approval, etc. The Requisition Form will be generic in nature which will enable it's use in virtually all purchasing situations. The BM-31 form that is currently in use in Austin will be the predecessor for the new Requisition Form.

Time frame for development of the form is December 1, 1996. Following design of the form, guidelines will be developed to assist users. An important component of the requisition process will be development and training on lead times that are necessary for various types of purchases. Refinement of the planning process will be the key factor in improvement of the current purchasing cycle. Awareness of when certain items should be ordered will make the purchasing process truly efficient.

RECOMMENDATION 2-C

Procurement should be restricted to the Purchasing Department.

ORESPONSE 2-C: TDCJ CONCURS

This recommendation was partially implemented with the formation of the Consolidated Purchasing Department (May 1996). Further implementation will occur with the combination of all purchasing departments. This combination will eliminate the designation of "Consolidated" or "Administrative" purchasing and will result in all individuals with purchasing authority being under one Director. The effect of this combination will be the elimination of "non-dedicated" purchasers. There is still the issue of the purchase of small items from low volume user departments which could possibly be addressed by the use of a procurement card system of purchase. Such a system could potentially eliminate massive amounts of paperwork. There is currently a feasibility study on the use of procurement cards being conducted in parole offices throughout Texas.

There still remains the ability of management to override Purchasing Department decisions. This authority should not be eliminated however, it should be based upon written justification and only used in rare cases with the approval of the Executive Director. Systemwide notification to management concerning restriction of procurement to the dedicated purchaser and justification for any deviation from that procedure will be issued January 1, 1997.

RECOMMENDATION 2-D

Management should ensure purchasers have adequate training.

ORESPONSE 2-D: TDCJ CONCURS.

TDCJ Purchasing in conjunction with Financial Operations held a training session on August 20, 1996. This session was attended by close to 200 agency personnel. These personnel were mainly budget managers, purchasers, property officers and inventory managers. The training covered purchasing and payment topics. The training will be scheduled on an annual basis.

The Interim Division Director of Administrative Services and the Interim Assistant Director for Purchasing and Leases have met with General Services Commission representatives in Austin to plan training sessions

Management's Response (continued)

that will be offered. The GSC plans to offer a class on writing specifications and general state requirements.

The Purchasing Department is continuing training activities for agency personnel. Fifteen agency employees are now Certified Professional Public Buyers and 26 employees are qualified to take the examination for certification. The majority of Purchasing employees have now had most of the training required to become Certified Professional Public Buyers and the department is reviewing the frequency with which future training classes will be held.

Upon finalization of the Purchasing policies and procedures manual in mid-October 1996, plans will begin for training sessions and distribution of the manual. Among the topics planned for training during the session will be the area of planning lead times for purchases.

RECOMMENDATION 2-E

Exemptions from competition should be granted on a case-by case basis.

ORESPONSE 2-E: TDCJ CONCURS.

TDCJ's new purchasing and procedures manual will provide guidelines to ensure competition is utilized whenever feasible, unless otherwise prohibited by law.

The risk associated with direct purchases has been eliminated by the suspension of direct purchases. Preliminary recommendations made to the General Investigative staff by the Board member in charge of Administration and Finance, the Executive Director and the Interim Division Director of Administrative Services advocate suspension of the direct purchasing authority for one biennium. The suspension will allow the opportunity for the agency to reestablish credibility and make much needed improvements to the area of direct purchasing.

Emergency purchases will be administered in accordance with the policy contained in the TDCJ Purchasing policies and procedures manual. The policy strongly discourages emergency purchases and states that emergency purchases will be considered on a case-by-case basis only.

RECOMMENDATION 2-F

Management should develop and implement a single information system that includes all TDCJ division and which provides timely, reliable, and useful information. This information should be used to analyze and review purchasing operations.

ORESPONSE 2-F: TDCJ CONCURS.

The Advanced Purchasing and Inventory Control System (ADPICS) implementation is currently underway. The Facilities program is expected to be on-line by the end of the year. Other departments will be phased by December 1997. Once fully operational, the ADPICS system will have the capabilities to supply timely and meaningful reports that will enable management to make informed decisions concerning purchasing functions.

Management is currently looking at taking immediate steps to initiate a contract profile system relative to the current financial system for reporting purposes.

RECOMMENDATION 2-G

The Purchasing Department should develop an internal monitoring system for trained personnel to perform periodic, risk-based reviews of purchases and compliance issues. Purchasers making non-compliant purchases should be counseled as to the proper methodology ;recurrent errors should be dealt with appropriately.

ORESPONSE 2-G: TDCJ CONCURS WITH MODIFICATION.

This recommendation is detailed and expertise will be required to develop such a system. In an attempt to reestablish credibility, it is requested that for the first year or year and a half that TDCJ Internal Audit along with Purchasing be allowed to perform the period review to develop a checklist. Purchasing will work in conjunction with Internal Audit to properly train the personnel to conduct the assessments. It is recommended that October 1, 1996 be the date identified for this recommendation to proceed. It is agreed that recurrent errors should be dealt with by means of disciplinary action. A policy will be incorporated into the TDCJ policies and procedures manual that reflects that initiative.

In addition, it is proposed that monitoring of purchases be initiated through a quarterly report to the Board. The report will highlight categories of purchases, depict purchasing trends and target areas of improvement. The Board will be briefed on the proposed format and solicited for input prior to the preparation of the first quarterly report. Any disciplinary action that is necessary will administered in accordance with Texas Department of Criminal Justice Human Resource policy PD-22 *Guidelines for Employee Disciplinary Action*.

SECTION 3: CJAD'S CONTRACT MANAGEMENT HAS NOT ENSURED THAT STATE FUNDS ARE SPENT EFFECTIVELY OR EFFICIENTLY

GENERAL RECOMMENDATION:

To better ensure state funds are spent appropriately and on effective programs, CJAD must improve its methods for allocating state funds, its contracts with CSCDs, and its monitoring of CSCDs' use of state funds and program effectiveness. CJAD also must provide more assistance to CSCDs in developing good processes for selecting subcontractors, setting rates, developing contracts, and ensuring the delivery of quality services.

Specific recommendations were made relative to 3A) Selection/Rate Setting , 3B) Contracting, and 3C) Monitoring.

ORESPONSE 3A: TDCJ CONCURS.

The state auditors recommended several improvements in the selection and rate-setting processes. TDCJ agrees with the recommendations specified in the report, and has stated their response below :

CJAD is in the process of developing a process for grant fund distribution based on selection criteria that will include past performance, geographical need, quality of programs, and cost. Preliminary surveys will be used in future processes to determine geographical needs. When subsequent proposals are solicited, the geographical needs criteria will be based on these surveys and weighted appropriately with other criteria such as cost and quality factors. The evaluation process should be more effective when this process is utilized and more efficient, especially when program funding is limited.

CJAD will begin to review the processes CSCDs use to calculate and collect data reported to CJAD which is the basis for their funding of the basic supervision and community corrections programs. Future reviews will be performed on a random basis after CJAD has developed assurances that the self-reported information is accurate. In addition, the Community Supervision Tracking System ("CSTS"), once matched to the monthly summary data currently provided by the CSCDs, will become the reporting mechanism for funding. The CSTS has individual offender data (not summarized) and will be sampled for audit purposes.

CJAD in cooperation with other Divisions within TDCJ that provide similar services will develop program standards for residential services and costs comparisons will be performed as applicable.

CJAD Management agrees that the concept of setting ceiling rates or ranges for certain types of services by region is prudent.

CJAD will provide assistance to the CSCDs as needed for the development of cost analysis methodologies relative to the selection of providers' proposed costs through training and technical assistance.

ORESPONSE 3B: TDCJ CONCURS.

The state auditors recommended several improvements in the contracting processes. TDCJ agrees with the recommendations specified in the report, and has stated their response below :

Standard contracts for similar type services will be developed and enhanced as needed to provide for consistency in contracting for all areas in the agency that may have similar type providers and in some cases the same providers. The grantor/grantee relationship between CJAD and the CSCD serves as a primary contract with the CSCD, who may subcontract with a provider. CJAD provides funding to the CSCD or their subcontractor derived from state appropriations. Subcontractors will be held to the same level of accountability for program operations as are contracted vendors in other TDCJ divisions. In programmatic service contracts, provisions will be added to provide the flexibility needed to accomplish programmatic requirements such as the definition of outcomes, sanctions for nonperformance, etc.

If standard contracts are not utilized, or are deemed inappropriate, a timely review process will be developed to ensure that necessary and mandated clauses are included in the contracts.

ORESPONSE 3C: TDCJ CONCURS.

The state auditors recommended several improvements in the monitoring processes. TDCJ agrees with the recommendations specified in the report, and has stated their response below :

Monitoring by the field service staff will be enhanced by establishing an approach for conducting visits based on the risk associated with the CSCD's. Refining this type of audit approach will save valuable time and resources. Factors to be utilized to determine the risk level related to CSCDs will be developed, collected, and consolidated into an overall assessment database for analysis. At a minimum, the factors will include those identified by the State Auditors Office.

CJAD together with other TDCJ Divisions will develop more efficient ways to analyze and compare program components. Divisions that manage similar programs will share an integrated management system for consistency, comparison and control purposes.

TDCJ-CJAD is working in conjunction with the Department of Information Resources to develop an integrated database to enable staff to better analyze and compare proposed program components, etc. We are scheduled to begin implementation in spring of 1997.

SECTION 4: CJAD'S ADMINISTRATION OF THE TREATMENT ALTERNATIVES TO INCARCERATION PROGRAM HAS NOT ENSURED STATE FUNDS ARE USED EFFECTIVELY

RECOMMENDATION:

CJAD should improve it's contract management of the TAIP substance abuse program by 4A) refining the RFP process, 4B) establishing a rate setting methodology, 4C) improving the grant award statements and conditions between CJAD and the CSCDs, and the standard subcontracts between the CSCD and the provider, 4D) providing guidance to providers on reasonable, allowable and unallowable expenditures, 4E) developing comprehensive monitoring processes, and 4F) developing systematic monitoring processes.

ORESPONSE 4A: TDCJ CONCURS.

CJAD rewrote their Solicitation for Program Proposal ("SFPP") for the TAIP program and it was distributed in July for the services required in 1997. The point system was utilized in accordance with the comments noted in the audit report. The TAIP unit and field services staff developed improved review criteria for the recent SFPP selection process and it will be re-evaluated this fall for the fiscal year 1998 SFPP.

Through the RFP process between the CSCD and the vendor, CJAD provided the vendors with a list of unallowable expenditures. These expenditures will be detailed in the revised TAIP contract in addition to other relevant provisions for expenditures.

CJAD will incorporate all the additional steps recommended to refine the selection and evaluation process.

ORESPONSE 4B: TDCJ CONCURS.

In conjunction with an agency wide review of contracting processes, management will be reviewing the different aspects of contracting for services. This review will include looking at the cost benefit analysis of different payment methods related to contract types, and the related impacts on current resources to maintain different type of contracts. The setting of contract rates will need to be reviewed as a possible payment mechanism for either a fixed rate or cost-reimbursement type contract. Developing methodologies for rate-setting is a prudent step for management to pursue. The rates developed can be utilized internally to serve as a reasonable cost gauge, especially for areas where competition does not exist. In areas where competition is present, a competitive rate process should be utilized. The rates proposed can be compared and analyzed against the internal reasonable rates.

CJAD is currently conducting the cost analysis for providers' rates to establish rates in accordance with each provider's submitted costs.

Budget cut decisions should be documented and based on a needs assessment allocation method that is reasonable. Data utilized to develop the allocation will be based on reliable and verifiable information provided by the CSCDs. If available, independent data from other sources may be utilized in the allocation formula. In order to make better decisions in the future, budget analysts will receive training in this area.

ORESPONSE 4C TDCJ CONCURS.

CJAD is currently working to rewrite grant award statements and standard conditions or other mechanisms as needed to hold the CSCD programmatically and fiscally responsible on the fiscal year 1997 contracts. Time extensions to the existing 1996 programs has been granted in an effort to take immediate steps to comply with the audit recommendations. Therefore, the goal for the fiscal year 1998 programs is for the CSCDs to have a better understanding of the expectations of CJAD by defining the relationship in contractual terms.

The TAIP contract utilized by the CSCDs is currently being reviewed by legal counsel for the proposed changes noted in the audit report in addition to any new agency requirements from the agency.

ORESPONSE 4D: TDCJ CONCURS.

The current Financial Management Manual will be reviewed and expanded as needed to incorporate the changes needed for the TAIP program. CJAD has recently become aware of the draft revisions that are being made to the Uniform Grant and Contract Management Standards ("UGCMS") manual by a task force of representatives from different agencies will also be reviewed. This manual currently is being revised to incorporate revisions to the Federal OMB Circulars and to incorporate state annotations. The purpose of the UGCMS manual is to provide uniform guidance for local governments that receive grant funding. CJAD will incorporate the appropriate components of this manual into their existing Financial Management Manual.

ORESPONSE 4E: TDCJ CONCURS.

Monitoring processes will be developed that cover both programmatic and fiscal aspects for both the CSCD and the providers they contract with. As standard contracts will be revised to include provisions for independent audits, these audits will be utilized in conjunction with our monitoring processes for risk analysis purposes and increased efficiency.

ORESPONSE 4F: TDCJ CONCURS.

Award statements and conditions (contract) will outline the outcome and output measures. Performance against these measures will impact future funding.

SECTION 5: WEAKNESSES IN THE DEVELOPMENT OF THE CONTRACTED STATE JAILS AND IN CURRENT CONTRACT MONITORING INCREASE THE RISK THAT STATE FUNDS ARE NOT BEING SPENT EFFICIENTLY AND EFFECTIVELY

GENERAL RECOMMENDATION:

The State Jail Division ("SJD") should strengthen its contract administration to ensure that state funds are spent efficiently and effectively. Specific recommendations were made relative to 5-A) contract administration and 5-B) monitoring and oversight processes for the Mode II state jails that are operated by the CSCD or a provider who subcontracts with the CSCD.

RECOMMENDATIONS 5-A:

The SJD should fully plan and document future site and contractor selection processes. The approach should ensure that decisions are based on objective information.

Proposed costs should be analyzed for future contract renewals or re-negotiations to ensure that all components are reasonable and necessary for providing the contracted service.

All proposed contracts should be reviewed to consistency, completeness, and legality. Provisions which allow the SJD sanctions other than contract termination should be included in new contracts.

ORESPONSE 5-A: TDCJ CONCURS.

We agree that the Mode II selection and contracting process could have been performed more efficiently and objectively. If any new facilities are required in the future, the TDCJ will fully plan and document the site selection and contractor selection process. In addition, the responsibilities for each Division within TDCJ will be clearly defined.

Proposed costs will be analyzed in the future by line item. Budget breakdowns of per diems will be requested for any subsequent re-bid processes or renegotiations. The extent to which TDCJ should be involved in the cost analysis of the CSCD's responses to the proposals was not determined until late in the process. The cost proposals revealed that it was evident that many of the proposers had knowledge of the maximum rate that could be granted, and therefore presented the very best rehabilitative programs that the budget could yield. It would appear that the competition was based on who could provide the best programs. Cost analysis on a fixed rate proposal with varied programmatic components is difficult to perform. In the future, standards will need to be set on programmatic versus other cost components in order to perform a true cost analysis.

Future operating contracts will be standardized. The type of contract (fixed vs. cost) will determine the financial requirements. Flexibility in the language relative to the programmatic provisions will be necessary.

RECOMMENDATIONS 5-B:

Written policies and procedures should be established for planning, conducting of field work, and reporting. These procedures should be shared with the CSCD staff in the field who are also responsible for monitoring the private state jail contractors.

A formal risk assessment process to risk rank facilities and issues, and use the assessment as the basis for a monitoring plan. A quality plan ensures that SJD limited resources are focused where risk is high.

Oversight should be expanded to include fiscal and programming issues. Close coordination with the Programs and Services Division for these and other monitoring issues will be needed to ensure coverage is complete but does not overlap.

ORESPONSE 5-B: TDCJ CONCURS.

The SJD is currently developing written policy and procedures for the systematic review process of operations and programs on all TDCJ-SJD units/facilities to determine compliance with statutory responsibilities and to account for the expenditure of state appropriations. These policies and procedures will be shared with the CSCD staff responsible for the monitoring of the private contractors.

A formal risk assessment process is currently being drafted that will define procedures to provide for an annual audit, risk ranking of the facilities into defined categories, and will establish the criteria to be utilized to determine the level of risk. The SJD staff will prepare an annual audit schedule for all facilities under their jurisdiction including the Mode II state jails .

The SJD is currently performing fiscal oversight in regards to the billings for the Mode II state jails, which involves verification of capacity for application of the fixed rate per diem. The SJD will play an active role in any future contracting processes involving cost analysis, etc. The SJD will coordinate with the Programs and Services Division by sharing audit plans and scopes to avoid duplicated efforts.

SECTION 6: RECENT IMPROVEMENTS IN PAROLE'S CONTRACT ADMINISTRATION SHOULD ENABLE THE DIVISION TO BETTER MANAGE ITS CONTRACTS

RECOMMENDATION 6-A:

The Parole Division ("Division") has significantly improved its system of selecting vendors and negotiating rates. This system should be employed when awarding new contracts or renegotiating new rates for continued contracts. When providers include indirect or general and administrative expenses in their proposals, sufficient analysis should be conducted to ensure that allocated costs are reasonable and necessary for providing the contracted services.

ORESPONSE 6-A: TDCJ CONCURS.

The Division will utilize the new system developed for all contracts that require future actions involving a selection process or renegotiation process.

The Division continues to find ways to improve the system utilized to select vendors and negotiate rates. Indirect costs will be reviewed in sufficient detail for the Division to determine if the costs are excessive and/or necessary.

RECOMMENDATION 6-B:

The Division should continue with efforts to develop good measures of program success.

ORESPONSE 6-B: TDCJ CONCURS.

The Division will be revising measures of program success. The agency is currently reviewing outcome and output measures relative to the recidivism rates in an attempt to determine the best data to be collected to measure performance and thereby pinpoint areas to reduce recidivism and meet other goals for the programs success. Any changes determined will be incorporated into the next contract period.

RECOMMENDATION 6-C:

The Division should formalize its basic plan for monitoring and improve and update the plan as needed.

ORESPONSE 6-C: TDCJ CONCURS.

The Division is currently in the process of formalizing, standardizing and improving its basic audit plan. This process will be a coordinated effort between TDCJ Divisions that are responsible for administering and monitoring similar programs or services and will be a risk based plan.

SECTION 7: TDCJ COULD ENHANCE ITS MANAGEMENT OF THE SUBSTANCE ABUSE TREATMENT CONTRACTS THROUGH MORE DETAILED ANALYSIS OF VENDOR PROPOSALS AND BY DEVELOPING GUIDELINES FOR EXTERNAL AUDITS OF PROVIDERS

RECOMMENDATION 7-A:

TDCJ should analyze indirect cost components and how indirect costs are allocated in reviewing vendor submissions. TDCJ should also define the allowable components of direct costs in the RFP's. If these added steps were performed, the result might be a reduction in the negotiated rates.

ORESPONSE 7-A: TDCJ CONCURS.

The Substance Abuse Programs administered by the Programs and Services Division and the Paroles Division, (the In-Prison Therapeutic Community ("IPTC"), Substance Abuse Felony Punishment ("SAFP"), and the Transitional Treatment Centers ("TTC") programs) went through a similar selection process. The request for proposal ("RFP") represented to the provider that the proposal was to be in the form of a fixed rate price for a unit of service (a per diem basis for residential services and a per unit price for a counseling session). The proposal did request that a budget detail sheet provided in the RFP packet be submitted to support the proposed unit cost. These budgets were used for the purpose of determining primarily if the proposed cost was reasonable considering how it was calculated and if the costs appeared to be justifiable. Below indicates some of the uses for the budgets provided:

- Reasonableness of certain cost items
- Salaries should correlate with staffing ratios
- Did annual revenue projections (utilization) equal the budget for expenses
- Possible identification of Unallowable items
- Items excluded that may indicate inexperience
- Negotiation tools
- Cost comparisons to other vendors
- Future rate setting processes

Future RFPs could be improved to include explicit instructions on what costs items should be detailed as indirect costs and not to include costs that are unallowable as part of their proposed fixed unit cost.

It should be noted that the competitive selection process utilized by TDCJ did provide for lower rates than paid by TCADA through the cost contracting methods of grant awards or "lower of costs or fixed rate per service". Through the competitive proposal process used, the rates initially proposed to TDCJ were lower than those set by TCADA, and subsequent negotiations in some cases yielded even lower rates.

RECOMMENDATION 7-B:

TDCJ should define audit elements that external auditors must perform in auditing the contracted providers. Based on feedback from vendors, CPAs, and other sources, the Department may need to revise the contract to provide the CPA more guidance or some specific reference to audit standards to follow. Also given the cost benefit of performing a program specific audit, the Division should consider requiring a reconciliation of budget to actual cost instead of a full program audit (with limited expenditure testing, particularly of indirect costs). With 90 percent of the budget made up of salaries, fringes, and indirect costs, the other 10 percent of the budget may not be material to warrant more extensive testing.

ORESPONSE 7-B: TDCJ CONCURS.

When we require the vendor to provide for certain specific type audits, more guidance will be provided to external auditors as needed. The requirement for a program specific audit was incorporated in SAFP and IPTC contracts. Our contracts specify reporting requirements that provide us with added information for assessment purposes such as reports on internal controls, program budgets by revenue and expenditures, and any management letters relating to material problems noted by auditors. This is in addition to the annual financial statement audit required. Although vendors may have annual financial statement audits performed to meet other requirements, our contracts should require little additional audit costs for vendors if they have adequately segregated program expenditures in the financial records.

Management is considering utilizing a modified fixed rate contract in future contracts. This type of contract would require a reconciliation of budget to actual costs for certain line items such as salaries. This reconciliation audit will provide feedback on cost and performance.

RECOMMENDATION 7-C:

Because Programs and Services is a new division, much of the monitoring function is still in the planning phase. Plans are mostly shared through discussion and are not formally documented. The Division should formalize a basic plan for contract monitoring and improve and update the plan as needed.

ORESPONSE 7-C : TDCJ CONCURS.

The Programs and Services Division is currently developing a risk based audit plan to identify the program areas, and allocate audit resources among those areas; specific audits will be identified, along with the scope of the audit. The plan will be prepared annually, and updated as needed to assure that audit resources are focused on higher risk areas and issues that concern management.

Substance Abuse Administration's monitoring section, which was staffed in January of 1996, is currently performing limited scope audits of twelve SAFP and IPTC facilities. These reviews focus on quality of treatment services provided, and risk assessment reviews.

SECTION 8: ANALYSIS OF PROPOSED COSTS, IMPROVED CONTRACT PROVISIONS, AND EFFECTIVE OVERSIGHT OF PRE-RELEASE CENTERS WOULD ENHANCE TDCJ'S ABILITY TO ENSURE THE EFFECTIVE USE OF STATE FUNDS

RECOMMENDATION 8-A:

TDCJ should analyze the cost components of proposed rates to determine the reasonableness of individual proposed expenditures. TDCJ should also define the unallowable components of cost in the RFPs. If these added steps were performed, the result might be a reduction in the negotiated rates.

ORESPONSE 8-A: TDCJ CONCURS..

Future RFPs will be improved to include explicit instructions on how to accurately represent the costs in the detail budget sheets. Future cost analysis of the individual cost components will be improved by including a line item in the budget detail sheet for profit, excluding line items that are vague or cannot be well defined such as "other costs", and defining the unallowable costs that can not be included.

RECOMMENDATION 8-B

The contracts should require program specific audits performed by independent CPAs. Performance measures that adequately address program outcomes should be included in the contracts. TDCJ should also define the audit elements that external auditors must perform in auditing the contractors.

ORESPONSE 8-B: TDCJ CONCURS.

Management is considering utilizing a modified fixed rate contract in future contracts. This type of contract would require a reconciliation of budget to actual costs for certain line items such as salaries. This reconciliation audit will provide feedback on cost and performance. If we require the vendor to provide certain specific type audits, more guidance will be provided to external auditors as needed.

The outcome measure approved by the Governor's Office and the Legislative Budget Board for this program is the percent of compliance with the Pre-Release Facility Operating Plan. Management will expand the outcomes required of the vendors. The future contracts will be improved to include self-reporting of compliance factors. These reports can be utilized in conjunction with TDCJ audits to complete risk assessments and target areas for special attention by monitors.

RECOMMENDATION 8-C:

TDCJ should develop a risk assessment process to decide which center of what areas within each center will be reviewed. A risk-based approach to scheduling and conducting reviews would ensure that resources are used in the most efficient manner. TDCJ should develop a system to track identified problems and the areas that have been reviewed each quarter.

Management's Response (continued)

ORESPONSE 8-C: TDCJ CONCURS.

Management will be accomplishing these improvements as a coordinated effort between TDCJ Divisions that are responsible for administering and monitoring similar programs or services. A risk based approach will be utilized to provide for the most efficient use of limited resources.

RECOMMENDATION 8-D:

Although contract compliance is important, TDCJ's monitoring of pre-release centers should also focus on the delivery of quality services by the contractors.

ORESPONSE 8-D: TDCJ CONCURS.

With the additional staff referred to in the State Auditor's report and another position approved since the report was issued, TDCJ looks forward to the ability to resume addressing both.

Summary of Management Responses to Overall Assessment

Purchasing

The Texas Department of Criminal Justice has made progress toward the implementation of many of the recommendations aimed at improving TDCJ's purchasing process. In March 1996, the Chair of the Board of Criminal Justice issued a Twelve Point Plan that dealt expressly with the issues of purchasing oversight and accountability. Special emphasis has been placed upon proper planning as a component of the purchasing process and the discouragement of emergency purchases. A Board Special Committee on Purchasing has been formed to establish purchasing guidelines and, for an interim period, will approve all purchases over \$50,000.

One area of particular concern has been the lack of complete purchasing policies and training to insure that purchasers are educated in purchasing requirements. In response to this concern, a draft of the *Purchasing and Contracting Manual* was completed August 1, 1996, and routed for comments. The final version of the manual is slated for agency wide release October 15. The manual contains policies and procedures related to ethics, responsibilities of purchasers, determining the proper method of purchase, the purchasing cycle, flow charts of purchasing processes, detailed descriptions of each purchasing method, a glossary of terms and updated forms. Training will begin on the manual soon after the final version is issued. A committee will be formed to update the purchasing and contracting manual on a quarterly basis.

The issue of control over direct purchases has been addressed by recommendations made to the General Investigative Committee by the Executive Director and Interim Division Director of Administrative Services. The use of direct purchases has been suspended through fiscal year 1999. The suspension will allow the opportunity for TDCJ to restore credibility and establish controls over the area of direct purchases.

Implementation of the Advanced Purchasing and Inventory Control System (ADPICS) will provide TDCJ management and departments with an information system that will enable the provision of timely reliable and useful information for analysis. The Facilities Division will be on-line by December 1996 and it is anticipated that ADPICS will be fully operational throughout TDCJ by December 1997.

The process of educating purchasers and the exercise of oversight of purchasers have been established as ongoing priorities for TDCJ. The process was initiated by a training session held August 20, 1996, for over 200 budget managers, purchasers, property offices and inventory managers. Training offered by the National Institute of Governmental Purchaser is supported by TDCJ and the majority of TDCJ purchasers have completed the training necessary to become Certified Professional Buyers. General Services Commission classes will be offered in the near future on general state requirements and specification writing.

Contract Administration of Programs

Contract Administration within TDCJ

In recent years, TDCJ has been challenged with many new programs requiring special attention with many philosophical perceptions on how the programs should be administered. Primarily, the Mode II State Jails and Substance Abuse Treatment Programs have been the most challenging in getting the programs through the selection process

Management's Response (continued)

and in the implementation of the new programs. We have learned through the process and we do agree that the request for proposal document, proposal evaluations, cost analysis, selection, negotiating, renegotiating, contracting, reporting and monitoring processes need improvement. Since the growth of TDCJ has somewhat diminished, we can concentrate on the best approach to utilize in the future to ensure contracting processes are handled effectively in all areas and for all parties involved.

A centralized contract administration division is being developed to provide at a minimum 1.) technical and legal assistance to departments responsible for the programs, 2.) internal management reports, 3.) external reports on contracts, 4.) planning for subsequent contracting processes, and 5.) an independent review in the evaluation process. This type of approach will provide a communicational link between upper management and the divisions responsible for administering the programs. The divisions will be fully involved in the entire process. However, the technical and legal expertise is needed primarily for the contracting phase of the programs which can be provided by the contract administration division. Concentrating these resources in a centralized division will allow for consistency in proven effective methods to be used in the contracting process and the communication of upper management's direction and concerns. Responsibilities between the contract administration divisions and the user divisions will be clearly outlined. The divisions will be able to more effectively administer the programs if they are responsible for all aspects of the contracts including actively in the negotiations which may impact future agreements. The contract administration division should remain an independent resource that can provide guidance to the divisions.

Improving the Selection Process

The Request for Proposal ("RFP") process has been used in the past few years to provide a method of selection for services to include the operation of private prisons, state jails, and treatment services. The RFP process has worked well for these types of services due to the professional nature of the services being provided. Unlike the hard competitive bid process that is utilized for a construction project where a detailed set of specifications provides assurances that cost comparisons are true, these service programs are not as easy to compare. Several other factors must be considered in the selection process such as historical experience. Therefore, the evaluation process must include several categories weighted appropriately to arrive at a score that reflects all the factors. In cases where the Texas Board of Criminal Justice will make the selection, the results are provided to the Board for their review and other factors may be considered prior to their selection.

The current process will be improved to add more emphasis to the budget detail provided to support the vendors proposed rates. The Request for Proposal will be more explicit in the definitions of each line item in order to provide better assurance that the budgets are comparable when analyzed against other vendors.

In addition it will be required that the RFP basically mirror the intended contract terms. This requires more up front planning in the RFP phase. Defining the standards expected and the contracts financial terms clearly in the RFP will eliminate a substantial amount of negotiating. This is especially important when requesting fixed rate proposals.

It should be noted that the type of contracting for private profit oriented vendors utilizing tax- exempt facilities is mandated by the federal statute. For future contracts, we will consider the latest federal statutes that primarily dictate the type of contract permitted (i.e. fixed vs.cost basis, and the term of the contracts).

Tax law experts have confirmed our compliance to the federal statutes though a review of the current operations agreements for the private prisons and the Mode II State Jails.

Improving the Monitoring of Contracts

In recent months, cost has been a primary focus in state government. Performance monitoring and risk based cost monitoring will provide for an efficient monitoring process for fixed rate contracts when resources are limited. The performance measures (outcomes, outputs etc.) are a analytical investment tool comparable to a financial statement for a profit making entity and can be of primary consideration when agencies are in competition for funding.

Management's Response (concluded)

TDCJ will tighten the contract language to require specific performance measures or standards are met. Defined penalties will be assessed for non-performance. Random audits or routine audits will be used to determine if reports submitted by the vendor are correct. In addition, a full or risk based audit for cost compliance will occur for cost contracts, as required.

In certain cases, such as contracts with profit making providers, a modified form of fixed rate contracting may be appropriate. When appropriate, the RFP will clearly define the budget line items that will be subject to a not to exceed cost verification process. We agree the concentration of audit resources on high dollar cost components that are easily verified is cost effective. An audit of the budget for salaries for example, may yield information for two monitoring aspects, financial and performance. Utilization of this type of contract, would allow the risk of inflation or under budgeted expenses to remain with the provider for the other line items.

Objectives, Scope, and Methodology

Objectives

The primary objectives of this project were to determine if:

- Procedures used to select contractors ensure that the best contractor is fairly and objectively selected.
- Contract provisions are sufficient to hold the contractor accountable for delivering quality services.
- Contract monitoring functions are sufficient to ensure that contractors consistently provide quality services and that contractors spend state funds appropriately.
- TDCJ's rate-setting/grant allocation methodologies ensure that the State pays a fair and reasonable amount for services.
- TDCJ's purchases were in compliance with applicable state laws and regulations, General Services Commission rules, Texas Board of Criminal Justice policies, and TDCJ policies.

Our review of purchasing was conducted in cooperation with TDCJ's Internal Audit Department and was conducted at the request of TDCJ's Executive Director.

Scope

The scope of this audit included:

- Purchased service grants and contracts awarded and administered by the:
 - Community Justice Assistance Division
 - State Jail Division
 - Pardons and Parole Division
 - Programs and Services Division
 - Financial Services Division

We reviewed the financial records of six Community Supervision and Corrections Departments (CSCDs), six CSCD providers, two Pardons and Parole Division providers, and one state jail contractor. These CSCDs and providers were selected using a risk assessment designed to identify high-risk contractors.

CSCDs and contractors were given a copy of all potential findings and questionable expenditures and were asked to submit additional information which might clear the findings. The questionable expenditures contained in this report have been adjusted based on any information submitted.

- A sample of goods and services purchased by TDCJ using the authority delegated to the agency by the General Services Commission during fiscal years 1995 and 1996 (including catalog purchases)

Methodology

The methodology used on this audit consisted of collecting information, performing audit tests and procedures, analyzing the information, and evaluating the information against pre-established criteria:

Information collected to accomplish our objectives included the following:

- Interviews with management and staff of the Texas Department of Criminal Justice
- Interviews with management and accounting staff from the CSCDs, providers, and County Auditors reviewed
- Documentary evidence such as:
 - Policies and procedures related to purchasing, contract administration, and rate-setting practices at TDCJ
 - Minutes from the Board of Criminal Justice's meetings from January 1993 through June 1996
 - Applicable federal and state statutes and guidelines
 - Contract monitoring files, selection records, and contracts from TDCJ and CSCDs
 - CSCD community justice plans and statistical reports from fiscal year 1994 through the second quarter of fiscal year 1996
 - Accounting policies and procedures used by CSCDs, County Auditors, and contractors
 - Contractors' board meeting minutes and, when available, minutes from Community Justice Counsels' meetings
 - Purchase orders, purchase order logs, payment information from LONESTARS, and decision memos related to selected purchases
 - Review of USAS vendor information for fiscal years 1994, 1995, and 1996
 - Review of Judicial Advisory Council meeting minutes
 - Memos, correspondence, and analyses related to the award of the Mode II state jail contracts

Procedures and tests conducted:

- Tests of the contractor selection processes used by TDCJ to determine if the best contractor was objectively selected
- Tests of statistical reports submitted by the CSCDs to determine the accuracy of information used in CJAD's fund allocation methods
- Review of the process used to evaluate contract budgets proposed by CSCDs and contractors
- Review of monitoring files to determine if procedures were sufficient to ensure quality services and fiscal accountability
- Review of sufficiency of contract provisions and tests of contractor compliance with contractual terms
- Tests of CSCDs' and contractors' revenue transactions to determine if revenue was properly accounted for
- Tests of CSCDs' and contractors' expenditure transactions to determine if expenses were reasonable and necessary to the program objectives, accurately supported, and specifically allowed by applicable state guidelines
- Tests of CSCDs' and contractors' billings to determine if services billed were actually rendered and if services were only billed to one funding source
- Review of contractor expenditure records of start-up funds
- Tests of selected high risk purchases from fiscal years 1994, 1995, and 1996, as well as some randomly selected purchases from fiscal year 1995. Because we were unable to identify the entire population of fiscal year 1995 purchases, and because TDCJ was also not able to isolate this population, we could not project the results from our sample to the population of purchases.

Criteria used:

- Best business practices related to contract administration and purchasing
- Federal guidelines and costs principles: Office of Management and Budget Circulars A-87, A-122, A-110, and A-102 and Federal Acquisition Regulations 48 Code of Federal Regulations, Chapter 1
- Texas Government Code and Texas Administrative Code
- General Services Commission Purchasing Rules
- Contract management model developed by the State Auditor's Office
- Department policies and procedures
- Contract provisions and provider proposals

- Standard audit criteria

Fieldwork was conducted from January 15, 1996, through July 15, 1996. The audit was conducted in accordance with applicable professional standards, including:

- Generally Accepted Auditing Standards
- Generally Accepted Government Auditing Standards

There were no significant instances of noncompliance with these standards.

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

- Julie L. Cleveland, CIA (Project Manager)
- Henrietta Cameron-Mann, CPA
- Rachel Cohen, CPA
- Hector T. Gonzales, CPA
- Ashaer Khawaja Hamid, MBA
- Michelle Joseph, CPA
- Kimberlee N. McDonald
- James F. McGathy, CPA
- Robert R. Rodney, CPA
- Cynthia L. Reed, CPA (Quality Control Reviewer)
- Barbara S. Hankins, CPA (Audit Manager)
- Craig D. Kinton, CPA (Audit Director)

In addition, the following members of TDCJ and other agencies assisted us in this review:

- Robert R. Buntyn, CPA, Administrator for Fiscal Management, TDCJ-CJAD
- Shirley Davenport, Field Services Specialist, TDCJ-CJAD
- Robert Elizondo, CIA, Internal Auditor, Texas Department of Transportation
- Raymundo S. Eufrazio, CPA, Internal Auditor, TDCJ
- Donna Farris, Field Services Administrator, TDCJ-CJAD
- Terry Graham, Director of Finance, Texas Youth Commission
- Gil Hays, Monitor, TDCJ-Parole
- Daniel Madison, Monitor, TDCJ-Parole
- Leo Matias, Field Services Specialist, TDCJ-CJAD
- Marcia Roberts, Field Services Specialist, TDCJ-CJAD
- Marvin Stromberg, Texas Department of Transportation
- John Quintinilla, Field Services Specialist, TDCJ-CJAD

We would also like to express our appreciation to all the management and staff of TDCJ's Internal Audit Department for their work on purchasing.

Elements of an Effective Contract Administration System

All four of the control areas listed below are important to an effective system of contract management. However, the significance of each control area varies depending on the nature of the contracting relationship.

Control Area	Elements
Contractor Selection	<p>Procurement process should be sufficient to ensure that the best contractors are fairly and objectively selected.</p> <ul style="list-style-type: none"> • Whenever feasible, and unless otherwise prohibited by law or other restrictions, contractors should be selected through competitive procurement procedures. • Past performance should be considered in subsequent selection/contract renewal decisions. • Formal, documented procedures should be used to assess prospective contractors' strengths and weaknesses.
Contract Provisions	<p>Contract provisions and agency regulations should be sufficient to hold contractors accountable for delivery of quality services and prevent the inappropriate or inefficient use of public funds.</p> <p>Contract provisions should contain all of the following:</p> <ul style="list-style-type: none"> • Clear statements of services and goods expected from the contractor • Clearly defined performance standards and measurable outcomes • Clear statements of how contractor performance will be evaluated • Sanctions sufficient to hold contractors accountable for failing to meet intended objectives • Appropriate restrictions regarding the contractors' use of public funds • Specific audit clauses which allow the funding agency and other oversight entities access to the contractors' books and records
Payment Reimbursement Methodology	<p>Methods used to establish contractor reimbursement should be sufficient to ensure that the State pays fair and reasonable prices for services.</p> <ul style="list-style-type: none"> • Prior to the contract award, the cost of services, as well as the services themselves, should be analyzed in order to determine the most effective payment methodology. • Approval of proposed contractor budgets should focus on ensuring that proposed expenses are reasonable and necessary to accomplish program objectives. Both program results and contractor efficiency should be considered as part of the budget approval process. • For unit-rate contracts, the rate setting process should ensure that there is a reasonable correlation between the quality of the services provided, costs of providing the services, and the rate paid.
Contractor Oversight	<p>Contractor oversight should be sufficient to ensure that contractors consistently provide quality services (by measuring performance against well-documented expectations) and that public funds are spent effectively and efficiently.</p> <ul style="list-style-type: none"> • Monitoring functions should focus on the outcomes of services provided and the cost-effectiveness/prudence of contractor expenditures in addition to compliance with regulations. • Results of monitoring reviews, audits and investigations should be routinely followed up on to ensure corrective actions have been taken and to identify common problem areas. • A formalized risk assessment process should be used to select contractors for review and identify the level of review necessary at each contractor. • Standardized criteria should be established to evaluate contractor performance.