



## REPORT HIGHLIGHTS SPECIAL AUDIT

### Department's standard terms and conditions protect the State, but should be specialized for IT procurement

#### Our Conclusion

Pursuant to Laws 2013, Ch. 100, the Office of the Auditor General has conducted a special audit addressing selected state practices for information technology (IT) procurement as compared to other states. Specifically, we analyzed the State's practices in the areas of indemnification, liability, insurance, and warranties. As with other states we reviewed, Arizona's IT contracts help to protect the State from risk of loss, but would benefit from IT-specific contract templates. We also reviewed best practices for the ownership of intellectual property. Although Arizona's terms and conditions generally require state ownership of intellectual property for IT projects, the State should provide options for intellectual property ownership based on who pays for the development costs. In addition, we analyzed IT standardization and its impact on the procurement process. Although standardization can impact procurement, IT must still be purchased through a competitive procurement process.

**SPO oversees the State's procurement process**—The Arizona Department of Administration's (Department) State Procurement Office (SPO) administers the state laws and administrative rules that govern the procurement of goods and services for the State. SPO delegates procurement authority to state agencies, with or without limitations, based on state agencies' expertise, knowledge, and the impact on efficiency and effectiveness. Procurements exceeding an estimated \$100,000 are solicited through an invitation for bid or request for proposal, and contracts are awarded to the vendor whose offer is the most advantageous to the State. The Department has established uniform and special terms and conditions that are included in solicitations and become part of the awarded contract.

#### Terms and conditions transfer liability to vendors and help ensure product/service quality

The terms and conditions related to indemnification, liability, insurance, and warranties are intended to protect the State by transferring unlimited liability for potential claims to vendors and helping ensure the quality of materials and services provided. Although these terms and conditions are generally in line with the standard terms and conditions used in nine other states we reviewed, vendors we contacted expressed several concerns with them. In particular, vendors were concerned that the terms and conditions do not limit vendor liability, which they reported transfers too much financial

risk to them relative to the value of the contract. Additionally, although the State can negotiate these terms and conditions and did negotiate them in some contracts we reviewed, vendors expressed concerns regarding the State's willingness to negotiate. Some vendors indicated that these concerns affect their participation in the procurement process, such as not responding to a solicitation or submitting proposals with exceptions to the terms and conditions.

**Department should develop IT-specific contract templates**—IT-specific contract templates could help ensure that terms and conditions are appropriate, streamline the negotiation process, and help address some vendor concerns. The Department developed IT-specific contract terms and conditions in May 2012, including a provision that allows for limiting vendor first-party liability to an amount that is equal to or a specified multiple of the contract value. However, other states we reviewed have developed separate contract templates that are relevant to the procurement of IT materials and/or services. These templates provide terms and conditions that also can be modified prior to solicitations or through the negotiation process, as appropriate. States with these templates reported that the modifications have strengthened their relationship with vendors, reduced the need for negotiation, or increased efficiency in the procurement process.

**Indemnification**—An agreement to hold a party harmless in the event of loss or damage.

**Liability**—The legal responsibility to pay debts or other obligations.

**Insurance**—A contract between insurer and insured that indemnifies the insured by making payments in the event of certain losses.

**Warranty**—A promise that a claim is true.



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## Recommendations

The Department should:

- Review existing terms and conditions;
- Seek direction from the Legislature and/or Governor, as appropriate;
- Develop and use specialized templates with IT-specific terms and conditions;
- Develop and implement policies and procedures to regularly review the templates; and
- Provide training and/or written guidance for the use and modification of templates.

### Department should further modify intellectual property terms and conditions

The State's existing standard terms and conditions generally require state ownership of intellectual property created as a result of a contract. In contrast, the Federal Acquisition Regulation (FAR) provides for three options for intellectual property rights based on whether the government pays for all, a portion, or none of the development costs. Intellectual property rights were a concern for several vendors we interviewed, and vendors requested modifications to the intellectual property terms and conditions in most of the requests for proposal we reviewed, which the State agreed to in some cases. Although the Department created an IT-specific intellectual property provision in May 2012 that is similar to one of the FAR's options, it should include the options described in the FAR in the IT-specific contract templates we recommend that it develop.

#### Recommendation

The Department should include options for intellectual property rights, as described in the FAR, in the IT-specific contract templates.

### IT standardization can impact procurement, but IT must still be purchased through a competitive procurement process

Standardization can occur at any level of an IT system, including computing platforms such as mainframes, servers, and personal computers; operating systems; and applications. The Department's Arizona Strategic Enterprise Technology Office is responsible for setting state-wide IT standards and standardization efforts. Some goals of standardization are to reduce costs and increase efficiencies. For example, the State has purchased a single, state-wide financial accounting system to be used by all agencies instead of each having its own system. Standardization can also affect specifications or the scope-of-work requirements for a particular solicitation. For example, an agency with specific requirements may develop solicitation specifications or scope-of-work requirements to ensure compatibility with existing systems. However, standardization can lead to state agency concerns about standards requiring changes to agency operations, increasing costs, or not meeting agency needs.

Although IT standardization can impact procurement, IT materials and services must still be competitively procured. Similar to Arizona, states we reviewed reported that they do not develop IT standards specifying a particular product or vendor and that contracts must be awarded through a competitive procurement process.