

Technology Sourcing Office  
Contracts and Vendor Management

# **Follow-up Audit on the SAO Report 12-004**

## **Internal Audit Report 15-301.2**

June 2015



Texas Department of Information Resources  
Internal Audit

Internal Audit is DIR's independent, objective assurance and consulting activity designed to add value and improve the agency's operations. It helps the agency accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

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## Executive Summary

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This report presents the results of the Internal Audit's follow-up audit on the Department of Information Resources (DIR) Information and Communications Technology Cooperative Contracts Program report (#12-004) issued by the Texas State Auditor's Office (SAO) in October 2011. The SAO audit report included 30 recommendations DIR management agreed to implement.

To provide assurance improvements were made in the operational areas addressed by the SAO, this follow-up audit was included in the approved Fiscal Year 2015 Internal Audit Annual Plan. The objective of the follow-up audit was to verify the implementation status of the corrective action plans developed to address 30 of 30 recommendations DIR management reported as implemented.

The following is a summary of the results on the implementation status of the 30 recommendations verified by Internal Audit.

Fully Implemented	Substantially Implemented	Incomplete/ Ongoing	Not Implemented	Total
19	8	3	0	30

Overall, DIR improved its operating controls over the management of Program fees, execution of contract provisions for non-compliance with reporting requirements, negotiating customer discounts, and the development and documentation of sales projections and budget. Additional controls were implemented over the accounting of the Program, accounting reconciliations, and reporting of financial information. DIR also coordinated with the Legislative Budget Board to clearly identify General Appropriations Act (GAA) fund requirements, and implemented a new accounting system, the Centralized Accounting Payroll and Personnel System (CAPPS). Furthermore, DIR strengthened its operating controls over the management of user access to the Contract Management System and the accounting systems.

DIR management agreed with the results presented in this report.

Internal Audit thanks the DIR staff from the Technology Sourcing Office, Chief Financial Office, and Information Technology Services divisions for their time, cooperation, and assistance provided during this follow-up audit.

## Background

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Texas Government Code, Section 2157.068, mandates the Department of Information Resources (DIR) procures commercial software, hardware, or technology services other than telecommunication services that are generally available to business or the public and for which DIR determines that a reasonable demand exists in two or more state agencies. Through its Cooperative Contracts Program DIR establishes contracts for information resources technology products and related services. In addition to state agencies and higher education institutions, Texas Government Code, Section 2054.0565, authorizes local governments, school districts, assistance organizations, and out-of-state governmental entities to purchase from DIR cooperative contracts. For the first quarter of Fiscal Year 2015, DIR reported total sales of approximately \$555.4 million through its Cooperative Contracts Program.

In Fiscal Year 2012 the State Auditor's Office (SAO) conducted an audit of the DIR Information and Communications Technology Cooperative Contracts Program and issued an audit report (#12-004) that included 30 recommendations DIR management agreed to implement. The audit objective was to determine whether DIR set the administrative fee at a reasonable amount sufficient to recover costs and complies with state laws, rules, and policies and procedures; accurately and completely recorded financial transactions in a timely manner and processed them in compliance with state laws, rules, and policies and procedures; and maintained proper accounting controls over the cooperative contracts program.

To provide assurance improvements were made in the operational areas addressed by the SAO, this follow-up audit was included in the approved Fiscal Year 2015 Internal Audit Annual Plan. The objective of the follow-up audit was to verify the implementation status of the corrective action plans developed to address 30 of 30 recommendations DIR management reported as implemented.

To accomplish the objective, Internal Audit interviewed DIR staff from the Technology Sourcing Office, Chief Financial Office, and the Information Technology Services divisions, reviewed procurement documentation and contracts, statutes, rules, policies and procedures, and other relevant documentation. In addition, Internal Audit conducted observations of processes, and performed testing on the application controls over the Centralized Accounting and Payroll/ Personnel System (CAPPS), and the user access controls over the Contract Management System. Internal Audit also assessed the adequacy and effectiveness of the controls implemented to determine whether the controls mitigated the risks associated with the audit recommendations.

The follow-up audit was conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing* and the *Generally Accepted Government Auditing Standards*. These standards require audits to be planned and performed to obtain sufficient

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and appropriate evidence to provide reasonable support for the results and conclusions included in the report. Internal Audit states that the evidence obtained provides reasonable support for the results and conclusions included in this report.

## Detailed Results

In summary, Internal Audit verified the implementation status of the corrective action plans developed to address 27 of 30 recommendations was “Fully Implemented” or “Substantially Implemented.” The implementation status categories and their definitions include:

- Fully Implemented – successful development and use of a process, system, or policy to implement a recommendation
- Substantially Implemented – successful development but inconsistent use of a process, system, or policy to implement a recommendation
- Incomplete/ Ongoing – ongoing development of a process, system, or policy to address a recommendation
- Not Implemented – lack of a formal process, system, or policy to address a recommendation

Fully Implemented	Substantially Implemented	Incomplete/ Ongoing	Not Implemented	Total
19	8	3	0	30

### Chapter 1: Policies and Procedures, Customer Discounts, Vendor Sales Reports, Late Fees, and Contract Survivability

Management from the DIR Technology Sourcing Office (TSO) has not fully implemented the corrective action plans developed to address the recommendations included in Chapter 1 of the SAO report. TSO management asserted the corrective action plans for the recommendations were “Fully Implemented.” However, due to additional controls needed to fully implement the recommendations, Internal Audit determined four recommendations were “Substantially Implemented” and two recommendations were “Incomplete/ Ongoing.”

TSO management made progress in implementing the corrective action plans developed to address the recommendations included in Chapter 1 of the SAO report. Additional controls are in place to strengthen the processes over 1) assessing and collecting fees for late vendor sales reporting, 2) updating administrative fee changes timely, and 3) including contract provisions for non-compliance with reporting requirements.

Reference	Recommendation	Status, as Verified by Internal Audit	Internal Audit Status Comments
1-A-1	Restore, revise, and comply with its previous policies and procedures to ensure that it	Substantially Implemented	DIR revised its policies and procedures to include procedures for verifying the accuracy, completeness,

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Reference	Recommendation	Status, as Verified by Internal Audit	Internal Audit Status Comments
	<p>verifies the accuracy, completeness, and timeliness of the Program fees it collects.</p>		<p>and timeliness of the Program fees collected. However, procedures are not always followed or performed in the time period required.</p>
<p>1-A-2</p>	<p>Ensure that Program fees are not included in the customer discount so that the fees that customers pay vendors are equal to the fees that vendors pay the Department.</p>	<p>Substantially Implemented</p>	<p>DIR has policies and procedures in place to ensure that Program fees are not equal to the customer discounts. Policies and procedures also indicate the contract manager periodically verify that pricing reported on monthly sales reports is consistent with the contracted discount. However, while contract managers have policies and procedures to perform this task, documentation did not show that the procedures are being performed.</p>
<p>1-B-1</p>	<p>Develop, document, and implement policies and procedures that</p> <ul style="list-style-type: none"> <li>• Establish processes for contract managers to identify and collect past-due monthly vendor sales reports.</li> <li>• Ensure that the Department amends Program contracts to reflect fee changes in a timely manner.</li> <li>• Establish processes to assess and collect penalties when vendors submit Program fees late.</li> </ul>	<p>Incomplete/ Ongoing</p>	<p>DIR developed, documented and implemented policies and procedures for contract managers to identify and collect past due monthly vendor sales reports, and for timely amendment of Program contracts. DIR runs monthly reports to identify vendors that submit late sales reports to assess and collect late fees, if needed. The auditors reviewed a sample of contracts and verified Program fee changes were updated timely (within 30 days, as required). However, DIR has not developed, documented or implemented policies and procedures to assess and collect penalties when vendors submit their Program fees late, as recommended.</p>

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Reference	Recommendation	Status, as Verified by Internal Audit	Internal Audit Status Comments
1-B-2	Review and revise the format of its vendor sales report to require Program vendors to report (1) the manufacturer's suggested retail price (MSRP) for products and services at the time of purchase and (2) the customer discount applied to the purchase.	Substantially Implemented	DIR vendor sales reports require the Program vendors to report the MSRP of their products and services; however, they do not require the Program vendors to report the customer discount, as recommended.
1-B-3	Ensure that its Program contracts include provisions that define (1) the corrective actions and (2) late fee penalties the Department may assess for non-compliance with payment and reporting requirements.	Incomplete/ Ongoing	DIR incorporated in its Program contracts provisions for corrective actions and late fee penalties for non-compliance with reporting requirements. However, DIR has not incorporated provisions for corrective actions and late fee penalties for non-compliance with payment requirements, as recommended.
1-B-4	Revise survival provisions in the Program contracts to include provisions that establish a time limit for how long after the contract expiration date a vendor has to fulfill a customer order.	Substantially Implemented	DIR is modifying the survivability language of its contracts by adding a timeframe of not to exceed 5 years; unless the customer demonstrates best value justification for a longer period of time. DIR is in the process of obtaining approval from the Contract Advisory Team (CAT) for this change. This change will affect all new cooperative contracts.

## Chapter 2: Program Fee Methodology, Standardized Fees, and Program Sales Projections and Documentation

Management from the DIR Chief Financial Office (CFO) and the Technology Sourcing Office (TSO) fully implemented the corrective action plans developed to address the five recommendations included in Chapter 2 of the SAO report.

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Additional controls are in place to strengthen the processes over 1) establishing administrative fees, 2) negotiating customer discounts, and 3) developing and documenting the sales projections and budget.

Reference	Recommendation	Status, as Verified by Internal Audit	Internal Audit Status Comments
2-1	Develop, document and implement a methodology for establishing the Program fee that includes identifying the actual costs for performing key Program contract management activities, including planning, procurement, contract formation, rate/ price establishment, and contract administration.	Fully Implemented	<p>DIR developed, documented, and implemented a Program fee-setting methodology based on:</p> <ul style="list-style-type: none"> <li>• Determining total operating expenses to be recovered by administrative fees;</li> <li>• Forecasting customer demand for goods and services;</li> <li>• Setting fees at levels that will recover operating costs based on forecasted customer consumption; and</li> <li>• Monitoring of financial operating results throughout the year to determine if DIR is generating revenue at the level needed to recover operating cost and take corrective action, if necessary.</li> </ul> <p>The methodology is based on the recovering of the costs associated with the administration of the Program.</p>
2-2	Discontinue using the Program fee as a tool to negotiate higher customer discounts with vendors.	Fully Implemented	<p>DIR amended its Program contracts to include language indicating that the administrative fee is not used for negotiation of a higher customer discount; instead the customer discount is based on volume purchasing. The Request for Offer (RFO) templates also indicate the customer discount must be provided by the vendor and calculated based on</p>

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Reference	Recommendation	Status, as Verified by Internal Audit	Internal Audit Status Comments
			the manufacturer's suggested retail price (MSRP).
2-3	Establish a standard fee for Program contracts. Because of the variety of products and services offered through the Program, the Department should consider establishing standard fees by product and service type.	Fully Implemented	DIR established standard fees for Program contracts. The fees are based on the various products and services offered to the DIR customers. For a sample of contracts reviewed the auditors verified that all contracts had the same fee for the same type of service or product.
2-4	Ensure that is does not include non-Program contracts in its annual review of Program sales projections.	Fully Implemented	DIR does not include non-Program contracts in the annual review of the Program sales projections. All products and services included in the projections are only offered through its cooperative contracts.
2-5	Maintain complete records of the documentation it uses to develop sales projections and the Program budget.	Fully Implemented	DIR maintains documentation for its sales projections and the Program budget. In addition, the revenue forecast contain sales information that supports the sales projections and the Program budget.

### Chapter 3: Accounting System Requirements, Financial Reporting, Program Fee Documentation, Fees Usage, and Updating the General Appropriations Act

Management from the DIR Chief Financial Office (CFO) fully implemented the corrective action plans developed to address 11 of 12 recommendations included in Chapter 3 of the SAO report. CFO Management asserted the corrective action plan for recommendation 3-A-1 was “Fully Implemented.” However, due to additional controls needed to fully implement the recommendation, Internal Audit determined the recommendation was “Substantially Implemented.”

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CFO management made significant progress in implementing the corrective action plans developed to address the recommendations included in Chapter 3 of the SAO report. Additional controls are in place to strengthen the processes over the 1) accounting of the Program, 2) accounting system's reconciliations, 3) reporting of financial information, 4) processing and documentation of transfers, and 5) identification of the General Appropriations Act (GAA) fund requirements.

Reference	Recommendation	Status, as Verified by Internal Audit	Internal Audit Status Comments
3-A-1	Record in its accounting system both the contract number and reporting period for all Program fees it collects.	Substantially Implemented	The Centralized Accounting Payroll and Personnel System (CAPPS) captures both the contract number and the reporting period for the Program fees remitted by the vendors. However, the auditors tested one-month transactions and determined that 53 of 528 (10%) transactions reviewed did not include the reporting period, and 42 of 528 (8%) transactions reviewed did not include the contract number. DIR developed a process to identify and correct payments received with missing contract numbers, reporting periods, or both. The process and tools developed are used to identify the missing data, contact the vendor, and complete posting of vendor payments.
3-A-2	Ensure that the fees deposited into the Clearing Fund are only for Program contracts.	Fully Implemented	DIR has procedures in place and a well-established method of finance to ensure the fees deposited into the Clearing Fund are associated to Program contracts only. DIR conducts periodic reviews on the deposits made to the Clearing Fund. The reviews are approved by the Program management staff.

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Reference	Recommendation	Status, as Verified by Internal Audit	Internal Audit Status Comments
3-A-3	Ensure that the Telecommunication Revolving Account recovers the funds that were incorrectly deposited into the Clearing Fund.	Fully Implemented	DIR ensured the Telecommunication Revolving Account recovered the funds that were incorrectly deposited into the Clearing Fund. The funds were transferred to the Telecommunication Revolving Account on 9/15/2011.
3-A-4	Consistently perform monthly reconciliations of its accounting system with the Uniform Manual Statewide Accounting System (USAS).	Fully Implemented	DIR accounting staff consistently performs monthly cash reconciliations of CAPPs with the USAS system.
3-B-1	Include on its annual encumbrance report only actual financial obligations, in accordance with the Office of the Comptroller of Public Accounts (CPA)'s requirements.	Fully Implemented	DIR only reports actual financial obligations in its Annual Encumbrance Report, as required by the Office of the CPA.
3-B-2	Comply with reporting requirements in Texas Government Code, Section 316.045, and the GAA.	Fully Implemented	DIR complies with the reporting requirements included in the Texas Government Code, Section 316.045, and the GAA. DIR reports on both the Annual Financial Report and on Rider 12.

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Reference	Recommendation	Status, as Verified by Internal Audit	Internal Audit Status Comments
3-C-1	Maintain accurate and complete documentation of its transfer transactions.	Fully Implemented	DIR maintains accurate and complete documentation of its transfer transactions. DIR policies and procedures include guidance on how to complete a transfer, required approvals, and required supporting documentation. DIR maintains transfer documentation from the CAPPs system that reconciles with transfer reports from the USAS system. Testing conducted by the auditors verified there are controls in place to ensure that transfers between the CAPPs and the USAS systems are allocated to the correct appropriations, as defined by the DIR method of finance and the transaction codes set by the Texas CPA.
3-C-2	Develop, document, and implement policies and procedures to ensure that temporary transfers from the Clearing Fund to other Department fund accounts are reimbursed in a timely manner.	Fully Implemented	DIR developed, documented, and implemented policies and procedures to ensure that temporary transfers are reimbursed timely. Agency policy clearly states that temporary transfers are reimbursed to the original appropriation when cash flow is positive. In addition, agency policy states these transfers are rare in occurrence and are completed within the fiscal year. DIR has authority to perform these transfers and the transfers are supported by the GAA and the Texas CPA.

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Reference	Recommendation	Status, as Verified by Internal Audit	Internal Audit Status Comments
3-D	The Department should ensure that it does not use Program fees to secure the procurement of Program contracts.	Fully Implemented	DIR does not use Program fees deposited into the Clearing Fund to procure Program contracts. Fees deposited in the Clearing Fund are used to pay for operational expenses such as: security enhancements, statewide security, statewide planning, rule and guidance, continuity of operations, and other daily operations.
3-E-1	Coordinate with the Legislative Budget Board (LBB) during the 83 <sup>rd</sup> legislative session to clarify and update the GAA Clearing Fund requirements to state that the Department receives Program fees from vendors.	Fully Implemented	DIR coordinated with the LBB to update the GAA Clearing Fund requirements to state, "As a depository for funds received as payments from state agencies, units of local governments, or vendors for goods and services provided." The proposed language was approved by the LBB on 2/23/15 and should be reflected in the GAA Clearing Fund for the 2016-2017 biennium.
3-E-2	Coordinate with the LBB during the 83 <sup>rd</sup> legislative session to clarify and update the GAA fund requirements to increase the amount of the total revenue that the Department can carry forward each year to an amount that will provide it with sufficient funding to maintain the Program at the start of a new fiscal year.	Fully Implemented	DIR coordinated with the LBB to update the GAA Clearing Fund requirements by increasing the amount of total revenue that could be carried forward each year to maintain the Program at the start of a new fiscal year. The LBB approved a carry forward of 10% of total revenue.

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Reference	Recommendation	Status, as Verified by Internal Audit	Internal Audit Status Comments
3-E-3	Coordinate with the LBB during the 83 <sup>rd</sup> legislative session to clarify and update the GAA fund requirements to Correctly identify the annual financial report that the Department prepares.	Fully Implemented	DIR coordinated with the LBB to update the GAA Clearing Fund requirements to rename DIR's annual financial report from "Comprehensive Annual Financial Report" to "Annual Financial Report."

## Chapter 4: Information Technology Controls

Management from the DIR Chief Financial Office (CFO) and the Information Technology Services (ITS) division fully implemented the corrective action plans developed to address three of seven recommendations included in Chapter 4 of the SAO report. Management asserted the corrective action plans to address recommendations 4-A-2, 4-A-3, 4-B-1, and 4-B-4 were implemented. However, due to additional controls needed to fully implement the recommendations, Internal Audit determined three recommendations were "Substantially Implemented" and one recommendation was "Incomplete/ Ongoing."

Management made progress in implementing the corrective action plans to address the recommendations included in Chapter 4 of the SAO report. Additional operating controls are in place to strengthen the processes over the 1) recording and updating of administrative fees, and 2) management of user access to the Contract Management System and the accounting systems.

Reference	Recommendation	Status, as Verified by Internal Audit	Internal Audit Status Comments
4-A-1	Ensure that the Contract Management System can record both current and prior fees for each Program Contract.	Fully Implemented	SalesForce, the Contract Management System for DIR, records both current and prior fees, as applicable, for Program contracts.

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Reference	Recommendation	Status, as Verified by Internal Audit	Internal Audit Status Comments
4-A-2	<p>Develop, document, and implement policies and procedures that:</p> <ul style="list-style-type: none"> <li>• Establish and implement a quality assurance process, including a review process, to verify that all data entered into the Contract Management system is accurate and complete.</li> <li>• Establish and implement a process to ensure that amended Program fees are updated in the Contract Management System in a timely manner.</li> </ul>	Substantially Implemented	<p>DIR developed, documented, and implemented policies and procedures for quality assurance over the data entered into the Contract Management System. DIR requires its staff to document their reviews of data completeness and accuracy, and it has a process in place to ensure that the Contract Management System data is updated timely and reviewed. Auditors reviewed a sample of Program contracts and determined that changes are entered into the Contract Management System timely, as required by agency policy. However, the quality assurance review is not documented, as required.</p>
4-A-3	<p>Establish and implement processes to ensure that:</p> <ul style="list-style-type: none"> <li>• The Department deactivates and removes all former employees' access to the Contract Management System in a timely manner.</li> <li>• Only Program staff can add, change, and delete Program-related information in Data Warehouse.</li> <li>• The Department reviews, and changes as necessary, the user</li> </ul>	Incomplete/ Ongoing	<p>DIR has procedures in place to manage user access to the Contract Management System; however, the procedures are not documented to ensure they are repetitive, consistent, and time bound. Having written policies and procedures over user access help ensure the staff has clear guidance on 1) timeframes for provisioning or de-provisioning user access, 2) review of user permissions, 3) review of user/ system accounts, 4) password management, and 5) user accountability, among other controls.</p>

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Reference	Recommendation	Status, as Verified by Internal Audit	Internal Audit Status Comments
	<p>access rights of non-Program staff.</p> <ul style="list-style-type: none"> <li>• The Department changes the password to the administrative account in Data Warehouse on a periodic basis.</li> <li>• Each employee is assigned an individual user account.</li> <li>• All active user accounts are assigned to specific staff.</li> </ul>		
4-B-1	Ensure that the new accounting system provides reliable, system-generated reports.	Substantially Implemented	CAPPS includes application controls to help ensure the system contains reliable financial data and generates reliable reports. Internal Audit performed limited testing over the CAPPS modules and identified that application controls are in place for the main modules that are relevant to the capturing, processing and reporting of the cooperative contracts sales and revenue data. However, application controls over unrelated modules need to be strengthened.
4-B-2	Deactivate and remove CDI Accounting System user accounts associated with former staff.	Fully Implemented	DIR decommissioned the CDI Accounting System and removed all user accounts associated with the system. In addition, DIR implemented a process to review and update user access to the current financial systems semi-annually.

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Reference	Recommendation	Status, as Verified by Internal Audit	Internal Audit Status Comments
4-B-3	Limit access to the CDI Accounting System to only users who need access to perform their job duties.	Fully Implemented	The CDI Accounting System has been decommissioned; however, a SQL data set was kept for records retention purposes. Access to the SQL data set is limited to two employees from the ITS Division who perform database administration functions.
4-B-4	Develop, document, and implement policies and procedures for the new Accounting System to ensure that: <ul style="list-style-type: none"> <li>• The Department deactivates and removes user access of former staff in a timely manner.</li> <li>• The Department properly restricts users' access to the system's database.</li> </ul>	Substantially Implemented	DIR has procedures in place to properly update user access to its Accounting System, CAPPs. However, the procedures are not documented. DIR will formalize its procedures in a standard operating procedure manual.

## Appendix A

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### Objective, Scope, and Methodology

The objective of this follow-up audit was to verify the implementation status of the corrective action plans developed to address 30 of 30 recommendations from the Texas State Auditor's Office (SAO) audit report 12-004 that DIR management reported as implemented.

To accomplish the objective, Internal Audit interviewed DIR staff from the Technology Sourcing Office, Chief Financial Office, and the Information Technology Services divisions, reviewed procurement documentation and contracts, statutes, rules, policies and procedures, and other relevant documentation. In addition, Internal Audit conducted observations of processes, and performed testing on the application controls over the Centralized Accounting and Payroll/ Personnel System (CAPPS), and the user access controls over the Contract Management System. Internal Audit also assessed the adequacy and effectiveness of the controls implemented to determine whether the controls mitigated the risks associated with the audit recommendations.

## Appendix B

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### Internal Report Distribution

Department of Information Resources (DIR) Board  
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