Secretary of State

State of Oregon

DRIVER & MOTOR VEHICLES SERVICES

New Licensing System—Software Contract Expenditures

Special Review

Audits Division

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This audit reviewed selected expenditures associated with the New Licensing System (NLS) software design and construction contract between Driver and Motor Vehicles Services (DMV) and DMR Group, Inc. for the period October 1, 1993, to February 29, 1996. The objectives of the audit were to determine whether contract charges paid by DMV were adequately supported, complied with the terms of the contract, and were reasonable, appropriate expenditures of public funds. An additional objective was to identify significant risks associated with the other contracts for the NLS project.

Our audit found that DMV managers engaged in several practices contrary to prudent contract administration, specifically:

- Failing to obtain and review detailed documentation supporting contractor expense reimbursement invoices;

- Failing to establish adequate guidelines for the reimbursement of travel and living expenses; and

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- Approving the use of the contractor's international relocation program without obtaining knowledge of the specific provisions of the program and without incorporating the agreed-upon provisions into the contract.

By engaging in these practices, DMV paid more than $700,000 in charges that were either not clearly allowed under the contract or erroneous. In addition, DMV paid for contractor expenses that may not have been incurred in the most cost-effective manner possible. The audit also disclosed other matters that warrant management attention.

We conducted our audit in accordance with generally accepted government auditing standards. In this regard, we inquired of agency and contractor personnel, reviewed policies and procedures, tested relevant documents, and evaluated management controls as required to accomplish the objectives of our audit.

Our audit was limited to the specific matters described above, and was based on tests and procedures we considered necessary in the circumstances.

OREGON AUDITS DIVISION

Don Waggoner, CPA
State Auditor

Fieldwork Completion Date:
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T A B L E O F C O N T E N T S

SUMMARY

Driver and Motor Vehicle Services branch (DMV) project managers' absence of effective contract administration practices for the New Licensing System (NLS) software design and construction contract (contract) resulted in more than $700,000 in payments to the contractor that were either not clearly allowed under the contract or erroneous. During this period, the contractor was paid a total of approximately $20 million.

State managers have a responsibility to ensure that public funds are utilized efficiently, economically, and effectively. However, several practices by DMV managers contributed to diminished controls over payments made to the contractor, resulting in less assurance that only appropriate expenditures were reimbursed. For example, DMV project managers paid contractor expenses without obtaining and evaluating documentation supporting the charges billed. Project managers also failed to include in the contract adequate guidelines and criteria for determining allowable expenses. In particular, this was true for the contractor's international relocation program (IRP). We are questioning over $550,000 paid under this program. In addition, contractor expenses which may not have been cost effective also went unnoticed and unquestioned by project managers.

DMV project managers also engaged in questionable project administration practices. Project managers shifted budgeted costs from tasks not yet started to cover the costs of tasks in progress. These funding shifts may result in reduced functionality of the system and/or future cost increases. Project managers also confused Legislative biennial budget issues with contract deliverable budgets, resulting in misstated deliverable budgets. Furthermore, DMV managers authorized amendments to the software design and construction contract for services for another Department of Transportation branch that were not directly related to the contract's original scope of work and in doing so, circumvented the state personal services procurement process established by the Department of Administrative Services.

To ensure that public funds are spent prudently and appropriately, DMV project managers need to establish effective procedures for reviewing and monitoring contractor billings. Since this contract is a "not to exceed" contract, the state can recognize savings by closely monitoring contractor charges. DMV should seek guidance from the Department of Justice and where appropriate recover contract payments that are erroneous or are not clearly allowed under the contract. Furthermore, DMV project managers should discontinue the practice of shifting funding from contracted tasks not yet started to cover cost overruns of current tasks without first assuring that the completion of the future tasks is not jeopardized.

In response to the audit recommendations, the Department of Transportation generally agreed that the financial contract management for the DMR Reengineering Project needed improvement and has taken major steps to gain better financial control of all project related contracts. The department is also working with the Department of Justice to determine which charges are inappropriate under the contract, and will seek reimbursement as appropriate.

INTRODUCTION

Driver and Motor Vehicle Services (DMV) is the branch of the Oregon Department of Transportation (department) responsible for regulatory requirements for driver and vehicle licensing and vehicle titles for approximately 2.5 million drivers and 3 million vehicles registered in Oregon. DMV has 65 field offices around the state. Each year, DMV processes approximately 1.8 million vehicle registrations, 1.1 million vehicle titles, .9 million driver licenses, permits, and ID cards, and 1.9 million other driver- or vehicle-related activities. In addition, law enforcement agencies, private businesses and other state agencies access DMV records approximately 13.7 million times a year.

NLS PROJECT HISTORY

In 1988, DMV was notified that its computer system for vehicle and driver licensing and registration activities, which was first installed in the 1960's, would no longer be supported by the manufacturer. At the direction of the Legislature, DMV contracted for a study of its information systems needs. After dismissing one vendor for failing to complete a plan, DMV contracted with DMR Group, Inc. (contractor) to complete the information systems strategic plan. This plan, which was presented to the Legislature in 1991 called not only for a new computer system, but also a complete re-engineering of how DMV conducts business.

In 1991, the Legislature authorized DMV to develop a business requirements and high-level system design study, including a cost/benefit analysis. This study was also completed by DMR Group, Inc. The study presented two options: 1) Replace hardware and software only, at a cost of $40 million with projected annual savings of $1 million, or 2) replace hardware and software, and re-engineer business processes for an additional $10 million and receive an additional annual savings of $6.5 million. DMV recommended and the Legislature selected the second option in 1993. The following four major contracts were signed for the required hardware and software:

Description	Contractor
Software Design and Construction	DMR Group, Inc.
Technology Hardware Partnership	IBM
Digital Photo Licensing	Polaroid
Quality Assurance Consultant	ECG, Inc.

The resulting project, known as the New Licensing System (NLS), was originally expected to be completed by December 1997 at a total cost of $48.3 million. Estimates at the time of our audit put the project cost at $123.9 million and the completion date at December 1999. The software design and construction contract with DMR Group is currently at about $28 million for the first two major phases. DMR Group was paid approximately $20 million under the software design and construction contract during the period of our review.

SCOPE AND METHODOLOGY

In July of 1995, the Oregon Audits Division began a statewide review of Information Technology procurements. One of the 68 contracts selected for review in this audit was the DMV software design and construction contract (contract) with DMR Group. Inc. During our examination of payment administration processes for this contract, we noted conditions that warranted additional review and subsequently became the focus of this audit. The objectives of this audit were to:

(1) Determine whether charges paid by DMV to the contractor under the contract:

- were adequately supported
- complied with the terms of the contract
- were reasonable and appropriate expenditures of public funds

(2) Identify significant risks associated with other DMV contracts for the NLS project.

To accomplish our audit objectives, we interviewed pertinent personnel from DMV, the contractor, and ECG, Inc. (the project's quality assurance contractor). We reviewed applicable contracts, laws, regulations, and policies and procedures related to the NLS project.

In addition, we reviewed contractor invoices, expense documentation, and fee documentation for selected months and contractor employees from October 1993 through February 1996. We reviewed all relocation charges for selected contractor employees who relocated to Salem, all expense report charges for selected contractor expense reports, and fee billings for three months. We also reviewed the methods used by DMV to track and control the costs of deliverables under the contract. In addition, we analyzed the contract budgets including change order revisions. Finally, we evaluated the potential impact of discrepancies and questionable charges which had been identified.

One of our audit procedures included requesting written representation from DMV management to confirm that:

- All financial records pertaining to the NLS were made available to us;
- There were no undisclosed irregularities pertaining to the NLS contract;
- There were no violations of laws pertaining to the contract, and;
- There were no material unrecorded transactions related to the contract.

DMV management expressed concerns about signing such a representation because the current DMV management was not involved in the NLS project during our audit. Consequently, they declined to sign the representation letter. Therefore, the scope of our audit work was limited because we do not have DMV management's assurance that all relevant information has been provided.

We conducted this audit in accordance with generally accepted government auditing standards. We limited our review to those areas specified in this section of the report.

AUDIT RESULTS

CONTRACT EXPENDITURES

State managers have a responsibility to ensure that public funds are utilized efficiently, economically, and effectively. However, Driver and Motor Vehicles services branch (DMV) project manager's absence of effective contract administration practices for the New Licensing System (NLS) software design and construction contract (contract) resulted in payments of more than $700,000 for contractor charges that were either not clearly allowed under the contract or were erroneous.

The contract between DMV and DMR Group, Inc. (contractor) is a "not to exceed" contract. This type of contract has a set upper cost limit for specified results, called "deliverables," and certain expense line items such as "travel and living expenses." However, while the upper limit provides a maximum, the state may realize cost savings if the actual cost is less than that budgeted. For this reason, not-to-exceed contracts should be closely monitored by agency managers to assure optimum savings to the state. However, several practices by DMV managers contributed to diminished controls over payments made to the contractor, resulting in less assurance that only appropriate expenditures were reimbursed and that the state might realize cost savings from the travel and living expenses portion of the contract. For example, DMV project managers did not obtain or review source documentation supporting the contractor expense invoices at any time prior or subsequent to authorizing payment. Furthermore, DMV project managers told the contractor not to submit supporting documentation with the billing invoices; rather, the contractor should simply retain the documentation for audit. As long as there were sufficient unspent funds remaining in the total contract, invoices were approved by project managers for payment and were not closely scrutinized for errors or contract compliance. Project managers informed us that they were advised that as long as costs did not exceed the amount allowed by the contract and were prudent uses of the funds, nothing further was required to approve the expenditure. However, the failure to establish contractual guidelines for reimbursing travel and living expenses and obtain detailed documentation supporting the charges provided DMV managers with no basis on which to assess the prudence of the costs being reimbursed. Compounding this problem, project managers provided only minimal assurance, through limited post-payment reviews performed by the quality assurance consultant, that expenditures under the NLS project were adequately supported and mathematically accurate. The quality assurance reviews did not address whether the costs were a prudent use of public funds or, because of the lack of contractual cost reimbursement guidelines, could not assure that the costs complied with the intent of the contract. The project managers' lack of attention to the specific charges resulted in DMV paying more than $700,000 for contractor charges that were either not clearly allowed under the contract or were erroneous. Furthermore, DMV has also paid for contractor expenses that may not have been incurred in the most cost-effective manner possible.

QUESTIONABLE PAYMENTS

DMV paid more than $700,000 to the contractor for charges that were not clearly specified in the contract, contained billing errors on the part of the contractor, or were not supported by source documentation. In the detailed descriptions below, the inappropriate charges are categorized as follows: Excess Payroll, Other Relocation Costs, Changes in Key Personnel, Family Airfare Charges, and Billing Errors.

EXCESS PAYROLL

Some contractor employees from outside the United States who worked in Salem on the NLS project received a salary increase adjustment in lieu of travel and living expenses as part of the contractor's international relocation program (IRP). This increase was allocated to DMV as excess payroll and classified on the contractor's invoices as a relocation expense. According to information provided by the contractor, from October 1993 through February 1996, DMV paid more than $550,000 in excess payroll charges to the contractor for 23 contractor employees.

The contract specifies that relocation expenses will be reimbursed to the contractor. The "Travel Lodging, Meals and Living Expense" section states that it includes:

> "travel and living costs for consultants working on-site in Salem except for local hires. The cost for relocation will be covered through this expense item."

The contract does not specify what types of charges will be included in relocation. While some employees were permanently relocated to Salem, initially, most were paid some combination of travel and living expenses. It was not until later in the project that the contractor offered an alternative plan called the international relocation program (IRP) that was reimbursed under this section of the contract. DMV managers indicated that sometime in March or April of 1994 they gave DMR permission to use the IRP in lieu of travel and living expenses. DMV staff could not provide any evidence showing such approval was given and the effective date of the approval. Furthermore, DMV managers indicated that they were not aware of the specifics of the IRP and did not obtain and review a copy of the DMR IRP handbook published in March 1994 that outlined the specific provisions of the IRP either before granting DMR approval to use the IRP or at anytime up through the end of our fieldwork. Also, DMV managers were not involved in the decision to place DMR employees on the IRP and did not establish criteria to ensure that individual relocation decisions were made in the state's best interests. Last, DMV managers did not amend the contract to incorporate the provisions of the IRP.

In addition to providing for DMR employees' moving expenses, the program included a salary increase adjustment associated with employee relocation. The salary adjustment typically included a 15 percent assignment allowance, an individual allowance of $2,700 per family member, a 15 percent provincial allowance, a 7 percent partial year tax allowance, and a 7 percent state tax allowance as part of the cost of relocation. These IRP salary adjustment payments were in addition to the contractor employee's billing rates which were governed by another section of the contract.

We reviewed the compensation increases for five of the 23 contractor employees on the IRP and found that the following adjustments were made to the base salaries and allocated as part of the billings:

Employee No.	**Base Salary (US Dollars)**	**Adjustment (US Dollars)**	**Adjusted Salary (US Dollars)**	**Percent Increase**
1	83,353	29,174	112,527	35.0%
2	39,309	22,690	61,999	57.7%
3	36,899	23,218	60,117	62.9%
4	34,505	19,992	54,497	57.9%
5	24,462	13,979	38,441	57.2%

In four of the five instances reviewed, calculations of the excess payroll amount did not appear to conform with the provisions set out in the contractor's IRP handbook. For example, in two instances an assignment allowance greater than 15 percent was used.

While the description of relocation expenses in the contract is vague, relocation expenses under state guidelines do not include salary adjustments such as these. Therefore, we question whether salary adjustments are an allowable relocation expense under the contract, particularly when the contractor's salary costs are already limited by another section of the contract. Although DMV management informed us that they believed the IRP was less expensive than the contractor's travel and living expenses plan, they were not able to provide us with a valid analysis supporting that assertion. Evidence was not provided to show that DMV performed an analysis prior to accepting this plan or periodically analyzed its cost effectiveness once the plan was put into use. Furthermore, DMV management did not obtain documentation of the IRP details or discuss the plan with the Department of Justice prior to acceptance.

We asked the Department of Justice (DOJ) about the allowability of these excess payroll charges. DOJ's preliminary evaluation was that the contract does not allow the contractor to indirectly increase its professional services billing rates by charging excess payroll costs as an expense item. Based on its initial review, DOJ commented that payment of these charges as relocation expenses would run counter to the professional fee provisions stipulated in the contract. Therefore, DOJ concluded that excess payroll costs cannot be construed as a relocation expense that would be covered under the travel, lodging, meals and living expenses provisions of the contract. These excess payroll charges would appear to violate the contractually established limitations on professional fees.

OTHER RELOCATION COSTS

In addition to reviewing excess payroll charges, we reviewed approximately $195,000 in other relocation costs incurred on behalf of 10 contractor employees. Approximately $52,000 of these charges were for the equivalent of two months' salary for DMR employees paid under a United States relocation plan, separate from the IRP and not formalized between DMV and the contractor in writing. Since there is no formal plan for United States relocation and this charge could give the appearance of being a form of relocation incentive, we question the appropriateness of paying these charges.

Other charges appear to be related to moving costs and a localization allowance and a relocation allowance included as part of the IRP. The IRP localization allowance is intended to cover expenses related to the employee relocating to the United States. Under the contractor's IRP policy, these expenses may include spouse job hunting, spouse education and training, language training, child care, and educational counseling. The contractor's IRP policy manual places a $5,000 (Canadian) limit on localization allowance charges. The IRP relocation allowance is intended to cover incidental expenses such as required additional clothing, alteration and/or purchase of draperies and carpeting, telephone installation, work permit application, losses on frozen foods and house plants, etc. The maximum amount paid to the employee under the relocation allowance is as follows:

Status	**Allowance (Canadian $)**
Single	2,500
Couple	4,000
Family	5,000

According to documentation provided by the contractor, more than $15,000 of the $195,000 reviewed was associated with the relocation allowances. In each case reviewed, DMV paid the maximum amount indicated for relocation allowances. Because the contractor did not require its employees to submit receipts for expenses claimed under the relocation allowance, DMV had no assurance that the amounts paid for relocation allowance were used only for those types of charges listed in the contractor's guidelines. Furthermore, DMV reimbursed the contractor more than $10,000 to pay for the income tax consequences faced by four contractor employees because of the benefits offered through the localization and relocation allowances of the IRP. DMV paid not only for the IRP benefit, but for the tax consequences of both the benefit and the payment to cover the tax consequences.

If DMV chooses to incorporate the IRP into the contract, DMV officials should confer with legal counsel from the Department of Justice and identify those specific provisions that will be reimbursable under the contract.

CHANGES IN KEY PERSONNEL

The contract stipulates that certain contractor positions play "key" roles on the project. These roles and their initial daily billing rates are as follows:

Key Role	Daily Billing Rate (US Dollars)
Engagement Manager	$1,591
Architecture Manager	1,198
Business Architect	1,198
Systems Architect	742
Work Systems Architect	1,018
Functional Architect	920
Data Architect	645
Technology Architect	712
ADE Architect	1,198
Team Leader (Primary)	837

The contract also stipulated that in the event the contractor wished to reassign assigned personnel with key roles, the contractor would obtain the approval of DMV and provide the substitutes' initial 20 working days of effort to DMV at no cost. However, these contract provisions were not consistently applied. In five of the nine instances in which DMR requested approval to replace key personnel, DMV managers waived part or all of the initial 20 working days of effort at no cost requirement, resulting in approximately $73,000 of incurred costs. DMV managers could not provide us the authority under which they waived this contract provision. In three instances, the state received the full benefits of this provision. In one case, DMV did not waive the provision but had not yet received a credit equivalent to the 20 working days, valued at more than $24,000. In addition to the nine instances in which DMR requested approval to replace key personnel, our review found two instances in which it appears that individuals in key roles left the engagement without the contractor promptly identifying and obtaining DMV approval of a replacement.

FAMILY AIRFARE CHARGES

We reviewed selected months' expense billings and air travel billings for calendar years 1994 and 1995. Included in the billings paid by DMV were 16 round trips to Salem for contractor employees' family members at a total cost of over $11,000. Although not specifically prohibited by the contract, travel charges for family members of contractor employees do not appear to be a reasonable expense. Because they did not obtain or review invoice supporting documentation prior to authorizing payment to the contractor, project managers were not aware that family members of contractor employees were traveling to Salem at DMV's expense. The contract stipulates that contractor travel and living expenses are reimbursable. The contract does not, however, provide any guidelines regarding the conditions and circumstances under which the expenses may be incurred. However, travel expenses for contractor employee family members would not be usual or customary charges for a state agency to pay.

BILLING ERRORS

In addition to the above inappropriate charges, we found numerous contractor billing errors. These errors, totaling more than $4,000, included costs such as double billings, use of incorrect currency exchange rates, and billing for late fees incurred by the contractor. A listing of these errors and the related amounts is presented in Appendix A of this report.

OPPORTUNITIES TO REDUCE FUTURE EXPENSE COSTS

We noted numerous charges that do not appear to be a prudent use of public funds and are not specifically reimbursable under the contract. These charges include frequent employee air travel, rental car expenses, per diem in excess of state rates, and other miscellaneous charges. DMV project managers should have questioned whether these charges were appropriate, and negotiated clearer contract provisions with the contractor as necessary.

RENTAL CAR EXPENSES

According to the contractor's travel and living policy, each employee traveling to Salem to work on the project on a short term basis (six months or less) is entitled to a car for his/her use while in Salem. The rental car charges are billed to DMV as a travel expense. The contractor has been renting these cars from a local rental company at a monthly cost of $516 for each vehicle. We found, however, that similar cars could be leased from a local auto dealer under a $0 down, two-year lease for $276 per month for each vehicle. According to information provided by the contractor, there have been as many as 20 and as few as 11 contractor employees in Salem on a short-term basis, for the project during calendar years 1994 and 1995. If the contractor had leased a fleet of 10 cars instead of renting cars on a month-to-month basis, DMV could have realized savings of $2,400 per month in rental car expenses for a two-year savings of $57,600.

PER DIEM

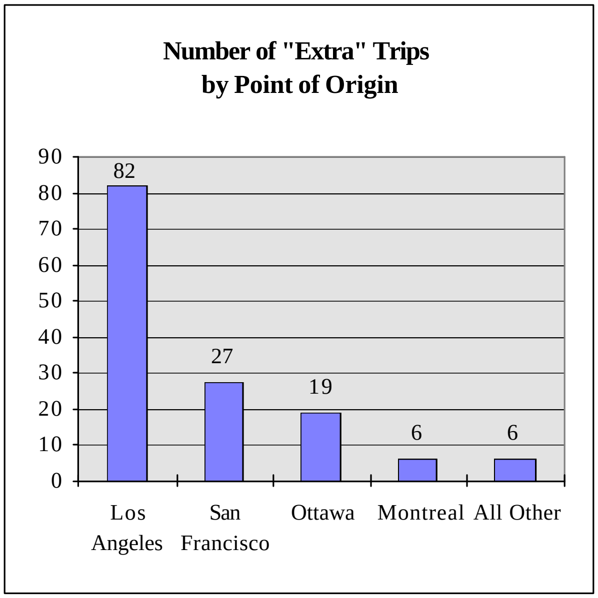
The contract between DMV and the contractor does not stipulate a daily per diem rate for meals and other incidental expenses for contractor employees who are in Salem on a short-term basis. DMV managers, in an internal memo, agreed to pay a $26 per diem for each full day in Salem for each contractor employee in travel status. This rate was in excess of the $23 state per diem rate at the time. DMV managers stated that they did not believe they were required to follow state travel rules and rates for contractor reimbursements. According to the Department of Justice, DMV may have been given inaccurate legal advice regarding the applicability of state travel rules.

From October 1993 until August 1995 when the state rate increased to $26, DMV paid the contractor approximately $20,000 in excess of the established state per diem rate. Because the current state rate and the agreed-upon rate now agree, this condition has been resolved for the time being. DMV, however, may need to address this issue in the future, should state rates again change.

Our review of per diem charges also found that contractor employees do not always prorate per diem for partial days of travel. The contract does not stipulate that per diem be prorated for partial days of travel, but the contractor's own policy as well as DMV's memo of agreement states that $26 per *full day* of travel is to be paid (emphasis added). However, we found cases where the full day's per diem was charged by contractor employees for partial days of travel. For example, one contractor employee charged a full day of per diem to the project even though his flight was not scheduled to arrive in Portland from San Francisco until after 10 p.m. Furthermore, this employee also charged per diem for days he spent in his home city; this charge is included in the billing errors listed in Appendix A. State travel rules provide specific guidelines for prorating partial days of travel. DMV managers, however, did not require that the contractor follow these guidelines. Contractor employees do not provide itineraries with their travel and per diem claims; therefore, we did not determine the full extent of per diem overcharges due to partial days of travel and charges for days that did not involve travel.

CONTRACTOR EMPLOYEE TRIPS HOME

In reviewing air travel billings for 1994 and 1995, we found 17 contractor employees working in Salem on a temporary basis (less than 12 months) who averaged more than one air trip per month, with a total of 140 "extra" trips. A large percentage of the employees incurring multiple air trips each month originate from Los Angeles and San Francisco, as shown in the following diagram:



The contract does not stipulate the number of reimbursable trips to an employee's city of origin (home), nor did DMV project managers establish a guideline for these costs. The contractor, therefore, developed its own travel and expense policy specifically for the DMV contract after the contract was signed and without input from project managers. The contractor's travel and living expense policy states: "One full-price flight home will be provided each month ..." The contractor establishes a budget for each employee based upon a walk-up, no-advance purchase ticket price, intended to approximate the cost of a single round trip home. Contractor employees can travel home as often as their individual budgets allow, and they can carry forward unused budget dollars to future months. As a result of being based on the highest airfares, these budgets usually will pay for multiple trips each month. For example, one employee, who worked on the project from June 1994 to December of 1994, traveled between Los Angeles and Salem 21 times, an average three trips home per month. Another employee, who worked on the project from June 1994 to March 1995, traveled between Los Angeles and Salem 32 times, also averaging over three trips home per month. Both employees remained within their travel budgets of $850 per month, but were able to make multiple trips home due to advance bookings or special fares. These airfare cost savings should have reduced billings to DMV rather than being used for the contractor employees' personal benefit.

The contract provides no specific guidance for determining the appropriate number of trips home per month to be reimbursed by DMV. Project managers, however, should have questioned the frequency of contractor employee travel and negotiated an appropriate standard.

An additional $2,100 in air travel charges were billed and paid for contractor employee trips to their home city after they relocated to Salem. For example, a contractor employee who relocated to Salem in January 1995 flew to his previous home city in December 1995 with his spouse (also a contractor employee relocated in January) and two children, at a total cost to DMV of $3,170. The cost of the children's airfare ($1,584) is included in the Family Travel total described previously in this report. It does not appear reasonable for DMV to pay for contractor employees' trips to their previous homes after incurring significant costs to relocate the employees to Salem. The contract is silent on reimbursement of employee travel to their previous homes subsequent to relocation. However, this is not a type of benefit that would normally be allowed by state agencies under the state relocation guidelines.

OTHER QUESTIONABLE CHARGES

We also noted numerous other charges totaling more than $9,000 that may not be reasonable uses of public funds. A listing of these charges is included in Appendix A of this report.

ACCOUNTABILITY FOR PUBLIC FUNDS

Public officials entrusted with handling public resources are responsible for applying those resources efficiently, economically, and effectively. The Oregon Accounting Manual states that *"Each employee authorized to make an expenditure decision involving state funds is responsible for the 'good judgment' and 'lawfulness' of the expenditure. He/she must ensure that the transaction is for authorized purposes and is a responsible and appropriate use of these funds*." The manual goes on to state that the penalty for managers acting with a "...*wanton or reckless disregard of one's duty of due care*..." may include personal financial responsibility for the expenditures and/or disciplinary action up to and including dismissal.

For the NLS software design and construction contract the responsible DMV managers did not establish adequate guidelines for reimbursing travel and living expenses or an effective means for review of contractor billings to ensure the charges were consistent with the terms of the contract and a prudent use of public funds. As a result, DMV made over $700,000 in contractor payments that are either not clearly allowed under the contract or erroneous.

RECOMMENDATIONS

DMV should establish an effective system of review and control over fees and expenses paid under the contract. Specifically, we recommend DMV:

1. Work with the Department of Justice to clarify the contract and determine the allowability of the charges questioned in this audit. Based upon this determination, DMV should seek reimbursement for all inappropriate charges. Furthermore, DMV should evaluate whether further in-depth reviews should be completed to identify whether additional inappropriate charges exist.

2. Require the contractor to provide original documentation such as receipts, invoices, and/or canceled checks for all future expenses billed. In addition, require the contractor to provide original documentation for all past IRP allowance charges and pursue recovery of expenses that cannot be substantiated.

3. Require the contractor to provide copies of signed contractor employee timesheets supporting all fees billed.

4. Establish a cost-effective method for systematically reviewing some or all of the supporting documentation for fees and expenses to reduce the risk of inappropriate or erroneous charges being paid by DMV.

5. Establish guidelines for payment of contractor employee travel and living expenses. We further recommend that DMV discontinue paying for family travel unless it results in cost savings to DMV. Additionally, DMV should reimburse no more than one trip home per month per contractor employee at the most reasonable rates obtainable unless the contractor demonstrates a project-related reason for the additional travel and receives DMV approval in advance of the travel.

6. Require the contractor to provide itineraries for all travel expenses claimed. The itineraries should indicate the reason for travel and the employee's departure and arrival dates and times. Furthermore, DMV should ensure that per diem is paid only in accordance with the Oregon Accounting Manual.

7. Negotiate with the contractor a more cost-effective means of obtaining ground transportation for contractor employees in Salem on a short-term basis. For example, the contractor could establish a fleet of leased cars for a baseline number of employees and rent cars only for additional needs beyond the baseline.

OTHER MATTERS

The following conditions came to our attention during the course of our fieldwork. Although they were not our primary audit objectives, these topics warrant corrective action by DMV management.

CONTRACT BUDGET REALLOCATIONS

DMV management has authorized numerous budget reallocations between contract deliverables, releases, and engagements. While it may be acceptable project management practice to use cost savings from completed deliverables to enhance functionality or to address unforeseen difficulties in current deliverables, it is not prudent to reduce funding from future deliverables to cover cost increases in current deliverables. The latter practice only serves to defer funding decisions to future project phases.

For example, Release 3 (which is contained in Engagement 1) is significantly over the initial budget contained in the contractor's proposal. The majority of this cost increase has been funded by shifting funds from Release 5 budgets which are contained in Engagement 2. As a result of these shifts, the budgets for the final three phases of Release 5, which were originally contracted to cost approximately $1 million, now have zero dollars available. Therefore, unless DMV requires the contractor to complete these three deliverables without compensation, the contract will have to be amended. This amendment would result in either reduced functionality of the software or additional costs to complete the project. If contract amendments for the cost increase in Release 3 were necessary, it would be more appropriate to address those amendments while Release 3 is in progress.

These contract cost reallocations resulted from DMV managers' focusing on the contract's "not to exceed" total rather than on holding the contractor accountable to the individual prices for each specific deliverable. Former DMV project managers have stated that they felt the only requirement for managing the cost of deliverables was ensuring the total contract price was not exceeded.

CONTRACT COST VERSUS BIENNIAL FUNDING

Through interviews with former project managers, we found that there was considerable confusion on the part of DMV managers regarding the difference between the contracted budgets and the legislatively approved budgets to pay for the contract. These two budgets, although dealing with the same project, should be managed separately. Biennial budgets are a legislatively authorized limit on expenditures during a two year time period. Biennial budgets require managers to forecast estimated expenditures to enable expenditure planning and control on a statewide basis by the Legislature. Alternatively, the contract provides specific budgets for each project deliverable. These contracted budgets represent the amount DMV must pay for a specific deliverable. Additionally, the contract does not limit or specify from which biennial period deliverables can be paid.

By confusing legislative budgetary considerations and contract budgets, DMV managers made incorrect adjustments to the contract budget. Consequently, the contract budgets for project administration, Release 1, and Release 3 were reduced by $387,000 to agree with the amount actually spent at the end of the 93-95 biennium. This occurred because project managers considered this spending authority to have expired at the end of the 93-95 biennium, when the legislatively authorized budget lapsed. However, the contract stipulates that these contract deliverables have a set, not-to-exceed price, which is not affected by the end of the biennium. Therefore, the remaining $387,000 should have been added to DMV's 95-97 biennial budget request, and the contract deliverable budgets should have remained unchanged at the end of the 93-95 biennium. As a result of our discussions with current project managers, the contract budgets were corrected in June 1996 to eliminate the end of biennium adjustments previously made.

NON-NLS CONTRACT AMENDMENTS

DMV officials approved contract amendments totaling $410,000 for services that are unrelated to the contractor's obligations under the software design and construction portion of the NLS project. The Oregon Department of Transportation Information Services Branch (ISB) is responsible for ongoing maintenance of the computer environment. ISB attached amendments to DMV's NLS contract for ongoing maintenance activities that have no direct relation to the software design and construction in the original contract. These activities included: leadership and coaching of ISB personnel, development of an advanced development environment beyond DMV, and a technology readiness assessment of ISB.

Although ongoing support for the new system is essential, this support role is not part of the system design and construction and was not included in the scope of work in the original solicitation. The necessary support services, therefore, should have been procured under a separate contract or contracts. Former DMV project managers indicated that they were told by upper level management that it would be more expedient to use amendments to the existing contract rather than to go through a separate procurement process. However, these amendments circumvent the personal services procurement process and requirements established by the Department of Administrative Services.

AMENDMENT 6

Amendment 6 to the contract includes a $50,000 increase to complete the Problem Driver Pointer System (PDPS) in Release 3 of NLS. The former project managers stated that the department obtained a federal grant of $50,000 to integrate PDPS into the NLS. Work qualifying for this grant, however, was already included in the original cost proposal and contract, so an amendment to add this task was not necessary. DMV managers should have used the available federal funding to pay for this portion of Release 3, thereby saving the state $50,000. Instead, after the amendment was signed, project managers reallocated $50,000 of state funds originally budgeted for PDPS into a contingency fund, to pay for additional functionality or cost overruns as necessary. The availability of federal funds should have had no bearing on the total cost of the contract. Instead of using it to reduce the amount of state funds expended for NLS, project managers elected to use the $50,000 federal grant to increase the contract total.

PERFORMANCE BOND

The software design and construction contract includes an option for DMV to require the contractor to obtain a performance bond for $1,000,000 at any time during the life of the contract. To date, this option has not been exercised by DMV.

The purpose of a performance bond is to guarantee that the contractor will perform the required duties and that the terms and conditions of the contract will be met. If the contractor does not meet the terms and conditions of the contract, DMV could make a claim against the bond. The bond issuer then would ensure that the project was completed or DMV received compensation for the default.

We were informed that DMV management made its decision to not require a performance bond based on the contractor's satisfactory performance on past projects. Due to the magnitude and complexity of the current project, however, the performance required for the current undertaking is not comparable to the requirements of the contractor's previous obligations. Given the risks inherent in a long-term software development project, it appears to be an imprudent management decision to waive a standard protection such as a performance bond.

During our interviews, former DMV project managers stated that they believed $1 million was an insufficient amount for the performance bond on this contract. However, the amount was never actually an issue since they did not choose to exercise the option of requiring the performance bond. According to a surety manager with a large insurance company, entities generally obtain performance bonds for 100 percent of the contract amount. For example, another Oregon state agency recently required a performance bond for the entire contract amount of $5.6 million for its computer project. The surety manager we contacted indicated that a performance bond for the entire contract price of this project would probably be difficult to obtain, but may have been possible. Not only should DMV have exercised its option for the $1 million performance bond, it would have been prudent to require a bond for the largest amount possible to obtain, up to the total contract amount.

OTHER NLS CONTRACTS

To determine if the identified weaknesses in management controls could also have affected the other contracts associated with the NLS project, we performed a limited review of those contracts.

Based on these limited reviews, we identified risks associated with DMV's oversight of the IBM technology partner hardware contract and ECG quality assurance contract similar to those associated with the software design and construction contract. As with the software design and construction contract, DMV project managers did not establish effective controls for monitoring expenditures associated with the IBM and ECG contracts. Supporting documentation was not submitted with expense invoices, and project managers did not request any supporting documentation for review. Consequently, project managers had no assurance that expenditures were consistent with contract terms and provision, adequately supported, mathematically correct, or a prudent use of public funds at the time they approved DMV's payment of the billings.

RECOMMENDATIONS

DMV managers need to establish an effective contract management process that allows project managers to monitor and control the cost of contract deliverables and ensure that contract amendments are reasonable and appropriate. This process should be applied to all NLS contracts, not just the software design and construction contract. Specifically, we recommend that DMV:

1. Discontinue the practice of shifting funds from future project phases to current releases without also addressing the risk of scope limitations for future contracted tasks. Address scope of work increases and cost overruns as they occur through contract amendments or cost savings from completed deliverables as appropriate.

2. Manage the state legislative budget constraints separate from NLS contract deliverable budgets. In the future, consider requesting from the Legislature a capital projects funding approach for large hardware and/or software system acquisitions expected to span multiple biennia.

3. Ensure that future amendments to the contract relate solely to NLS software development at DMV. Require that ISB services be obtained through a separate contract procured in accordance with Department of Administrative Services rules.

4. Attempt to negotiate with the contractor a larger bond amount to further reduce the risk of default. Immediately exercise the contract option requiring the contractor to furnish a $1 million performance bond.

SUBSEQUENT EVENTS

During the course of our fieldwork, DMV's current managers have taken actions based on our preliminary results to improve NLS project operations and finances. These actions include personnel changes, reevaluation of contract payment practices, and a major project replan intended to speed up completion and control the ultimate cost of the NLS. At the present time, we are unable to evaluate the effect these actions may ultimately have on the NLS project.

RECENT STAFF CHANGES

The Department of Transportation (department) and DMV have had significant turnover in key agency and project management positions since late 1995. Both the director of the department and the manager of the Information Services Branch (ISB) left the agency in December 1995 for positions in the private sector. In April 1996 the governor appointed a new department director. A new ISB manager was hired in May 1996.

The former DMV manager and two of three project managers have left DMV and taken positions with other department branches. The other former project manager remains in his ISB position, but no longer has NLS project management responsibilities. The current DMV transition staff includes a new DMV manager; a program director (new position); a chief financial officer (new position); a project budget manager (new position); a single project manager, and a service delivery manager (new position). These changes occurred late in or subsequent to our audit period of October 1993 to February 1996.

CONTRACT EXPENSES

In April 1996 the project Chief Financial Officer notified the software design and construction contractor that travel-related expenditures will be reimbursed only in accordance with state travel rules. This action was taken in response to our preliminary audit findings presented to DMV managers in April 1996. The contractor had disputed DMV's contract authority to restrict expenditures in accordance with state rules but, according to the Chief Financial Officer, is currently complying with state travel regulations. Since the state travel rules do not specifically address some issues such as contractor relocation expenses and long term travel and living expenses, these issues remain to be resolved.

PROJECT REPLAN

Current DMV management announced on May 20, 1996, that DMV would temporarily stop the NLS project development process for four months. During this period, the replan team intends to:

- Perform a technical evaluation of work completed to date;
- Determine what DMV's options are for the future;
- Review the composition of releases to ensure the most beneficial phases receive priority;
- Define allowable reimbursable expenses based on state travel policy, i.e., mileage, lodging, and per diem;
- Establish financial controls; and
- Submit a budget request for the addition of a Fiscal Coordinator 2 position.

REPORT DISTRIBUTION

This report is a public record and is intended for the information of Oregon Department of Transportation and Driver and Motor Vehicle Services management, the governor of the state of Oregon, the Oregon Legislative Assembly, and all other interested parties.

COMMENDATION

The courtesies and cooperation extended by the officials and staff of the Oregon Department of Transportation and Driver and Motor Vehicle Services branch were commendable and much appreciated.

AUDIT TEAM

Nancy Buffinton-Kelm, CISA, CPA, Audit Administrator
Christina Shearer, CPA
Patricia Hovey
Mark Montgomery
Jim Scott

APPENDIX A

QUESTIONABLE PAYMENTS

Description	Amount	Report Section
1. IRP Excess Payroll	$ 556,248	Excess Payroll
2. Other Relocation Costs		Other Relocation Costs
- Two Month's Salary	$ 52,442	
- Relocation Allowance	$ 15,018	
Tax Consequences	$ 10,464	
3. Key personnel changes		Key Personnel
- 20 Day Waiver	approximately $ 73,000	
- Credit Not Received	$ 24,640	
4. Spouse/Partner or Family air travel charges	$ 11,687	Family Airfare
5. Double billing	$ 1,000	Billing Errors
6. Paid Loss/Damage waiver for rental car	$ 727	
7. DMR Consultant expense reimbursement for non-NLS project employee	$ 218	
8. Child care expenses on employee expense reports	$ 1,068	
9. DMR employee health insurance premiums	$ 708	
10. Exchange rate errors (10 occurrences)	$ 183	
11. Late charges billed to DMV (3 occurrences)	$ 38	
12. Overbilled for Pacific Sanitation invoice	$ 5	
13. Per Diem rates for "Special Travel" exceed the state rates (2 occurrences)	$ 90	
14. Billed per diem at $28 per day instead of agreed upon rate of $26 per day.	$ 22	
15. Per diem for contractor employee days at home	$ 52	
16. Non-NLS project airfare	$ 94	
Subtotal Billing Errors	$ 4,205	
GRAND TOTAL QUESTIONABLE PAYMENTS	***$ 747,704***	

Opportunities to Reduce Future Expense Costs

Description	Amount	Report Section
1. Renting instead of Leasing	$ 57,600	Rental Cars
2. Per Diem Rate	$ 19,821	Per Diem
3. Post relocation air travel (3 occurrences)	$ 2,168	Post Relocation Airfare
4. Legal fees for work visas for employees (and family) (13 occurrences)	$ 6,302	Misc. Questionable
5. Post relocation per diem and living expenses	$ 503	
6. Damage waiver on furniture rental	$ 35	
7. Housekeeping fees	$ 100	
8. Kitchen supplies	$ 4	
9. Meals for meetings	$ 110	
10. Meal charges for employee at or near home city	$ 278	
11. Expenses for “working late” (2 occurrences)	$ 54	
12. Shipped furniture for employee to Salem for 6 months then shipped back - Total cost $2,119.99; furniture rental for 6 months: $565	$ 1,555	
13. Garage rental in Montreal, Canada	$ 255	
Total Miscellaneous Questionable Charges	$ 9,196	

AGENCY'S RESPONSE TO THE AUDIT REPORT

Oregon

DEPARTMENT OF TRANSPORTATION

December 24, 1996

Don Waggoner
Secretary of State Audits Division
255 Capitol Street NE, Suite 250
Salem, OR 97310

FILE CODE:

Dear Mr. Waggoner:

As noted in your report, significant management changes have occurred within the Department of Transportation (ODOT) and the Driver and Motor Vehicles (DMV) Branch since your audit field work was completed in June, 1996. In general, ODOT/DMV agree that the financial contract management for the DMV Reengineering Project needed improvement. The current project management team and the new DMV Branch Manager, Jan Curry, have taken major steps to gain better financial control of all project-related contracts.

ODOT/DMV is working with the Department of Justice to determine which charges are inappropriate under the contract. DMV will seek reimbursement of inappropriate charges. DMV is in the process of terminating this contract with DMR and in so doing ensuring that the state's interest in seeking reimbursement from the contractor is protected.

Since June 1996, DMR has not been reimbursed for International Relocation Program (IRP) related expenses. DMV's research and analysis indicates that IRP reduced contractors' expenses and was a cost-effective alternative to travel and living expenses for consultants. The IRP program was not specifically provided for under the contract with DMR, however.

Beginning in April 1996 with the help of your auditors, DMV strengthened its financial management of the DMR contract. By August 1996 DMV had established effective contract management processes within the project for all information systems related projects. DMV acquired two experienced financial staff, an administrative staff, a contract analyst/technician, and changed financial monitoring/control systems and procedures.

Attached are responses to specific recommendations contained in the draft audit report. Please take these comments into consideration as the final report is prepared.

Sincerely,

Grace Crunican

Grace Crunican
Director

TM:/dmr/audit2.doc: 12/24/96

734-3122 (1-93)

Transportation Building
Salem, OR 97310

Responses to Recommendations on Contract Expenditures

1. **Work with the Department of Justice to clarify the contract and determine the allowability of the charges questioned in this audit. Based upon this determination, DMV should seek reimbursement for all inappropriate charges. Furthermore, DMV should evaluate whether further in-depth reviews should be completed to identify whether additional inappropriate charges exist.**

   Comment: ODOT/DMV, in cooperation with the Department of Justice, is assessing the legal basis for seeking reimbursement of various expense-related payments made to the contractor. If the payments were not valid according to the contract, DMV will evaluate cost-effective approaches to determine the actual extent of overpayment and will pursue reimbursement.

2. **Require the contractor to provide original documentation such as receipts, invoices, and/or canceled checks for all future expenses billed. In addition, require the contractor to provide original documentation for all past IRP allowance charges and pursue recovery of expenses that cannot be substantiated.**

   Comment: Since April 1996, DMR has supplied documentation with each invoice for expenses. Payment of IRP-related expenses was discontinued for consultants' expenses incurred after June 1996. DMV will determine cost-effective approaches to reimburse for travel and living expenses in any new contracts. DMR will be asked to supply documentation for IRP-related expenses prior to April 1996. By March 1997, cost-effective steps to recover funds will be implemented for amounts lacking original documentation.

3. **Require the contractor to provide copies of signed contractor employee time sheets supporting all fees billed.**

   Comment: Time sheets from DMR employees are available for review by DMV managers and our oversight consultant (ECG) upon request. Previous audits of these time sheets compared to invoiced fees have produced few discrepancies. The time reporting and invoicing process was documented and audited by ECG in January 1996. ECG concluded, "the process DMV employs to track DMR budgets and invoices is reasonably effective in maintaining accurate records and ensuring that DMR invoices are correct."

4. **Establish a cost-effective method for systematically reviewing some or all of the supporting documentation for fees and expenses to reduce the risk of inappropriate or erroneous charges being paid by DMV.**

   Comment: Effective May 1996, DMV established a cost-effective method for systematically reviewing supporting documentation for fees and expenses under current contracts. In addition, DMV is exploring a variety of approaches to contracting that are cost-effective and help reduce the risk of inappropriate or erroneous charges being paid in the future.

5. **Establish guidelines for payment of contractor employee travel and living expenses. We further recommend that DMV discontinue paying for family travel unless it results in cost savings to DMV. Additionally, DMV should reimburse no more than one trip home per month per contractor employee at the most reasonable rates obtainable unless the contractor demonstrates a project-related reason for the additional travel and receives DMV approval in advance of the travel.**

   Comment: In future contracts, DMV will establish guidelines for payment of contractor employee travel and living expenses. These guidelines will consider the audit report's recommendations on the number of reimbursable trips per month and payment for family travel unless it results in cost savings to DMV.

6. **Require the contractor to provide itineraries for all travel expenses claimed. The itineraries should indicate the reason for travel and the employee's departure and arrival dates and times. Furthermore, DMV should ensure that per diem is paid only in accordance with the Oregon Accounting Manual.**

   Comment: DMV is considering the recommendation to require contractors to supply itineraries for all travel expenses claimed as well as other approaches for determining if travel is appropriate. Effective July 1, 1996, the contractor now supplies documentation with all requests for travel-related expenses and complies with travel standards specified in the Oregon Accounting Manual for per diem, mileage and lodging.

7. **Negotiate with the contractor a more cost-effective means of obtaining ground transportation for contractor employees in Salem on a short-term basis. For example, the contractor could establish a fleet of leased cars for a baseline number of employees and rent cars only for additional needs beyond the baseline.**

   Comment: DMV will explore more cost-effective means of obtaining ground transportation for contractor employees in Salem on a short-term basis. However, we do not necessarily agree that the auditor's suggestion that a base fleet of leased cars is an appropriate alternative.

Responses to Recommendations on Other Matters

1. **Discontinue the practice of shifting funds from future project phases to current releases without also addressing the risk of scope limitations for future contracted tasks. Address scope of work increases and cost overruns as they occur through contract amendments or cost savings from completed deliverables as appropriate.**

   Comment: DMV will work to minimize scope of work increases and cost overruns, but if they occur, DMV will develop an effective process to determine needs and prioritize work within the resources available to DMV. The process will be in place by March 1997. DMV will provide regular updates to the Joint Legislative Committee on Information Management Technology (JLCIMT) and highlight changes of this nature.

2. **Manage the state legislative budget constraints separate from NLS contract deliverable budgets. In the future, consider requesting from the Legislature a capital projects funding approach for large hardware and/or software system acquisitions expected to span multiple biennia.**

Comment: DMV has revamped how it manages legislative budget limitations and contract deliverable budgets. The Department of Administrative Services (DAS) and Legislative Fiscal Office must determine if multi-year information technology projects should receive expenditure limitations similar to capital construction projects. In the future, DMV intends to break large projects into smaller phases that are easier to manage and finance through the normal biennial budget legislative process.

3. **Ensure that future amendments to the contract relate solely to NLS software development at DMV. Require that ISB services be obtained through a separate contract procured in accordance with Department of Administrative Services rules.**

Comment: Contracting processes of the Department of Administrative Services, ODOT and DMV are being examined to ensure that amendments do not depart from the original scope of work defined in contracts. Future contract amendments will relate to the original scope of work. Information Systems Branch (ISB) services are now procured through a separate contract in accordance with DAS rules.

4. **Attempt to negotiate with the contractor a larger bond amount to further reduce the risk of default. Immediately exercise the contract option requiring the contractor to furnish a $1 million performance bond.**

Comment: The contract is being terminated so we will not pursue a larger bond on this contract. For other contracts, DMV will work with Department of Administrative Services (DAS) to develop appropriate performance bonds on our future contracts.