

# Financial & Audit Solutions

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Office of the State Comptroller

Alan G. Hevesi

Division of State Services

## Awarding Bids with Options

**A**warding of items with options can be tricky and there are some issues to watch out for when considering options. We recently reviewed an agency contract where the IFB (invitation for bid) method of award was by item. However, one item had an option that the vendor was not required to bid on. The agency reserved the right to award the item with or without the option.

Bids were received and the low bidder for the item in question was not the low bidder when considering the option. In most cases, the agency chooses the option or does not. However in this case, the agency only intended to use the option for a limited time. Based on this scenario, the agency wanted to award the contract item to the low bidder regardless of what their price was with the option. The agency had two choices for properly awarding this contract: 1) award the item to the low bidder with the option only for the time period the

option was needed and then re-bid the procurement for the item after that time period, or 2) award the item to the low bidder without the option. The agency chose to award to the low bidder with the option and re-bid after the option was no longer needed.

When agencies desire to use such options, the IFB should require vendors to submit two prices, one with the option and one without the option. This will help ensure that, whatever action is desired, you will be awarding the item to the true low bid. In addition, the agency should outline in the procurement record and in advance of its receipt of the bids, its basis for determining whether or not it will exercise the option. For example, the agency in the prior example decided it would exercise the option if the total cost was below a certain dollar threshold. If the basis for determining whether the option will be used is not determined prior to the bids being received, a re-bid, bid protest or

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## Bernie McHugh Appointed Director of State Expenditures



**B**ernie McHugh was recently appointed Director of the Bureau of State Expenditures. Bernie, who reports to Joan M. Sullivan, Assistant Comptroller for the State Financial Services Group, has been employed by the Office of the State Comptroller

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# Comptroller's 2004 Fall Conference

## *Building Accountability in Government*

Following a one year hiatus, the Comptroller's Fall Conference was, once again, an event not to be missed. Held on October 7 and 8 at the Hudson Valley Resort in Kerhonkson, New York, State agency representatives were invited to two full days of interesting and informative seminars on a broad range of financial management topics. The Fall Conference, designed for agency financial managers and staff at all levels, has been recognized as a wonderful opportunity for the Comptroller's staff to gain a better understanding of the needs and concerns of the agencies we work with, while providing valuable training and updates on current initiatives.

The theme of the conference—Building Accountability in Government—served as a foundation for all workshops given by staff within the Division of State Services. On the first



day, conference participants were welcomed by First Deputy Comptroller Tom Sanzillo, who kicked off the event with an informative opening address. In addition, two popular presenters served as keynote speakers: Mike Hourigan, who provided tips on how to increase results and lower stress by maximizing your personal influence; and Joe Healy, who discussed how to achieve peak performance in spite of great demands and shifting realities.

The keynotes were followed by a full two day's worth of seminars on such timely topics as ground breaking procurement concepts in government contracting, engaging in quality contract performance, current and evolving legal issues relating to contracts, rethinking controls, the redesign of New York



State's Central Accounting System, and how an agency can create a fraud prevention program. In addition, attendees received continuing professional education credits (CPEs) and continuing legal education credits (CLEs) for conference attendance.

The Comptroller's Office has received a tremendous amount of positive feedback from attendees, who reported that the conference was a success and were pleased with the facility, the food and subject matter of the presentations. In fact, most agency staff would have preferred a longer conference allowing for expansion of many of the topics and issues addressed.

OSC is already looking forward to next year's conference and we sincerely invite any agency comments that may further improve future events.



# “Data Capture” - Payroll’s Priority for Reform

When payroll professionals across the State are asked to identify the payroll process that is most in need of improvement, the results are always the same and almost always unanimous. Without a doubt, the payroll community is in agreement that the current “data capture” process must be eliminated and replaced.

For those unfamiliar with this process, this is how it works: Currently, ten “data capture” agencies send transaction files from their internal Human Resource Systems to OSC. These files are printed onto hard copy reports at OSC and then data-entered into the payroll system (PayServ) by OSC staff. This inefficient process has been a target for reform for a number of years. The Automated Interface (AI) Development Project was initiated to develop a workable alternative to the data capture process.

The AI Project’s short-term goal is the elimination and replacement of the ten agencies’ existing data capture program. Over the longer term, the goal is to make the standardized, automated interface between HR systems and the payroll system available to any agency interested in replacing its direct data entry into PayServ with the submission

of a payroll transaction file.

The automated interface will substantially reduce errors and improve controls at OSC and the agencies. Key benefits include:

- Automated input of transactions will eliminate data entry errors and increase overall data quality in PayServ and agency systems.
- The AI process will incorporate all of the online edits of the PayServ system. Thus, each transaction will be subject to the same validations as transactions entered online.
- An AI reconciliation file will greatly improve agencies’ ability to reconcile PayServ actions with their internal systems. This automated feedback will also incorporate all online warnings and errors to enable agencies to quickly address problematic transactions.
- The elimination of manual data entry will increase the data capture agencies’ window for submitting payroll transactions by up to six days.
- Significant savings will be realized by both OSC and the agencies. OSC

will eliminate its manual pre-audit and data entry of these transactions. Agencies will reduce or eliminate redundant data entry into agency systems and automate their manual, time consuming reconciliation processes. Agencies and OSC will reap significant savings and other benefits from improved data accuracy.

The AI project, which is currently in Phase 3 (Development and Testing), is a collaborative effort among OSC payroll and technical staff, the data capture agencies and consulting staff. The first three “lead agencies” (SUNY Central Administration; Office of Parks, Recreation and Historic Preservation; and State Senate) are on schedule to implement the new interface in February 2005. The remaining seven data capture agencies will migrate to the interface throughout the remainder of 2005. Beginning in 2006, other interested agencies will be offered the opportunity to migrate to the interface.

Interested parties may contact Chris Gorka, Assistant Director of Payroll Services ([cgorka@osc.state.ny.us](mailto:cgorka@osc.state.ny.us) or (518) 473-5066), with questions or for more information about this exciting project.

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## Understanding Internal Controls

Ask people what internal controls are and the consistent answer is policies, procedures, or segregation of duties. In fact, the Wall Street Journal in a November 3, 2004 article said, “Internal controls are the policies and procedures that a company must have in place to ensure that all its assets,

liabilities and transactions are properly reflected on its financial statements.”

This limited view of internal controls has caused organizations to not build the right controls into an organization. At the national level, we have been plagued with corporate scandals that have sent people

to prison, caused stock prices to plummet and caused pension funds to lose significant value. If you study the frauds that occurred at Enron, Tyco, Worldcom, Aldelphia, Parmalat and others, it was not the lack of policies, procedures or segregation of duties that caused these failures. Rather it had to do with the

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Address <http://www.osc.state.ny.us/agencies/index.htm> > Click on Accounting Bulletins

New York State Office of the State Comptroller  
Alan G. Hevesi, State Comptroller

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## Bank Account and Advance Account Manual Update

On October 25, 2004, the Bureau of Accounting Operations issued Accounting Bulletin A-541, announcing important updates to the Controls and Special Procedures Manual, Vol. XI, related to bank accounts and advance accounts. The bulletin and sections that were updated can be viewed from the State Comptroller's website at: [www.osc.state.ny.us](http://www.osc.state.ny.us) - Comptrollers News For: State Agencies/Accounting Bulletins. Many of the changes outlined below were developed and incorporated as a result of recent cash advance audits conducted by the Bureau of State Expenditures and from issues evolving from annual advance account confirmations conducted by the Bureau of Accounting Operations.

### Bank Accounts

- Requires written affirmation, at the time of application, by the agency chief financial officer or designee that the account custodian has implemented the internal controls necessary to protect State assets, including monthly preparation of bank-to-book reconciliations.
- Outlines new procedures related to the designation of depository banks and the authorization needed to establish new accounts.
- Updates requirements for monthly reporting to the Department of Taxation and Finance, Division of the Treasury.
- Updates post reconciliation procedures for monthly account reconciliations and cancellation procedure for checks that have been outstanding for one year.

### Advance Accounts

- Outlines new procedures including a template for monthly cash advance account reconciliations.
- Provides direction on accounting for unexplained shortages and overages.
- Incorporates electronic cash advance account procedures from bulletins A-472, A-474 & A-470.
- Clarifies procedures related to reimbursing, liquidating or reducing cash advances including advances charged to lapsed appropriations.
- Provides guidance related to controls over Change Funds or Cash Boxes and use of Petty Cash monies for certain Personal Service Payments.



# The State of New York to Implement GASB Statement Number 39

The Office of the State Comptroller is in the process of implementing Governmental Accounting Board Statement Number 39 (GASBS 39), titled “*Determining Whether Certain Organizations Are Component Units.*” GASBS 39 must be implemented in the State’s financial statements prepared in accordance with generally accepted accounting principles (GAAP) for the State’s current fiscal year ending March 31, 2005. GASBS 39 is an amendment to GASB Statement Number 14 (GASBS 14) which established standards to define the government financial reporting entity. When issued, GASBS 14 stated that GASB was studying circumstances

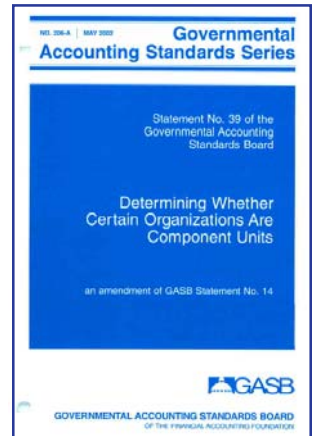
under which foundations and similar organizations might be included in the financial reporting entity. GASBS 39 resulted from those studies.

Implementation of GASBS 39 will generally result in the inclusion of organizations that raise and hold significant economic resources for the direct benefit of the State or its constituents in the State’s GAAP financial statements. A college foundation is an example of such an organization. It will also result in the inclusion of other organizations that are “financially integrated” with the State.

Implementation of GASBS 39 will also

affect the individually issued financial statements of the State’s component units as the financial reporting entity is determined in layers “from the bottom up.”

If you have any questions or comments about GASBS 39 please contact OSC’s Bureau of Financial Reporting at [finrep@osc.state.ny.us](mailto:finrep@osc.state.ny.us).



## Vendor Responsibility

On November 1 the State Comptroller’s Office issued Bulletin No. G-221 entitled “Vendor Responsibility: Standards, Procedures, and Documentation Requirements.” The bulletin brings an enhanced focus to vendor responsibility in New York State procurements.

The requirement for vendor responsibility determinations is well established in legislative and case law and is not a new concept in New York State. Vendor responsibility reviews are intended to ensure that vendors are capable of providing the required goods and services, are authorized to do business in New York, have performed satisfactorily in the past, and conform to acceptable standards of integrity. State contracting agencies have the primary role in ensuring that proposed contractors meet the standards of responsibility when issuing purchase orders and contracts.

Bulletin G-221 was issued to refocus agency and OSC efforts related to vendor responsibility. The Bulletin:

- reminds contracting agencies of the requirement for vendor responsibility,
- highlights the four factors impacting vendor responsibility (integrity, performance, legal authority, and financial and organizational capacity) and
- enhances the procurement record to provide additional documentation of contracting agency responsibility determinations.

Benefits of a renewed focus on vendor responsibility include increased public trust and confidence in the State’s procurement process, open and fair procurements, anticipation and mitigation of administrative and programmatic problems related to contracts, and greater participation by vendors.

As part of this renewed focus, OSC will

increase the level of review of vendor responsibility determinations in contracts submitted to OSC for approval, and will work to normalize vendor responsibility processes and understanding across contracting agencies. This standardization will benefit both contracting agencies and the vendor community. A significant component of the vendor responsibility initiative is knowledge growth and exchange among agencies and OSC. To this end, OSC will conduct outreach and facilitate the sharing of best practices.

Effective January 1, 2005, contracting agencies will be required to certify responsibility determinations for their procurements and document these decisions in the procurement record. OSC is available to assist and has established an outreach and training capacity within the Bureau of Contracts.

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# Awarding Bids with Options

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other undesirable event may be the result.

The Office of the State Comptroller's Bureau of Contracts can be a valuable resource for assisting agencies in overcoming difficult procurement issues and problems. We have developed this expertise through experience in reviewing contracts issued by State agencies and public authorities. On an annual basis, we see more than 45,000 contractual transactions covering a wide range of goods and services. We are happy to share the knowledge we have gained from our collective experiences and we encourage you to seek our assistance, preferably before a contract is submitted for approval in order to avoid procurement issues and delays. We will gladly pre-review RFP's and other solicitation documents and evaluation instruments to help you identify possible procurement pitfalls. In addition, we can use our expertise to help you through a problem during any phase of the procurement to ensure your programmatic goals are achieved.

When procuring goods with a potentially substantial delivery cost, especially one that varies based on the supplier's locale, it makes sense to evaluate the bids based on the true cost of the acquisition by including the delivery fees/costs. This evaluation methodology must be well thought out and should be in place before the solicitation is issued to help ensure a clean procurement. Two examples follow that describe situations where agencies ran into some problems trying to accomplish this type of cost evaluation.

In the first example, an agency submitted a fatally flawed procurement that we were unable to approve. Flaws occurred in both the development of the bid document and in the evaluation of the bids. Specifically, the agency bid

document required bidders to offer delivered price as well as a price for agency pick-up from the vendor's location in either New York or New Jersey. The bid consisted of three items with the method of award by grand total. Although the bid document required the vendor to offer both pick-up and delivered pricing, the agency proposed



to award the contract to a bidder who appeared to be non-responsive. This bidder offered delivered pricing only. Further examination of the procurement record disclosed that the vendor did not submit the lowest price by grand total.

Commodity contracts by statute must be awarded based on lowest price and the bid document did not provide an evaluation methodology for determining lowest price when comparing delivered versus pick-up pricing. For example, if the grand total for all three items at the delivered price was \$180,000 and the grand total at the pick-up price was \$179,500, which price would represent the lowest cost to the agency? The bid document also did not provide a methodology to evaluate variances in transportation distances or pick-up locations. In this instance, \$180,000 may be the lowest price if you consider the opportunity cost associated with agency staff picking up the commodity (staff wages and fringe benefits, transportation and operating costs).

In discussions with the agency, agency officials told us they chose the grand

total method of award because they did not want to send a driver and truck to three separate locations for pick-up. We were also told they were not opposed to having multiple contractors supply the three bid items if the products were delivered.

Based on this information, we were able to work with the agency to revise the bid document to reflect their needs and satisfy statutory requirements. First, the bid was separated into three bidding Lots. The bid specifications were amended to read that award would be made on Lot 1, 2 or 3, whichever resulted in the lowest price to the facility. Lot 1 consisted of the three items delivered to the facility with a method of award by item within the Lot. Lot 2 consisted of the same three items being picked-up from the bidder's location with the method of award for all three items by grand total. Lot 3 consisted of three items delivered with a method of award by grand total rather than by item. This is a different option than Lot 1 in that bidders may be able to offer reduced pricing based on reduced shipping costs and increased sales volume. The agency then calculated a pick-up cost rate per mile based on all operating costs and the cost per mile was added to the bid specifications in order to calculate the bid cost of Lot 2. The agency noted that this additional cost would be evaluated with this rate multiplied by the distance between the bidder's location and the agency to determine which Lot represented the lowest price. The agency subsequently re-bid this procurement using the recommended bidding/award methodology and reduced their acquisition costs by more than 25 percent.

In the second example, an agency recently conducted a bid of the purchase for sand where transportation would be the responsibility of the agency. The

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# Understanding Internal Controls

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control environment - management's attitude, philosophy, operating style; the ethics and integrity of the people in the organization; and the competence of people.

Internal controls are not something that gets tacked onto an organization; rather they must be built into an organization. Internal controls are fundamental to how an organization is managed.

Back in 1992, the Treadway Commission, in response to prior corporate frauds, issued its seminal report **Internal Control – Integrated Framework**, also known as the COSO report. The authors said, "Internal controls promote efficiency, reduce the risk of asset loss and help ensure the reliability of financial statements and compliance with laws and regulations." This comprehensive view of internal controls recognizes there is a synergy and linkage among the five components

of control. The five components don't stand alone – they are intertwined. They are:

- Control environment
- Risk assessment
- Information and communication
- Control activities
- Monitoring

Betty Vinson, an accountant for Worldcom, is a good example of the inappropriate influence management can exert on its people and cause them to do improper things. When management decided to capitalize certain line costs that were previously expensed (to inflate the company's income statement), Betty objected and told management this was not appropriate. Management insisted and Betty complied. She objected again, when more expenses were capitalized, but management gave her a \$30,000 raise and she again complied. Ultimately, Betty was arrested along with other Worldcom employees. She has been convicted and

is now facing 10 years in prison. The control environment and the communication system at Worldcom were woefully lacking. It was these internal control weaknesses that brought down Worldcom – not policies, procedures or segregation of duties.

The foundation of any control system is the control environment. If it is compromised, no matter how good the policies, procedures or segregation of duties, the control system will ultimately fail. Enron had a code of ethics, but its Board of Directors decided to "suspend" the code to allow for certain special purpose entity transactions to occur. How can you suspend a code of ethics?

The question all managers should be asking is, "Do I have strong controls, but the wrong controls?" The right controls need to be built into an organization, and it starts with the control environment.

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# Awarding Bids with Options

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method of award was based on the cost per ton of sand plus agency transportation costs calculated on a pre-determined cost per mile basis from the source to the delivery point. Bidders were required to quote a cost per ton for the sand and identify the location of the sand pit from which the sand would be provided. To determine the low bidder, the agency multiplied the cost per mile by the number of miles from source to delivery point, and added that cost to each bid to determine the true low cost bid. The bid tabulation showed the bidders' cost per ton of sand, the distances from the sand pit to the delivery location and the transportation cost

calculations. A map of the area was included in the procurement record. A review of the map raised concern with respect to the distances used in calculating the low cost bid; therefore, the agency was asked to verify the distances used in their determination. The verification of the distance between the sand pit and the delivery location showed the low bid was understated. When the delivery distances were revised to reflect actual distances, the recommended bidder was no longer the low bidder. As a result, the award recommendation had to be changed to award to the true low bid. In this case, the agency may have relied on estimated

distance information provided by the bidders rather than calculating the distances themselves.

Exercising due diligence in the awarding of contracts ensures statutory compliance and fair treatment of all bidders. Also, as was the case in the prior two examples, exercising due diligence can result in cost savings to the State.

For more information or questions, please contact John Moriarty at (518) 474-4622 or e-mail him at [jmoriarty@osc.state.ny.us](mailto:jmoriarty@osc.state.ny.us).

## Financial & Audit Solutions

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## Vendor Responsibility

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To learn more about the Comptroller's vendor responsibility initiative, find answers to the most frequently asked questions or to request training, please visit the Comptroller's vendor responsibility website at [www.osc.state.ny.us/vendrep/](http://www.osc.state.ny.us/vendrep/), send an e-mail to [vendrep@osc.state.ny.us](mailto:vendrep@osc.state.ny.us), or call (518) 408-3687.

## Bernie McHugh Appointed Director of State Expenditures

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(OSC) since graduating from Siena College in 1981. Bernie first began his career with OSC's State Audit Bureau where he participated in auditing the finances and operations of many State agencies. In 1997, Bernie moved to the Bureau of State Expenditures, where he continued to take on positions of greater responsibility.

Today, Bernie's 93-person staff helps carry out the Comptroller's constitutional and statutory requirements to audit all State expenditures prior to payment. Using a risk-based approach, last year the Bureau audited approximately \$80 billion in payments, including transactions involving agency procurements of goods and services, travel expenses, local and school aid payments, workers' compensation, unemployment insurance and State refunds. The Bureau is also actively involved in efforts to encourage agencies to reduce low-dollar payment transactions by using procurement cards and is engaged in measuring agency effectiveness in submitting accurate transactions for payment.

Bernie is a Certified Public Accountant and a Certified Information Systems Auditor. He is active in many professional organizations and is President of the Hudson Valley Chapter of the Information Systems Audit and Control Association. Bernie is also an Adjunct Professor at Siena College where he teaches Information Technology Auditing, an activity he enjoys very much. He lives in Glenmont and is the father of three children—Brendan, Heather and Jacqueline.

## David Hasso Appointed Assistant Director of Financial Reporting



In September, David Hasso was appointed Assistant Director of the OSC's Bureau of Financial Reporting. Prior to this assignment, Dave served as a Project Director and led project teams charged with installing a new general ledger system and implementing the GASBS 34 financial reporting standards for the State. He is a CPA and a CGFM and has worked for 27 years in the State Comptroller's Office.

Dave is a member of several professional organizations and is the current chairman of the New York State Society of CPAs, Government Accounting and Auditing Committee.

Dave has studied at Siena College, Oxford University, and Imperial College at the University of London, and lives with his wife Michele in North Greenbush.



# HAPPY HOLIDAYS!

