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OFFICE OF THE STATE COMPTROLLER

November 9, 2017

Ms. RoAnn M. Destito
Commissioner
Office of General Services
Corning Tower, 41st Floor
Albany, NY 12242

Ms. MaryEllen Elia
Commissioner
State Education Department
State Education Building - Room 125
89 Washington Avenue
Albany, NY 12234

Re: Preferred Source Contracting
Report 2017-F-15

Dear Commissioners Destito and Elia:

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 followed up on the actions taken by officials of the Office of General Services (OGS) and the State Education Department (SED) to implement the recommendations contained in our audit report, *Preferred Source Contracting* (Report 2014-S-77) issued June 28, 2016.

Background, Scope, and Objective

New York State's Preferred Source Program (Program), established under Section 162 of the New York State Finance Law (Law), grants "preferred source" status to Corcraft and not-for-profit organizations that serve and employ the blind, the severely disabled, and veterans. The intent of the Program is to advance social and economic opportunities for these groups. Under the Program, the acquisition of commodities or services from preferred sources is exempted from statutory competitive procurement requirements. All State agencies, political subdivisions (i.e., local government agencies), and public benefit corporations are required to purchase certain approved products and services from preferred sources, if available. Purchases from preferred sources take precedence over all other sources of supply and competitive procurement methods.

OGS is the State's central procurement agency and is responsible for approving pricing for preferred source contracts over \$50,000, and for maintaining, on behalf of the New York State Procurement Council (Procurement Council), a current List of Preferred Source Offerings (List). The List includes the categories of commodities and services that are available and provided by preferred sources.

Facilitating agencies are non-profit corporations established to serve the approved, non-profit preferred sources as their agent by disseminating information regarding preferred sources and their offerings, by processing inquiries and orders as a one-stop contact for purchasers, and by facilitating the distribution of commodities and services provided by preferred sources. The New York State Industries for the Disabled (NYSID) is the facilitating agency designated by the Commissioner of Education to facilitate orders among agencies for the severely disabled and veterans' workshops. The Procurement Council's March 2017 List included 43 approved preferred source services available from NYSID.

NYSID serves a network of more than 120 contract-holding preferred source member agencies and corporate partners. Member agencies are the charitable, not-for-profit organizations serving and employing people with significant disabilities and qualified veterans' workshops, and are the entities granted preferred source status under the Law. Corporate partners are private vendors that partner with member agencies to complete contracts for services or commodities. Both member agencies and corporate partners must be approved by the State Education Department (SED). On behalf of its members, NYSID enters into contracts with State and local government agencies for services (e.g., document imaging, mailing) and goods (e.g., custodial products). NYSID receives a percentage-based administration fee of 4 percent from each preferred source contract.

Our initial audit report examined how State agencies and facilitating agencies are monitoring contracts fulfilled in partnership with private entities to ensure contract requirements are being met; whether the majority of the work is completed by disabled workers at preferred source vendors, as required by the Law; and whether facilitating entities are awarding contracts in a manner that best meets the purpose of the Program and is in the best interest of the State. We found OGS was appropriately fulfilling its responsibilities under the Program, but identified opportunities for OGS to improve its effectiveness by more clearly defining some of the services available under preferred source contracts and by working with the Procurement Council to consider regulatory changes that would more specifically define the role of facilitating agencies. We found that although SED was responsible for monitoring NYSID's activities, it provided only minimal oversight. As such, there was little assurance that NYSID was awarding contracts in a manner that best meets the purpose of the Program, that member agencies and corporate partners were meeting contract requirements, and that the majority of the contracted work was being completed by disabled workers. Finally, we found that the Program was extremely vulnerable to manipulation and circumvention of the competitive bid process to increase profits for corporate partners and revenue for NYSID itself. Many NYSID contracts awarded for reproduction services appeared to have circumvented the competitive process. We found one private printing company, which partnered with a NYSID member agency, had received 89 contracts for reproduction valued at over \$1.5 million. However, it appeared most – if not all – of these contracts were actually for

digital printing, a service the Procurement Council has specifically excluded from the Program.

The objective of our follow-up was to assess the extent of implementation, as of October 18, 2017, of the five recommendations included in our initial report.

Summary Conclusions and Status of Audit Recommendations

We found OGS has implemented all three of our recommendations while SED has partially implemented its two recommendations. OGS has developed definitions for the services on the List, taken steps to communicate those definitions to purchasing entities, and made improvements to the application required for preferred source contract approval. Although SED has entered into a new designation agreement with NYSID requiring it to make changes that would address many of the issues identified in the audit, we found additional progress is needed by NYSID in implementing changes required by the agreement. Further, SED has not yet taken the appropriate steps to ensure compliance with the designation agreement or verify self-reported contract data (which NYSID has been required to submit to SED since March 2014).

Follow-Up Observations

Recommendation 1

Provide clear definitions for the services on the List to make it easier for purchasing agencies to determine if the services they need are approved preferred source offerings.

Status - Implemented

Agency Action - The current List, dated March 2017, includes definitions for 45 of 46 services listed. For the remaining service, Temporary Personnel - Office, a workgroup was established and the proposed definition was to be presented for adoption at the Procurement Council meeting on November 8, 2017. Additionally, application procedures for new services outlined in OGS's Preferred Source Guidelines require the application to include a description of the new service, including how it is new or substantially different from the services already offered by the preferred source. OGS officials indicated this will ensure the new service is clearly defined at the time of approval.

Recommendation 2

Communicate with purchasing entities to clarify the definition of digital printing and that this service has not been approved as a preferred source offering.

Status - Implemented

Agency Action - The State Procurement Council adopted the definition for digital printing at its July 14, 2016 meeting. In part, this definition states, "Digital Printing is defined as a physical process that transfers an image stored in a digital format on a computer or other storage

media (e.g.: flash/thumb drive) to paper or other media.” This definition was adopted in conjunction with the adoption of definitions for mailroom services (both off site and on site) and reproduction, both of which are approved preferred source service offerings. In addition to posting the updated List on its website, OGS issued General Information Bulletins to authorized purchasers notifying them that preferred source definitions were added to the List. During the 2016 State Purchasing Forum training class on preferred sources, OGS advised attendees that definitions were being added to the List and to check the List when seeking preferred source services. In 2017, OGS updated this training (now called NY GovBuy) to “determine if the job meets the definition of an approved preferred source offering” as a required step in the process of purchasing approved preferred source services. Finally, in May 2017 OGS conducted a town hall with preferred source vendors, which included explaining that the List has been updated to include preferred source definitions.

Beginning August 15, 2017, OGS mandated the use of the Preferred Source Electronic Service Application (ESA), which it designed with input from NYSID. The application restricts the selection of services to only those approved on the List, using a drop-down box. In addition, the application contains a link to the List and advises the purchasing agency/facilitating agency to review the definitions of the service(s) to ensure it is selecting the correct one.

Recommendation 3

Work with the Procurement Council to consider regulatory changes that would include specific criteria that facilitating agencies would be required to use in awarding contracts among the qualified preferred sources they serve.

Status - Implemented

Agency Action - OGS submitted legislation that was included in the 2017 Budget Bill, but was ultimately stricken before the budget was passed by the Legislature. The legislation would have amended State Finance Law Section 162 by requiring facilitating entities to provide OGS with sufficient information to determine price reasonableness. Information provided includes but is not limited to a pricing application and comparable price information from private contracts and contracts executed by private vendors accorded preferred source status under a partnering arrangement. OGS also reports that it has passed this recommendation onto SED and has consulted with SED, NYSID, and the Procurement Council on several occasions to consider statutory or regulatory amendments, as well as to strengthen the Preferred Source Guidelines.

In addition, as part of OGS’s ESA, facilitating entities are now required to submit a Market Comparison Attachment with documentation of at least one acceptable prevailing market comparable price. OGS reviews the documentation submitted as well as research it has compiled and previous comparable prices as part of its price review.

OGS's ESA also requires facilitating entities to document the actual tasks to be completed by preferred source employees and their frequency. In addition, they are required to submit a detailed cost summary for the contract. While a cost summary was previously required, the new summary is in a spreadsheet and requires a direct labor breakdown for each job title, the number of employees per title, total hours, and hourly wage information. The spreadsheet automatically calculates the percentage of labor hours and full-time equivalents applicable to disabled workers on the proposed contract. Providing this information in advance of contract approval provides greater assurance that a sufficient number of disabled workers are actually working on the contract.

Recommendation 4

Implement a strong system for monitoring and oversight of NYSID that includes procedures for verification of self-reported information such as review of contract performance data.

Status - Partially Implemented

Agency Action - The designation agreement with NYSID is SED's first step in addressing this recommendation. Since that agreement only became effective January 1, 2017 (while it was actually signed March 2, 2017), it is still in the early stages of implementation. SED states that most of its past meetings with NYSID focused on the agreement as well as the corporate partnership application and binding agreement between the member and corporate partner. We issued the preliminary reports on these issues on July 10, 2015. Therefore, it has taken SED approximately 20 months since first being notified of our audit findings to finalize its designation agreement with NYSID. Further, SED has not taken the necessary steps to ensure compliance with the designation agreement since it went into effect, nor has it verified self-reported contract data during this extended period (which NYSID has been required to submit to SED since March 2014).

While SED states it will meet with NYSID on a quarterly basis to review the terms of the designation agreement, review activities during the previous quarter, address areas of concern, and ensure compliance, including review of NYSID's annual report, SED acknowledges it will not conduct the first of these meetings until November 28, 2017, and it plans for the review to be completed that morning. As a result, it will have taken over two years since we first informed SED of our findings for the agency to visit NYSID to begin any reviews of information that it should have been reviewing from the outset. Further, as of September 13, 2017, SED has not developed procedures or agendas, or identified items to be reviewed or in what manner. As a result, we cannot state whether these reviews will provide assurance of NYSID's compliance with the specific requirements of the designation agreement or of the accuracy of self-reported data.

Recommendation 5

Require NYSID to:

- *Limit the detailed information provided to members/partners in advance of quality reviews;*
- *Maintain documentation to support the contract award process;*
- *Make contract opportunities available to all member agencies and give all private vendors expressing an interest equal opportunity to become corporate partners; and*
- *Discontinue awarding reproduction contracts for digital printing services.*

Status - Partially Implemented

Agency Action - The designation agreement between SED and NYSID addresses concerns identified in the original audit, including requiring NYSID to revise the amount of information provided in advance of quality reviews, afford all members equitable and fair opportunities for contract work, ensure all contract files contain appropriate documentation to support NYSID's contract award decision, ensure all preferred source contracts comply with applicable laws and regulations, and ensure that only preferred source products and services approved by the Procurement Council be utilized.

We visited NYSID September 11-13, 2017 to determine the extent to which it has implemented the designation agreement. We reviewed a judgmental sample of ten compliance reviews (formerly quality reviews), which included a mix of service types and member agencies as well as a proportional number of contracts containing corporate partners as appeared in the total population of reviews, to determine whether the reviews were accurately completed, what advance notice of review was given, and whether corrective action plans were submitted as required. NYSID has re-titled its quality reviews to compliance reviews as part of an effort to send a message to membership that program requirements are being monitored and will be strictly enforced. We were able to see this improved tone reflected in email correspondence between NYSID staff and a corporate partner in one of the records we reviewed.

NYSID officials state they still provide notice 30 days in advance of a review. However, officials state they have revised many of their compliance review procedures to reduce the amount of information members/corporate partners receive in advance, including requesting one year of information be prepared (while they primarily review one quarter) and providing one week's notice of the sample to be reviewed. However, we continue to have concerns about the amount of information provided in advance of reviews based on our follow-up, including:

- For nine of the ten compliance reviews, we found the review took place five or more weeks after the initial notification letter was sent.
- One review provided almost four weeks' notification of the exact quarter, as well as the contract and documentation, to be reviewed. Furthermore, only two employees worked on this contract, and the member/corporate partner thus had

almost four weeks' notice of the employees who would be reviewed.

- In another instance, NYSID allowed over eight weeks' notice of a review. This is particularly concerning since there were only four disabled workers on the contracts reviewed. Further, the member/corporate partner was granted an additional two months after the review to provide the required disability documentation.
- We had to replace one review in our sample because it was still in process. However, we found all ten employee disability reviews had August 2, 2017 (two days before the review date) listed as the date of most recent assessment. This is similar to findings from the original audit, in which we found a member agency obtained disability documentation for an employee two years after the individual was hired – action that was taken in anticipation of an impending NYSID quality review.
- Finally, we found errors within one review. NYSID officials explained they had problems with this specific reviewer's performance and she is no longer with NYSID, and the review will be redone.

After discussion with NYSID officials, they agreed to further refine the information provided in advance of reviews, including reducing advance notice to two weeks and not providing notice of the sample to be reviewed.

We also selected a judgmental sample of ten contract award files for review that included contracts with start dates beginning February 1, 2017 (as this is when NYSID's updated contract award process began) and/or contracts that appeared to pose a risk of including digital printing. We reviewed this sample to identify any new or ongoing digital printing contracts, determine whether NYSID's contract files contain appropriate documentation to support NYSID's contract award decision, and whether NYSID's contract award decisions show NYSID affording all members equitable and fair opportunities for contract work. We found no evidence of newly awarded digital printing contracts. However, we identified one ongoing digital printing contract, with a contract period of January 1, 2013–December 31, 2017. We found NYSID continued this contract through 2016. Then, prior to the completion of an amendment to extend the contract through 2017, NYSID notified the contracting agency that the Procurement Council and OGS had updated several definitions of the service offerings available on the List, including reproduction. NYSID is now "only approved to provide reproduction when making duplicates of a preexisting original hard copy document/s and cannot reproduce a document/s that is in an electronic format."

While NYSID argues that the audit report's recommendation was to discontinue awarding reproduction contracts for digital printing services, and this was a contract extension so they were allowed to continue the contract in 2016, OGS's price approval (which is required for preferred source contracts) included a note that explicitly stated the contract cannot include digital printing: "the 'reproduction' services referenced in this application cannot entail 'digital printing services' as defined in NYSID's original application 1381 (which was denied by the Procurement Council on May 25, 2014, appealed by NYSID, and upheld by Commissioner Destito). In particular, the use of a Xerox iGen4 or similar digital printing device is not permitted." (Per the contract's cost analysis, this contract includes printing on a Canon IR 110 and TDS 860, both of which we confirmed as digital printers as part of

the original audit.) Further, we do not differentiate between continuing the contract in 2016 or 2017, as digital printing was not an approved preferred source service in either year. We believe NYSID should have sent a letter in 2016 similar to the one sent in 2017, which would likely have resulted in contract termination.

All nine of the remaining contract award files in our sample contained a Service Contract Member Assignment form (Assignment form), which NYSID is using to document contract award decisions. However, in eight of these files, we were able to find proposals and other documentation dated a month or more before the Assignment form was dated and completed, showing the decision was made without the Assignment form or the form was filled out after the fact. NYSID officials argued that, while the form was filled out later, they still documented the decision making process. Nevertheless, completing the Assignment form in this manner defeats its purpose (as it was not filled out as part of the decision making process), and calls into question whether NYSID has made actual changes to its contract award process to ensure equitable and fair distribution of contracts. Further, during our review, NYSID officials stated they would expect to see the Assignment form as one of the first things completed. In addition, we found the form does not actually support the contract decisions made because it does not contain sufficient information/support and/or the information is questionable:

- While NYSID officials asserted that decisions are made in order of the factors listed on the Assignment form and the form states to attach pertinent information, for five of eight files, we did not find documentation/support for statements that the contract was requested by the contracting agency, the contract was initiated by the approved member, and/or there was an existing relationship between the contracting agency and the approved member.
- For all eight files, we found that, where the Assignment form asks for members/partners eligible/canvassed, the form either said “n/a” or listed the contract awardee. We did not see any instances where alternate members were canvassed, and officials stated they have only conducted one mini-bid. Further, for seven of these eight files, the form then stated the service provider expressed an interest in performing the services, but no other member was canvassed and given an opportunity to express interest.
- For five files, the Assignment form was checked as an opportunity to utilize a new or under-represented approved service provider. However, at the time of the original audit, many of these providers had significantly more contracts than others, including one with 142 – far outnumbering the next highest-awarded provider (with 63 contracts). The seventh and eighth most awarded providers had 44 and 34 contracts, respectively – outnumbering more than 54 and 53 other providers, respectively.
- Finally, we found two contracts that had no documentation clearly showing how the contract was awarded. In both cases, the service provider was not requested by the contracting agency, the service opportunity was not initiated by the member, and there was not an existing relationship. Both forms showed “n/a” for other members/partners eligible/canvassed, and then stated the member expressed

interest in providing the opportunity – but no one else was canvassed to express interest. The member selected is in the geographic proximity and has the ability (which we would expect). Finally, the form was checked as an opportunity to utilize a new or under-represented approved service provider. However, on our original audit, we found the member had the seventh most contracts of any member (44 contracts) and more contracts than 54 other members, so we cannot consider the member to be underutilized.

In addition to the revisions above, NYSID has planned further changes to address issues raised in the original audit report, including the required submission of supporting documentation with Quarterly Employment Reports (QERs) and QER-based audits. These changes will not be implemented until 2018 so they could not be included in our review, but we recognize these as additional planned positive changes.

Major contributors to this report were Walter Irving, Brandon Ogden, Vicki Wilkins, and Philip Boyd.

We would appreciate your response to this report within 30 days, indicating any actions planned to address the unresolved issues discussed in this report. We thank the management and staff of OGS and SED for the courtesies and cooperation extended to our auditors during this review.

Sincerely,

Brian Reilly
Audit Director CFE, CGFM

cc: Theresa Bonneau, Director of Internal Audit
Thalia Melendez, Director of the Office of Audit Services