U.S. Department of Labor
Office of Inspector General
Washington, D.C. 20210

June 2, 2015

MEMORANDUM FOR: CHRISTOPHER P. LU
Deputy Secretary

FROM: SCOTT S. DAHL
Inspector General

SUBJECT: **Alert Memorandum**: DOL Needs to Strengthen its Oversight of NCFMS to Control Costs
Report Number: 22-15-007-01-001

We continue to have significant concerns about the financing arrangement and the Department of Labor's (DOL) oversight relating to the transition of the New Core Financial Management System (NCFMS) from Global Computer Enterprises (GCE) to the Department of Transportation's Enterprise Services Center (DOT), which primarily uses a contractor to operate this program.

In a memorandum issued in August 2014, as well as the "Top Management Challenges," issued in November 2014, we advised you of our serious concerns regarding DOL's continuity plans for NCFMS.[1] We stated that DOL needed to closely monitor the operation of the financial system for the foreseeable future to ensure that it is operating effectively. Although DOL continues to make progress in addressing our concerns, they have not provided for our review a finalized plan for the reconstitution of manually processed, interim data into a financial system of record— in the event the financial system becomes unavailable for any reason.

This memorandum is to alert you to our additional serious concerns regarding this transition, specifically regarding several time and materials agreements with DOT. We are concerned that the Department:

- continues to use an interagency agreement with DOT that does not best serve the interests of DOL;
- is not providing sufficient oversight of planned and actual charges related to the transition, operation, and maintenance of NCFMS; and
- failed to adequately budget for the costs of operating the system.

[1] See Report No. 22-14-007-01-001, *The Department Has Made Significant Progress in Developing Financial Management Continuity Plans, but Critical Parts Need to Be Finalized*, issued August 15, 2014; Top Management Challenges – November 2014 , *FY 2014 DOL Agency Financial Report.*

Continued Use of Interagency Agreement with DOT Does Not Best Serve the Interests of DOL

In July 2014, DOL entered into an interagency reimbursement agreement based on time and materials with DOT for approximately $5 million to transition NCFMS from GCE over a three-month period. By September 2014, the agreement increased in value to $14.5 million to provide additional time and funding to complete the transition, stabilize NCFMS operations, and operate the system through December 2014. By February 2015, the value of the agreement reached approximately $18.4 million and was extended through September 2015, as it was apparent the completion of transition deliverables was taking longer than anticipated and the agreement for the ongoing operation and maintenance phase had not yet been entered into with DOT. As of April, DOL had used $16.3 million of this amount.

We recognize that when DOL entered into the agreement it faced the possible loss of its financial accounting system due to the business circumstances that prevented its contractor from continuing to provide and operate NCFMS. Given the complexities involved with understanding the operation of NCFMS, the volume of transition work, and the risks related to this transition, a time and materials agreement may have been the most appropriate type of agreement for that stage of the transition.

As DOL has moved from the transition phase into the operations and maintenance phase, it should have been able to better define its requirements and move towards entering into a fixed-priced agreement. However, DOL entered into another $24.9 million time and materials interagency agreement with DOT to operate and maintain NCFMS over a one-year period that began in April 2015. As previously noted, we understand the initial time and materials agreement may have been the most appropriate as DOT was gaining an understanding of the operations and stabilizing the system. DOT has now been operating NCFMS for 8 months, yet DOL has not been able to define its requirements and move to a fixed-price agreement.

DOL stated these time and materials agreements provided the greatest flexibility to control costs and respond to a changing environment. However, we did not find evidence that DOL has sufficiently monitored the billings from DOT and its contractor to control the cost. This puts DOL at increased risk of paying for services that are either not necessary or outside the scope of the agreement.

Although DOL officials told us they may not necessarily incur the total amount obligated under these agreements, the total amount obligated represents almost double the amount it cost to operate NCFMS previously under contract with GCE, which maintained NCFMS operations for almost 5 years. Under the current agreement through March 2015, the Department has been incurring approximately $2 million per month to operate and maintain NCFMS, which is about $1 million more per month than DOL was paying GCE. Indeed, based on the information provided to us, an average of about 90 fulltime equivalent staff are operating and maintaining NCFMS under DOT, almost double the amount of GCE staff that were identified. The Department could not identify for us what necessary services are being provided for these additional costs and by these additional personnel. DOL stated it is getting a much better value of service with this agreement, but DOL has not provided anything to quantify or justify the value of this purported increase in service.

A firm fixed-price arrangement for the routine operation and maintenance of NCFMS would provide cost stability and assist DOL in managing its costs within budgeted amounts. While DOL has said the time and materials agreement gave it increased flexibility, we are concerned DOL has not sufficiently defined its requirements. If DOL needs some flexible service arrangement for non-routine services, it could contract for that separately. Although DOL has stated this amount is the maximum amount of the agreement and the actual amount to operate the system may be less, DOL hasn’t developed its own estimate and does not know what the actual costs may be to assess whether this amount is sufficient to operate the system for the one-year period.

In its attached response, DOL stated OIG has adopted a short-term view of the Department’s best interests by focusing on the cost and structure of the current interagency agreement with DOT when the more appropriate focus is the Department’s long-term interests of maintaining uninterrupted financial controls and services.

OIG agrees the focus should be on the Department’s long-term interests, but we remain concerned that after operating NCFMS for nearly 6 years, DOL appears to be still defining its financial management system requirements. Moreover, almost one year after entering into an agreement with DOT to transition NCFMS from GCE, DOL stated its financial system is now stabilized, but “operating NCFMS continues to lack the certainty needed to make a firm-fixed price a reasonable and prudent choice.” DOL further stated it “is regularly assessing the functions that may be reduced or eliminated, and the present type of arrangement provides greater flexibility to do so.”

As we previously noted, the Department could consider multiple agreements for the core functions that it knows must be done by the service provider (e.g., hosting the general ledger system) and for the services it is still not sure it needs.

Insufficient Oversight of Planned and Actual Charges

DOL has not conducted sufficient oversight of the planned and actual charges for the NCFMS transition to DOT, as well as its ongoing operation and maintenance. We identified planned uses of funds and actual costs incurred during the transition of NCFMS to DOT that were not supported or for which we could not determine their reasonableness. For example, DOL did not have detailed information or support for DOT’s planned use of $3.1 million to shadow and recruit approximately 50 GCE employees prior to the transition, including holding a career fair at the GCE facility. This planned cost would have allowed for a virtual one-to-one shadowing of every GCE employee assigned to NCFMS for a one-month period. We were unable to determine the amount DOL actually paid for these shadowing and recruitment services because the costs were not specified in the documentation submitted by DOT for reimbursement.

DOL officials indicated we needed to validate the costs directly with DOT. However, DOL should have been able to explain to us if the services acquired were reasonable and within the scope of the agreement, but were unable to do so. DOL's failure to maintain documentation to support actual costs invoiced by DOT is a significant concern and demonstrates the need for better oversight of NCFMS operations.

In its response, the Department stated the actual expenditures for shadowing and recruiting were slightly more than $1.25 million; however, DOL provided us billing information from DOT that did not sufficiently break down individual cost items. Our concern is with how well the Department is monitoring and accounting for costs if this type of information cannot be readily produced as evidence of its contemporaneous review.

We questioned DOL officials as to what oversight they performed of planned or actual costs. DOL officials replied DOL does not have privity of contract with the DOT contractor. As a result, they believe DOT is solely responsible for monitoring contractor performance and protecting DOL interests. However, DOL has the ability and the responsibility to question unreasonable and unsupported costs funded by DOL appropriations. In fact, DOL's interagency agreement with DOT provides DOL the opportunity to dispute procedures or amounts within 60 days of the transfer of funds, yet DOL has not exercised this authority.

DOL does not have a sufficient internal control process in place to monitor the services and costs requested for reimbursement. *The Government Accountability Standards for Internal Control in the Federal Government*, which sets the standards for an effective internal control system for federal agencies, states internal control should generally be designed to assure ongoing monitoring occurs in the course of normal operations.

In its response, DOL cited examples of the oversight procedures it has implemented to ensure costs are contained and performance expectations are met. These examples, however, only included descriptions of meetings and discussions DOL has had with DOT. While these meetings provided some level of oversight, DOL was not able to readily provide information OIG requested regarding the underlying support for the payments being made to DOT.

Failure to Adequately Budget for Known or Easily Foreseen Costs

Based on the information available, the costs to operate and maintain NCFMS could exceed the costs budgeted by DOL for FY 2015 by $14 million. DOL initially budgeted $10 million to operate and maintain NCFMS under DOT, which was 30 percent less than it was costing to operate under GCE. DOL officials described to us on several occasions the challenges and uncertainty of transitioning the system to a new operator, as well as the difficulty of estimating costs. In fact, these challenges were also the reasons given for entering into time and materials agreements, yet DOL's budget estimate assumed that under these circumstances it would achieve a reduction of costs of 30 percent compared to its cost under the previous contractor.

DOL significantly underestimated the amount it was going to cost to operate NCFMS. DOT had provided estimates to operate the system as high as $2.6 million per month through March 2015, and the costs were not trending downward as of March.

DOL officials stated they relied on DOT for these estimates and did not prepare their own independent cost estimates. DOL officials did not consider their recent experience with the transitioning of the financial management system or consider clear warning indications that the transition would be costly. As a result, DOL has had to charge back DOL agencies for these significant additional costs through the working capital fund. These additional costs have forced DOL agencies to shift funds away from program-related expenditures to pay for the additional costs that were averaging more than $2 million.

In its response, the Department stated OIG benchmarked the costs of the transition against monthly operation and maintenance costs of the previous provider. However, we did not do this, but rather compared prior costs to the current operation and maintenance period through March 2016, for which the Department has obligated approximately $2 million per month.

Conclusion

OIG recognizes the Department's financial management system faced a number of significant challenges due to GCE's legal and financial problems. However, we are concerned that after almost 6 years of operating NCFMS, the Department's failure to adequately define its requirements may be resulting in unnecessary costs. The sooner the Department can define its requirements and move to a fixed-price agreement for the routine financial management services being provided by DOT, the better it will be able to control costs. As long as the Department continues to operate NCFMS under a time and materials agreement, it needs to improve its monitoring to ensure the costs being incurred are necessary and reasonable.

Recommendations

To strengthen its oversight of NCFMS to control costs, we recommend the Department:

1. Develop and implement a process to review and approve the services and costs requested for reimbursement.

2. Negotiate a firm-fixed price agreement with DOT for a baseline of operation and maintenance services for NCFMS, including the Department developing its own cost estimate.

The concerns discussed in this memorandum are based on fieldwork conducted from April 1, 2015, through May 8, 2015, based on documentation provided by DOL. We did not extend our procedures to DOT, but instead focused our work on DOL's oversight and monitoring of NCFMS operations by DOT. DOL has the ability and responsibility to monitor NCFMS operations regardless of the contractual relationship between DOT and their contractor. Additional information may be available at DOT or its contractors to address issues identified in this report; however, the fact that sufficient information is not available at DOL is in itself a concern. We will continue to monitor DOL's oversight of NCFMS operations and maintenance.

We request that you respond to this memorandum within 30 days indicating your agreement or disagreement with each recommendation. If you agree with a recommendation, your response should explain the planned corrective actions, identify officials responsible for such actions, and provide dates by which the actions will be taken and full implementation achieved. If you disagree with a recommendation, your response should fully explain the reasons for disagreement.

If you have any questions, please contact me or, alternatively, your staff may contact Elliot P. Lewis, Assistant Inspector General for Audit at (202) 693-5170.

Attachment

cc: Geoffrey Kenyon, Principal Deputy Chief Financial Officer
Karen Tekleberhan, Deputy Chief Financial Officer
T. Michael Kerr, Assistant Secretary for Administration and Management
Edward Hugler, Deputy Assistant Secretary for Operations
Myrian Myer, Associate Deputy Chief Financial Officer for Financial Systems
Robert Balin, OCFO Audit Liaison

Attachment

U.S. DEPARTMENT OF LABOR

DEPUTY SECRETARY OF LABOR
WASHINGTON, D.C.
20210

MAY 29 2015

MEMORANDUM FOR SCOTT S. DAHL
Inspector General

FROM: CHRISTOPHER P. LU CPL
Deputy Secretary

SUBJECT: Response to Alert Memorandum 22-15-007-01-001:
DOL Needs to Strengthen its Oversight of NCFMS to Control Costs

Thank you for the opportunity to review and comment on the above-mentioned Alert Memorandum regarding the Department's oversight of the New Core Financial Management System (NCFMS). We appreciate the challenges in reviewing such a complex subject.

This response to the Office of Inspector General's (OIG) Alert Memorandum aims to clarify a number of concerns we have identified. Generally, we believe the OIG's Alert Memorandum fails to provide adequate context regarding the circumstances surrounding the transition from the previous private-sector service provider to the current provider, the Department of Transportation (DOT). Without this context, and correspondingly more complete analysis, we believe the DOL management's decision-making cannot be fully or accurately portrayed.

Background

As alluded to in the Alert Memorandum, in the early part of 2014, the Department's financial management system faced a number of significant challenges. Due to its private-sector service provider's legal and financial issues of unknown – at the time – severity, the Department was abruptly confronted with a situation that risked total failure of the Department's automated financial management system that is used to manage and account for $60 billion of taxpayer funds. After estimating that replacing the financial system with a commercial solution would take more than two years and require some $200 million – both of which were unacceptable – and faced with the real possibility of losing the financial management system, the Department took extraordinary measures to ensure that did not happen.

The Alert Memorandum adopts a short-term view of the Department's best interests by focusing on the cost and structure of the current interagency agreement with DOT. The appropriate focus, however, is the Department's long-term interests. Maintaining uninterrupted core financial controls and services lies at the heart of these long-term interests. This requires balancing of risk and resources, remaining mindful that the failure to maintain automated accounting services may, at any time, increase the potential for error and lead to a significant diversion of personnel time to avoid violations of the Anti-Deficiency Act and a corresponding loss of program delivery by DOL agencies. Moreover, this view does not take into account several benefits of working with DOT at this stage, which include an expectation of a more stable transition when the Department migrates to the DOT shared service provider solution.[1]

To mitigate the high-risk situation, the Department developed an unprecedented innovative solution, in partnership with five other federal agencies, to purchase data rights, software and intellectual property, and hardware, in addition to securing operational support to run the system through DOT. This also included a concurrent DOL-wide effort to develop contingency plans based on manual processes.

Despite the extenuating circumstances surrounding the transition and the considerable unknowns with regard to costs and processes, the Department's financial system is now stabilized, owned and operated as a federal government asset, and the Department is on a path to transition to DOT as its federal shared service provider – with DOT having a greater understanding of DOL processes from its operations during this time period. These efforts have significantly reduced the risk of system failure, and an evaluation of the current situation, including the costs spent to avoid such a risk, must take this into account. Moreover, the Fiscal Year 2014 year-end financial close-out was seamless despite the acquisition and assumption of operational control of the financial system occurring just days before the end of the fiscal year. The Department ultimately received an unmodified audit opinion.

Throughout this process, the Department has taken reasonable steps to mitigate costs wherever possible. Since October 2014, the Department has worked closely with DOT to: realize savings through changes to the service desk (including reducing service desk hours and eliminating on-site support, resulting in an estimated annual reduction of $1 million); streamlining accounting operations and reporting (estimated annual reduction of $1 million); and reducing program office reporting and support (another estimated annual reduction of $1 million).

Going forward, the Department will continue eliminating services not returning value in order to achieve additional cost savings. In April 2015, DOT began the operations and maintenance phase for NCFMS, which includes a full-scale review by both departments of all services and service levels provided by DOT's contractor during the stabilization phase in an effort to further reduce costs. For instance, the Department will not undertake any system development activities for new functionalities that are not required to comply with core federal mandates.

Cost Analysis

Given the complexities and uncertainties surrounding the transition, we believe that the methodology used by the OIG to determine "cost reasonableness" is flawed. In several instances, OIG compares transition costs without an equal comparison of the time over which those costs were to have occurred. Based on estimates by DOT, the Department initially projected a cost of $4.9 million for a three-month transition period. In the end, the transition period tripled to nine months along with the cost, but the Alert Memorandum simply notes the increased cost. As we have explained, the transition period took longer than anticipated prior to acquiring the system because it was only then that both DOL and DOT could fully understand the intricacies and customization of the system and the steps necessary to stabilize the system.

[1] DOT serves as a government shared service provider for financial management systems and was already supported by the Department of Treasury and the Office of Management and Budget to provide accounting services to the Department under a shared services arrangement.

The Alert Memorandum benchmarks the cost of the transition to past monthly operation and maintenance costs of the private-sector service provider. This is wrong for two reasons. First, the transition costs should be expected to be higher given the intense nature of stabilization and more fulsome services provided. Second, we now know that the lower costs charged by the private-sector contractor were marked by short-cuts and poor practices as documented by our experience and noted in OIG reports. For example, we have learned that the service provider did not effectively test the system, failed to staff essential functions with sufficient staffing, and did not have functional disaster recovery. Simply put, the flawed past practices of the former contractor – which led to a federal investigation – are not an appropriate comparison and surely not the model the Department should follow.

Budgeting for Known Costs

The Alert Memorandum unfairly characterizes the Department as failing to adequately budget for known or easily foreseen costs and, as a result, having to charge back agencies for "significant additional costs through the working capital fund." The Department has been, and remains, committed to limiting Working Capital Fund (WCF) charges to agencies. The following table displays the total collections from DOL agencies in the first four fiscal years of the current Administration:

Fiscal Year	Amount Collected (in 000s)
2010	$219,260
2011	$222,985
2012	$224,406
2013	$212,058

In FY 2014 and 2015, it became necessary to collect additional WCF resources for several reasons, including providing increased bandwidth for information technology services to meet agency needs, as well as managing the anticipated end of the NCFMS support contract in June of 2016. The Department started collecting resources for the planned transition of NCFMS in FY 2012 as it estimated it would cost $15 to $25 million to transition accounting services to a shared service provider. Initiating collections early was designed to spread and thereby minimize the impact on DOL program services; however, the unforeseen issues of the private-sector service provider forced the Department to change its plans and financing model for transitioning to new accounting services. Despite this abrupt shift, the Department minimized the impact on agency programs by using unobligated balances of the WCF to offset increased costs.

Ownership of NCFMS did not change until mid-September 2014, which provided little time and information prior to the beginning of the fiscal year for the two departments to determine what would be necessary to stabilize and maintain the NCFMS system through FY 2015. As discussed above, DOT provided approximations for the cost and time of transition as well as the cost of operating the system based on similar-sized customers and systems it supports. More accurate estimates were not available until the stabilization phase was close to being complete due to the customized nature of NCFMS, which became more fully apparent during the transition.

In September 2014, the Office of the Chief Financial Officer (OCFO) convened a WCF Committee meeting to review the expected WCF budget for FY 2015. At this meeting, OCFO made it clear that the WCF budget included $10 million for NCFMS operations and maintenance, but that additional agency collections were expected to be needed once the stabilization phase was complete. Agencies were told prior to the beginning of the fiscal year to make plans for these additional amounts, and that OCFO and OASAM would limit the financial burden of the transition by finding offsets and using unobligated balances. OCFO alone identified deobligations of $5.72 million in the last quarter of FY 2014 that were applied to the NCFMS transition.

When compared to the WCF plan presented to DOL agencies in September 2014, the Department limited the additional amounts charged to agencies for NCFMS operations and maintenance in FY 2015 to $6.1 million and informed the agencies with sufficient time in the fiscal year to maximize their plans for FY 2015 funding.

Firm-Fixed Price vs. Time and Materials Agreements

In the Alert Memorandum, the OIG asserts that a firm-fixed price agreement would have provided better cost stability. Generally, firm-fixed price contracts are best suited for routine or recurring services where the risk of potential changes to the scope of work is minimal or can be predicted with a degree of certainty. Given the circumstances and uncertainty surrounding the NFCMS transition, a firm-fixed price option would not have been the best contracting vehicle.

Under firm-fixed pricing, costs likely would have been significantly higher, because such agreements typically place all risk and responsibility on the contractor, maximizing the contractor's incentive to control costs. To ensure its costs of performance are covered due to uncertainties and/or changes in the government's requirements, the service provider's firm-fixed price would have had to account for such uncertainties in the form of a higher cost to the government.

In addition, under a firm-fixed price agreement, the Department would have been unable to realize cost reductions by asking DOT to stop or reduce unnecessary work. With a time and materials agreement, the Department has been able to adjust services to just what is needed to maintain the core functions of NCFMS, thus lowering costs. As noted above, the Department is regularly assessing the functions that may be reduced or eliminated, and the present type of arrangement provides greater flexibility to do so.

Operating NCFMS continues to lack the certainty needed to make a firm-fixed price a reasonable and prudent choice. However, the Department continually monitors its agreement with DOT and will consider a firm-fixed price agreement if and when it becomes the more cost-efficient model.

Oversight of Costs and Services

The Department disagrees with the Alert Memorandum's claim that it lacks controls or oversight of costs and service related to DOT's management of NCFMS. The question posed by auditors was related to DOL's oversight of DOT's contractor. Our answer noted that DOT maintains the contractual relationship with its contractor and DOL does not have privity of contract. However, it is inaccurate for the Alert Memorandum to allege that DOL believes DOT has sole responsibility for "protecting DOL's interests," as evidenced by the regular and well-documented meetings between DOT's managers of the NCFMS operations and DOL management.

For example, the OCFO represents the Department at a *weekly* integrated program team review meeting with DOT to discuss issues and cost impacts, and at an *in-depth monthly* integrated program review meeting at which DOT and the contractor discuss their performance using the service level agreement as the structure for the conversation. Detailed meeting minutes are available for both these meetings.

In addition, OCFO holds *weekly* configuration control board meetings for all DOL system change request actions. System requirements are defined, analyzed, agreed upon, and presented for board decisions. OCFO records and tracks all issues, including change requests.

These are just a few examples of the oversight procedures DOL has implemented in order to ensure costs are contained and performance meets expectations. The Alert Memorandum finds a lack of DOL oversight in the simple absence of the Department exercising its authority to challenge or dispute procedures or amounts within 60 days of transfer of funds, as outlined by the interagency agreement with DOT. In fact, because of the regular oversight exercised by the Department, no such disputes have arisen.

As an example of DOL's purported insufficient oversight, the Alert Memorandum cites DOT's planned use of $3.1 million (for its contractor) to shadow and recruit some 50 employees of the former private-sector service provider, prior to DOT assuming operations of the NCFMS. As the term "planned use" indicates, the relevant question is the actual expenditures for shadowing and recruiting. The amount for these specific activities was slightly more than $1.25 million. These activities occurred at a pivotal time in the transition from vendor operation to government operation of the NCFMS – between August and September 2014 – just before DOT assumed operation of the system. DOL and DOT both understood that, because of the lack of system documentation and the system's high degree of customization, knowledge transfer was absolutely essential to a successful transition. DOL and DOT planned and executed a strategy that addressed the risk of losing essential knowledge by: (1) documenting the application and infrastructure associated with NCFMS; (2) developing standard operating procedures for the daily operations associated with the system and financial processing; (3) recruiting the private-sector service provider staff with the skills to operate the system to the extent practicable; and (4) converting contracts for hosting, accounting and security services. As a result of this strategy, many of these employees were successfully recruited to continue operating NCFMS and, at the same time, critical efforts to update system documentation were completed. This preservation of the knowledge of NCFMS operations was essential to the seamless FY 2014 year-end closeout.

Conclusion

We appreciate the difficulties of reviewing such a complex issue, and we hope this response provides context necessary to accurately frame management's past and current actions.

If you have any questions, please contact Geoffrey Kenyon, Principal Deputy Chief Financial Officer, or Ed Hugler, Deputy Assistant Secretary for Administration and Management.

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