



Pension Benefit Guaranty Corporation
Office of Inspector General
Audit Report

**Audit of Monitoring Activities Related to
Morneau Sobeco Contracts
PBGC01-CT-00-0597 and PBGC01-CT-03-0667**

September 29, 2005

2005-19/CA-0008-2



Pension Benefit Guaranty Corporation
Office of Inspector General
1200 K Street, N.W., Washington, D.C. 20005-4026

September 29, 2005

MEMORANDUM

TO: Bennie Hagans
Director, Benefits Administration & Payment Department

Robert Herting
Director, Procurement Department

FROM: Luther Atkins
Assistant Inspector General for Audits

SUBJECT: Report on Audit of Monitoring Activities Related to Morneau Sobeco Contract
Nos. PBGC01-CT-00-0597 & PBGC01-CT-03-0667

This memorandum transmits report no. 2005-19/CA-0008-2 prepared by Cotton & Company LLP at the request of the Office of Inspector General. During the fourth quarter of 2004, the firm assessed PBGC's compliance with applicable federal procurement, acquisition, and contract laws and regulations as well as PBGC policies and directives related to the monitoring of the two contracts

Attachment 3 of this report includes your response dated August 25, 2005 to the findings and recommendations in the draft report. In addition, summaries of the response and auditors' evaluation are incorporated in the body of the report.

Attachment

cc: Stephen Barber
William Hulteng
Martin Boehm
Debra Graul
Janice D. Johnson

**AUDIT OF MONITORING ACTIVITIES RELATED TO
MORNEAU SOBECO
CONTRACT NOS. PBGC01-CT-00-0597 AND PBGC01-CT-03-0667**

**SUBMITTED TO
PENSION BENEFIT GUARANTY CORPORATION
OFFICE OF INSPECTOR GENERAL**

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February 17, 2005

Mr. Luther Atkins
Assistant Inspector General for Audit
Pension Benefit Guaranty Corporation
1200 K Street, NW, Suite 470
Washington, D.C. 20005

Subject: Audit of Monitoring Activities Related to Morneau Sobeco Contracts
PBGC OIG Project No. CA-0008, Task Order No. CA-0008-2

Dear Mr. Atkins:

In accordance with terms of the subject task order, Cotton & Company LLP performed an audit of the contract monitoring practices used for Morneau Sobeco (Morneau) Contract Nos. PBGC01-CT-00-0597 and PBGC01-CT-03-0667. During the course of this audit, we assessed compliance with applicable federal and contract laws and regulations as well as PBGC policies and directives related to the monitoring of these Morneau contracts. We interviewed key personnel involved in the process and reviewed documents supporting these efforts for compliance and reasonableness. We also performed testing to determine if stated procedures were in place and functioning as intended.

We identified specific control weaknesses and deficiencies and developed recommendations designed to improve contract monitoring functions and procedures. We conducted the audit in accordance with *Government Auditing Standards*. We were not engaged to, and did not perform a financial statement audit, the purpose of which would be to express an opinion on specified elements, accounts, or items. This report is intended to meet the objectives described above and should not be used for other purposes.

Please call me if you have questions.

Very truly yours,

COTTON & COMPANY LLP

Michael W. Gillespie, CPA, CFE
Partner

**AUDIT OF MONITORING ACTIVITIES RELATED TO
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AUDIT REPORT 2005-19/CA-0008-2**

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ACRONYMS AND ABBREVIATIONS

Acronym/Abbreviation	Full Title
ASP	Application Service Provider
COTR	Contracting Officer's Technical Representative
EER	Expanded Examination Reviews
ERISA	Employee Retirement Income Security Act of 1974
FAR	<i>Federal Acquisition Regulation</i>
GAO	U.S. Government Accountability Office
IOD	Insurance Operations Department
Morneau	Morneau Sobeco
OIG	Office of Inspector General
OIT	Office of Information Technology
OMB	Office of Management and Budget
PBGC	Pension Benefit Guaranty Corporation
PD	Procurement Department
PER	Prepayment Examination Reviews
PwC	PricewaterhouseCoopers
SLCM	System Life Cycle Methodology

**AUDIT OF MONITORING ACTIVITIES RELATED TO
MORNEAU SOBECO
CONTRACT NOS. PBGC01-CT-00-0597 AND PBGC01-CT-03-0667
AUDIT REPORT 2005-19/CA-0008-2**

A. EXECUTIVE SUMMARY

The Office of Inspector General (OIG), Pension Benefit Guaranty Corporation (PBGC) contracted Cotton & Company LLP to audit monitoring activities related to Morneau Sobeco (Morneau) Contract Nos. PBGC01-CT-00-0597 and PBGC01-CT-03-0667. The audit included assessing compliance with applicable federal and contract laws and regulations as well as PBGC policies and directives related to award of these Morneau contracts.

These contracts were subject to management oversight through Contracting Officer's Technical Representative (COTR) presentations at Operations Integration Board, Steering Committee, and sponsor meetings. Thus, critical decisions were made by representative PBGC management rather than an individual COTR, providing an added control.

PBGC generally complied with applicable *Federal Acquisition Regulation* (FAR) and PBGC directives, policies, and procedures with respect to the items discussed in a later section titled Objectives. We did, however, note issues of noncompliance with either contract requirements or PBGC policies and procedures, as follows:

1. The COTRs did not maintain evidence of performing required reviews of all invoices submitted by Morneau.
2. The COTR did not create all required status reports in the COTR Status Report System and, for those created, did not always create them in a timely manner.
3. The COTR did not document the acceptance and receipt of contract deliverables in writing.
4. The Contract Specialist did not obtain required yearly invoice summaries from Morneau.
5. Contract No. PBGC01-CT-03-0667 requires annual SAS 70 audits, as needed, beginning with the 12-month period ending June 30, 2004. This audit was not performed and no documentation was available to explain why this SAS 70 audit was not deemed necessary for the period.

We also noted other matters that present opportunities for improving PBGC's monitoring process:

1. PBGC did not have written operating procedures for the Contract Specialist and Contracting Officer addressing all aspects of contract monitoring, which affects all contracts, including those with Morneau.
2. The Contract Specialist did not document review of COTR status reports, and also did not document review of monthly contractor invoices or provide evidence of notifying the COTR of issues related to invoicing.
3. A May 3, 2004, preliminary Office of Information Technology (OIT) report concluded that the Ariel project was noncompliant with PBGC's System Life Cycle Methodology (SLCM) for Phases 1, 2, and 3, although the Insurance Operations Department (IOD) stated that the report was inaccurate when it was issued, and that considerable work accomplished after May 2004 is not reflected in the report.

Management's Comments and Auditors' Evaluation

We provided a draft of this report to PBGC for comment. In addition, we met with PBGC officials to discuss the report's findings and recommendations. PBGC's response is included as Attachment 3. Management generally agrees with our findings and recommendations. It did not, however, concur with our recommendations that written operating procedures be established for PBGC's contract monitoring activities and Contract Specialist review of invoices. After considering the reasons for management's disagreements, we continue to recommend that detailed policies and procedures be established and documented.

B. BACKGROUND

PBGC was established under Title IV of the Employee Retirement Income Security Act of 1974 (ERISA), as amended, to insure the pension benefits of participants in certain private-sector defined benefit pension plans. PBGC currently protects the pensions of more than 44 million Americans in approximately 31,000 plans.

PBGC has two major roles: (1) administering the plan termination process, including providing plan sponsors and administrators with guidance for compliance with legal termination rules, and (2) paying ERISA Title IV benefits to plan participants and their beneficiaries when a plan terminates with insufficient assets to pay the benefits.

The Procurement Department (PD) is responsible for planning and administering PBGC's procurement of goods and services. Each department is, however, responsible for identifying its needs, performing needs and alternative analyses, verifying availability of budgetary resources, preparing purchase requisitions, and monitoring contract performance.

The Insurance Operations Department (IOD) manages most of the process by which insured pension plans are terminated by their sponsors, or involuntarily by PBGC, and benefits are paid to participants in those plans.¹ A critical portion of this process is valuation of the terminated pension plan and calculation of benefits due plan participants and their beneficiaries. IOD decided that replacing the procedures and tools being used with parameter-driven benefit calculation software would greatly improve the valuation and benefit calculation process.

PBGC published a request for information on June 1, 1999, regarding potentially qualified sources to provide parameter-driven benefit calculation software that would be capable of valuing pension plans and calculating individual participant benefits in accordance with ERISA and PBGC regulations. Three firms responded to this request, including PricewaterhouseCoopers (PwC) with Morneau as a subcontractor. After reviewing the software and products offered by responding vendors, PBGC concluded that only Morneau met its needs. Morneau, based in Toronto, Canada, provides actuarial consulting services to both commercial and governmental entities.

A notice was published in the *Commerce Business Daily* on September 2, 1999, announcing PBGC's intention to award a sole-source contract to Morneau, without PwC, to acquire its Ariel software package and associated services. PBGC's Competition Advocate approved the sole source award in February 2000.

PBGC awarded a labor-hour contract to Morneau on July 14, 2000. The purpose of this contract (No. PBGC01-CT-00-0597) was to provide services required to develop system specifications for modifying the Ariel software package in four phases, as follows:

¹ Due to reorganization, these functions are now the responsibility of the Benefits Administration and Payment Department.

- **Phase 1:** Prepare a plan for developing system specifications.
- **Phase 2:** Document PBGC and ERISA regulations, procedures, processes, actuarial standards, and business processes that must be incorporated in the modified Ariel software package.
- **Phase 3:** Produce specifications for modifying the Ariel software package.
- **Phase 4:** Develop an overall plan for constructing, testing, and reviewing the modified software.

Contract No. PBGC01-CT-00-0597 has been amended 14 times through May 2004 to modify the performance period, expand the scope, and increase funding. The contract was incrementally funded for each phase of the project and for additional requirements including a Reference Guide, pilot rollout, and currency exchange rate variances. The original contract ceiling of \$541,838 has been increased to \$2,875,773. Contract modifications are listed in Attachment 1.

PBGC awarded Morneau a second labor-hour contract on December 31, 2002. Contract No. PBGC01-CT-03-0667, effective January 1, 2003, was awarded for services required to modify Ariel, provide it for use by PBGC, and assist PBGC in its initial production implementation. Contract No. PBGC01-CT-03-0667 has been amended 13 times through October 2004 to modify the performance period, expand the scope, and increase funding. The contract was incrementally funded for each phase of the project and for additional requirements, including ongoing monthly Application Service Provider (ASP) costs, currency exchange rate variances, and software modifications. The original contract ceiling of \$1,788,577 has been increased to \$11,946,777. Contract modifications are listed in Attachment 2.

PBGC considers both contracts active. The performance period for Contract No. PBGC01-CT-00-0597 contract expired in May 2004. PBGC has, however, maintained this contract as open for any additional specification work needed to complete the second contract.

These contracts were subject to management oversight through COTR presentations at the Operations Integration Board, Steering Committee, and sponsor meetings. Thus, critical decisions were made by representative PBGC management rather than the just an individual COTR, providing an added control.

C. OBJECTIVES

PBGC's OIG contracted with Cotton & Company to audit monitoring practices performed on two Morneau contracts: No. PBGC01-CT-00-0597 and No. PBGC01-CT-03-0667. The audit focused on determining if PBGC appropriately monitored the contracts. This included reviewing practices related to:

- Preparing, monitoring, and reviewing monthly status reports.
- Reviewing and approving invoices.
- Authorizing work phases.
- Reviewing and accepting deliverables.
- Preparing, reviewing, and approving modification requests.
- Performing management oversight.
- Verifying compliance with contract requirements.

D. SCOPE AND METHODOLOGY

During the course of this audit, we assessed compliance with applicable federal and contract laws and regulations as well as PBGC policies and directives related to monitoring these Morneau contracts. We interviewed key personnel involved in the process and reviewed documents supporting these efforts for

compliance and reasonableness. We also performed testing to determine if stated procedures were in place and functioning as intended.

To achieve evaluation objectives, we obtained applicable federal laws, regulations, and guidance governing federal agency acquisition of information technology and services and compared and assessed these against applicable PBGC directives, policies, and practices.

We interviewed key persons involved in monitoring these contracts, including individuals from PD, IOD, Contracts and Controls Review Department (CCRD), and OIT as well as contract employees and a past employee who performed Contracting Officer's Technical Representative (COTR) duties during the initial months of the first contract. We reviewed and gathered pertinent documents related to monitoring of both contracts.

We performed detailed testing of invoices, status reports, contract modification documentation, SLCM documents, audits and reviews performed by independent parties, and management briefings. We determined if supporting documents supported stated processes and met applicable policies and regulations.

Through our review of this information, we gained an understanding of contract monitoring efforts performed by PBGC and noted other matters that present opportunities for improvement.

We conducted the audit in accordance with *Government Auditing Standards*, as promulgated by the Comptroller General of the United States for performance audits. We conducted this audit from October 20, 2004, to January 8, 2005.

E. AUDIT RESULTS

PBGC generally complied with applicable FAR requirements and PBGC directives, policies, and procedures with respect to the items discussed in the earlier section titled Objectives. We did, however, note control weaknesses related to some monitoring practices performed for the two Morneau contracts. We discuss these weaknesses below and provide recommended corrective actions to strengthen the control environment.

1. COTR Invoice Review

The COTRs did not maintain evidence of performing required reviews of all invoices submitted by Morneau. Although the COTRs stated that they reviewed all invoices before approving them, most invoices contained no evidence of such review. Of 62 invoices submitted by Morneau for both contracts, we noted documentation of only three Prepayment Examination Reviews (PERs) and seven Expanded Examination Reviews (EERs). PERs were required for all invoices, and at least three EERs per year were required for each contract. In addition, we identified two invoices that were not approved within 7 days, as required.

PBGC Directive 15-1, PBGC Systems for the Requisition of, Acquisition of and Payment for Goods and Services (March 19, 2002), describes procedures for COTR review of invoices:

Once received, COTR reviews invoice for the following: Name of contractor and invoice date, contract number, invoice number, description, price and quantity of services, payment terms, other substantiating documentation of information as required by contract. COTR determines if proper and service has been acceptable. Also, COTR must sign off and send back within 6 work days of having received the invoice.

PBGC's intranet site under *Finance, Budgeting, Purchasing & Auditing > Invoices* includes more detailed procedures for invoice review:

Most invoice reviews will be limited to a Prepayment Examination Review (PER). This standard level of review by COTRs must be performed on all invoices and be completed within seven calendar days of the official receipt by PBGC. An EER is required for the first invoice under all contracts. After that, such a review must be completed three times a year for all contracts which have total billings in excess of \$300,000 in a year. The EER must be performed in accordance with the outlined procedures and be completed within 20 calendar days. The COTR file must demonstrate that an EER was performed. The file will be reviewed by the Procurement Department to verify that the EER is performed in accordance with established procedures. (Printed from the intranet on September 27, 2004.)

Both COTRs indicated that they had not received training on invoice review as part of the two COTR training courses they attended. They stated that they were unaware of PBGC's required invoice review procedures. The current COTR had no prior experience as a COTR.

COTRs not trained in invoice review procedures may not be able to perform the level of invoice review required to ensure that invoices are accurate and submitted for services provided.

Recommendation

We recommend the following corrective action:

The COTR for the Morneau contracts should ensure that all required invoice reviews are performed and documented. **(OIG Control Number PD-41)**

Management's Response

Management concurs with the finding and recommendation and will review COTR guidance, especially procedures included on PBGC's intranet, and will ensure COTR compliance with the guidance.

Auditors' Evaluation

Management is responsive to our recommendation.

2. Status Reports

The COTR did not create all required status reports in the COTR Status Report System and, for those created, did not always create them in a timely manner. Of the 10 monthly reports we reviewed for the Morneau contracts, none was prepared in a timely manner in accordance with PBGC policy. Additionally, for each of the contracts, there are seven reporting periods between 2003 and 2004 in which a report was not created.

PBGC Directive 15-1 states:

COTRs will: prepare and submit electronically Monthly Status Reports to the Contract Specialist within 10 workdays after the end of the month.

The COTR has stated that the established due date for submission of the status report is not practicable. The contractor is not required to submit invoices within ten working days after month end; therefore the COTR cannot review and provide accurate invoice information on the status report. Additionally, the COTR and Contract Specialist stated that they have not placed a high priority on status reporting, as they communicate regarding contract issues on a more frequent basis.

PBGC cannot ensure that COTRs are adequately monitoring its contractors if required status reports are not entered into the Status Report System consistently and in a timely manner as required.

Recommendations

We recommend the following corrective actions:

The PD should ensure that status report due dates have appropriate reporting deadlines and that the report contains useful information. **(OIG Control Number PD-42)**

The COTR for the Morneau Sobeco contracts should ensure that all required status reports are submitted timely. **(OIG Control Number PD-43)**

Management's Response

Management concurs with the finding and recommendations. An assessment will be made to determine whether the current status report should be revised or replaced by another process. The COTRs will be informed of any new requirements.

Auditors' Evaluation

Management is responsive to our recommendations.

3. Contract Deliverables

The COTR did not document acceptance and receipt of contract deliverables in writing. The COTR did not think that required documentation was necessary given her daily involvement in this project.

Contract Section E.2, PBGC-46-001, Inspection and Acceptance of Deliverables, states that Morneau is:

...required to furnish all deliverable items under its contracts with PBGC to the Contracting Officer's Technical Representative (COTR). Delivery does not constitute acceptance. Final acceptance must be made by COTR or Contracting Officer in writing.

Additionally, PBGC Directive 15-1, PBGC Systems for the Requisition of, Acquisition of and Payment for Goods and Services, outlines specific COTR duties. These include ensuring that deliverables are acceptable and maintaining documentation and records for actions taken.

Without formal receipt and acceptance of contract deliverables, PBGC cannot ensure that Morneau met all deliverable requirements.

Recommendation

We recommend the following corrective action:

The COTR for the Morneau Sobeco contracts should ensure that acceptance and receipt of all contract deliverables are documented in writing. **(OIG Control Number PD-44)**

Management's Response

Management concurs with the finding and recommendation. Management will review this area to determine needed changes and inform the COTRs of any new requirements.

Auditors' Evaluation

Management is responsive to our recommendation.

4. Yearly Invoice Summaries

The Contract Specialist did not obtain required yearly invoice summaries from Morneau.

Contract No. PBGC01-CT-00-0597 states:

The contractor shall prepare and maintain a summary of all amounts billed under this labor-hour contract....This information must be submitted to the Contracting Officer within 90 days of the program year....

Contract No. PBGC01-CT-03-0667 states:

The contractor shall prepare and submit an annual summary of all amounts billed under this contract for year of the period of performance [sic].... This information must be submitted to the Contracting Officer within 90 days after the completion of each government fiscal year.

Recommendation

We recommend the following corrective action:

The Contract Specialist for the Morneau Sobeco contracts should ensure that all yearly invoice summaries are obtained as required. **(OIG Control Number PD-45)**

Management's Response

Management concurs with the finding and recommendation and will emphasize the requirement for the contractor to prepare and submit yearly invoice summaries to PBGC.

Auditors' Evaluation

Management is responsive to our recommendation.

5. SAS 70 Audits

Contract No. PBGC01-CT-03-0667 states that an annual SAS 70 audit is to be performed, as needed, beginning with the 12-month period ending June 30, 2004. This audit was not performed, and no documentation was available to explain why this SAS 70 audit was not deemed necessary for this period.

Contract Section H.11, SAS 70 Reporting requirements, states that Morneau is required to provide an annual SAS 70 (Type II) report prepared pursuant to requirements of AICPA's Statement of Auditing Standards (SAS) 70. SAS 70 is the authoritative guidance that allows service organizations to disclose their control activities and processes to customers and customer auditors in a uniform reporting format. The audit is

performed by an independent auditing firm, and a formal report including an opinion is issued at the conclusion.

Morneau submitted a proposal to the Contract Specialist in February 2003 to perform SAS 70 audits for the years ending June 2004 and 2005. Two other reviews had been conducted before this, both by independent companies. The first was a review of Morneau's security policies and practices completed in the fall of 2003 under the direction of PBGC's information system security officer. The second was a review of internal controls for the Ariel system completed for PBGC's IOD in June 2004. During our testing PBGC representatives were unsure if a SAS 70 audit was necessary in 2004 as a result of these two earlier reviews. PBGC had not authorized Morneau to proceed or provided Morneau with documentation to support not performing the audit.

Recommendation

We recommend the following corrective action:

PBGC should determine if a SAS 70 audit is required for 2004 and, if so, ensure that it is obtained. **(OIG Control Number PD-46)**

Management's Response

Management's response stated that the contract did not contemplate a SAS 70 report for 2004 and it would not be practical to obtain such a report at this time. However, management is taking steps, in conjunction with Morneau, to initiate work that will result in the issuance of a SAS 70 report during PBGC's FY 2006.

Auditors' Evaluation

Management is responsive to our recommendation.

F. OTHER MATTERS

We noted two areas that present opportunities for improvement within the PBGC monitoring process, which are discussed below.

1. Written Operating Procedures

PBGC did not have written operating procedures for the Contract Specialist and Contracting Officer addressing all aspects of contract monitoring, which affects all contracts, including those with Morneau. Without specific written procedures provided to and understood by all personnel involved in contract monitoring, PBGC cannot be sure that contract monitoring is consistent, adequate, and timely. This documentation would include Contracting Officer invoice review and documentation requirements, documentation and timing of COTR status report reviews, and procedures for obtaining invoice summaries.

PBGC Directive GA 15-1, Management Control Program, provides guidance to PBGC management on improving the accountability and effectiveness of PBGC programs and operations by establishing, assessing, correcting, and reporting on management controls. The directive implements Office of Management and Budget (OMB) Circular A-123, Management Accountability and Control, which implements Section 2 of the Federal Managers Financial Integrity Act (FMFIA). FMFIA requires the Government Accountability Office (GAO) to issue standards for internal control in government. GAO's *Standards for Internal Control in the Federal Government*, Examples of Control Activities, cites the following as appropriate documentation for transactions and internal control:

Internal control and all transactions and other significant events need to be clearly documented and the documentation should be readily available for examination. The documentation should appear in management directives, administrative policies, or operating manuals and may be in paper or electronic form. All documentation and records should be properly managed and maintained.

Recommendation

We recommend the following corrective action:

The PD should establish written operating procedures, including establishing due dates, for contract monitoring duties, including those of the Contract Specialist and Contracting Officer. **(OIG Control Number PD-47)**

Management's Response

Management does not concur with the finding and recommendation. The response states that the FAR was adopted as PBGC's policy for the acquisition of goods and services and supplemental policies and procedures are not required or needed. The response also indicates that PBGC directive FM 15-1, PBGC Systems for the Requisition of, Acquisition of and Payment for Goods and Services, details the duties of COTRs, Procurement Department staff and the Contracting Officer. PBGC has made significant investments in training COTRs with respect to contract monitoring techniques.

Auditors' Evaluation

We do not agree with management's response. While the FAR and PBGC directive FM 15-1 may be used as a baseline, they do not document specific daily and monthly responsibilities related to the monitoring of contracts. We continue to recommend that the PD establish written operating procedures for PBGC's contract monitoring activities.

2. Contract Specialist Reviews

The Contract Specialist did not document review of COTR status reports and also did not document review of monthly contractor invoices or provide evidence of notifying the COTR of issues related to invoicing. PBGC had not prepared written operating procedures requiring these reviews and follow-up communication with the COTR if issues arise. Unless Contract Specialists review status reports and invoices, PBGC cannot ensure that invoices are accurate and submitted for services provided. Further, the COTR could potentially approve invoices for payment without Contract Specialist approval.

OMB's *Best Practices in Contract Administration* states that the Contracting Officer has the authority to approve or disapprove invoices. Further, sound business practices and prudent fiscal and fiduciary management dictate that reviews conducted be documented in writing as an audit trail.

Recommendations

We recommend the following corrective actions:

The Contract Specialist for the Morneau Sobeco contracts should document reviews performed of the COTR status reports as well as any review and approval of invoices. **(OIG Control Number PD-48)**

The PD should formalize its procedures for Contract Specialist review of invoices, including determining compliance with contract terms, such as labor rates, other direct costs, and subcontracting. (**OIG Control Number PD-49**)

Management's Response

Management does not concur with the portion of the finding and recommendations dealing with Contract Specialist review of invoices. The response states that given resource constraints and cost/benefit considerations, it is not practical for each Contract Specialist to review each invoice submitted under each PBGC contract.

Auditors' Evaluation

We do not agree with management's response. We recommend that procedures for Contract Specialist review of invoices be formalized and these reviews be documented. We are not recommending a detailed review of invoices but rather a review to determine whether the invoices are in compliance with contract terms.

Management did not directly respond to the recommendation concerning documentation of reviews performed of the COTR status reports; however the response to Finding 2, Status Reports, states that an assessment will be made to determine whether the current status report should be revised or replaced by another process. We assume that documentation of Contract Specialist's review of the reports will be considered during that assessment.

3. SLCM Compliance

A May 3, 2004, preliminary report of an OIT inspection review of Ariel through the first three of five phases of PBGC's SLCM concluded that system development controls covering the Ariel project through Phase 3 warranted improvement and generally suggested non-compliance for the project. In January 2005, an IOD manager stated that the report was inaccurate when it was issued, and that considerable work was accomplished after May 2004 that is not reflected in the report.

Contract No. PBGC01-CT-00-0597 did not require Morneau to adhere to PBGC's SLCM. PBGC's COTR indicated that an undocumented SLCM that Morneau followed in Canada was used during the initial years of the contract. This undocumented methodology was used even though the director of PBGC's Information Resources Management Department (now OIT) had sent a memorandum dated January 31, 2000, to IOD's director recommending use of PBGC's SLCM for the parameter-driven software system.

Contract No. PBGC01-CT-03-0667 states that PBGC is responsible for ensuring that the modified Ariel software adheres to PBGC's SLCM as defined in the System Life Cycle Framework produced by PBGC's Information Resources Management Department (Version 3.0.0, March 15, 2002).

PBGC's SLCM provides a blueprint for acquiring, developing, and maintaining information systems and information technology throughout their life cycles. The five phases of SLCM are:

1. **Project Initiation:** Establish that the project is formally initiated and that appropriate project control measures exist.
2. **Definition and Analysis:** Establish that the overall project plan has been undertaken to determine the most appropriate solution to a stated problem in terms of organizational capability, economic justification, and technical suitability.

3. **Design and Planning:** Ascertain that data processed and stored by the system will be complete, accurate, and authorized, and that security, privacy, and accessibility levels for the system data are specified.
4. **Development:** Ensure that the system operates efficiently, effectively, and economically.
5. **Operations and Refinement:** Establish that all appropriate forms, manuals, programs, and training materials are created from detailed systems specifications. Ensure that the system operates in accordance with design objectives and other measurement criteria, and project costs/benefits have been achieved.

OIT representatives stated that the Ariel project had been underway for years before their Project Management Office began working with IOD on the review of the first three phases, and that compliance is almost impossible for a project that has been underway for this long. OIT is working with IOD on review of Phases 4 and 5. The work should be completed by September 2005.

Because PBGC's SCLM was not followed during the first three phases of this project, it is possible that Ariel may not operate as intended. We have recommended that OIG perform a post-implementation review of Ariel to determine if it is functioning as planned and complies with the intent of PBGC's SCLM.

We have removed the recommendation for this finding which was included in the draft report issued to management. Management agreed in its response that the Benefits Administration and Payment Department will coordinate with OIT regarding SCLM requirements and take steps to ensure compliance.

ATTACHMENT 1

**CONTRACT MODIFICATIONS AND AMENDMENTS UNDER
MORNEAU SOBECO CONTRACT NO. PBGC01-CT-00-0597**

ATTACHMENT 1
CONTRACT MODIFICATIONS AND AMENDMENTS UNDER
MORNEAU SOBECO CONTRACT NO. PBGC01-CT-00-0597

No.	Date	Dollar Value	Reason	Revised Contract Value
1	1/30/2001	\$237,396	Extended performance period, added modifying Ariel process documentation as a Reference Guide, incorporated Cash Balance Plans and included training.	\$779,234
2	6/1/2003	None	Added internal PBGC clearance requirements.	\$779,234
3	4/10/2001	None	Revised hours.	\$779,234
4	7/1/2001	\$986,929	Provided funding for future phases, incorporated additional plans in specs and analysis.	\$1,766,163
5	8/1/2001	None	Changed COTR.	\$1,766,163
6	12/1/2001	None	Redistributed labor hours.	\$1,766,163
7	4/10/2002	\$74,400	Added new requirements due to PBGC changing policy and required revision of some documents.	\$1,840,563
8	6/5/2002	\$782,594	Increased statement of work to do Phase 1 of Stage 2, obligated funds, extended period of performance.	\$2,623,157
9	1/21/2003	None	Added labor category.	\$2,623,157
10	3/1/2003	\$227,708	Separated Modification 8 activity into two steps to roll pilot out, incorporated minor change requests, extended performance period.	\$2,850,865
11	6/1/2003	\$24,908	Adjusted costs because of variances in currency exchange rate and to fund additional hours related to complexities in design of value due to PBGC calculations.	\$2,875,773
12	12/22/2003	None	Changed COTR.	\$2,875,773
13	5/3/2004	None	Changed COTR.	\$2,875,773
14	5/30/2004	None	Extended performance from 7/20/00 to on or before 12/31/04.	\$2,875,773

ATTACHMENT 2

**CONTRACT MODIFICATIONS UNDER
MORNEAU SOBECO CONTRACT No. PBGC01-CT-03-0667**

ATTACHMENT 2
CONTRACT MODIFICATIONS UNDER
MORNEAU SOBECO CONTRACT NO. PBGC01-CT-03-0667

No.	Date	Dollar Value	Reason	Revised Contract Value
1	3/1/2003	\$65,827	Required Morneau to supply workstations for PBGC use in Montreal and separated the initial activity into two phases.	\$1,854,404
2	6/1/2003	\$186,938	Adjusted costs because of variances in currency exchange rate and to fund additional hours related to complexities in coding, to redistribute hours among labor categories, and to separate Help into two phases.	\$2,041,342
3	9/26/2003	None	Outlined costs for the ASP program.	\$2,041,342
4	10/1/2003	\$1,298,005	Provided FY 2004 funding for services.	\$3,339,347
5	10/1/2003	None	Authorized commencement of Activities 2-5 (Phase 6).	\$3,339,347
6	10/8/2003	None	Clarified and incorporated changes relative to the ASP program during the ASP pilot.	\$3,339,347
7	10/1/2003	None	Changed COTR.	\$3,339,347
8	1/1/2004	None	Added Large Plan Pilot support for Bethlehem Steel.	\$3,339,347
9	4/7/2004	\$1,276,678	Obligated funds for system testing of Version 1.0, work previously authorized during FY 2004, and ASP services through March 31, 2004.	\$4,616,025
10	1/1/2004	\$3,030,739	Provided funds for Activities 6, 8, and 9; and version 1.5 modifications and testing.	\$7,646,764
11	9/23/2004	\$1,300,013	Provided for software modifications and implementation support for Release 1.7 of Ariel, Bethlehem Steel implementation, integration and support.	\$8,946,777
12	10/1/2004	\$3,000,000	Increased labor for ASP services.	\$11,946,777
13	10/1/2004	None	Specified costs for ASP services.	\$11,946,777

ATTACHMENT 3

MANAGEMENT'S RESPONSE TO DRAFT REPORT



Pension Benefit Guaranty Corporation
1200 K Street, N.W., Washington, D.C. 20005-4026

To: Luther Atkins, Assistant Inspector General for Audits
Office of Inspector General

From: Robert Herting, Contracting Officer
Procurement Department

Subject: Response to Draft Report Regarding the Monitoring Activities Related to
Morneau Sobeco Contracts PBGC01-CT-00-0597 and PBGC01-CT-03-
0667

Thank you for the opportunity to review the draft report. We are pleased that the report concluded that “PBGC generally complied with applicable FAR requirements and PBGC directives, policies, and procedures” with respect to PBGC’s monitoring activities relating to the referenced contracts. We acknowledge that we can improve our processes and have, as detailed below, concurred with most of the report’s recommendations. The Procurement Department will be primarily responsible for implementing the agreed-upon recommendations, and will work with BAPD and OIT to ensure that the recommendation relating to SLCM compliance will be addressed. We will begin implementing the agreed-upon recommendations immediately, and anticipate that corrective actions to be taken should be completed within 6 months. Our responses to each recommendation included in this report are shown below:

1. COTR Invoice Review

OIG Recommendation:

We recommend that the COTR for the Morneau Sobeco contracts take the following corrective action: Ensure that all required invoice reviews are performed and documented.

Management Response:

We concur. We will review our guidance to PBGC Contracting Officer Technical Representatives’, especially as it relates to the guidance included on the intranet, and will take steps to ensure COTR compliance with our guidance.

It is important that the report indicated that all invoices were approved prior to payment. The approval of an invoice for payment by a COTR represents a provisional approval that, under the FAR, remains subject to adjustment by the Contracting Officer until contract settlement based on audit or other considerations.

2. Status Reports

OIG Recommendation:

We recommend that PD: Determine the value of the current status report and revise its contents to make it more useful.

Management Response:

We concur. We will make an assessment of the current design of the status report and determine whether it should be changed or replaced by another process.

It is important to note that the report indicates that the COTR and the Contract Specialist indicated they frequently discussed contract issues in lieu of relying on the status report to communicate issues relating to the contract.

OIG Recommendation:

We recommend that the COTR for the Morneau Sobeco contracts take the following corrective action: Ensure that all required status reports are completed and submitted to the Contract Specialist when due.

Management Response:

We concur. As stated above, we will review this status report, determine whether changes are needed, and inform PBGC Contracting Officer Technical Representatives of any new requirements.

3. Contract Deliverables

OIG Recommendation:

We recommend that the COTR for the Morneau Sobeco contracts take the following corrective action: Ensure that acceptance and receipt of all contract deliverables are documented in writing.

Management Response:

We concur. We will review this area, determine whether changes are needed, and inform PBGC Contracting Officer Technical Representatives of any new requirements.

4. Yearly Invoices Summaries

OIG Recommendation:

We recommend that the Contract Specialist take the following corrective action: Ensure that all yearly invoice summaries are obtained as required.

Management Response:

We concur. We will emphasize the requirement for the contractor to prepare and submit yearly invoices summaries to PBGC.

5. SLCM Compliance

OIG Recommendation:

We recommend that IOD and OIT take the following corrective action: Continue work together to ensure that the Ariel project complies with PBGC's SLCM.

Management Response:

We concur. BAPD, formerly referred to as IOD prior to the October 2004 reorganization, will coordinate with OIT regarding SLCM requirements and take steps to ensure compliance.

OIG Recommendation:

We recommend the following corrective actions: PBGC should determine if a SAS 70 audit is required for 2004 and, if so, ensure that it is obtained. If a determination is made that the SAS 70 audit is not required, the Contracting Officer should document the reasons for the determination through an amendment to the contract indicating the year not deemed required.

Management Response:

We do not concur. The contract does not contemplate a SAS 70 report being due for the period ending June 30, 2004, and it would not be practical to obtain such a report at this time. The contract indicates these audits are to be performed as needed. This requirement was placed into the contract at the direction of the then-Chief Financial Officer in order to facilitate the financial statement audit process later during contract performance. At the time this clause was incorporated into the contract, Ariel was in a pre-production design phase and no valuations were being processed through the system for financial statement purposes. Given the increasing number of valuations that will be processed using the Ariel system and the resulting impact on the financial statement process, we are taking steps, in conjunction with Morneau Sobeco, to initiate work that will result in the issuance of a SAS 70 report during PBGC's FY 2006.

6. Written Operating Procedures

OIG Recommendation:

We recommend that PBGC take the following corrective action: Establish written operating procedures, including establishing due dates, for contract monitoring duties, including those of the Contract Specialist and Contracting Officer.

Management Response:

We do not concur. The report does not identify any significant issues with respect to the administration of the subject contracts that would indicate the need for additional policies and procedures. It has been the policy of the Procurement Department to adopt the Federal Acquisition Regulation (FAR) for the purposes of procuring goods and services for PBGC. The FAR provides specific guidance for the purpose of the award, administration, and settlement of contracts. The FAR anticipates that the Contracting Officer must exercise judgment in determining specific actions to take in monitoring contract activities. We are not aware of a specific FAR requirement for supplemental policies and procedures, and the report does not reference such a requirement. In fact, PBGC has not seen the need to develop supplemental guidance as other agencies have done (e.g., Defense Federal Acquisition Regulation Supplement).

PBGC does maintain specific policies and procedures over the acquisition of goods and services as detailed in the existing PBGC directive entitled, FM 15-1 - PBGC Systems for the Requisition of, Acquisition of and Payment for Good and Services. This document details the duties of COTRs, Procurement Department staff, and the Contracting Officer.

PBGC has invested significantly in training COTRs with respect to contract monitoring techniques, and the contracting professionals within the Procurement Department staff are familiar with contract monitoring techniques.

7. Contract Specialist Reviews

OIG Recommendation:

We recommend that the Contract Specialist for the Morneau Sobeco contracts take the following corrective action: Document reviews performed of the COTR status report as well as any review and approval of invoices. We also recommend that PD formalize its procedure for Contract Specialist review of invoices, including determining compliance with contract terms, such as labor rates, other direct cost, and subcontracting.

Management Response:

We do not concur. Given resource constraints and cost/benefit considerations, it is not practical for each Contract Specialist to review each invoice submitted under each PBGC contract. In accordance with PBGC Directive 15-1, all invoices are reviewed by a COTR prior to payment. When problems, including significant invoice issues, are noted by the Contracting Specialist, or raised by the COTR via the status report or through direct communications, actions are taken to address the identified issues. All payments made to contractors are subject to audit and adjustment by the Contracting Officer until contract settlement. Therefore, if mistakes or errors are noted, they can be addressed later during contract performance or as part of the final invoice.

Detailed reviews of each invoice submitted can increase processing costs and the potential for late payments. In fact, certain government agencies permit contractors that maintain adequate billing systems to receive payments with limited or no review of invoices prior to payment.

We believe that implementation of this recommendation would negatively impact the performance of other duties performed by the Contract Specialist, and is not necessary since risk in this area is reduced to an acceptably-low level based on:

- existing COTR invoice review and monitoring processes,
- existing Contract Specialist oversight of contract monitoring processes,
- contract evaluation services provided by the Contracts and Controls Review Department,
- independent contract audit services provided by the Office of Inspector General, and
- a newly-implemented requirement for the Office of General Counsel to review major contract actions.

It is important to note that a preliminary draft audit report from your office regarding costs claimed by Morneau Sobeco under its PBGC contracts did not indicate the need for the contractor to reimburse PBGC for any previously-paid costs.

If you have questions regarding this memorandum, please contact me.