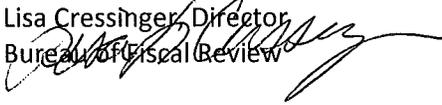




PENNSYLVANIA
TREASURY
Earn. Learn. Invest.

Bureau of Fiscal Review

TO: Debra Chernicoff, Director of Payable Services
Comptroller Operations

FROM: Lisa Cressinger, Director
Bureau of Fiscal Review


DATE: June 5, 2013

SUBJECT: Rejection of Payments for Pennsylvania Interactive, LLC

The Pennsylvania Treasury Department has determined that it is unable to conclude that requested payments totaling just under \$3.48 million to Pennsylvania Interactive, LLC, appear to be lawful and correct and is consequently rejecting them. The payments are for invoices dated January 31, February 28, March 31, and April 30, 2013.

The bases for our rejection follow. We also offer several auditors' observations for your consideration.

A. Failure to secure approval of contracts from the Office of Attorney General as to form and legality

Contracts between Commonwealth agencies and private vendors are not effective until the Office of Attorney General ("OAG") has approved them for form and legality.

In this instance, the Office of Administration ("OA") submitted to the OAG for review a three-page contract entitled "Contract for SELF-FUNDED eGOVERNMENT SERVICES" that contained no term or provision authorizing the payment of either a specific sum or a maximum amount to the vendor, Pennsylvania Interactive, LLC ("Pennsylvania Interactive"). The contract explicitly incorporated by reference a number of other voluminous documents. Although at least some of these describe methodologies for providing compensation to the vendor (including methodologies through which the vendor receives compensation in the form of convenience fees paid directly to it by businesses engaging in commerce with Commonwealth agencies), none of them contain provisions authorizing the payment of either a specific sum or a maximum amount to the vendor.

The OAG appears to have provided its approval to the foregoing contract on November 8, 2012. On the same date, OA issued through SAP a form document assigning contract number 4400010625 to the "Self-Funded EGovernment Services" contract and establishing a total amount for materials and services under the contract of \$100,000.01.

While we believe this SAP form document may have been available to the OAG at the time of its review, we are uncertain whether confusing presentation allowed the OAG to recognize its significance. The first page of the document included line items for self-funded egovernment services and development of additional applications, but each was priced at a rate of \$0.00 per unit (meaning that there was no cost associated with provision of these goods or services). Consistent with this presentation, a brief narrative at the top of the second page of the form document contains such phrases as "This self-funded portal model . . .," "NIC funds the initial investments to transition to the new portal and the ongoing operation and maintenance . . .," and "NIC obtains its revenue through a self funding model where transaction fees are applied to business to government transactions . . ."¹

It is only on the bottom of this second page that the value of \$100,000.01 appears, without further explanation. This total amount should reflect the sum of the individual items on the first page, but in this instance the first page and the second are discrepant.²

OA appears to have reissued Contract 4400010625 in SAP on January 3, 2013. The first page continues to refer to self-funded egovernment services and development of additional applications and it continues to list them as no-cost materials/services. The top of the second page of the SAP document repeats the same NIC narrative seen on the original contract form. The Total Amount box on the bottom of the second page, however, contains the figure "\$5,000,000.00."

OA thereafter created Purchase Order 4300358952 (referencing Contract 4400010625) for Pennsylvania Interactive. The first version of this PO, dating from or about December 21, 2012, includes, and references on its face, a work order – identified simply as "Work order for Drivers Info Portal" – and provides for a total amount to be paid to the vendor of \$0.01. OA modified the PO on or about February 7, 2013, through the substitution of i) "2,499,999.00" as the quantity of "Work Order" to be provided, ii) \$2.00 as the new net price per unit and iii) \$4,999,998.00 as the new Total Amount. Finally, the second page of the revised PO contains the statement, "The issuance of this PO provides authorization to perform the services described in the attached work order and statement of work as outlined in Exhibit A." It also contains the information "Service Period: 1/1/13 – 6/30/13," which attempts to retroactively authorize commencement of work on January 1, a date on which the then effective PO provided funding approval of only \$0.01.

¹ "NIC" refers to NICUSA, Inc., the parent of Pennsylvania Interactive, LLC.

² Compounding the potential confusion, the summary of the Pennsylvania Interactive contract that the Office of Administration provided to Treasury for inclusion in our public on-line contracts library cites the value of the contract as \$0.00.

As previously noted, there is some basis for ambiguity regarding exactly what the OAG considered in approving the Pennsylvania Interactive contract originally submitted to it. Under the most favorable interpretation, the OAG would have considered and approved a contract that it understood called for a total amount to the vendor of \$100,000.01. Regardless of how the OAG regarded the November 8 SAP contract available at the time of its review, there appears to be no contention that either the modified contract or a modified PO authorizing compensation in the amount of almost \$5 million was ever submitted to the OAG for its approval.

It is common practice for agencies to submit contracts that are substantially changed by amendments to the OAG for additional review as to form and legality. In this instance, the contract and PO as amended to increase Pennsylvania Interactive's compensation to \$5 million were neither reviewed nor approved by the OAG. Treasury is therefore unable to accept the contract as effective (at least as to any provisions not originally presented to the OAG). As a consequence, Treasury lacks legal authority to make the payments presented to us.

Accordingly, we respectfully request that you present the amended contract and the PO to the OAG for review as to form and legality.

B. Insufficient justification for specific payments requested

You previously explained that the contract with Pennsylvania Interactive allows for three payment methods (nominal convenience charge to transactions with the Commonwealth; free services; consulting services, involving fixed cost or time and materials billing). You further advised that the invoices in question allow the Commonwealth to fund the project using the consulting services method in accordance with PO 4300358952 and its accompanying work order for development and delivery of a records portal for PennDOT.

We begin by observing that the invoices do not resemble those customarily utilized to secure compensation for consulting services. They neither present names of individuals (or their positions) who provided services, the number of hours of services, and the unit rates for such services nor identify or describe tasks or projects that have been completed and supplied to the Commonwealth (commonly referred to as "deliverables") according to a contractual schedule that assigns a fixed value for their completion. Each invoice simply states "Work Order – Driver Information Records," and then provides a quantity and rate. While – as noted – rates are frequently an element of consulting services invoices, a rate of \$2.00 per unit of services is uncommon. In addition, charges for mere quantities of products (in this instance, apparently of records) are not commonly found on consulting services invoices.

Moreover, the work order attached to PO 4300358952 makes no reference to the consulting services method of compensation in its fees section. Among other things, it lacks any fee schedule for hourly services by different job classifications or fixed prices associated with specifically identified deliverables.³

³ Treasury has identified a "Supplier Price Request" issued by the Office of Administration to Pennsylvania Interactive, and signed by a representative of the vendor on October 15, 2012, that appears to provide hourly rates for a number of position classes involved in the delivery of consulting services (e.g., Lead Developer, System

Rather, the fees section created in the work order describes a promise by the Commonwealth to begin paying Pennsylvania Interactive on January 1, 2013, \$2.00 for every regular transaction by driver information wholesalers until a future time when Pennsylvania Interactive is able (and approved by the Commonwealth) to share in fees it collects directly from wholesalers for their use of the portal.

The fees section appears, in essence, to establish a commitment by the Commonwealth to provide revenue to Pennsylvania Interactive for the period of time during which the vendor will be expending effort to create the desired portal.⁴ Calculation of the revenue to be provided, however, is not based upon any particular measure of services contributed by Pennsylvania Interactive (such as hours worked by individuals in various job classifications) or deliverables completed by the vendor according to an established schedule for payment. Instead, payment is calculated based upon the number of particular transactions the Commonwealth continues to conduct without benefit of Pennsylvania Interactive's operation of the portal, pending its completion.

The invoices submitted for payment conform precisely to what we would expect to see if the Commonwealth was compensating Pennsylvania Interactive in accordance with the methodology described in the fees section of the work order.

Treasury expresses no opinion about either the appropriateness of this methodology in general or of the specific fees that its application would authorize to be paid to Pennsylvania Interactive. It is clear to us, however, that this methodology is not based upon a consulting services model, whether for time and materials according to an established labor pay scale or for a fixed fee.⁵ Indeed, the methodology seems to represent the antithesis of a fixed price since the fees section provides no certain latest end date by which Pennsylvania Interactive must deliver a functional and approvable portal to the Commonwealth.⁶ Until the time of such delivery (which theoretically could be delayed for an unknown

Administrator, Developer, Web Developer, etc.). This document does not appear to be made part of PO 4300358952 or the accompanying work order, it does not contain any references to Driver Information Records, and none of the hourly rates are \$2.00. Based on content, it is also unclear whether this document – if applicable to the contract at all – is intended to relate to the portal development or only to development of additional applications.

The Commonwealth in its response to our initial questions did not provide a fee schedule for labor or a fixed price schedule that would establish fees for the completion of identified tasks by Pennsylvania Interactive.

⁴ This perception is strongly supported by the provisions of the MOU between PennDOT, OA, and Office of the Budget, which address issues of allocation and reimbursement of costs associated with development of the portal.

⁵ Nor do we believe that the compensation requested fits within either of the other two contract methodologies that you described in your response (and which you have not urged upon us in this instance).

⁶ We note that your response states that payment to Pennsylvania Interactive will be accomplished by the addition of convenience fees to certain transactions after July 1, 2013, replacing the Driver Information Wholesalers transaction fees at that point. On a very narrow point, we initially observe that "after July 1, 2013," taken literally, does not identify a specific end date; there are technically an infinite number of dates that will occur after July 1 of this year. For purposes of our response, we have assumed that you intended to communicate that July 1 was in

period of time), or perhaps termination by the Commonwealth pursuant to other contractual provisions, the Commonwealth would appear to be contractually obligated to continue making these payments.⁷

fact the end date. If the "after" phrasing were intentional in order to convey that an explicit end date for these payments is not established somewhere, there would be even less basis to assert that the invoices were based upon a fixed fee method of calculation for consulting services.

Unfortunately, we have not been able to find a basis in the work order for a July 1, 2013, end date. The fees section calls for the Commonwealth to pay the fee of \$2.00 per Driver Information Wholesalers transaction starting on January 1, 2013, and continuing until such time as PennDOT accepts the Records Portal being developed by the vendor and authorizes the collection of fees from businesses engaging in transactions with the Commonwealth through the portal. On its face, this formulation is open-ended, and dependent upon the successful development and implementation of complex technology. There appears to be no reference in the fees section to July 1, 2013, (or any other later specific date) on which direct payments by PennDOT of \$2.00 per each Driver Information Wholesaler transaction will terminate. A table attached to the work order that projects payments using this methodology bears a line reading, "**July 1, 2013: Self-Funding Begins: Value Add Status Achieved - \$2 Convenience Fee Assessed,**" but this appears to be more projection of future events than legally binding contractual language. Further, the table is not referenced in the fees section of the work order.

Moreover, the MOU between PennDOT, OA, and Office of the Budget regarding costs for the portal acknowledges the difficulty in establishing advance certainty about the completion date of a project such as the portal when it provides a mechanism for allocating the excess payments that will need to be made, "[i]n the event that the Penn DOT Records Portal has not been completed by the time that the five million dollars (\$5,000,000) is paid by PennDOT to the Contractor"

More simply, the Driver Information Wholesalers payments to the vendor are derived from the actual number of transactions occurring each month, a number that is unknown, varying, and unpredictable until the end of the month. Payments based upon such transactions cannot be considered fixed fees as that term is commonly understood even if the length of time of such payments is known with specificity.

⁷Assuming that the fees section methodology that the work order established were in fact valid. As explained in the following paragraph, Treasury does not find payment under the methodology to be lawful and correct.

We recognize that the current contract value – the \$4,999,998 established by the revised contract and PO 4300358952 – represents a kind of upper limit on payments that could be requested by the vendor. A maximum value is not the same, however, as a fixed fee. Moreover, OA has already demonstrated that it believes that it may increase the contract value without obtaining approval from the OAG. We similarly recognize that the February 7 version of the PO defines a service period ending on June 30, 2013. The difficulty in accepting that date as establishing even a maximum potential value is that it conflicts with the plain language of the work order, which marks conclusion of the period for payment by Driver Information Wholesalers transaction fee by the development of an acceptable portal. While that development might occur by June 30, it also might not. In such instance, the two provisions – neither of which acknowledges the other – appear to be in conflict. Finally, we refer again to the MOU provision we cited in footnote 6 that makes clear that Commonwealth participants in this venture were all explicitly aware – and prepared to accept – that portal development efforts (and direct fee payments to Pennsylvania Interactive for such efforts) could continue past nominal completion milestones.

Further, we cannot agree that the payments in question here were calculated based upon a methodology that was included in the contractual materials submitted to the OAG for review. The payment methodology actually utilized – compensation based not upon any measure of efforts or accomplishments that signify progress towards completion of the scope of work but upon a kind of proxy for revenues the vendor will receive once it has delivered an operating portal – appears only in the work order, which was not part of the original contract and not available to the OAG for consideration in its review. Any payments made pursuant to this methodology would be outside the terms of an effective Commonwealth contract.

Consequently, the payments are not lawful and correct.

C. Inadequate basis for sole source justification

In your response to Treasury's question about the sole source justification for the selection of Pennsylvania Interactive, you attempt to distinguish IBM's bid for an Arizona portal contract opportunity in 2007 by explaining that "the Arizona portal contract was a fixed-fee model, not a self-funded model." In light of the fact that the revised contract for the development of the Commonwealth's portal and PO 4300358952 establish a potential value (so far) to the selected vendor of almost \$5 million in direct Commonwealth payments (and the vendor has already submitted invoices for fees of \$3.48 million), we are unable to understand the basis for the distinction you draw. How can the Commonwealth be certain that IBM – or other possible competitors – would not have submitted viable proposals if they had been advised through an appropriate procurement that the Commonwealth was prepared to contribute substantial revenue to the project (*i.e.*, that Pennsylvania was not requiring a model that was limited strictly to self-funding)?

Auditor's Observations

- 1) As we previously suggested, Information Technology Bulletin ITB-BUS002 (Transaction Fee Policy) establishes the following policy: "In general, agencies are to avoid the use of transaction fees when implementing e-government applications. Some exemptions may be made, but are to be the exception, rather than the rule." We asked whether such an exemption was secured in this instance.

You responded that the Community of Practice Procurement and Architectural Review ("COPPAR") action on October 25, 2012, considered and approved a Source Justification Form ("SJF") that indicated that a transaction fee would be applied under the contract with Pennsylvania Interactive. We note initially that the SJF is concerned entirely with providing a sole-source justification for the selection of NICUSA, Inc. (the parent of Pennsylvania Interactive). While it does make clear that transaction fees will be applied to certain commercial

interactions, the SJF neither references the ITB-BUS002 policy nor explicitly seeks an exemption from its application.

Similarly, the COPPAR "Business justification" section fails to make any mention of the Commonwealth's existing policy regarding transaction fees for "e-governmental applications." Even more curiously, it contains no language expressing the intention to grant a waiver from ITB-BUS002. Instead, the COPPAR document addresses exclusively the significant costs associated with maintaining the Commonwealth's existing portal infrastructure and notes that the self-funded solution eliminates the need to rely upon the General Fund for portal support. The COPPAR justification also refers to some 145 on-line applications that are currently available to Commonwealth customers and points out that the self-funded model offers the opportunity to implement applications that could be customized for these customers.

We believe it to be better practice for Commonwealth bodies to grant exemptions or waivers from important policies in express language that leaves no ambiguity about the nature and intention of the action taken. This is especially true here, given the apparent scope that you wish to attribute to the COPPAR action. The sweeping approval of so many self-funding on-line applications in one paragraph is inconsistent with the careful, exception by exception review process called for by ITB-BUS002. It would be far easier to accept that COPPAR's action has the significance you assert if the document offered some acknowledgment that it was rejecting the fundamental element of the existing policy.

In light of the foregoing, we are uncomfortable about the implications of the scope of the COPPAR action. Given the decision here (and its failure to even acknowledge the extant policy), what vitality remains to the aspiration to preserve on-line transactions with the Commonwealth free from so-called convenience or efficiency fees as much as possible?

- 2) Your response to our question about the characterization of revenue makes clear that our inquiry was poorly worded. The contractual provision to which we referred appears on page 3 of the work order that accompanies PO 4300358952. In the section dealing with the treatment of account fees collected through the portal by the vendor – fees which are to be split evenly between the vendor and PennDOT – subsection d. provides, in part, as follows: "Efficiency Fees and Account Fees do not constitute PennDOT revenue."

It is to these funds – money paid to PennDOT but identified as non-Commonwealth revenue – that our question was directed. Why are these funds characterized as non-Commonwealth revenue? If that is not their characterization, what are they? Will they constitute augmenting revenues? Will they be included as estimated augmenting revenue in the agency's budget and reported to the General Assembly?

- 3) The laws regarding the collection of fees by Commonwealth agencies are quite heterogeneous. Some establish specific fixed fees for services, and we assume that OA agrees that neither the Commonwealth nor its vendor can increase those fees by the addition of a convenience or efficiency fee (or an account fee) associated with conducting an on-line transaction.

Other laws entrust to agencies the ability to set fees for services, generally through a formal process. We would appreciate understanding better your basis for imposing additional fees in these instances. For example, what procedural requirements do you believe apply to the fees established on page 3 of the work order? We are specifically referring to the provision that, "... Contractor is authorized to execute Account Holder Agreements with the Account Holders pursuant to which Contractor may charge the Account Holders the Account Fee and Efficiency Fee set forth below in addition to any applicable statutory or other fee imposed by PennDOT or the Commonwealth."

Similarly, we would appreciate understanding the governance structure that you utilized in developing the fee schedule on page 3 of the work order. The role of a governance process is explicitly contemplated in this language from the **Header Text** provided in both the original and then the revised SAP contract (4400010625): "NIC obtains its revenue through a self-funding model where transaction fees are applied to business to government transactions based on fees approved by a governance structure."

- 4) According to records available to Treasury in SAP, Purchase Order 4300358952 and accompanying work order were first issued (with an effective date of December 21, 2012) with a total authorized amount of \$0.01. The same PO was subsequently modified with a "Change Date" of February 7, 2013, which was the first time it apparently included the current total authorized amount of \$4,999,998.00.

In addition, SAP records show the PO to remain in draft status as of this time, meaning that there is no evidence that it was ever issued. In the absence of a recorded issue date, there is no evidence that Pennsylvania Interactive was authorized to proceed. Articles 1 and 2 of the IT Contract Terms and Conditions, which are a part of the contract, provide that the vendor is not authorized to start performance until it has received a Purchase Order (or other written notice to proceed signed by the Contracting Officer) and that the Commonwealth is not obligated to pay for delivered products unless the authorizing agency has received an acknowledgment.

The terms of the work order accompanying Purchase Order 4300358952, however, purport to authorize Pennsylvania Interactive to begin performing services and receiving the Driver Information Wholesalers payments commencing on January 1, 2013. The vendor's first submitted invoice, for \$889,294 was dated January 31, 2013. This invoice therefore seeks payment of an amount that far exceeds the \$0.01 value established by the version of the PO effective as of the date of the invoice. As a consequence, it appears to us that payment of the invoiced amount is impermissible since the requested payment exceeds the total amount authorized for Pennsylvania Interactive at the time that it billed for services.

We would appreciate your assistance in understanding a) whether Purchase Order 4300358952 has been properly issued to and acknowledged by Pennsylvania Interactive and, if so, on what date, and b) if the only version of the PO that might have been issued to Pennsylvania Interactive prior to February 7, 2013, provided for total payment of only \$0.01, on what basis is

the Commonwealth authorized to pay an invoice for a period earlier than that date that exceeds the total authorized PO value?

- 5) On February 2, 2013, OA changed the funding on Purchase Order 4300358952 from an Executive Offices appropriation to a PennDOT appropriation. The electronic approvals provided in your response to Treasury's questions do not include an approval by PennDOT. We are concerned that the system controls did not require approval from PennDOT prior to executing a purchase order encumbering that agency's funds.

LC/KW/ss