Internal Control and Compliance Assessment
Arkansas Legislative Audit

Department of Information Systems
For the Fiscal Year Ended June 30, 2016

INTRODUCTION

This report is issued to inform the Legislative Joint Auditing Committee of compliance with state fiscal laws and regulations as well as deficiencies in internal controls for the Department of Information Systems (DIS). As discussed in the Results of Assessment section below, our procedures disclosed a personal relationship between the former DIS Director and a vendor representative that affected various procurements.

SCOPE AND METHODOLOGY

We performed an internal control and compliance assessment of the Department of Information Systems, a department of Arkansas state government, as of and for the year ended June 30, 2016, and have issued our report dated May 18, 2017. Management of the Agency is responsible for establishing and maintaining internal controls and complying with applicable laws and regulations.

The assessment included cash on deposit, cash receipts, accounts receivable, expenditures, liabilities, capital assets, and data entry to the Arkansas Administrative Statewide Information System (AASIS). The assessment consisted principally of inquiries, observations, analytical procedures, and selected tests of internal control policies and procedures, accounting records, and other relevant documents. We relied on financial data in AASIS recorded by the Agency and audit work conducted in the fiscal year 2016 State Comprehensive Annual Financial Report (CAFR) and Single Audit Report. The methodology used in conducting this assessment was developed uniquely for this engagement and, therefore, was more limited in scope than an audit or attestation engagement performed in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States.

RESULTS OF ASSESSMENT

Assessment procedures disclosed the following internal control or compliance matter that was discussed with Agency officials during the assessment and at the exit conference:

> **Finding:** Standards of conduct contained in state law indicate that public employment is a public trust, public employees must discharge their duties impartially so as to assure fair competitive access, and companies desiring to do business with the State should observe the same standards. An abuse of public trust occurs when an employee solicits, accepts, or agrees to accept any benefit for making a decision favorable to another person or otherwise exercises discretion in favor of another person.
>
> Additionally, the Agency's Information Technology Acceptable Use Policy (Technology Policy) identifies unacceptable uses of state technology.
>
> Review of the Director's text and email messages, stored on the Agency's servers, revealed a personal relationship between the Director and a Vendor representative involved in at least three

Agency procurement projects. This relationship and the correspondence contained on the servers appears to conflict with state law and the Agency's Technology Policy, respectively. The Director resigned on November 23, 2016, but remained on payroll until January 1, 2017.

Three procurement projects with which the Vendor representative was involved are discussed below.

Project 1: Data Consolidation Proof of Concept: The Agency procured $642,552 of Vendor equipment through Reseller A[1] in August 2016 for a data consolidation proof of concept.[2] The initial invoice contained equipment, software licenses, and services, and according to Reseller A, a replacement invoice, in the same amount, was produced at the former Director's request, with the services portion of the initial invoice deleted. Ark. Code Ann. § 19-11-265 requires that contracts that contain services and total at least $100,000 be presented to Legislative Council. By misclassifying the services as equipment and software licenses, the Agency avoided Legislative review.

To resolve the violation of Ark. Code Ann. § 19-11-265, the Agency sought guidance from the Department of Finance and Administration – Office of State Procurement (DFA-OSP), who stated that Arkansas Code allows a contract to be voided when a vendor acts fraudulently or in bad faith. As of March 2017, the Agency had not paid Reseller A for the equipment, software licenses, and services, nor have these items been utilized. Agency management stated that it intends to void the contract and return all equipment.

Project 2: Unified Communication: In April 2016, the Agency purchased $584,521 in equipment to build and implement a video infrastructure to enhance the existing VoIP system available to state entities through the Agency. The Agency decided to purchase the video infrastructure equipment because integration services could be received at no cost and use of the equipment would reduce state employees' travel costs; however, Agency staff stated that the free integration services were not received and that integrating the equipment will cost approximately $21,000. The equipment was purchased from the Vendor through Reseller B. In February 2017, the Agency had yet to utilize equipment costing $255,901.

Project 3: K-12 Upgrade: To increase bandwidth to schools throughout the State, the Department of Education worked with the Agency to provide a secure K-12 Backbone network. Agency staff stated that several networking retailers were contacted to discuss parts of the upgrade project; however, after only a short period of time, the former Director decided to use the Vendor and Reseller B, before any other quotes were received, resulting in a purchase of $6,973,922 in Vendor equipment from Reseller B. While the Agency was able to increase bandwidth to school districts from 5Kbps per user to 200Kbps per user, the use of the Vendor, without obtaining sufficient input from Agency personnel with technological knowledge, appears to be questionable and not in the best interest of the State.

In summary, based on review of the three projects costing $8,200,995 and the personal relationship between the former Director and the Vendor representative, it appears the former Director violated standards of conduct contained in state law, potentially wasted state resources, and did not adhere to the Agency's Technology Policy.

We recommend Agency management and staff comply with the Agency's Technology Policy and applicable state law and receive appropriate training on ethics and procurement law.

---

[1]Although the Vendor has representatives who solicit business from the State, vendor products must be procured through authorized resellers.

[2]A proof of concept demonstrates a concept to establish feasibility or verify the concept has practical potential. Historically, the Agency has not paid for equipment related to proof of concepts.

Management response: *In regard to Project 1: Data Consolidation Proof of Concept, and in accordance with the recommendation provided by the Director of DFA-OSP on March 28, 2017, the Department notified the vendor on March 29, 2017, that it had adopted OSP's recommendation, the purchase order had been voided, and the State would not be remitting payment based on the submitted invoice. The Department has also advised the vendor to coordinate the retrieval of the hardware and has agreed to vendor personnel coming on site to perform packaging and removal of its hardware.*

In regard to Project 2: Unified Communication, the Department has identified a vendor and obtained a statement of work to provide integration services in conjunction with other enhanced unified communication services to meet customer requirements (i.e., encryption of Internal Revenue Service data for DFA and the Department of Human Services). The Department is developing a strategy to address how best to utilize the video infrastructure equipment.

In regard to Project 3: K-12 Upgrade, it has been an accepted departmental practice for agency personnel with technological knowledge to determine best of breed and pricing factors prior to making a recommendation to the Director. The Department shall develop a policy to formalize this practice in order to effectuate the best interests of the State.

Although the assessment addresses the actions only of the former Director, the Department will comply with the recommendation that its management and staff comply with the Department's Technology Policy and receive additional training on ethics and procurement law as appropriate.

ENABLING LEGISLATION AND ORGANIZATIONAL STRUCTURE

Act 914 of 1997 reestablished the Department of Computer Services as the Department of Information Systems (DIS). Its mission is to develop an information technology (IT) plan and IT standards for the State, manage IT infrastructures, provide IT services, and increase state government awareness of opportunities to share information. Act 648 of 2009 expanded the idea of enterprise architecture and prescribed powers and duties of the cybersecurity office.

DIS has six primary teams:

1. **The Director,** who is appointed by the Governor and subject to confirmation by the Senate, serves as the chief technology officer and broadband manager for the State. The Director also serves as the chair of the Technology Oversight Council.
2. **The Deputy Director** oversees the fiscal division and the enterprise architecture division, which includes the project management, quality management, and human resources departments. Additionally, the Deputy Director is responsible for ensuring Agency compliance with state and federal laws.
3. **Enterprise Operations** is comprised of five subdivisions, each with its own director who reports to the Chief Operating Officer:
   - AASIS.
   - Enterprise Network Services.
   - Enterprise Systems Management.
   - Enterprise Solutions Management.
   - Enterprise Operations – Data Center MAC and State Data Center West (SDCW).
4. **General Counsel** facilitates the review and negotiation of contracts, works to resolve issues with vendors, and expedites freedom of information requests from the public and press.
5. **The Cybersecurity Office** establishes security standards and policies for IT in state government. It also encompasses the Arkansas Continuity of Operations Program (ACOOP),

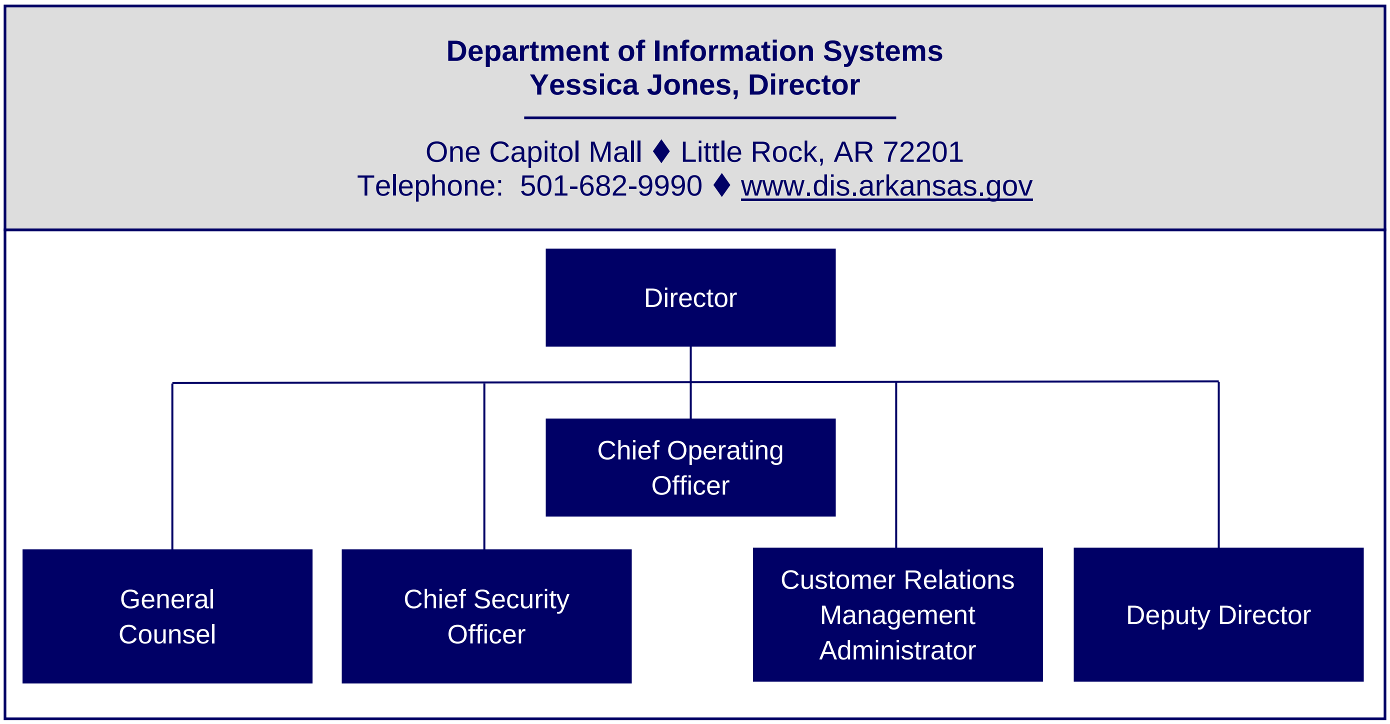
which oversees and manages the development of disaster recovery plans and continuity of operations plans for state agencies and the Arkansas Wireless Information Network (AWIN). AWIN is the statewide interoperable wireless communication system for emergency responders and Arkansas public service entities.

6. **Customer Relations Management (CRM)** is a team of customer account representatives providing IT advice to state agencies, boards, and commissions regarding the latest technology products and services. The call center is also a department within CRM.

The DIS organizational chart is presented in **Exhibit I**.

Exhibit I

Department of Information Systems
Organizational Chart



Source: *Department of Information Systems*

FISCAL ANALYSIS

Revenues, Expenditures, and Transfers

Agency revenues, expenditures, and transfers for fiscal years 2012 through 2016 are illustrated in **Exhibit II on page 5**.

The Agency reported $66.4 million in total revenue for the fiscal year ended June 30, 2016. The primary sources of revenue are data processing and voice communication service fees totaling $58 million and federal reimbursements totaling $8.1 million.

Expenditures totaled $62.5 million for the fiscal year ended June 30, 2016. Salaries comprised 27% of total expenditures; communications and transportation of commodities comprised 40%; and repairing and servicing comprised 11%.

The Agency reported net transfers of approximately $258,000 for the fiscal year ended June 30, 2016.

Assets and Liabilities

Agency asset and liability balances at year-end for fiscal years 2012 through 2016 are presented in Exhibit III on page 6. Agency assets and liabilities totaled $93.2 million and $16.0 million, respectively, at June 30, 2016. The increase in fixed assets and other liabilities in 2014, 2015, and 2016 were primarily due to the acquisition of the new State Data Center West (SDCW) in West Little Rock. According to the Agency, the SDCW provides Arkansas backup service capacity for all governmental entities and currently houses backup operations for a growing number of state agencies. The SDCW was funded by a bond of $5.34 million that was issued through the Arkansas Development Finance Authority.

DIS operations must be self-supporting by purchasing IT services and reselling these services to other governmental customers. This self-supporting nature of operations results in DIS being defined as a Central Services Billed agency under 2 CFR § 200. DIS is required to include all expenses in its cost model and develop rates to recover these costs. The costs are accumulated in 28 service categories that have been approved by the U.S. Department of Health and Human Services' (DHHS) Division of Cost Allocation. The current categories were approved by DHHS as part of a 2007 settlement agreement for overcharging federal programs.

Although DIS is only allowed to recover costs, 2 CFR § 200 does allow DIS to maintain up to a 60-day working capital reserve in each category to allow for sufficient operating capital between billing cycles. This operating capital is calculated along with prior fund balance, current profit or loss, and imputed interest to obtain the "Excess/Insufficient Fund Balance" for each category. The results are used to adjust the billing rates annually so that the adjusted rates will affect the excess/insufficient fund balance for the next fiscal year. The categories that are under recovered are subsidized by over recoveries in other categories, in noncompliance with 2 CFR § 200, and increases the risk that federal programs are subsidizing services not being received. DIS could be liable for the portion of over recoveries paid by state agencies with federal money. In the past, DIS has obtained a Billed Central Service Cost Examination to review compliance with 2 CFR § 200. The last review performed was dated January 23, 2014, for the year ended June 30, 2013.

Exhibit II

Department of Information Systems
Revenues, Expenditures, and Transfers
For the Years Ended June 30, 2012 through 2016

	Fiscal Year				
	2016	**2015**	**2014**	**2013**	**2012**
Revenues					
Data processing and voice communication service fees	$ 58,040,093	$ 64,083,988	$ 70,843,467	$ 66,729,076	$ 68,141,401
Federal reimbursements	8,104,041	1,957,086	2,149,476	11,426,571	6,371,424
Federal grants	0	0	0	500,000	0
Other income	270,191	69,265	3,475	14,485	165,129
Total Revenues	$ 66,414,325	$ 66,110,339	$ 72,996,418	$ 78,670,132	$ 74,677,954
Expenditures					
Salaries	$ 17,007,929	$ 18,418,059	$ 19,092,161	$ 19,063,570	$ 19,284,725
Communication and transportation of commodities	24,787,475	23,502,893	25,601,265	30,335,108	33,443,044
Repairing and servicing	6,893,425	7,810,516	8,334,155	8,401,587	8,305,112
Other expenses	13,857,142	16,169,405	24,310,233	22,040,972	16,744,107
Total Expenditures	$ 62,545,971	$ 65,900,873	$ 77,337,814	$ 79,841,237	$ 77,776,988
Net Transfers In (Out)	$ 258,357	$ 761,588	$ 420,941	$ 580,356	$ 1,852,218

Source: *Arkansas Administrative Statewide Information System Trial Balance (unaudited by Arkansas Legislative Audit)*

Exhibit III

Department of Information Systems
Assets and Liabilities
For the Years Ended June 30, 2012 through 2016

	Fiscal Year				
	2016	**2015**	**2014**	**2013**	**2012**
Assets					
Cash and cash equivalents	$ 16,189,444	$ 14,392,259	$ 10,026,098	$ 8,528,930	$ 7,668,155
Fixed assets	58,850,702	54,983,360	55,376,138	46,560,261	45,360,493
Receivables	14,202,859	9,966,998	13,312,707	9,840,333	11,909,796
Other assets	3,934,261	3,771,169	3,771,440	3,971,530	4,114,068
Total Assets	$ 93,177,266	$ 83,113,786	$ 82,486,383	$ 68,901,054	$ 69,052,512
Liabilities					
Accounts payable	**$ 8,018,557**	**$ 7,161,705**	**$ 5,944,629**	**$ 4,059,849**	**$ 1,544,904**
Payroll liability	**544,577**	**446,530**	**453,901**	**358,171**	**375,645**
Accrued leave	**1,553,241**	**1,570,747**	**1,632,127**	**1,599,174**	**1,556,267**
Other liabilities	**5,932,771**	**5,578,214**	**7,049,971**	**1,004,057**	**3,609,907**
Total Liabilities	**$ 16,049,146**	**$ 14,757,196**	**$ 15,080,628**	**$ 7,021,251**	**$ 7,086,723**

Source: *Arkansas Administrative Statewide Information System Trial Balance (unaudited by Arkansas Legislative Audit)*