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October 15, 2004

Mr. Kenneth J. Ringler, Jr.
Commissioner
Office of General Services
Corning Tower
Empire State Plaza
Albany, NY 12242

Mr. Andrew S. Eristoff
Commissioner
Department of Taxation and Finance
State Office Campus – Building #9
Albany, NY 12227

Mr. Michael McCormack
Director
Office for Technology
Empire State Plaza
Albany, NY 12220

Re: Administration and Use of Contract
PS00374, IBM Corporation-
Comprehensive Services Agreement
Report 2004-R-5

Dear Messrs. Ringler, Eristoff, and McCormack:

Pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law, we have audited selected aspects of the Office of General Services' administration of Contract PS00374, IBM Corporation – Comprehensive Services Agreement, as well as selected aspects of the use of this contract by the Department of Taxation and Finance and the Office for Technology, for the period April 1, 2001 through March 31, 2004.

A. Background

The Office of General Services (OGS) provides a broad range of support services that are necessary for the efficient operation of State government. Such services include centralized information processing; space planning and leasing; real property management and maintenance;

centralized contracting for commodities and services; and other support services. The statewide procurement of commodities and services totals about \$2 billion annually. For such purchases, OGS is responsible for developing detailed specifications, evaluating bids, and monitoring vendor performance. In addition to State agencies, eligible local governments, schools, and not-for-profit organizations may use these centralized contracts, which generally offer the best prices because of the State's purchasing power.

An area where OGS has played an important role is in negotiating comprehensive service agreements with its major computer hardware providers: IBM Corporation (IBM) (contract executed in March 1997); Sun Microsystems (contract executed in April 1994); Hewlett-Packard (contract executed in February 1996); and Unisys Corporation (contract executed in February 1998). These contracts cover a full range of services and provide for sales volume discounts.

The contract with IBM is the focus of our audit. This contract covers a full range of IBM services for use by agencies that are IBM customers. This comprehensive service agreement was intended to cover four categories: advisory consulting services, hardware maintenance services, packaged software/consulting services, and IBM education (training). The packaged software/consulting services portion of the contract was to be added by formal amendment at a later date, but this did not occur. This contract represented the first time such services from IBM were made available through one statewide contract. The intent of the contract was to provide all agencies the benefit of sales volume discounts that otherwise would not be available if each agency alone were to independently solicit such services.

The contract provides for an increasing level of discount from a list price for consulting services when the sales volume of consulting services rises to certain levels. The discounts are based on the State as a single customer. All New York State agencies and non-State entities, such as local governments and school districts, that have IBM-installed products and/or services may use this contract. In computing the sales volume for the appropriate discount rate, the contract requires that IBM accumulate all sales for each type of service for all eligible users of the contract, State agencies, municipalities and eligible not-for-profits, irrespective of whether the sales were made from this contract or other contracts with IBM. (This concept is discussed later in this report under the section entitled Audit Objective #3.)

The original contract covered the period March 21, 1997 through March 21, 1999. As provided for in the contract, IBM and OGS mutually agreed to extend the contract at various intervals. The contract was extended four times, and was scheduled to terminate on September 30, 2004. On September 20, 2004, the contract was extended through December 31, 2004, for use by all New York State agencies and non-State entities. School districts may use the contract through September 30, 2005.

As of March 31, 2004, contract expenditures totaled about \$200 million since the inception of the contract in March 1997. For the 2001-02, 2002-03, and 2003-04 State fiscal years, 38 State agencies spent a total of about \$137 million on contract-related services. The Office for Technology (OFT) and the Department of Taxation and Finance (Tax Department), both of which rely heavily on technology and computer systems to conduct their operations, incurred the highest expenditures over the three-year period. Because of this, we selected OFT and the Tax Department to assess how they

used the contract and what prices they were charged.

The following table summarizes contract expenditures by the ten agencies with the highest expenditures, as well as the combined total of the remaining 28 agencies, over the three-year period.

Agency	FY 2001-02	FY 2002-03	FY 2003-04	TOTAL
Office for Technology	\$8,275,382	\$12,452,091	\$13,935,954	\$34,663,427
Department of Taxation & Finance	2,035,868	6,905,382	10,806,247	19,747,497
Department of Labor	3,775,562	3,080,166	5,645,186	12,500,914
Workers Compensation Board	7,551,097	0	4,033,024	11,584,121
City University of New York	926,728	6,195,992	1,144,733	8,267,453
State Education Department	758,979	3,684,304	2,477,294	6,920,577
State University of New York	1,179,799	2,213,869	1,817,472	5,211,140
Office of Children & Family Services	788,729	1,261,372	2,560,027	4,610,128
Division of Parole	1,711,678	1,611,550	777,441	4,100,669
Department of Motor Vehicles	984,112	1,273,681	1,231,772	3,489,565
Total for Other 28 Agencies	6,463,700	12,091,218	7,033,556	25,588,474
Total	\$34,451,634	\$50,769,625	\$51,462,706	\$136,683,965

OFT is the central technology office in New York State and plays a unique and critical role in overseeing the State's technology infrastructure. OFT's statutory responsibilities include, but are not limited to: acting as the official planning and coordinating office for advancement of technology to improve government efficiency and effectiveness; as well as advising and assisting state agencies in developing policies, plans and programs for improving statewide coordination, administration, security, confidentiality, program effectiveness, acquisition and deployment of technology. In the last few years, OFT has shifted its primary focus from setting statewide policy to a more operational role. This shift was primarily driven by the completion of the Data Center Consolidation Plan, the creation of the Human Services Network (a statewide network supporting the public programs of the Department of Health, Department of Labor, Office of Children and Family Services, and Office of Temporary and Disability Assistance), and the transfer of the Division of Telecommunications from OGS to OFT. One of these operational responsibilities includes the operation of the State's computer data centers, which support the data processing requirements of 27 agencies.

The Tax Department administers the State's Tax Laws and manages the State Treasury. In fulfilling its responsibilities, the Tax Department uses its computer systems to collect about \$43 billion in State revenue and about \$21 billion in local taxes on behalf of municipalities, including New York City and the City of Yonkers income taxes. The Tax Department has utilized the contract extensively to design and implement its Audit Case Management System (ACMS). The purpose of ACMS is to provide the Tax Department with a central repository of all tax cases selected for audit. In addition to helping the Tax Department design and implement ACMS, IBM has assisted the Tax Department in integrating this system with other Tax Department applications.

B. Audit Scope, Objectives, and Methodology

We have audited selected aspects of the Office of General Services' administration of Contract PS00374, IBM Corporation - Comprehensive Services Agreement, as well as selected aspects of the use of this contract by the Tax Department and OFT, for the period April 1, 2001 through March 31, 2004. The objectives of this performance audit were to determine whether:

1. OFT and the Tax Department used the contract to purchase only the types of services allowable under the contract;
2. OFT and the Tax Department were satisfied with the quality of the services provided under this contract;
3. The prices charged by IBM were consistent with the contract's terms; and
4. OFT and the Tax Department evaluated other procurement options before using this contract.

We conducted only a limited review of the educational services provisions of the contract because these services were of a relatively low dollar value. We also limited our review of the maintenance services provisions of the contract to testing the accuracy of the rates charged by IBM for the services and the extent of management review by OFT and the Tax Department of the IBM charges. We did not test the procedures used by OFT and the Tax Department to ensure that only existing equipment was included in the maintenance billings and that items retired from service were appropriately deleted from the maintenance billings and new items were added only when appropriate.

To accomplish these objectives, we interviewed officials from OGS, OFT, the Tax Department, the Office of the State Comptroller, and IBM to discuss the terms of the contract, how the contract has been used, and the rates charged. In addition, we reviewed aggregate sales volume reports prepared by IBM and submitted to OGS to assess the accuracy of discounts charged. In addition, we reviewed any complaints received by OGS on this contract and met with officials from OFT and the Tax Department to determine their satisfaction with IBM's performance.

As part of our audit testing, we obtained a record of the payments charged by OFT and the Tax Department to this contract from the State Accounting System during our audit scope period. From the population of payments made by OFT and the Tax Department on this contract, we selected a judgmental sample of 20 payments by OFT and 20 by the Tax Department in order to test whether the services purchased and the amounts paid by the agencies for those services complied with the contract. Our samples consisted of large payments made by OFT and the Tax Department during our audit scope. We did not consider the types of services purchased by the agencies with these payments when selecting our samples. The 40 payments selected in our sample were used to support the costs of 21 different projects (13 at OFT and 8 at the Tax Department). For each payment, we determined whether OFT and the Tax Department paid the appropriate net price for the purchased services and whether the services purchased were allowable under the contract. For each

project, we determined whether OFT and the Tax Department did any evaluation of other available procurement options prior to using this contract. Lastly, we reviewed the calculation of maintenance costs for a sample of 20 machines covered under maintenance payments we selected for review (10 each for OFT and the Tax Department). We determined whether OFT and the Tax Department was able to verify that the rates charged for these maintenance costs were appropriate.

We conducted our audit in accordance with Generally Accepted Government Auditing Standards. Such standards require that we plan and perform our audit to adequately assess those operations of OGS, OFT and the Tax Department that are within our audit scope. Further, these standards require that we understand the internal control structure of OGS, OFT and the Tax Department and their compliance with those laws, rules and regulations that are relevant to the operations included in our audit scope. An audit includes examining, on a test basis, evidence supporting transactions recorded in the accounting and operating records and applying such other auditing procedures, as we consider necessary in the circumstances. An audit also includes assessing the estimates, judgments, and decisions made by management. We believe that our audit provides a reasonable basis for our findings, conclusions, and recommendations.

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State, several of which are performed by the Division of State Services. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds, and other payments. In addition, the Comptroller appoints members to certain boards, commissions and public authorities, some of who have minority voting rights. These duties may be considered management functions for purposes of evaluating organizational independence under Generally Accepted Government Auditing Standards. In our opinion, these management functions do not affect our ability to conduct independent audits of program performance.

C. Results of Audit

Audit Objective # 1: *Did OFT and the Tax Department use the contract to purchase only the types of services allowable under the contract?*

The contract allows New York State agencies, local governments, and others authorized by law to use the contract for three different categories of services: advisory consulting services, hardware maintenance services, and IBM education (training). Authorized entities should use the contract only for these types of services. We selected a judgmental sample of 20 contract payments by OFT and 20 contract payments by the Tax Department to test whether the services purchased by the agencies were allowable under the contract.

We reviewed a total of about \$11.9 million out of \$34.7 million in payments made by OFT during our audit scope period. Of this amount, we found that \$9.2 million was for maintenance services, while the remaining \$2.7 million was for advisory consulting services. For each payment, OFT's use of the contract was allowable under the contract.

We reviewed a total of about \$7 million of the \$19.7 million in payments made by the Tax Department during our audit scope period and found that \$6.6 million was for advisory consulting

services, while the remaining \$370,000 was for hardware maintenance services and IBM training. For each payment, the Tax Department's use of the contract was allowable under the contract.

Conclusion:

For each of the 40 payments we reviewed, the services purchased by OFT and the Tax Department were allowable under the contract.

Audit Objective #2: *Were OFT and the Tax Department satisfied with the quality of the services provided under the contract?*

Users of the IBM contract should be satisfied with the quality of services provided by the contract vendor, in this case IBM. If an agency is not satisfied, it should notify OGS, which is responsible for resolving the complaint.

OFT officials stated they are satisfied with the quality of services they receive under this contract. They indicated that one of the reasons they like purchasing services through IBM is the level of expertise IBM employees have with IBM equipment. OFT has not made any formal complaints against IBM under this contract. OFT officials stated that if there is a problem, the problem is solved directly with IBM, and is usually resolved quickly.

Tax Department officials stated they are generally satisfied with the quality of services they receive under this contract. However, Tax Department officials are currently in discussions with IBM and the New York State Chief Information Officer (CIO) regarding a complaint they have relating to IBM's current approach to providing services. Tax Department officials contacted the CIO about this complaint in a formal letter, dated February 18, 2004, from the Commissioner of the Tax Department, in which the Commissioner states that the Tax Department has "serious concerns regarding this Department's ongoing relationship with IBM" and, "several IBM products are not meeting our expectations." The complaint revolves around performance problems encountered when the Tax Department integrates IBM software and how IBM's organizational structure and work order process delay addressing integration issues. The letter refers to three IBM products that were procured under the contract. Two software projects, Content Manager and MQ Series Workflow, had performance issues. Another software project, Case Selection, was being delivered late and the Tax Department expected it to have performance problems as well. While the Tax Department took action to address their complaint, they did not notify OGS of this matter. Tax Department officials stated that they were only looking for assistance in mediating some issues and that this letter was not a formal complaint against IBM. Therefore, Tax Department officials did not feel the need to elevate the matter to OGS. They stated that they would work with the CIO to resolve their complaint, and would only involve OGS if the CIO could not resolve the complaint.

OGS is responsible for monitoring vendor performance and quality control, and therefore should be notified of any major complaints about contract performance. Absent such notification, OGS, the administrator of this contract, will be limited in its ability to ensure agencies using this contract are receiving quality services. Since this complaint was deemed significant enough by the Tax Department to notify the CIO, we feel the Tax Department should have also notified OGS of its

complaint.

(In their response to the draft report, OGS officials state that OGS does not routinely monitor vendor performance under this, or any contract. Instead, OGS sees its role as standing ready to aid agencies requesting assistance with any aspect of using a contract, including resolving complaints. Thus, agencies should attempt to resolve issues with vendors as they occur, and to request assistance from OGS when the issue is not satisfactorily resolved.)

Auditor's Comments: Because the IBM contract can be used by multiple entities, OGS in this instance serves as the central repository for all complaints expressed by contract users. As such, only OGS can detect patterns and trends with contract complaints and, if warranted, step in and resolve such issues with IBM. Also, OGS's awareness of complaints concerning vendor performance can inform their decision to extend a current contract, or revise terms of new contracts based on the extent and types of complaints received.

Conclusion:

Both OFT and Tax Department officials stated they are generally satisfied with the quality of services provided under the contract. However, the Tax Department sent a letter of complaint to the New York State Chief Information Officer regarding some IBM work, which makes it appear that the Tax Department is not completely satisfied with IBM's services. As contract administrator, OGS should have been notified of this complaint.

Recommendation

To the Tax Department

- 1. In the future, formally notify OGS of any complaints regarding IBM's performance under this contract.*

(Tax Department officials agree with this recommendation.)

Audit Objective #3: *Were the prices charged by IBM consistent with the contract's terms?*

Issue: *Volume Discounts for Consulting Services*

The contract provides for an increasing level of discount for consulting services when the sales volume of consulting services rises. (Maintenance and education services are set at one discount rate, regardless of sales volume.) The contract provides for three discount tiers based on the annual aggregate sales volume of these services, as follows: \$0 to \$25 million - Tier 1; \$25 to \$50 million - Tier 2; and over \$50 million - Tier 3. Tier 3 offers the highest discount rates for services, followed by Tier 2 and Tier 1. According to the contract, IBM should aggregate each calendar year's sales volume of consulting services to determine the discount tier applicable for eligible agencies for the following State fiscal year (beginning April 1).

Within 30 days of the close of each calendar quarter, IBM is contractually required to provide OGS with quarterly reports showing the sales volume of products and services purchased by all eligible agencies (State and non-State) under this contract, as well as under all other contracts with IBM for like products and services. In computing the sales volume for purposes of determining the correct discount rate, the IBM contract included a unique provision. IBM was required to report the volume of all sales made to entities eligible to use this contract, irrespective of whether the contract was in fact used by the eligible entity. For example, if the City of Albany procured consulting services similar in nature to the services they could obtain under this contract, but purchased the services separately from this contract, IBM was required to include this sale in their volume report. The same would be true if a public authority or an eligible not-for-profit entity procured services. This presented IBM with the problem of accumulating sales information from diverse locations and business units. It also presented OGS with problems in validating the IBM sales information because OGS must try to obtain this confirming information from sources outside the State Accounting System and from a wide number of entities. As a result, there is risk that the State (and all other users) may not have received the appropriate discount for consulting services procured under this contract.

In order to insure the correct discount rate is used, OGS needs to obtain detailed, timely reports from IBM identifying what the applicable sales volume is for consulting services. OGS should ensure that it receives these reports on a timely basis and should do their best to verify their accuracy and completeness. We found that OGS needs to make substantial improvements in this regard, as IBM routinely failed to submit timely volume reports during our audit scope. In addition, we found that OGS needs to develop and consistently utilize procedures for independently verifying volume in order to ensure IBM is reporting accurate and complete information.

In order to determine the appropriate discount tier for the 2001-02, 2002-03, and 2003-04 State fiscal years, OGS should have received from IBM quarterly sales volume reports covering the 2000, 2001, and 2002 calendar years. In addition, OGS should have received from IBM quarterly sales volume reports for the 2003 calendar year in order to determine the discount tier for agencies that will use the contract during the 2004-05 State fiscal year. We found that IBM did not submit its sales volume reports to OGS as required under the contract. OGS officials told us that they attempted to obtain the quarterly reports from IBM, but that IBM did not submit them. For the 2002 calendar year, IBM submitted each of the quarterly reports late, ranging from four days late to more than four months late. IBM submitted all four quarterly reports for the 2003 calendar year at the same time on April 26, 2004, rather than 30 days after each quarter, as required. Thus, all four quarterly reports were submitted well past their due date. By not obtaining the required sales volume reports from IBM on a timely basis, OGS left it to the contractor, IBM, to report the sales volume, and resulting discount tier, without any independent verification.

The contract further states that "the State and authorized agencies shall have the right to suspend all contract payment for [IBM's] failure to deliver said report(s) within the required time frames, and may apply an appropriate level of higher discount on the annual anniversary date in the absence of such report(s)." Therefore, if IBM did not provide all sales volume reports on a timely basis, agencies using the contract were entitled to a higher discount on services they purchase under this contract during the subsequent fiscal year. Since IBM did not provide any sales volume reports

to OGS for the 2000 and 2001 calendar years, agencies were entitled to a higher discount (a Tier 3 discount) for purchases made during the period April 1, 2001 through December 31, 2002 than what they were actually provided (a Tier 2 discount). OGS officials claimed they have tried to get IBM to comply with the contract's reporting requirements. For example, OGS provided our auditors with a copy of a letter it sent to IBM on December 26, 2003 re-requesting IBM's sales volume reports for calendar year 2003. However, OGS officials stated that their primary focus in administering this contract is to ensure quality services are being provided by IBM. They chose to not take punitive actions against IBM for not submitting quarterly volume reports. The timely receipt and review of these reports by OGS is necessary in order to ensure users of the contract are being provided with the appropriate discount on services purchased under the contract. Therefore, OGS should take a stricter approach to enforcing the contract's reporting requirements by using the means available through the contract.

(In their response to the draft report, OGS officials stated that the contract provision allowing them to impose a higher pricing discount tier because of late reports should be used only as a last resort to avoid making a negative impact on the level of cooperation from the vendor. They also feel that their approach of working with IBM to obtain the sales reports was successful. The officials also point out that the contract contains terms allowing contract users to recover any overpayments made under the contract, thus limiting OGS's exposure to the risk of incorrectly paying for services from a higher volume discount tier.)

Auditor's Comments: As discussed in the preceding paragraphs, these significant time lapses cost OGS the ability to monitor whether and when sales volume tier discounts should have taken effect. OGS's choice not to suspend payments or apply a higher pricing discount was a missed opportunity for OGS to ensure that all contract users were paying prices in accordance with proper contract sales volume discount tiers.

According to the contract, calendar year data should be aggregated to determine the discount tier for the next fiscal year beginning on April 1. For example, the volume of purchases during the 2002 calendar year should have been aggregated to determine the discount tier for the State fiscal year 2003-04. However, due to active negotiations by OGS with IBM, the State of New York was moved to the Tier 3 discount tier starting on January 1, 2003. This increase in the discount rate was obtained by OGS three months earlier than required in the contract. (In making this determination, OGS used sales volume data for the first three quarters of calendar year 2002 and projected the fourth quarter's sales volume data to determine that the State would exceed the threshold necessary for Tier 3.)

In addition, we are concerned that OGS, in negotiating the contract and in its role as contract administrator, did not develop a mechanism to independently test the accuracy of IBM's sales volume data (either by State or non-State agencies), and in effect placed heavy reliance on IBM for the reporting of such information. OGS officials claimed that they attempt to verify volume of State agencies by comparing what IBM reports in their volume reports to what is recorded on the State Accounting System. However, OGS officials did not provide documentation to support that they had done such verification for the calendar years applicable to our audit scope (2000, 2001, 2002, and 2003). Specifically, we were provided with documentation showing that OGS attempted to verify the volume of purchases made by State agencies under the contract for only 7 of the 16

quarters applicable to the 2000-2003 calendar years. OGS did not provide any documentation of their verification of the volume for 9 of these 16 quarters. In addition, OGS' review was limited to the volume of purchases made by State agencies solely under contract PS00374. The review did not examine non-State agencies' volume nor did it examine volume of purchases under other like contracts with IBM. The sales volume of products and services (i.e., consulting services) purchased by all eligible agencies (both State and non-State agencies) under this contract, as well as under all other contracts with IBM for like products and services, are to be used in determining the appropriate tier discount. OGS clearly needs to enhance its efforts to verify that IBM's reported volume is accurate and complete. For example, some of the non-State agencies, such as those of the City of New York, are potential high volume users of the contract (e.g., the City of New York's Department of Environmental Protection alone purchased over \$2.7 million in consulting services from IBM in calendar year 2002). Therefore, OGS should have a means of performing some tests of the accuracy of the reported sales volume of non-State agencies since the accuracy of this volume is vital when determining the appropriate discount tier. OGS had no procedures in place for verifying this information.

To determine whether IBM reported accurate, complete information in its sales volume reports, we compared IBM's reports to information recorded on the State Accounting System for State agencies. In calendar years 2003 and 2004, the State qualified for Tier 3 discounts for the purchase of consulting services. Since the State could not have received a higher discount in these years, we did not attempt to verify the accuracy and completeness of the sales volume reports applicable to these years (calendar years 2002 and 2003). For the 2000 and 2001 calendar years, we requested and received from IBM the applicable sales volume reports. IBM officials claim that their calendar year 2000 and 2001 sales volume reports included all revenue received on the contract from State and non-State agencies as well as all revenue received from purchases of like products and services by both State and non-State agencies on other IBM contracts. IBM initially reported to us that sales volume for calendar years 2000 and 2001 totaled about \$39.4 and \$48.5 million, respectively. IBM later informed us that these amounts included some sales volume that they should not have, and the correct amounts were \$34.3 million and \$46.7 million, respectively. Due to the complexity of tracking all sales volume applicable to this contract, and the fact that IBM initially reported inaccurate volume for calendar years 2000 and 2001, we question whether IBM's system for tracking volume is adequate. Because of the importance that sales volume plays in determining the discount agencies receive, we are conducting a separate examination of this issue. Of particular interest is the sales volume for calendar year 2001, which, according to IBM, was \$46.7 million or only \$3.3 million below the \$50 million threshold necessary to receive the Tier 3 discount for consulting services.

Conclusion:

OGS left itself largely dependent on IBM for calculating the correct discount tier for consulting services. Based on our discussions with OGS officials, we determined that OGS staff needed to make a stronger effort to secure the required sales volume data and to conduct tests of the reasonableness of the data reported by IBM. Further, OGS officials did not use the options available to it in the contract to enforce IBM's compliance with the sales volume reporting requirements. Under such circumstances, OGS officials left contract users vulnerable to being charged an incorrect rate for consulting services. Future contracts of a similar nature must take into account the

mechanisms necessary to properly administer the contract to protect the State's interests, as well as the interests of all parties authorized to use the contract.

Recommendations

To OGS

If the contract is extended or a similar contract is negotiated:

2. *Ensure that IBM submits all quarterly sales volume reports on a timely basis, as contractually required. If IBM does not submit the required reports, use the options available in the contract to suspend contract payments and apply an appropriate level of higher discount.*
3. *Implement procedures to verify the accuracy and completeness of sales volume reports and document the work.*

(OGS officials agree with both Recommendation 2 and Recommendation 3, and state that they will use all options available in the contract to ensure compliance in a measured and reasonable manner that will best promote the interests of the State, and will work with OSC to verify each quarterly report.)

Issue: *Hiring of Service Providers*

When procuring consulting services under the contract, agencies need to select the specific skills and levels of experience that they want the IBM employees hired for the job to possess. The contract lists the various job titles, and hourly rates, that agencies may choose from. The various job titles are standard within the IT industry. The job titles vary by skill and by experience. Please refer to Exhibit A at the end of our report for a listing of the various job titles and hourly rates from which agencies may choose when purchasing consulting services from IBM under the contract.

Agencies should hire only IBM employees with a job title that matches the skill and experience level required for a specific project. For example, if the project only requires a Technical Specialist 1, agencies should not hire a Technical Specialist 5, a more expensive level of service. Agencies should also ensure that the IBM employees they hire meet the minimum qualifications for their job title before hiring them.

The contract itself does not provide a detailed description of the various job titles and skill/experience levels offered under the contract. Therefore, we requested this information from OGS since OGS, as the contract administrator, should provide this information to the State agencies. However, the descriptions that OGS provided us, which are the same descriptions that they provide to other agencies such as OFT and the Tax Department, do not clearly distinguish among the

different levels within the same job title. For example, they describe what a Technical Specialist is qualified to do, but do not clearly distinguish a Technical Specialist 1 from a Technical Specialist 5.

IBM also provides descriptions of the job titles offered under this contract on their website. However, these descriptions also do not distinguish among the different levels within the same job title. Therefore, agencies have not been provided with detailed descriptions that would enable them to identify the specific job titles they require for consulting services purchased under this contract. The lack of such detailed descriptions limits an agency's ability to ensure it is receiving and paying for the appropriate level of service. For example, there is a large difference in rates (about \$55 per hour with a Tier 3 discount) between a Technical Specialist 1 and a Technical Specialist 5.

OGS and Tax Department officials responded that they did not believe developing more specific job descriptions would be practical as a consultant's experience level is not always the most significant factor when selecting the most qualified person. For example, if an agency needed to hire an IBM consultant to provide services on a newer application, a consultant with less experience may be more qualified to provide such services, as he or she may have recently been educated or received training on this newer application. While a consultant with more experience may be available from IBM, this person may not be as familiar with the newer application, and thus may not be the best person to hire.

We concur that developing more specific job descriptions may not be feasible. However, agencies that use this contract should, at the very least, maintain documentation to support their negotiation and choosing of specific job titles. This documentation should clearly illustrate why the agency felt the person they chose was the best person for the job and that no less expensive option was available. Neither OFT nor the Tax Department maintained such documentation for the consulting payments we reviewed. Absent such documentation, we were unable to determine whether OFT or the Tax Department hired the appropriate level of consultants, and therefore, there is a risk that OFT or the Tax Department paid for consultants that were overqualified for the services provided, resulting in excess costs for those services.

Both OFT and the Tax Department receive Statements of Work from IBM that detail the employees that will be working on the project. OFT typically identifies the service titles they need for a project prior to IBM completing the Statement of Work. OFT officials select the titles based on their expertise in the technology field, as the job titles offered under this contract are also used for other IT contracts. If they are hiring a new employee, they review the employee's resume to ensure the person is properly qualified. If they are hiring someone whom they have hired in the past, they do not review their resume. OFT officials stated that if they feel an IBM employee is not providing quality services, then they replace the person with someone else.

The Tax Department does not identify the specific job titles it needs for a project prior to receiving IBM's Statement of Work. Tax Department officials discuss the services they need with IBM officials, and then IBM identifies the job titles it feels are necessary to complete a project. Tax Department officials review these titles and if they feel a project does not require the level of service recommended by IBM, then they negotiate with IBM to change the job titles. Tax Department officials stated they also conduct interviews and review resumes of IBM consultants prior to using

them for a project under this contract. Tax Department officials stated that if they feel an IBM employee is not providing quality services, then they replace the person with someone else.

We tested the qualifications of a sample of IBM consultants that worked on the projects we reviewed. We reviewed the qualifications for a total of 21 consultants, 11 that worked on OFT projects and 10 that worked on Tax Department projects. We found that all 21 met the minimum qualifications established by IBM for their respective job titles.

Conclusion:

OFT and the Tax Department appear to have adequate controls in place to ensure that the IBM consultants they hire meet IBM's minimum qualifications. However, neither agency adequately documented why they chose to purchase a particular level of consultant over other levels. Therefore, there is a risk that both agencies may be paying for more costly job titles than are required for the services they need. Both OFT and the Tax Department should ensure they maintain documentation to support their decision to hire specific consultants over others.

(In their response to the draft report, OFT officials note that the auditors found that OFT has a process in place to identify the job titles needed for a particular task, therefore OFT disagrees that it may be paying for more costly job titles than are required for the services rendered.)

Auditor's Comment: As our report states, OFT did not document why a particular person was the best person for a particular job nor that a less expensive option was available. Therefore, the risk exists that OFT could incur higher costs than necessary for a project.

Recommendation

To OFT and the Tax Department

4. *Maintain documentation to support the agency's decision to hire a specific level of consulting services.*

(OFT and Tax Department officials agree with this recommendation.)

Issue: *Agency Review of Invoices*

Advisory Consulting Services

Agencies should have internal controls in place to ensure the rates and hours charged for consulting services are appropriate. We found that OFT has adequate procedures in place to ensure the payment rates charged for consulting services are appropriate. However, OFT officials need to ensure they always follow these procedures. OFT's Finance Unit compares the rates invoiced by IBM against the rates documented in the applicable Statement of Work. The rates in the Statement of Work are negotiated prior to any services being provided. OFT is able to verify that the rates they are charged for consulting services in a Statement of Work are appropriate by checking OGS' website, which documents the current applicable rates for the various consultant titles offered under

this contract. While OFT generally appears to verify the appropriateness of consulting payment rates, we found one invoice in which OFT overpaid for consulting services. Specifically, OFT paid IBM tier two consulting rates for two different consultants when, at the time, OFT should have paid IBM the lower tier three consulting rates. According to OFT officials, this was an oversight, as staff did not check against the new tier three rates that were in place at the time. This oversight resulted in an overpayment of about \$670. According to OFT, IBM has agreed to credit OFT for this overpayment.

We found that OFT has adequate internal controls in place for monitoring the time IBM consultants spend working on a project. IBM consultants submit periodic time sheets to OFT's Program Management Unit. An official from this unit is required to monitor the hours that consultants work at OFT and to attest, by signing the time sheets, that the hours IBM bills OFT are accurate. The OFT Finance Unit also reviews the time sheets to ensure the number of hours billed by IBM is appropriate. In addition, the Finance Unit monitors the total hours invoiced by IBM to ensure IBM does not invoice for more hours than what was agreed to in a project's Statement of Work. For each of the payments OFT made for consulting services that we reviewed, OFT provided signed time sheets to support each of the hours IBM billed them for.

The Tax Department also had adequate procedures in place for ensuring the rates and hours charged for consulting services are appropriate. Project managers monitor the time and attendance of consultants and sign off their time sheets. The time sheets are then forwarded to the administrative support unit, which enters consultants' time on a spreadsheet for tracking purposes. Both parties review the invoices received from IBM to ensure the time billed and rates charged by IBM are appropriate. For each of the consulting payments made by the Tax Department that we reviewed, we found the payment rates charged by IBM did not exceed the cap amounts authorized by the contract. In addition, the Tax Department provided time sheets to support all but 1.25 hours of service time that IBM billed it for. However, we determined that the Tax Department should improve its maintenance of time records to support these invoices. Specifically, the Tax Department did not initially provide a significant number of time sheets that we requested, even though its internal procedures are to keep each project's time records filed together. The Tax Department eventually provided all of the timesheets we requested, but these records should be kept together in accordance with the Tax Department's internal procedures. In addition, a large number of time sheets did not have a signature of the applicable project manager, making it appear as if these time records were not actually reviewed by a project manager. The Tax Department should develop controls to ensure that it follows internal procedures for reviewing consultant time sheets, including the signing off on time sheets by project managers and the filing of time sheets.

Maintenance Services

Both OFT and the Tax Department use the contract to provide maintenance coverage on IBM equipment. The pricing for equipment maintenance is based on IBM's base price for maintenance on that equipment less the applicable discount provided by the contract for that equipment. Each type of equipment has a different discount rate, while the base rate varies depending on the equipment's features. Therefore, agencies should have internal controls in place to ensure they are paying the appropriate rate for maintenance on their equipment.

We asked OFT and Tax Department officials how they monitor the appropriateness of IBM's rates for equipment maintenance under this contract. OFT officials stated that they focus their oversight efforts on ensuring the inventory covered under the contract's maintenance agreements is accurate and current, as opposed to ensuring the rates charged by IBM for these maintenance services are appropriate. According to OFT officials, there is a greater likelihood for identifying cost savings by taking this approach. OFT officials stated that their Finance Unit does occasionally review the pricing for a sample of equipment. However, OFT did not provide documentation to support that this review has ever taken place.

Tax Department officials stated that they annually verify that all the necessary equipment is covered under a maintenance agreement and that they are not paying for maintenance on equipment that no longer needs maintenance. Tax Department officials did not provide any documentation to support they have ever reviewed the appropriateness of the rates IBM charges for maintenance of equipment.

We also asked OFT and Tax Department officials to verify that the amounts they paid for maintenance costs for a sample of ten equipment items at each agency was appropriate. Neither agency was able to verify that the prices were appropriate. In fact, we learned that OFT, the Tax Department, and other users of the contract are not provided with detailed pricing lists that would enable them to independently verify IBM's pricing. The agencies annually receive an inventory of their covered equipment from IBM that lists the net price for each equipment item; however, these reports do not break down the equipment pricing by the equipment's features. If either agency wants to verify the specific maintenance price of a piece of equipment, they have to request a breakdown of the price from IBM to identify the amount IBM charged for each of the equipment's features. This does not provide for an independent review as it relies completely on information provided by IBM. The lack of an independent review increases the risk that agencies could be overcharged for maintenance costs, as IBM could simply provide whatever detailed pricing information is necessary to have the billed amount properly compute.

Conclusion:

OFT and the Tax Department generally have adequate procedures in place to ensure they pay the appropriate amount for consulting services purchased with this contract. Both agencies, however, need to ensure they follow these procedures all the time.

Neither OFT nor the Tax Department conducts an independent verification of the rates IBM charges for maintenance costs. If and when they do attempt to assess the appropriateness of IBM's rates, they completely rely on information provided by IBM. Both agencies need procedures for independently verifying the rates charged by IBM.

Recommendations

To OFT

5. *Follow established procedures for verifying the appropriateness of consultant payment rates.*

(OFT officials agree with this recommendation.)

To the Tax Department

6. *Ensure all IBM consulting time sheets are reviewed and approved by a project manager and filed in accordance with internal procedures.*

(Tax Department officials agree and state that project managers have been reminded to approve all time sheets.)

To OFT and the Tax Department

7. *Develop and implement standard procedures for independently verifying that the rates IBM charges for maintenance of equipment are appropriate.*

(OFT and Tax Department officials agree with this recommendation. It should also be noted that OFT's new contract with IBM, recently approved by the New York State Office of the Comptroller, addresses this issue through improvements in contractual language and pricing sources.)

Audit Objective #4: *Did OFT and the Tax Department evaluate other procurement options before using this contract?*

The contract requires all agencies considering the purchase of IT services to refer to existing services and technology contracts which also contain IT services. Agencies are urged to compare services on these contracts in order to determine the most cost effective and appropriate option for their particular needs. OGS expects agencies to maintain documentation supporting the agencies' evaluation of other procurement options and its decision that purchasing services under contract PS00374 was the most practical and economical option.

We found that OGS has not developed formal expectations concerning what documentation agencies should maintain to support their decisions to use this contract. As a result, neither OFT nor the Tax Department provided adequate documentation to support each of their decisions to use the contract. Therefore, there is an increased risk that these agencies are using this contract even if a better procurement option is available. This could negatively impact both the cost and quality of the services the agencies receive.

(In their response to the draft report, OGS officials point out that this issue is moot because the contract expired on September 30, 2004. Notwithstanding the contract's imminent expiration, the officials state that they believe that the OGS website's caution to agencies to compare services and costs among contract options and make appropriate determinations is sufficient to inform agencies of other contracts available for obtaining IT services.)

Auditor's Comments: Events subsequent to OGS's response to the draft report have changed the circumstances regarding this contract. On September 20, 2004, the Office of the State Comptroller agreed to extend the contract terms until December 31, 2004. Therefore our recommendations are still valid. Further, our recommendations may also be applied to other similar contracts administered by OGS. We also note that OGS's website only serves to notify potential contract users of the requirement to compare services among contracts before making a vendor choice. Our recommendation asks that OGS develop formal expectations as to how those decisions should be documented.

We reviewed about \$11.9 million of OFT's \$34.7 million in purchases under this contract for our three-year audit period, most of which (about \$9.2 million) was for hardware maintenance services. The Tax Department spent about \$19.7 million under this contract during the audit period and we reviewed about \$7 million in payments, most of which was for advisory consulting services related to software customization. The payments made by OFT and the Tax Department were used to support the costs of 13 and 8 projects, respectively.

For each project we reviewed, we asked both OFT and Tax Department officials to provide documentation showing that they analyzed the cost and quality of services provided under all available IT contracts and that they decided to purchase services under contract PS00374 because this was the most practical and economical option. If they did not maintain such records, we asked agency officials to provide a written statement indicating why they chose this contract for the specific services we reviewed. We found that OFT did not maintain any documentation for the purchased services we reviewed under this contract. Specifically, we found that OFT did not have any significant supporting documentation for any of the 13 projects we reviewed that would justify their use of contract PS00374 instead of other available procurement options. We also noted that OFT does not have standard procedures for evaluating other procurement options prior to using the contract. These procedures should ensure that the agency is receiving the best value, both in price and quality, for the services it intends to purchase.

OFT officials stated that they do not maintain documentation for every instance in which they decide to purchase services under this contract. OFT officials stated that they prefer using IBM because of IBM's expertise in working with IBM equipment, as it has saved them time in troubleshooting and implementing solutions. OFT prefers to use the contract because of the wide variety of services available under the contract and the fact that it enables OFT to select the IBM consultants that will work on OFT's projects. In addition, OFT officials value having a single vendor for IT consulting and maintenance services as they believe it increases vendor accountability (vendors cannot blame other vendors providing these services if there is a problem) and reduces OFT's administrative overhead. Absent documentation to support their evaluation of procurement options, we were unable to conclude that OFT selected the most practical and economical option

when using this contract, which increases the risk that OFT may be paying more for services available through other procurement options.

In contrast, we found that the Tax Department did consider other procurement options for some projects prior to using this contract. Tax Department officials stated that they only purchase services under this contract when they have to because the prices offered by IBM under the contract were, in their opinion, quite high. For the eight projects we reviewed, we found that the Tax Department was able to provide adequate documentation in two instances to support the use of the contract. Specifically, Tax Department officials provided evidence of their attempts to consider other options, which in these instances were unsuccessful attempts to bid the services (IBM prices were better or vendors did not meet service standards). For the remaining six projects, Tax Department officials provided a written statement as to why they chose to use this contract as opposed to other procurement options. For example, the Tax Department chose to purchase services from IBM under this contract for its Websphere project because this is an IBM product that Tax Department officials felt required IBM's expertise. However, the Tax Department did not have documentation for any of these six projects to substantiate its consideration of other available procurement options.

Conclusion:

OFT typically chooses to purchase services under this contract because of IBM's knowledge and expertise of the products that require service. Tax Department officials claim that although the prices offered under this contract are quite high, they will use the contract when they feel they have to (when IBM's expertise is needed). However, neither agency has standard procedures for considering other available procurement options prior to using this contract. In addition, although OGS expects agencies to maintain documentation supporting every decision made by an agency to use this contract instead of other available procurement options, neither OFT nor the Tax Department had documentation for every project we reviewed. As a result, OGS should provide guidance regarding what documentation agencies should maintain. OFT and the Tax Department need procedures for evaluating other available procurement options and should maintain documentation to support every decision to use the contract instead of other available procurement options.

Recommendations

To OGS

8. *Develop formal expectations as to what documentation agencies should maintain to support their decisions to use this contract instead of other available procurement options.*

(OGS officials disagree with this recommendation. They state their existing guidance is sufficient.)

To OFT and the Tax Department

9. *Develop standard procedures for evaluating other available procurement options prior to using the contract. These procedures should ensure the agency purchases services under the most practical and economical procurement option.*
10. *Maintain complete documentation to support the decision to use the contract as opposed to other contracts.*

(OFT and Tax Department officials agree with Recommendations 9 and 10. OFT officials note that as of August 19, 2004, the New York State Office of the State Comptroller had determined that the contract would not be extended beyond September 30, 2004. However, for data center purchases made from IBM, OFT will use its new contract, which requires OFT to prepare an Annual Acquisition Plan pre-approved by the State Comptroller. OFT officials further note that they are in the process of drafting agency Procurement Record guidelines, which will, among other things, complete OFT's action on these recommendations.)

Auditor's Comments: On September 20, 2004, the New York State Office of the State Comptroller approved an extension of this contract to December 31, 2004.

We provided a copy of this report to officials from OGS, OFT and the Tax Department for their review and comment. Their comments were considered in the preparation of this report and are included as Appendixes A, B, and C respectively. OGS, OFT and Tax Department officials generally agreed with many of our recommendations directed to each of them in this report. OFT officials stated they were pleased that the audit recognizes OFT's appropriate and allowable usage of the contract. Tax Department officials indicated that they either have already or plan to implement the recommendations addressed to them. However, for recommendations that require development of procedures, the officials noted that considering that the contract expired, such procedures may not be formalized. OGS officials stated that they believed that the audit showed the value of the contract and that refinements recommended in the audit can help OGS continue to offer agencies and contract users necessary services at discounted prices. Appendix D contains State Comptroller's Notes in response to comments made by OGS officials.

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, the Commissioner of the Office of General Services, the Director of the Office for Technology, and the Commissioner of the Department of Taxation and Finance shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons why.

Major contributors to this report were Brian Mason, Karen Bogucki, Dennis Graves, Michael Breer, Michael Durkin, Jessica Feltman, Theresa Lawrence, Alexander Marshall, Wendy Matson, and Paul Bachman.

We wish to thank the management and staff of OGS, the Tax Department, and OFT for the courtesies and cooperation extended to our auditors.

Very truly yours,

Steven E. Sossei
Audit Director

cc: Robert Barnes, Division of the Budget

Exhibit A
Contract PS00374
Advisory Consulting Services
Current Pricing (Tier 3)

Title	List Price	Discount %	Net Price
System Support Specialist 1	\$32.00	18.00%	\$26.24
System Support Specialist 2	\$46.00	18.00%	\$37.72
System Support Specialist 3	\$60.00	18.00%	\$49.20
System Support Specialist 4	\$77.00	18.00%	\$63.14
System Support Specialist 5	\$95.00	18.00%	\$77.90
Technical Specialist 1	\$106.00	18.00%	\$86.92
Technical Specialist 2	\$126.00	18.00%	\$103.32
Technical Specialist 3	\$138.00	16.00%	\$115.92
Technical Specialist 4	\$154.00	19.00%	\$124.74
Technical Specialist 5	\$175.00	19.00%	\$141.75
Integration Technical Specialist	\$196.00	20.00%	\$156.80
Advanced I/T Specialist	\$217.00	21.00%	\$171.43
Senior I/T Specialist	\$239.00	22.00%	\$186.42
Project Manager / Architect 1	\$217.00	21.00%	\$171.43
Project Manager / Architect 2	\$239.00	22.00%	\$186.42
Project Manager / Architect 3	\$258.00	22.00%	\$201.24
Project Manager / Architect 4	\$319.00	33.00%	\$213.73
Project Manager / Architect 5	\$345.00	33.00%	\$231.15
Principal Consultant	\$345.00	33.00%	\$231.15
Industry Consultant	\$385.00	33.00%	\$257.95
E-Business Strategy Consultant	\$415.00	33.00%	\$278.05



KENNETH J. RINGLER, JR.
COMMISSIONER

STATE OF NEW YORK
EXECUTIVE DEPARTMENT
OFFICE OF GENERAL SERVICES
MAYOR ERASTUS CORNING 2ND TOWER
THE GOVERNOR NELSON A. ROCKEFELLER EMPIRE STATE PLAZA
ALBANY, NEW YORK 12242

ROBERT J. FLEURY
FIRST DEPUTY COMMISSIONER

August 24, 2004

Mr. Steven Sossei
Audit Director
Division of State Services
New York State Office of
the State Comptroller
110 State Street
Albany, NY 12236

Dear Mr. Sossei:

Thank you for the opportunity to respond to your draft audit report 2004-R-5, Administration and Use of Contract PS00374, IBM Corporation – Comprehensive Services Agreement. We are pleased your report finds that the contract has been useful to State agencies in obtaining quality services, and that all 40 payments made by the Office for Technology and the Department of Taxation and Finance were for services clearly intended as part of the original contract. Unfortunately, these contracts will no longer be available to State agencies as a result of a decision by the Office of the State Comptroller based on a belief that “the expanded use of these agreements far exceeds what was originally intended” (copies of letters dated July 25, 2003 from Ruth S. Walters and July 28, 2004 from John Moriarty are attached). Specific comments about the report are included below, presented by section.

*
Note
1

Audit Objective #2: Were OFT and the Tax Department satisfied with the quality of the services provided under the contract?

The report states “OGS is responsible for monitoring vendor performance and quality control and, therefore, should be notified of any major complaints about contract performance.” There appears to be a misperception of OGS’s role. OGS does not routinely monitor all vendor performance under this, or any, contract. Rather it stands ready to aid agencies requesting assistance with any aspect of using a contract, including resolving complaints. It is appropriate for agencies to attempt to resolve issues with the vendor as they occur and to request assistance from OGS when the issue is not satisfactorily resolved. From the description in the report, it appears OGS may have been able to help resolve the issue had we known about it, but the agency’s first approach was a reasonable one for resolving such issues.

Audit Objective #3: Were the prices charged by IBM consistent with the contract’s terms?

We believe it is appropriate to work with contract holders in a cooperative manner to resolve contract issues such as late sales volume reports. While the contract does contain punitive terms allowing us to unilaterally impose a higher pricing discount tier because of late reports, we believe this approach should only be used as a last resort. The level of cooperation and the chances of extending the contract would have been impacted had we imposed the higher tier discount.



Mr. Steven Sossei

2

August 24, 2004

The contract also contains terms allowing contract users to recover any overpayments made under the contract. Our approach of working with IBM to get sales reports is better for overall success of this contract and for future contracts with IBM. We believe the reflexive, immediate use of punitive terms is not in the States' best interest, as it would certainly result in letter-of-the-contract formality in all use of the contract from that point forward, which could prevent contract users from receiving the best possible service. The contractual ability to go to extreme measures is available to the State, and we recommend its use under appropriate circumstances.

We agree that our efforts to obtain and verify sales reports could be improved. We will use all options available in the contract to ensure compliance in a measured and reasonable manner that will best promote the interests of the State. We will also work with OSC to verify each quarterly sales report.

Audit Objective #4: Did OFT and the Tax Department evaluate other procurement options before using this contract?

The report recommends that OGS "Develop formal expectations as to what documentation agencies should maintain to support their decisions to use this contract instead of other available procurement options".

We believe this item has become a moot point in recognition of the OSC Contract Audit Group's recent disapproval of contract extensions for the CSA's. The Office of General Services and the State agencies that rely on these contracts are disappointed that OSC's rationale for not approving the extensions is based on an unsubstantiated concern over expanded use of consultant services beyond the intent of the contract.

*
Note
1

Notwithstanding the fact that the issue is now moot, we point out that our website cautions agencies to compare services and costs among contract options and make appropriate determinations:

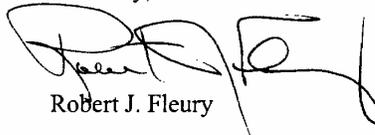
"All entities considering the purchase of IT Services are advised to refer to the existing IT Services contracts. Agencies are urged to compare services on both contracts in order to determine the most cost effective and appropriate option for their particular needs."

We believe this guidance is sufficient to inform agencies of other contracts available for obtaining IT services. This statement appears to be supported by your audit findings.

We would like to thank the auditors for their efforts. We welcome audits as a chance to identify ways to improve the services offered to our clients. We believe this audit showed the value of the contract and that refinements recommended in the audit can help us continue to offer agencies and contract users necessary services at discounted prices. I hope you will pass your findings on to the OSC Contract Unit, as they may be interested in the apparent contradiction between your findings and their actions.

*
Note
2

Sincerely,


Robert J. Fleury

Attachments

ALAN G. HEVESI
COMPTROLLER



STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER
110 STATE STREET
ALBANY, NEW YORK 12236

RUTH S. WALTERS
ASSISTANT COMPTROLLER
Tel. (518) 402-4103
Fax (518) 402-4212

NYS OFFICE OF
GENERAL SERVICES

JUL 29 2003

FIRST DEPUTY
COMMISSIONER'S OFFICE

July 25, 2003

Mr. Michael McCormack
Director
New York State Office for Technology
State Capitol
P.O. Box 2062
Albany, New York 12220

Dear Mr. McCormack:

We're returning the contract between the Office for Technology (OFT) and International Business Machines (IBM) unapproved. As you know, we're troubled by the breadth of this agreement and are concerned that the structure of the arrangement conflicts with the intent of Article 11 of the State Finance Law as it relates to the underlying principle of competition and the ultimate determination of best value.

As we've discussed, OSC believes that the original intent of the OGS Comprehensive Service Agreements was to provide an avenue to acquire hardware, software, maintenance and limited support from vendors who provide propriety equipment and knowledge so unique that competition does not exist. It appears that the expanded use of these agreements far exceeds what was originally intended and, as a result, we don't anticipate approving these OGS contracts in their current form once their terms expires. The IBM contract that you've forwarded to us is modeled after these agreements and must be restructured and scaled back significantly before we'll consider approval.

While we believe that it is prudent to enter into an arrangement with IBM and UNISYS to support the needs of OFT's Data Center Operations, these agreements must be limited to the securing of resources that can only be supplied by these two vendors. The agreements must lay out a definition of "Data Center Operations" that is clearly defined and limited. For example, the procurement of IBM products that will be used for purposes other than Data Center Operations should not be included in this agreement. In addition, performance standards must be included to assure that services are delivered and remedies are available if not met. OFT must demon-

Page 2

strate there's a structure in-place for closely monitoring these agreements including a description of the review process.

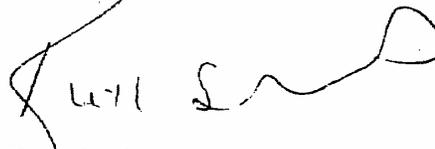
Further the following areas must be eliminated from the agreements:

- IBM Business and Strategic Partners. These products and services must be acquired via direct agreements with the providers based on a competitive solicitation or a separately justified and pre-approved single source contract.
- Consulting Services beyond those highly technical skills needed to support the Data Center that can only be provided by IBM. All other consulting services must be acquired via competitive solicitations and pre-approved by this office.

The process for acquiring the resources will also require a change from the current arrangement. As you know, the Comptroller is charged with the responsibility for approving contracts in excess of \$15,000. A significant rationale for this approval responsibility is to assure that the law is adhered to. In order to assure that best value is determined at the time of acquisition, we'll be requiring that all orders placed under these agreements that will result in a purchase in excess of \$15,000 be approved in advance by this office. We're certainly interested in assuring that approvals are granted quickly and will work with your staff to develop a streamlined process. We'll insist, however, that only those purchases described above are obtained through these contract arrangements.

Please call me if you would like to discuss further or if you are in need of clarification of any of the above stated positions.

Sincerely,



Ruth S. Walters
Assistant Comptroller

Enclosure

cc: James Dillon
Kenneth Ringler
Robert Fleury ✓

ALAN G. HEVERI
COMPTROLLER



110 STATE STREET
ALBANY, NEW YORK 12236

STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

July 28, 2004

Mr. Walter Bikowitz
Director, Procurement Services Group
New York State Office of General Services
Corning Tower Building
Empire State Plaza
Albany, NY 12242

Dear Mr. Bikowitz:

Re: Comprehensive Services Agreement
Extensions through September 30, 2005
PS60199 HP, PS00374 IBM,
P008068 SUN, PS00465 Unisys

We are returning the recently submitted amendments extending the comprehensive services agreements referenced above unapproved. As you know, OSC has for some time now expressed significant concerns with these contracts, particularly the use of services without any controls in place for pre-audit approval or monitoring agencies' use of these contracts to provide that consulting and training services were procured consistent with the intent of the contracts.

Given these concerns we are troubled that you have elected to have the vendors sign the agreements and process the extensions knowing that OSC would not approve them in their current form. It is my understanding that as far back as July 25, 2003, OGS was formally notified that OSC didn't anticipate approving the CSA's in their current form once their term expires due to our concern with the expanded and frequent use by agencies to obtain services over and above the intent of the contracts which was to support those agencies with installed vendor hardware by providing a mechanism to obtain consulting and training services directly from the hardware vendor, thereby allowing agencies the benefit of the expertise that the hardware vendor could lend in maximizing the efficient use of the installed hardware. It is also my understanding discussions were held last March that resulted in OSC asking OGS to come up with a proposed contract format that would satisfy OSC's concerns and meet customers' needs.

Since, in lieu of offering a proposal, you have now asked for guidance as to what OSC would find acceptable, we offer the following:

With respect to the maintenance component of the contracts, a renewal of the contracts for maintenance services only would be acceptable as long as:

Mr. Walter Bikowitz

-2-

July 28, 2004

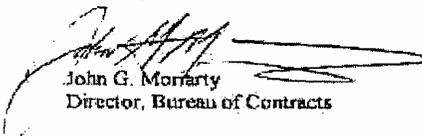
- OGS can demonstrate the continued need, individually for these four maintenance contracts and that an analysis was done to determine if there are other vendors that should also be awarded a contract for similar maintenance services.
- The contracts are restructured to remove all non-maintenance services and all items that do not relate directly to hardware maintenance.
- OGS performs a review of these contract formats and language in relation to the recently approved IBM contract with OFT. That contract was originally based on language in the CSA's and was subsequently changed to reflect better terms and conditions relating to protections for the State. We would expect that the CSA language would reflect those changes or otherwise be improved to better protect the State in regard to indemnification, performance, liability, etc.
- OGS can demonstrate reasonableness of price.
- OGS can demonstrate that this approach is more desirable than letting the CSA's expire and adding maintenance on to the hardware contracts.

We would consider separate service contracts for the consulting services portion of the CSA's under the following conditions:

- The need for these service contracts can be demonstrated and justified.
- An analysis would have to be done to explain how OGS determined which vendors should have these contracts.
- The new contracts contain revised instructions for usage requiring each task order issued pursuant to the contract to be subject to pre-audit and prior approval by OSC. The contract would have to be clear that if a vendor starts work before the task order is approved by OSC's Bureau of Contracts, the vendor is working at risk.
- We would expect that these contracts would have contract language as good or better than the IBM OFT contract cited above in regard to protections for the State and that the vendors would agree to price and performance commitments.

If you have any questions, please feel free to contact me at 474-4622.

Sincerely,



John G. Moriarty
Director, Bureau of Contracts

cmn

cc: Charlotte Breeyear
Dan Ryan
Donald Greene



George E. Pataki
Governor

STATE OF NEW YORK
OFFICE FOR TECHNOLOGY
STATE CAPITOL, ESP
PO BOX 2062
ALBANY, NY 12220-0062

James T. Dillon
Chief Information Officer

Michael McCormack
Director

August 19, 2004

Mr. Steven Sossei
Audit Director
New York State Office of the Comptroller
110 State St.
Albany, NY 12236

Re. Administration and Use of Contract PS00374, IBM Corporation -- Comprehensive Services Agreement, Report 2004-R-5

Dear Mr. Sossei:

In accordance with Section 170 of the Executive Law, the Office for Technology (OFT) is responding to the July 22, 2004 draft of the above referenced report. OFT generally agrees with the recommendations directed to OFT in this report and is pleased that the audit recognizes OFT's appropriate and allowable use of the contract. Our specific comments with respect to the audit findings and recommendations are as follows:

Audit Objectives 1-2: No recommendation

We agree with the audit's conclusion that OFT has used the contract to purchase only allowable services and that OFT has been satisfied with the quality of the services provided under the contract.

Audit Objective 3:

Recommendations: 1) Maintain documentation to support the agency's decision to hire a specific level of consulting services 2) Follow established procedures for verifying the appropriateness of consultant payment rates 3) Develop and implement standard procedures for independently verifying that the rates IBM charges for maintenance of equipment are appropriate

OFT Response:

Hiring of Service Providers Issue: The audit concluded that OFT may be paying for more costly job titles than are required for the services. OFT disagrees with this based on the audit findings which recognized that OFT has a process in place and works closely with IBM in developing Statements of Work that identify the job titles needed for a particular task. Further, the audit did not find any instances of inappropriate job titles being used or a lack of qualifications to support this conclusion and the recommendation.

Web Site: www.oft.state.ny.us
E-mail Address: nyoft@oft.state.ny.us

Appendix B

The audit recommends that OFT maintain additional documentation. OFT does agree that additional documentation can always strengthen evidence supporting the procurement decisions and choices and is a positive step that OFT will take to improve our records.

Agency Review of Invoices Issue: OFT agrees with the need to follow established procedures for verifying the appropriateness of consultant payment rates. It should be noted, however, that the .000056% error rate that was found (\$670 error out of \$11.9 million payments made) was not a result of OFT not following its established procedures, but merely a timing error. In that instance, OFT had not yet replaced the tier 2 with tier 3 price lists when this first purchase after the State became eligible for tier 3 pricing was processed. In regard to the last recommendation addressing the maintenance rates, OFT agrees. OFT's new contract, C000068, recently approved by the New York State Office of the Comptroller, addresses this through improvements in contractual language and pricing sources.

Audit Objective 4:

Recommendations: 1) Develop standard procedure for evaluating other available procurement options prior to using the contract. These procedures should ensure the agency purchases services under the most practical and economical option; 2) Maintain complete documentation to support the decision to use the contract as opposed to other contracts.

OFT Response:

OFT agrees with the recommendations, although it should be noted that as of the date of this letter, the New York State Office of the State Comptroller has determined that this contract, PS00374, will not be extended beyond September 30, 2004. For data center purchases from IBM, OFT will be using its new contract, C000068, referenced above, which requires OFT to prepare an Annual Acquisition Plan and have it pre-approved by the New York State Office of the Comptroller, thereby providing a procedure and more complete documentation. Additionally, for all procurements, OFT is in the process of drafting agency Procurement Record Guidelines, which will, among other things, complete OFT's action on these recommendations.

OFT would like to thank the audit team for their professionalism and consideration of OFT information and responses shown during this audit engagement.

Sincerely,



Michael McCormack



STATE OF NEW YORK
DEPARTMENT OF TAXATION AND FINANCE
W.A. HARRIMAN CAMPUS
ALBANY, NY 12227

Barbara G. Billet
Executive Deputy Commissioner

August 19, 2004

Mr. Steven Sossei
Audit Director
Office of the State Comptroller
110 State Street, 11th Floor
Albany, New York 12236

Dear Mr. Sossei:

Thank you for the opportunity to comment on the findings and recommendations contained in the draft audit report entitled, "Administration and Use of Contract PS00374, IBM Corporation – Comprehensive Services Agreement, (2004-R-5)."

Recommendation 1:

In the future, formally notify OGS of any complaints regarding IBM's performance under this contract.

Response:

The Department will adhere to the contract's requirement to notify OGS in the event that we have a reason to complain about their performance.

Recommendation 4:

Maintain documentation to support the agency's decision to hire a specific level of consulting services.

Mr. Steven E. Sossei

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August 19, 2004

Response:

The Department will maintain documentation supporting the specified level of consulting services. This documentation is generally provided in the statement of work and any changes will be documented.

Recommendation 6:

Ensure all IBM consulting time sheets are reviewed and approved by a project manager and filled in accordance with internal procedures.

Response:

Project managers have been reminded to sign consultant time sheets after review and approval and this is also an ongoing process.

Recommendation 7:

Develop and implement standard procedures for independently verifying that the rates IBM charges for maintenance of equipment are appropriate.

Response:

The Department will implement such procedures. However, considering that the contract expires in about a month, we may not formalize such procedures.

Recommendation 9:

Develop standard procedures for evaluating other available procurement options prior to using the contract. These procedures should ensure the agency purchases services under the most practical and economical procurement option.

Response:

The Department will implement such procedures. However, considering that the contract expires in about a month, we may not formalize such procedures.

Recommendation 10:

Maintain complete documentation to support the decision to use the contract as opposed to other contracts.

Mr. Steven E. Sossei

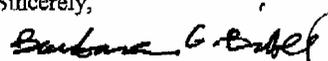
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August 19, 2004

Response:

Once the Department has developed evaluation criteria, such evaluation will be documented and maintained in accordance with the expectations and guidelines to be provided by OGS.

Sincerely,

A handwritten signature in black ink, appearing to read "Barbara G. Billet". The signature is written in a cursive style with some loops and flourishes.

Barbara G. Billet
Executive Deputy Commissioner

State Comptroller's Notes

1. The comments made by OGS officials in this section imply that the decision made by our office to discontinue the contract was in error. We disagree with this assessment. Our audit shows that OFT's, and to a lesser extent the Tax Department's decisions were undocumented. We did not find a thorough, comprehensive evaluation of the procurement alternatives before this contract was used for extensive amounts of consulting services. Moreover, events subsequent to OGS's response to the draft report have changed the circumstances regarding this contract. On September 20, 2004, the Office of the State Comptroller agreed to extend the contract terms until December 31, 2004. This was done to avoid hardship to contract users because OGS had not addressed the deficiencies identified in our report. Thus, our recommendations are still valid. Further, our recommendations may also be applied to other similar contracts administered by OGS.

2. The findings in our report support the position of the OSC Contract Unit. The decisions to hire consultants were for the most part, undocumented. We also made specific recommendations to OGS officials to address these deficiencies.