UNITED STATES DEPARTMENT OF STATE
AND THE BROADCASTING BOARD OF GOVERNORS

OFFICE OF INSPECTOR GENERAL

AUD-FM-13-36 | Office of Audits | September 2013

Audit of Selected Working Capital Fund Cost Center Financial Results

United States Department of State
and the Broadcasting Board of Governors

Office of Inspector General

PREFACE

This report is being transmitted pursuant to the Inspector General Act of 1978, as amended, and Section 209 of the Foreign Service Act of 1980, as amended. It is one of a series of audit, inspection, investigative, and special reports prepared as part of the Office of Inspector General's (OIG) responsibility to promote effective management, accountability, and positive change in the Department of State and the Broadcasting Board of Governors.

This report addresses the financial results of two Department working capital fund cost centers – Secure Warehouses and Information Technology. The report is based on interviews with employees and officials of relevant agencies and institutions, direct observation, and a review of applicable documents.

OIG contracted with the independent public accountant, Kearney & Company, P.C., to perform this audit. The contract required that Kearney perform its audit in accordance with guidance contained in the *Government Auditing Standards*, issued by the Comptroller General of the United States. Kearney's report is included.

Kearney identified areas in which improvements could be made in the Cost Centers' fee-setting and calculation methodologies and identifying and properly charging all Cost Center operating expenses.

OIG evaluated the nature, extent, and timing of Kearney's work; monitored progress throughout the audit; reviewed Kearney's supporting documentation; evaluated key judgments; and performed other procedures as appropriate. OIG concurs with Kearney's findings, and the recommendations contained in the report were developed on the basis of the best knowledge available and were discussed in draft form with those individuals responsible for implementation. OIG's analysis of management's response to the recommendations has been incorporated into the report. OIG trusts that this report will result in more effective, efficient, and/or economical operations.

I express my appreciation to all of the individuals who contributed to the preparation of this report.

Harold W. Geisel
Acting Inspector General

KEARNEY&
COMPANY

1701 Duke Street, Suite 500, Alexandria, VA 22314
PH: 703.931.5600, FX: 703.931.3655, www.kearneyco.com

Audit of Selected Working Capital Fund Cost Center Financial Results

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

Kearney & Company, P.C. (referred to as "we" in this letter), has performed an audit of selected working capital fund cost center financial results. This performance audit, performed under Contract No. SAQMMA09D0002, was designed to meet the objective identified in the report section titled "Objective" and further defined in Appendix A, "Scope and Methodology," of the report.

We conducted this performance audit in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. We communicated the results of our performance audit and the related findings and recommendations to the U.S. Department of State Office of Inspector General.

We appreciate the cooperation provided by personnel in Department offices during the audit.

Kearney & Company

Kearney & Company, P.C.
Alexandria, Virginia
July 18, 2013

Acronyms

ABC	activity based costing
A Bureau	Bureau of Administration
A/EX/WCF	Bureau of Administration, Executive Office, Working Capital Fund Division
FAH	*Foreign Affairs Handbook*
GAO	Government Accountability Office
GFMS	Global Financial Management System
ILMS	Integrated Logistics Management System
IRM	Bureau of Information Resource Management
IT	Information Technology
OIG	Office of Inspector General
S-ELP	Secure-Expedited Logistics Program
SW	Secure Warehouses
WCF	Working Capital Fund
WMS	Warehouse Management System

Table of Contents

Executive Summary

Government agencies use shared services, financed through revolving funds, to improve operational efficiencies. The Department operates and maintains a Working Capital Fund (WCF), a type of revolving fund, which does not receive appropriated funds. Instead, it finances its operations through the collection of fees from its customers. Federal regulations and Department policies require that WCFs charge sufficient fees to cover all operating and overhead expenses but not in excess of what is needed to cover costs. The Department's WCF includes 37 individual cost centers that provide unique services.

The objective of this audit was to determine whether the fees collected by two of the Department's WCF cost centers, Secure Warehouses (SW) and Information Technology (IT), were sufficient to cover all costs required to sustain operations for those activities. An external audit firm, Kearney & Company, P.C. (Kearney), acting on behalf of the Office of Inspector General (OIG), performed this audit.

Kearney found that the SW Cost Center did not collect sufficient fees to cover its costs. SW Cost Center expenses exceeded revenue by $8.8 million in total from FY 2005 through FY 2012. One reason that expenses exceeded revenue was that the Bureau of Administration (A Bureau) did not consider the SW Cost Center to operate independently from another WCF cost center for financial purposes. Instead, the A Bureau considered the gains and losses of two related cost centers—the SW Cost Center and the Freight Forwarding Service Center—to offset each other. In addition, revenue was not sufficient because the Cost Center had delayed the implementation of fee increases while obtaining customer buy-in for the fees and had not formally reassessed its fees since FY 2005. SW Cost Center officials indicated that a formal reassessment of the Cost Center's fees would be performed after the SW Cost Center moved to a consolidated warehouse in FY 2013. In addition, the SW Cost Center paid expenses, amounting to approximately $9.5 million from FY 2005 through FY 2012, that were not appropriate Cost Center expenses and did not fully bill its customers for one of its services.

Kearney also found that SW Cost Center operating expenses, totaling approximately $4.1 million in FY 2012, were paid from appropriated funds or other WCF cost center revenue. Had the additional operating expenses been paid by the SW Cost Center, the overall loss would have increased significantly. As a result, the SW Cost Center did not have a clear understanding of its actual financial position and could not determine the amount of fees that would be sufficient to sustain its operations. Kearney estimated that a total of $31.8 million in non-Cost Center funds had been used to pay for Cost Center expenses since 2005. Moreover, part of the losses covered by non-Cost Center funds related to services provided to other agencies. Kearney estimated that the SW Cost Center had undercharged other agencies by as much as $2.6 million during FY 2005 to FY 2012. Had the Department collected these funds from other agencies rather than using its own funds to subsidize the SW Cost Center operations, it would have been able to put the funds to better use.

Kearney found that the IT Cost Center collected fees in excess of the amount needed to cover the costs to sustain its operations. Specifically, IT Cost Center revenue exceeded expenses by approximately $26 million in total from the Cost Center's inception in FY 2009 through FY

2012. Bureau of Information Resource Management (IRM) officials were aware of this situation and indicated that they were considering how to address the excess funds. Revenue exceeded expenses because some operating costs, amounting to approximately $2.8 million in FY 2012, were paid from non-Cost Center funds and the Cost Center received $1.5 million in appropriated funds that were not earned. Kearney also found that the IT Cost Center's fee-setting methodology did not consider the Cost Center's retained funds or future changes to customer needs. In addition, during FY 2009 through FY 2012, the Cost Center did not have an effective method to determine the number of desktop computers in use by its customers, and the Cost Center had provided services to nonserviced bureaus and offices that were not billed for the services. As a result, the IT Cost Center did not have a true understanding of its actual financial position and could not establish fees in a manner that covered, but did not greatly exceed, its cost of operations. Kearney calculated that the Cost Center charged its customers as much as $350 more per desktop computer than was necessary, amounting to approximately $18.2 million during FY 2011 to FY 2012. These funds could have been used by customers for other priorities. In addition, the $2.8 million paid during FY 2012 using non-Cost Center funds could also have been put to better use. Further, the IT Cost Center may not have charged its customers correctly for the number of desktop computers that were serviced and may have paid more, or less, than warranted to the contractor operating the IT Help Desk.

OIG made 15 recommendations to the Department related to improving the Cost Centers' fee-setting and calculation methodologies and identifying and properly charging all Cost Center operating expenses.

In the August 27, 2013, joint response (see Appendix B) to the draft report, the A Bureau concurred with the 11 recommendations addressed to it, and IRM concurred with three of the four recommendations addressed to it and stated that IRM had taken action to address the fourth recommendation. Based on the response, OIG considers Recommendations 1–13 and 15 resolved, pending further action, and Recommendation 14 closed. Management's responses and OIG's replies to those responses are included after each recommendation.

Background

Agencies can improve their operational efficiency through the use of shared services, which are often financed through revolving funds. In 1963, the Department received congressional approval to operate and maintain a WCF, a type of revolving fund, to

- Provide a more effective means for controlling the costs of goods and services produced by commercial-type activities.
- Provide an effective and flexible way to finance, budget, and account for commercial-type activities.
- Encourage cost consciousness and efficiency for users and suppliers of services.
- Promote a buyer-seller relationship between the producing activity and the customer.

The WCF does not receive funds through appropriation legislation. Instead, the WCF finances operations through the collection of fees from customers. According to its authorizing legislation in the United States Code, the Department's WCF "shall be reimbursed, or credited with advanced payments…for supplies and services at rates which will approximate the expense of operations, including accrual of annual leave and depreciation of plant and equipment of the fund."[1]

The Department's WCF provides services to bureaus and offices throughout the Department and to other Federal agencies. According to the Department's FY 2013 Congressional Budget Justification, for management purposes, the Department's WCF is divided into 37 individual cost centers, including the SW and IT Cost Centers. Each WCF cost center provides unique services to customers, such as operating the Department's shuttle bus, ordering newspapers, shipping goods overseas, and providing IT services. The A Bureau Executive Office, Working Capital Fund Division (A/EX/WCF), has financial responsibility for the WCF cost centers; however, the cost centers operationally report to other bureaus or offices within the Department. For instance, the SW Cost Center is organizationally part of the A Bureau's Office of Logistics Management, and the IT Cost Center is organizationally part of IRM. As part of its financial oversight of the cost centers, A/EX/WCF is responsible for annually reviewing the fees charged by the cost centers.

Secure Warehouses Cost Center

The SW Cost Center provides warehousing services to both Department customers and outside agencies,[2] such as the Department of Justice and the Defense Intelligence Agency, primarily for items that will be shipped to controlled access areas at overseas posts. SW Cost Center services are necessary to ensure that these items are treated with the proper level of security prior to their arrival at post. During FY 2012, the SW Cost Center offered nine services, as detailed in Table 1.

Table 1. SW Cost Center Services and Fees

Service	Description	Fee Amount
Blind Procurement Flow-Through Receiving and Packing	To maintain the proper level of security, when goods are procured for a controlled access area at post, the vendor cannot know the final destination of the goods. The goods are shipped to the SW Cost Center where they are received, inspected, and packed for shipment to their final destination. During this process, Cost Center personnel validate that the goods received match the goods ordered.	$350 per receipt plus an additional $0.30 per pound over 400 pounds.
Project-In-Transit Receiving and Packing	This service is used for acquiring equipment for large projects, such as building renovations. In addition to receiving, inspecting, and packing the goods, the Cost Center coordinates with the post to ensure the items are shipped in a logical manner. For example, all parts must be included when cubical walls are sent to a post, and rug tiles should be sent in advance of the cubicle walls. The items received for these services are typically in the warehouse for 60 days.	$50 per line item received with a minimum charge of $350 per receipt.
Secure-Expedited Logistics Program (S-ELP)	Because the procurement of goods can take several months, the SW Cost Center purchases common goods used in controlled access areas based on anticipated needs and allows posts to make a material stock request rather than	Price based on product cost plus a 10 percent service fee.

[1] 22 U.S.C. §2684, "Capital Fund for Department of State."
[2] Since FY 2010, approximately 9 percent of warehousing services were provided to outside agencies.

Service	Description	Fee Amount
	initiating the procurement process. Over the past few years, posts' use of the S-ELP program has grown significantly.	
Custodial Stock	In certain instances, the Cost Center allows Department offices to store inventory items in its warehouse. The warehouse staff is responsible for receiving and tracking the goods.	$10 per line item per month, with a minimum charge of $1,600 per quarter per customer.
Extended Storage	The Cost Center charges customers for items that are not removed from the warehouses in a timely manner to deter customers from purchasing items without the intention of immediately shipping them. The charges are applied after 30 days for Blind Procurement Flow-Through and 60 days for Project-In-Transit services.	$1 per cubic foot per month.
Long-Term Storage	The Cost Center enters into rental agreements with various bureaus and offices to store excess property or files. The items being stored are not specifically tracked by the Cost Center.	$1 per cubic foot per month, with a minimum of $1,600 per quarter.
Customer Service Tickets	When a post has damaged equipment that can only be fixed in the United States, the item is sent to the Cost Center which facilitates the shipment of the item back to the manufacturer. The Cost Center also receives and packs the item for return shipment to the post after repair.	$10 per item.
Packing Request	The Cost Center packs items in accordance with a country's requirements on behalf of Department bureaus and offices.	Total packing cost plus a 5 percent administration fee.
Secure Local Purchases	The Frankfurt Secure Warehouse assists posts with secure local purchases, up to $25,000 per transaction, to aid with special or priority needs.	5 percent surcharge with a minimum charge of $100 and a maximum charge of $1,000. For premium service, $50 per hour with a minimum charge of $150 and a maximum charge of $1,500.

Source: Prepared by Kearney based on meetings held with SW Cost Center personnel and the Cost Center's Current Rate Schedule from the Cost Center's Intranet Web site <https://a/m/state.sbu/site/ex/WCF/Pages/SecureLogisticsDivision.aspx>, accessed on May 29, 2013.

SW Cost Center operations are closely integrated with those of the Freight Forwarding Service Center, which is another WCF fee-for-service provider that is responsible for shipping items that are received, inspected, and packed by the SW Cost Center to their final destination.

The SW Cost Center manages the services that it provides through the Integrated Logistics Management System (ILMS),[3] the Department's primary asset management system. In FY 2011, the Cost Center implemented a new ILMS module, the Warehouse Management System (WMS), which automated the warehousing processes and provided greater reporting functionality. For example, WMS enables the Warehouse Manager to run a report listing all items shipped during a period of time. WMS also improved the transparency over classified transactions. Before WMS, the Cost Center had to manually prepare vouchers[4] for classified

[3] ILMS combines purchasing, procurement, warehousing, transportation, property management, and other functions into one integrated system.
[4] Vouchers are documents used to bill customer for services provided.

transactions.[5] WMS allows the SW Cost Center to electronically prepare the vouchers and automatically send the vouchers to the Department's accounting system, the Global Financial Management System (GFMS), for processing.

Until May 2013, the SW Cost Center was primarily located in Springfield, VA. In May 2013, the SW Cost Center consolidated its domestic warehousing facilities at a new location in Lorton, VA. According to the Department, the new facility increases efficiency by consolidating redundant work centers, reduces the multiple transfers of material between warehouses, and increases storage capacity. In addition, the SW Cost Center maintains a small warehouse operation in Frankfurt, Germany, for S-ELP services.

Information Technology Cost Center

The IT Cost Center was formed in FY 2009 to consolidate all domestic IT Help Desk and desktop computer support services within the Department. Prior to the IT Cost Center, each bureau maintained its own independent IT Help Desk and desktop computer support operations. The Department determined that a centralized point of service would facilitate faster resolution of IT issues and provide the Department with cost savings as networks would be centrally managed and efficiencies would be achieved. When the IT Cost Center was formed, domestic bureaus and offices were given the option to become customers or to maintain their independent operations. As of FY 2012, the IT Cost Center provided services for 43 customer bureaus and offices with approximately 27,000 desktop computers.

The services provided by the IT Cost Center are documented in a Master Service Level Agreement that is signed by both the IT Cost Center and its customers. These services cover desktop computers operating on OpenNet, the Department's primary network, and ClassNet,[6] the network used to process classified information. During FY 2012, the IT Cost Center charged its customers an annual flat fee of $1,790 for each desktop computer serviced. The service categories and examples of the services provided by the Cost Center in FY 2012 for each category are listed in Table 2.

[5] ILMS previously produced vouchers only for unclassified transactions in the Global Financial Management System (GFMS).

[6] The IT Cost Center provides service for both Thick Client ClassNet computers, which are the standard ClassNet desktop computers, and Thin Client ClassNet computers, which are computers whose operating systems run on a remote server, meaning they do not have an internal hard drive. Based on discussions with Cost Center management, approximately 50 percent of classified computers are currently Thin Client, and another 10 percent of the population is expected to become Thin Client computers in FY 2013.

Table 2. IT Cost Center Service Categories and Examples of Services

Service Category	Examples of Services
Desktop Computer Support	• Unlock an account • Map a printer to the network • Restore files
Network, Data, and Infrastructure Support	• Support network connections and devices
Access, Permission, and Password	• Create a new account • Restore access to a network drive
Media, Events, and the Department's Broadcast Network	• Support video conferences
Security and IT Policy	• Ensure the desktop computer environment is in compliance with Department policies • Execute desktop computer security audits, including random security scans
Email	• Support exchange email • Create an email distribution list
Telephone, Blackberry, Open Network Everywhere fob, and Laptop	• Provide employees with loaner laptops upon request

Source: Prepared by Kearney based on information contained in the IT Cost Center Master Service Level Agreement.

IT Cost Center services include general support and maintenance services, such as server repairs, which are not always visible to customers. As part of its general support and maintenance services, the Cost Center is responsible for inventory management for the desktop computers that are owned by the IT Cost Center. Since its inception, the IT Cost Center has been transferring ownership of customers' desktop computers from the customers to the Cost Center. As of the end of FY 2012, only 18 of 43 customers had desktop computers that were not fully owned by the Cost Center.

The IT Cost Center also provides IT Help Desk services to its customers. To obtain issue resolution through the IT Help Desk, customers submit a request for service online using the Remedy system[7] or call the IT Help Desk. Once a request is received, IT Help Desk personnel create service tickets in Remedy for tracking purposes, assess the severity of the service request, assign the request to the appropriate service team for resolution, and close the Remedy ticket. If personnel in bureaus and offices who are not IT Cost Center customers submit a Remedy ticket or if an IT Cost Center customer creates a ticket for an out-of-scope service, IT Help Desk personnel route the ticket to the appropriate IT support group for resolution.

The IT Cost Center uses a contractor to provide many of its services, including operating the IT Help Desk, assisting in inventory management, and transitioning new customers to the Cost Center. The Department paid the contractor for the services provided based upon several factors, primarily the number of desktop computers serviced by the IT Cost Center.[8]

[7] The Remedy system is operated and maintained by IRM's Business Management and Planning Division, Project Services Office.
[8] Approximately 97 percent of the payments made to the contractor were based on the number of desktop computers serviced.

Objective

The objective of this audit was to determine whether the fees collected for the SW Cost Center and the IT Cost Center were sufficient to cover all costs required to sustain operations for those activities.

Audit Results

Finding A. Secure Warehouses Cost Center Did Not Collect Sufficient Fees To Sustain Operations

The SW Cost Center did not collect sufficient fees to cover the costs required to sustain its operations, as required by the *Foreign Affairs Handbook*[9] (FAH). The SW Cost Center recorded expenses that exceeded its revenue by $8.8 million in total from FY 2005 through FY 2012. SW Cost Center expenses exceeded revenue because the A Bureau did not consider the SW Cost Center to operate as a stand-alone organization within the WCF. Instead, for financial purposes, the A Bureau considered the consolidated results of the SW Cost Center and the Freight Forwarding Service Center, which work closely together. Although the services of the two cost centers may be closely integrated, the Department overcharges customers of the Freight Forwarding Service Center to offset the SW Cost Center losses as a result of consolidating the financial results of the cost centers.

Another reason that revenues were not sufficient was because the SW Cost Center did not implement its fee-setting methodology effectively. Specifically, the Cost Center did not implement the rate increases recommended by a FY 2005 fee study until FY 2008. According to A Bureau officials, the delay was due to the time it took to obtain customer buy-in of the new fees. In addition, the Cost Center had not formally reassessed its fees since an FY 2005 fee study. The A Bureau was in the process of planning for a new fee study.

Also contributing to the SW Cost Center losses, the Cost Center did not properly record or bill some financial transactions. Specifically, the SW Cost Center paid some Freight Forwarding Service Center shipping expenses, totaling approximately $9.5 million from FY 2005 through FY 2012. In addition, the Cost Center did not fully bill its customers for Extended Storage services. Kearney also found that SW Cost Center operating expenses, totaling approximately $4.1 million in FY 2012, were paid from appropriated funds or by other WCF cost centers. Had the additional operating expenses been paid by the SW Cost Center, the overall loss for the Cost Center would have increased significantly.

Without an accurate record of all expenses and revenue, the SW Cost Center did not have a clear understanding of its actual financial position; nor could it determine the amount of fees sufficient to sustain its operations. In addition, Kearney estimated that $31.8 million in appropriated funds and other WCF cost center revenue was used to pay SW Cost Center expenses during FY 2005 to FY 2012. Moreover, part of the losses covered by non-Cost Center funds related to services provided to other agencies. Kearney estimated that during FY 2005 to

[9] 4 FAH-3 H-113.4-3, "Working Capital Fund."

FY 2012 the Cost Center undercharged other agencies by as much as $2.6 million. Had the Department collected these funds from other agencies rather than using its own funds to subsidize the SW Cost Center operations, it would have been able to put the funds to better use.

Cost Center Expenses Had Exceeded Fees Collected

The FAH[10] states that the charges for WCF services "must be sufficient to cover all operating and overhead expenses, including the replacement of capital assets, required to sustain activity operations." The Principles of Federal Appropriations Law[11] further states that revolving funds "are intended to operate on a breakeven basis or reasonably close to it, over the long term." From FY 2005 through FY 2012, the SW Cost Center had not collected sufficient fees to sustain its operations in seven of eight years, as shown in Table 3.

Table 3. SW Cost Center Financial Results for FY 2005 – FY 2012

Fiscal Year	Revenue (in millions)	Expenses (in millions)	Profit/(Loss)	
			Amount (in millions)	Percent
2005	$4.6	$6.1	($1.5)	(33)
2006	4.3	4.4	(0.1)	(2)
2007	3.8	5.4	(1.6)	(42)
2008	5.6	6.5	(1.0)	(18)
2009	9.1	9.8	(0.8)	(8)
2010	8.6	12.0	(3.3)	(39)
2011	10.8	12.2	(1.4)	(13)
2012	13.0	12.1	0.8	6
Total	**$59.8**	**$68.6**	**($8.8)**	**(15)**

Source: Prepared by Kearney based on GFMS Data Warehouse General Ledger Account Activity Extract report.
Note: Numbers in this table may not add because of rounding.

FY 2012 was the only year in which expenses did not exceed revenue. Kearney's analysis of the SW Cost Center's FY 2012 financial results indicated that there was a $2 million increase in revenue for one category of service—S-ELP. The S-ELP fee structure, cost plus a fixed percentage, ensured that the amount of the fee increased with general inflation. When S-ELP represents a greater percentage of the Cost Center's operations, which was the case in FY 2012, the operating position of the Cost Center improves. Despite this 1 year improvement, as of September 30, 2012, the SW Cost Center had lost approximately $8.8 million, which represented a loss margin of approximately 15 percent since FY 2005.

Financial Results of the Secure Warehouses Cost Center Were Consolidated

One reason that the SW Cost Center had operated at a loss was that, according to A Bureau officials, the SW Cost Center is not considered a stand-alone organization within the WCF. Instead, the A Bureau consolidated the financial results for the SW Cost Center and the Freight Forwarding Service Center. According to the A Bureau officials, the A Bureau's philosophy is that these cost centers, which provide interrelated services, should break even at a

[10] Ibid.
[11] Principles of Federal Appropriations Law, 3rd ed., Vol. III, p 12-128 (GAO-08-978SP, Sept. 2008).

consolidated level but would not have to break even individually. One A Bureau official said that the A Bureau recognizes that certain cost centers consistently operate at a profit, while others, such as the SW Cost Center, may never break even. The A Bureau accepts that situation as long as overall the cost centers operate at a small profit.

The Freight Forwarding Service Center reported a 1 percent profit for FY 2005 through FY 2012, as shown in Table 4.

Table 4. Freight Forwarding Service Center Financial Results for FY 2005–FY 2012

Fiscal Year	Revenue (in millions)	Expenses (in millions)	Profit/(Loss)	
			Amount (in millions)	Percent
2005	$43.6	$42.7	$1.0	2
2006	73.2	47.1	26.1	36
2007	114.7	132.8	(18.1)	(16)
2008	146.4	140.5	5.9	4
2009	165.9	178.3	(12.5)	(8)
2010	206.6	191.0	15.6	8
2011	200.3	199.6	0.8	0
2012	215.7	220.3	(4.6)	(2)
Total	**$1,166.4**	**$1,152.3**	**$14.1**	**1**

Source: Prepared by Kearney based on GFMS Data Warehouse General Ledger Account Activity Extract report.
Note: Numbers in this table may not add because of rounding.

When the overall loss recorded for the SW Cost Center ($8.8 million as shown in Table 3) is netted against the overall profit recorded for the Freight Forwarding Service Center ($14.1 million), the result is a profit of $5.3 million for FY 2005 through FY 2012. Although on a consolidated basis, the results of the Freight Forwarding Service Center covers the losses of the SW Cost Center, the Freight Forwarding Service Center did not collect sufficient revenues in some years to fund the SW Cost Center’s losses.

Although the consolidated Freight Forwarding Service Center’s profits may currently be sufficient to cover the losses of the SW Cost Center, the A Bureau should still ensure that fees charged for all services fairly represent the actual costs of those services. The intent of a WCF is to behave in a commercial manner to ensure that costs are controlled more efficiently and to encourage cost consciousness among users. In fact, a SW Cost Center official stated that once the Cost Center began charging a fee for services, the number of requests for items decreased because customers understood the financial impact related to the acquisitions. In order to subsidize the SW Cost Center operations, the A Bureau overcharged customers that used Transportation services. This practice does not promote a business type relationship that encourages customers to make informed decisions about needs because the customers do not know the accurate costs of the services being provided. If the A Bureau chooses to consider the SW Cost Center on a consolidated basis with the Freight Forwarding Service Center, the A Bureau should better define the Cost Centers organizationally.

Fee-Setting Methodology Implementation Was Not Effective

According to the Government Accountability Office[12] (GAO), methodologies for establishing rates should be "transparent and equitable" and "allow agencies to ensure that rates charged recover agencies' actual costs and reflect customers' service usage." The rates charged by the SW Cost Center were not sufficient to cover its costs in part because the Cost Center's implementation of its fee-setting methodology was not effective. Specifically, the Cost Center did not implement the rate increases recommended in a FY 2005 activity based costing (ABC) study until FY 2008. In addition, the Cost Center had not formally reassessed its fees since the FY 2005 ABC study.

Activity Based Costing Study Fee Increases Were Delayed

In FY 2005, an external contractor performed an ABC study of the SW Cost Center's operations to determine whether the rates charged at that time were sufficient.[13] The contractor used FY 2004 data to analyze the cost of operations and the services provided. The study determined the total cost of the activities required to perform Cost Center services and associated a cost driver, such as number of receipts or number of orders, with each activity. The study allocated costs to each service and established per-service rates. The study recommended that the Cost Center increase certain rates by as much as 100 percent. The rate increases recommended by the ABC study are provided in Table 5.

Table 5. ABC Study Recommended Rate Increases

Services	Pre-ABC Study Rates	Recommended Rates
Project-In-Transit	$20 per line received with a minimum charge of $255 per receipt.	$40 per line received with a minimum charge of $255 per receipt.
Customer Service Tickets	No Charge.	$10 per item.
Extended Storage	$0.45 per cubic foot per month.	$1 per cubic foot per month.

Source: Kearney prepared based on information from the Washington Logistics Center Activity Based Costing Deliverable, issued in May 2005.

Although the ABC study was completed in FY 2005, according to SW Cost Center personnel, the Cost Center did not implement the rates recommended by the study until FY 2008. SW Cost Center officials stated that the delay was because it took the Cost Center some time to obtain customer buy-in of the new fees. In addition, according to an A/EX/WCF official, the delay was necessary to allow Cost Center customers to adjust their operating budgets.

Formal Reassessment of Fee Amounts Was Not Performed

According to the FAH,[14] fees charged by the Department's WCF cost centers are to be reassessed annually. In addition, GAO guidance[15] recommends that when setting fees a WCF

[12] *Intragovernmental Revolving Funds* (GAO-12-56, Nov. 2012).
[13] Kearney did not assess how the SW Cost Center rates that were in place before the ABC study were determined.
[14] 4 FAH-3 H-113.4-3, "Working Capital Fund."
[15] *Intragovernmental Revolving Funds* (GAO-12-56, Nov. 2012).

should "build in flexibility" to ensure rates are established in a manner that enables a WCF to recover its costs of operations over time.

Since implementing the recommended rate increases in FY 2008, the SW Cost Center had modified its fee structure for some services to better match revenues to the cost of operations. The services for which the rate charged as of May 2013 did not match the rate recommended by the ABC study are listed in Table 6. The Cost Center could not provide Kearney with detailed information on when the rates were changed or support for how the modifications were determined.

Table 6. SW Rates Schedule, ABC Study and Current Rates

Service	ABC Study Rates	Current Rates
Blind Procurement Flow-Through	$255 per receipt plus an additional $0.20 per pound over 500 pounds.	$350 per receipt plus an additional $0.30 per pound over 400 pounds.
Project-In-Transit	$40 per line item received with a minimum charge of $255 per receipt.	$50 per line item received with a minimum charge of $350 per receipt.
S-ELP	Price based on product cost; target weighted margin of 16 percent.	Price based on product cost plus a 10 percent service fee.
Custodial Stock	$10 per item.	$10 per item, with a minimum charge of $1,600 per quarter per customer.
Long-Term Storage	No charge established.	$1 per cubic foot per month, with a minimum charge of $1,600 per quarter per customer.
Packing Request	No charge established.	Total packing cost plus a 5 percent administration fee.

Source: Kearney prepared based on information contained in the Washington Logistics Center Activity Based Costing Deliverable, issued in May 2005, and the Cost Center's Current Rate Schedule published on the Cost Center's Intranet Web site <https://a/m/state.sbu/site/ex/WCF/Pages/SecureLogisticsDivision.aspx>, accessed on June 28, 2013.

Although some fee modifications were made, the SW Cost Center had not performed a formal fee reassessment for all services since the FY 2005 ABC study. As a result, significant changes in the Cost Center's operations had not been adequately reflected in the Cost Center's rates. For example, as security requirements increased, the Cost Center's operating expenses doubled since 2005. Additionally, some current services, such as Long-Term Storage, were not offered at the time of the ABC study.

Both SW Cost Center officials and officials from the A Bureau stated that the Department had been reluctant to reassess the Cost Center's fees and increase rates to cover all costs because of financial constraints on posts. The officials also expressed concern that if the Cost Center were to raise rates to a level that covered all costs of operations, posts might consider the costs too high and would obtain goods for controlled access areas through unsecure methods. However, during this audit, SW Cost Center officials acknowledged the need to perform a formal reassessment of its fees and informed Kearney that, even before the beginning of the audit, the Cost Center had been in the process of reengineering its processes and revalidating its fees pending its move to a consolidated warehouse in May 2013. SW Cost Center management believed that consolidating operations into one warehouse would achieve efficiencies and result in cost savings. The Cost Center had begun to preliminarily review financial data. However, the Cost Center did not plan to conduct the formal fee analysis until there was at least 1 year of financial data available related to operations at the consolidated warehouse.

Some Expenses Were Not Properly Recorded and Some Revenue Was Not Properly Billed

Improperly recorded or billed financial transactions also contributed to the SW Cost Center's losses. Specifically, the Cost Center used SW Cost Center revenue to fund shipping services provided by the Freight Forwarding Service Center and did not fully charge its customers for Extended Storage services.

Secure Warehouses Cost Center Revenue Was Improperly Used For Transportation Costs

The SW Cost Center incurred some costs for transportation of goods, which was not a service provided by the Cost Center. The Cost Center was responsible for preparing packages for shipment; however, the actual shipments were normally handled by the WCF Freight Forwarding Service Center. Kearney tested a statistical sample of 48 expense transactions recorded to the SW Cost Center from FY 2007 to FY 2012. (Information on the sampling methodology is provided in the Detailed Sampling Methodology section in Appendix A.) Of 48 transactions tested, 8 transactions, amounting to $152,000, were for transportation charges that should have been paid by the Freight Forwarding Service Center. SW Cost Center personnel stated that these 8 expenses were payments made to ship items to their final destinations.

Based on the results of the sample, Kearney further analyzed all FY 2007 through FY 2012 SW Cost Center expenses to identify transportation costs. The Cost Center paid transportation costs every year from FY 2007 through FY 2012. In FY 2012, the SW Cost Center spent $1.7 million for transportation, which represented almost 14 percent of its total expenses for that year. Because of the interrelated financial results for these two Cost Centers, A Bureau officials did not believe it was necessary to ensure that the costs were recorded to the Freight Forwarding Service Center. The amount of transportation expenses paid by the SW Cost Center that should have been paid by the Freight Forwarding Service Center is provided in Table 7.

Table 7. SW Cost Center Transportation Expenses

Fiscal Year	Transportation Expenses Paid (in millions)
2007	$0.6
2008	1.2
2009	1.6
2010	2.4
2011	2.0
2012	1.7
Total	**$9.5**

Source: Kearney prepared based on GFMS data.

Customers Were Not Fully Charged

The SW Cost Center did not sufficiently charge its customers for Extended Storage. In an effort to achieve efficiency for the Blind Procurement Flow-Through and Project-In-Transit services, the SW Cost Center charged an Extended Storage fee of $1 per cubic foot per month for items that were received at the Cost Center but did not ship to post within a specified time period. However, the method used by the SW Cost Center to calculate the charges for this service was flawed. Instead of tracking the period of time that items remained in the warehouse and calculating the fee when the items were provided to the customers, the SW Cost Center periodically performed a system calculation to determine which items in the warehouse at that point in time had incurred Extended Storage charges. Therefore, if a customer used the Extended Storage service but obtained its items before the SW Cost Center ran the system calculation, the customer would not be charged the Extended Storage fee.

From FY 2008, when the system calculation of the Extended Storage fee was implemented, to FY 2012, the SW Cost Center ran the calculation on only 177 days of the 1,305 possible business days, or approximately 14 percent of the time. Further, Kearney observed that the frequency with which the calculation was run was not consistent. For example, in January 2012 the calculation was run 10 times while in July 2012 it was run once. Between January 2008 and September 2012, there were four instances where the calculation was not run for 2 months or more. Because of the lack of sufficient information, Kearney was not able to estimate the financial impact to the SW Cost Center of not sufficiently charging this fee.

In addition, during revenue testing,[16] Kearney noted that Cost Center personnel could exclude transactions from the automatic billing process and documentation to support the exclusions was not always readily available. Additionally, there was no evidence that Cost Center personnel were monitoring the exclusion of transactions from billing.

Some Secure Warehouses Cost Center Expenses Were Paid With Non-Cost Center Funds

The SW Cost Center must collect fees "to cover all operating and overhead expenses, including the replacement of capital assets."[17] GAO guidance states that agencies should include all direct and indirect costs when determining full cost, including but not limited to personnel costs, overhead, utilities, rents, management and supervisory costs, and research.[18] However, some Cost Center operating expenses were paid using appropriated funds or by other WCF cost centers. For FY 2012, Kearney estimated that at least $4.1 million in recurring costs related to the SW Cost Center were paid with other Department funds, as shown in Table 8.

[16] Information on the sampling methodology for revenue is provided in the section "Detailed Sampling Methodology" in Appendix A.
[17] 4 FAH-3H-113.4-3, "Working Capital Fund."
[18] *Federal User Fees: A Design Guide* (GAO-08-386SP, May 2008).

Table 8. Estimation of Recurring SW Cost Center Expenses Paid Using Other Funds in FY 2012

Description of Expense	Funding Source	Amount (in millions)
WMS – System Support	Freight Forwarding Service Center	$1.1
Rent and Utilities	Appropriated Funds	2.7
Salaries	Appropriated and Freight Forwarding Service Center Funds	0.2
Other	Fees from Other WCF Cost Centers	0.1
Total		**$4.1**

Source: Prepared by Kearney based on review of operating expense categories necessary for Cost Center operations.

Some recurring SW Cost Center operating costs were paid from appropriated and other funds. Specifically, appropriated funds were used to pay the cost of rent and utilities for the SW Cost Center's use of four domestic facilities, which Kearney estimated to cost approximately $2.7 million annually. Appropriated funds were also used to pay the salaries of three SW Cost Center employees, including the Director of Secure Logistics and the Director of Management Operations. Kearney estimated that these salaries amounted to approximately $200,000 annually. In addition, A/EX/WCF performed a number of management and administrative roles for the SW Cost Center, such as assisting in developing annual budgets. These costs, which Kearney estimated to be approximately $100,000 annually, were covered by excess revenues from other WCF cost centers. Further, the contractor support and maintenance costs for the WMS module in ILMS were funded by the Freight Forwarding Service Center, even though the SW Cost Center was also a user of the WMS module. For FY 2012, Kearney estimated that WMS support costs of approximately $1.1 million should have been covered by the SW Cost Center. According to SW Cost Center officials, the Cost Center did not plan to include these recurring operating costs in its upcoming fee reassessment.

In addition to the recurring operating costs, during FY 2011 the SW Cost Center did not pay for its share of the design and implementation of the WMS module in ILMS. The cost of the WMS module was funded using some appropriated funds and some funds from the Freight Forwarding Service Center. Because the SW Cost Center is one of the primary users of WMS, approximately $1.2 million of development costs should have been paid from SW Cost Center revenue.

Customer Charges Were Too Low and Funds Could Have Been Put to Better Use

The ineffective implementation of a fee-setting methodology and the improper recording or charging of certain expenses and revenues have limited the SW Cost Center's ability to develop a true picture of its financial position and to establish fees that cover the total cost of Cost Center operations. Kearney estimated the SW Cost Center's adjusted losses for FY 2005 to FY 2012, taking into consideration the transportation expenses inappropriately paid by the Cost Center from FY 2005 to FY 2012, SW Cost Center expenses paid by others,[19] and the $1.2

---

[19] Kearney calculated the impact of expenses paid by non-Cost Center funds for FY 2005 through FY 2011 by multiplying the amount of those expenses identified for FY 2012, $4.1 million, by U.S. Department of Labor Consumer Price Index information. Although WMS did not exist prior to FY 2011, the system support costs for the previous system were also paid with non-Cost Center funds. In total, Kearney estimated that all of the recurring

million in expenses incurred for the development of WMS in FY 2011. The SW Cost Center operated at a much more significant loss, $31.1 million, than was reported in the SW Cost Center financial reports, as shown in Table 9.

Table 9. SW Cost Center Adjusted Financial Results – FY 2005 to FY 2012

Fiscal Year	Revenue (in millions)	Adjusted Expense (in millions)	Adjusted Profit/(Loss)	
			Adjusted Amount (in millions)	Adjusted Percent
2005	$4.6	$9.6	($5.0)	(109)
2006	4.3	8.0	(3.7)	(85)
2007	3.8	8.5	(4.7)	(123)
2008	5.6	9.2	(3.7)	(66)
2009	9.1	12.1	(3.0)	(33)
2010	8.6	13.5	(4.9)	(57)
2011	10.8	15.4	(4.6)	(43)
2012	13.0	14.6	(1.6)	(12)
Total	**$59.8**	**$90.9**	**($31.1)**	**(52)**

Source: Prepared by Kearney based on GFMS Data Warehouse General Ledger Account Activity Extract report and an analysis of audit results.
Note: Numbers in this table may not add because of rounding.

Kearney concluded that the Cost Center has significantly undercharged its customers for the services provided.[20] Although the Cost Center's financial position has improved greatly since FY 2005, operating at an aggregate loss of 52 percent is not a sustainable business practice and indicates that the Department did not treat this Cost Center as a WCF cost center. Although the Department planned to formally reassess the fees charged after its move in FY 2013, if it does not consider all operating costs when establishing the fees, the fees will continue to be insufficient to cover all SW Cost Center expenses. If the Cost Center does not increase the fee amount charged to its customers, then it would need to decrease the cost of providing services to operate as a true WCF cost center.

Because of its losses, the SW Cost Center's operations had been supported by appropriated funds and excess revenues from other WCF cost centers. Kearney estimated that this support amounted to $31.8 million from FY 2005 to FY 2012. By continually operating at a loss, the SW Cost Center was not meeting the intent of a revolving fund, which is to encourage cost consciousness and efficiency. Because the SW Cost Center had not developed a realistic fee amount that would generally cover its costs, its customers were basing decisions to obtain equipment on inaccurate cost information. If customers were charged for the actual costs of services, customers might have made different, more cost conscious, decisions. Additionally, by not charging sufficient fees, the Cost Center does not allow for future capital investment in the operation.

A portion of the losses covered by non-Cost Center funds related to services provided to other agencies. Because the Cost Center provided services to non-Department customers, by

expenses resulted in $30.6 million in Cost Center expenses for FY 2005 to FY 2012. The $1.2 million for WMS development in FY 2011 was added to this amount to arrive at a total of $31.8 million.

[20] Because of the complexity of the SW Cost Center operations, Kearney was not able to estimate the amount undercharged for each service.

setting rates that were not sufficient to cover costs, the Department had, in effect, used its funds to supplement other agencies' budgets. Although it was difficult to determine the exact amount of funds that should have been collected from other agencies, Kearney estimated that during FY 2005 to FY 2012 the Cost Center had undercharged other agencies by approximately $2.6 million.[21] Had the Department collected these funds from other agencies rather than using its own funds to subsidize the SW Cost Center operations, it would have been able to put its funds to better use. Specifically, appropriated funds could have been used to support mission critical objectives of the Department, and other cost centers could have lowered fees charged to their customers so that the customers could better allocate their funds to support their missions.

Recommendation 1. OIG recommends that the Bureau of Administration, Executive Office, Working Capital Fund Division (A/EX/WCF), in coordination with the Secure Warehouses (SW) Cost Center, reassess the fee amount for each of the services provided to ensure that all Cost Center costs are covered. If officials determine that the new fees, which cover all required costs, would be too high to charge to customers, then A/EX/WCF should identify cost savings that would reduce overall expenses or reassess the decision to include the SW Cost Center as a Working Capital Fund function. The results of the reassessment should be made available to customers.

Management Response: The A Bureau agreed with this recommendation and stated that it will conduct an ABC study "to determine the correct fees for each of the WCF services" and "will ensure that all appropriate costs are included." Although the A Bureau agreed with the recommendation, the A Bureau noted in its general comments that it "strongly disagrees with the proposal to include rent in the cost center's price structure" because the Bureau believes that it "will increase prices to a point where [its] services will no longer be competitive from a pricing perspective."

OIG Analysis: OIG considers the recommendation resolved. This recommendation can be closed when OIG reviews and accepts documentation showing that the A Bureau has reassessed the fees for each of the SW Cost Center services to ensure that all costs, including rent, are covered and has made the results of the reassessment available to its customers. As OIG noted in this report, GAO guidance specifically identifies rent as a cost that should be included when determining full costs. In addition, GAO defines a WCF as "a self-supporting entity" that functions "**entirely** [emphasis added] from the fees charged for the services they provide consistent with their statutory authority." If the increase in fees necessary to cover the Cost Center's full costs, including rent, results in prices that are no longer competitive, the Bureau could consider other alternatives. For example, as OIG suggested, the Bureau could explore ways to reduce its other costs or, if reducing costs is not feasible and the Bureau must continue to use appropriated funds to cover some of the Cost Center's costs, the Bureau should reconsider its designation of this service as a WCF.

---

[21] Kearney determined the percentage of SW Cost Center revenue attributable to other agencies each year and used the estimated annual percent loss to calculate the amount underpaid by other agencies.

Recommendation 2. OIG recommends that the Bureau of Administration ensure that the formal organizational definition of the Secure Warehouses Cost Center and Freight Forwarding Service Center aligns to the operational management of these Cost Centers.

Management Response: The A Bureau concurred with this recommendation and stated that it "will separate the financial results of [the] SW Cost Center from the Freight Forwarding Service Center."

OIG Analysis: OIG considers the recommendation resolved. This recommendation can be closed when OIG reviews and accepts documentation showing that the A Bureau has separated the financial results of the SW Cost Center from the Freight Forwarding Service Center in a way that reflects the intended operations of the two Cost Centers.

Recommendation 3. OIG recommends that the Bureau of Administration, Executive Office, Working Capital Fund Division, in coordination with the Secure Warehouses (SW) Cost Center, develop a policy that details how often the SW Cost Center fees will be formally reassessed.

Management Response: The A Bureau agreed with this recommendation and stated that it will conduct ABC studies "on a regular basis."

OIG Analysis: OIG considers the recommendation resolved. This recommendation can be closed when OIG reviews and accepts documentation showing that the A Bureau has developed a policy that details how often the SW Cost Center fees will be formally reassessed.

Recommendation 4. OIG recommends that the Bureau of Administration, Executive Office, Working Capital Fund Division, in coordination with the Secure Warehouses Cost Center, perform an analysis to determine appropriate fees for each of the services provided to other agencies.

Management Response: The A Bureau agreed with this recommendation and stated that it will "set appropriate fees for services provided to other agencies."

OIG Analysis: OIG considers the recommendation resolved. This recommendation can be closed when OIG reviews and accepts documentation showing that the A Bureau has determined the appropriate fees for the services the SW Cost Center provides to other agencies.

Recommendation 5. OIG recommends that the Bureau of Administration develop and implement a procedure to ensure that transportation expenses are recorded to the same Working Capital Fund Cost Center to which the related transportation revenues are recorded.

Management Response: The A Bureau agreed with this recommendation and stated that it “will develop a process to show transportation revenue in the same cost center that is incurring the charge.”

OIG Analysis: OIG considers the recommendation resolved. This recommendation can be closed when OIG reviews and accepts documentation showing that the A Bureau has implemented a procedure to record related transportation revenue and expenses to the same Cost Center.

Recommendation 6. OIG recommends that the Bureau of Administration’s Secure Warehouses Cost Center revise the methodology used to calculate the amount charged for Extended Storage to ensure that all Extended Storage charges incurred are billed to customers.

Management Response: The A Bureau agreed with this recommendation and stated that it will “set appropriate fees for Extended Storage and will implement processes to bill storage regularly.”

OIG Analysis: OIG considers the recommendation resolved. This recommendation can be closed when OIG reviews and accepts documentation showing that the A Bureau has implemented a methodology to ensure that all Extended Storage charges incurred are billed.

Recommendation 7. OIG recommends that the Bureau of Administration’s Secure Warehouses Cost Center design and implement a process to review transactions excluded from automatic billing and ensure that all exclusions are properly documented.

Management Response: The A Bureau agreed with this recommendation and stated that it “will implement a process to review transactions excluded from billing.”

OIG Analysis: OIG considers the recommendation resolved. This recommendation can be closed when OIG reviews and accepts documentation showing that the A Bureau has implemented a process to review and document transactions excluded from automatic billing.

Recommendation 8. OIG recommends that the Bureau of Administration, Executive Office, Working Capital Fund Division, in coordination with the Secure Warehouses (SW) Cost Center, identify all SW Cost Center costs and implement a process to pay for these costs using SW Cost Center revenue.

Management Response: The A Bureau agreed with this recommendation and stated that it will “identify all SW Cost Center costs” and that appropriate costs “will be included in the new [Cost Center] rates.”

OIG Analysis: OIG considers the recommendation resolved. This recommendation can be closed when OIG reviews and accepts documentation showing that the A Bureau has identified all SW Cost Center costs and has a process to pay these costs, including rent as discussed in OIG's Analysis of Recommendation 1, using SW Cost Center revenue.

Finding B. Information Technology Cost Center Collected More Fees than Necessary To Sustain Operations

The IT Cost Center collected fees in excess of the amount needed to cover the costs required to sustain its operations which was not in compliance with the Principles of Federal Appropriations Law. The total amount of IT Cost Center revenue from FY 2009, the year of the Cost Center's inception, through FY 2012 exceeded its expenses by approximately $26 million. Revenue exceeded expenses, in part, because certain costs, totaling $2.8 million in FY 2012, that should have been paid from the Cost Center's revenue were paid using non-Cost Center funds. Based on Kearney's calculations, the fees collected by the IT Cost Center would have been sufficient to cover these costs. In addition, Cost Center revenue included $1.5 million in appropriated funds. According to IRM officials, they were aware of the excess funds and had been working to identify the best course of action to address how the excess funds should be used.

Kearney also found that the IT Cost Center's fee-setting methodology was not sufficient. Specifically, the methodology did not consider the Cost Center's retained funds, totaling approximately $26 million at the end of FY 2012, or anticipate future changes to customer needs. In addition, during FY 2009 through FY 2012, the IT Cost Center did not have an effective methodology to determine the number of desktop computers in use by its serviced customers, which was a key factor in determining the appropriate amount of the fee. Kearney also found that the IT Cost Center had provided services to non-serviced bureaus and offices that were not billed for the services, amounting to an estimated $10.8 million in uncollected revenue.

Without an accurate record of all expenses and revenues, the IT Cost Center did not have a clear understanding of its financial position and could not monitor whether or not it was charging the correct fee. Kearney recalculated the fee, taking into consideration all operating expenses, the excess retained funds, a reasonable growth rate for desktop computer services, and lost revenue, and determined that the IT Cost Center charged approximately $350 more per computer than was necessary to sustain Cost Center operations.[22] Based on the recalculated fee amount, Kearney estimated that customers had been overcharged $18.2 million during FY 2011 to FY 2012. These funds could have been used by customers for other priorities. Further, the $2.8 million paid using non-Cost Center funds could have been put to better use.

In addition to the excessive fee amount, the IT Cost Center may not have charged its customers correctly for the number of desktop computers that were serviced. Incorrect charges could lead to the lack of customer confidence in the Cost Center billings as well as a lack of customer satisfaction with Cost Center performance overall. Further, the Cost Center may have paid more, or less, than warranted to the contractor operating the IT Help Desk since the contractor cost was based on the total number of desktop computers.

[22] According to IRM officials, the fee amount was too high, but based on IRM's calculations, officials believed that that the fee amount should be decreased by approximately $90 per desktop computer.

Fees Collected Have Exceeded Cost Center Expenses

The FAH[23] states that the charges for WCF services "must be sufficient to cover all operating and overhead expenses, including the replacement of capital assets, required to sustain activity operations." The Principles of Federal Appropriations Law[24] further states that revolving funds "are intended to operate on a breakeven basis or reasonably close to it, over the long term" and that "the fund should not augment its working capital by retaining funds in excess of what it needs to cover its costs."

The IT Cost Center had collected more fees than needed to sustain its operations. Since its inception in FY 2009, IT Cost Center revenue had exceeded expenses in three of four years, as shown in Table 10.

Table 10. IT Cost Center Financial Results for FY 2009 – FY 2012

Fiscal Year	Revenue (in millions)	Expenses (in millions)	Profit/(Loss) Amount (in millions)	Profit/(Loss) Percent
2009	$26.3	$19.3	$7.0	26
2010	45.1	32.5	12.6	28
2011	47.8	40.3	7.5	16
2012	48.2	49.6	(1.3)	(3)
Total	**$167.4**	**$141.7**	**$25.8**	**15**

Source: Prepared by Kearney based upon GFMS Data Warehouse General Ledger Account Activity Extract report.
Note: Numbers in this table may not add because of rounding.

FY 2012 was the only year in which revenue did not exceed expenses. This occurred because the Cost Center incurred approximately $9.7 million in costs to replace its server equipment in FY 2012. According to IT Cost Center officials, server replacement occurs once every 4 years. Overall, even with the server replacement costs, the IT Cost Center had retained funds in excess of what it needed to cover its costs. As of September 30, 2012, the IT Cost Center had $25.8 million in retained funds, which represents a profit margin of approximately 15 percent since its inception.

According to IRM officials, they were aware of some excess funds within the Cost Center but the officials did not agree that the entire $25.8 million in retained funds should be considered excess. Specifically, IRM officials stated that the funds available at the end of FY 2012 were needed to cover approximately $20.6 million in obligations,[25] the majority of which, $19.2 million, were related to the contract for the operation of the Help Desk. For the remaining balance of $5.2 million, IRM officials had been working to identify the best course of action to use these funds. For instance, the Cost Center had already decreased the fee amount in FY 2011. IRM officials had not made a decision on how to address the excess funds, but the officials stated that their preference was to determine whether IT Cost Center customers

[23] 4 FAH-3 H-113.4-3, "Working Capital Fund."
[24] Principles of Federal Appropriations Law, 3rd ed., Vol. III (GAO-08-978SP, Sept. 2008).
[25] Obligations are orders, contracts, and other binding agreements for which the goods and services ordered have not yet been received. Because these goods and services have not yet been received, the expense would not be recorded.

preferred decreased fee amounts or increased services. While Kearney recognizes the existence of the open obligations, these costs will be offset with future collections from customers. WCF cost centers have the ability to record obligations based upon estimated future collections; therefore, the retained funds do not need to be maintained to cover future expenses and the Cost Center should consider the entire $25.8 million when identifying a resolution for the retained funds issue.

Some Information Technology Cost Center Expenses Were Paid With Non-Cost Center Funds

The IT Cost Center has a responsibility to collect fees "to cover all operating costs including the replacement of capital assets required to sustain activity operations. Charges must also include overhead costs, costs which are not directly related to a position or production of a service but which indirectly contribute to the service."[26] GAO guidance states that agencies should include all direct and indirect costs when determining full cost, including but not limited to personnel costs, overhead, utilities, rents, management and supervisory costs, and research.[27]

IT Cost Center revenue consistently exceeded expenses in part because the IT Cost Center did not pay for all of its operating expenses from FY 2009 through FY 2012. In addition, the IT Cost Center was given $1.5 million in appropriated funds during FY 2011 that was not earned. Based on Kearney's calculations, if the cost center properly accounted for all expenses and revenues, the fees collected by the IT Cost Center would have been sufficient to cover all costs of operations without the assistance of appropriated funding.

For FY 2012, Kearney estimated that at least $2.8 million in expenses related to the IT Cost Center were paid from sources other than Cost Center revenue, as shown in Table 11.

Table 11. Estimation of IT Cost Center Expenses Paid Using Other Funds in FY 2012

Description of Expenses	Funding Source	Amount (in millions)
Remedy – Staff and System Maintenance	Appropriated Funds	$1.1
Rent and Utilities	Appropriated Funds	1.3
Payroll Salaries	Appropriated Funds	0.3
Other	Fees from Other WCF Cost Centers and Appropriated Funds	0.1
Total		**$2.8**

Source: Prepared by Kearney based on review of operating expense categories necessary for Cost Center operations.

The IT Cost Center is a primary user of the Remedy system, which tracks IT service requests, and should fund approximately $2.5 million in its operating costs annually.[28] However, in FY 2012, the IT Cost Center provided $1.4 million to IRM for Remedy costs. Appropriated funds covered the remaining $1.1 million of Remedy costs that were allocable to the IT Cost Center. The IT Cost Center did not reimburse the Department for rent and utilities costs, which

[26] 6 FAH-5 H-802.2, "WCF Characteristics and Benefits."
[27] *Federal User Fees: A Design Guide* (GAO-08-386SP, May 2008).
[28] Based upon discussions with IRM personnel, other offices use Remedy to track IT tickets for non-customers and for out-of-scope services.

Kearney estimated to total approximately $1.3 million annually. In addition, three IT Cost Center employees were only partially funded using Cost Center revenue. Kearney estimated that the portion of these employees' salaries that was paid using appropriated funds in FY 2012 totaled approximately $300,000. Further, A/EX/WCF performed a number of management and administrative roles for the IT Cost Center, such as recording obligations in GFMS. These costs were covered by excess revenues from other WCF cost centers. Kearney estimated that the support provided to the IT Cost Center by A/EX/WCF would cost approximately $100,000 annually. All of these costs should have been funded using IT Cost Center revenue.

In addition to not covering all operating costs, IRM provided $1.5 million to the IT Cost Center in FY 2011. According to Cost Center personnel, the funds were not in exchange for goods or services provided. Rather, the funds were provided to the Cost Center to purchase 150 Citrix software licenses[29] on behalf of customer bureaus. However, 150 Citrix licenses would only cost approximately $80,000—not $1.5 million. In addition, according to the IT Cost Center Master Service Level Agreement, purchasing software is not a service provided by the Cost Center. If the Cost Center were to purchase licenses on behalf of its customers, the customers would reimburse the IT Cost Center for the costs of the licenses. Receiving appropriated funding from IRM did not represent a buyer-seller relationship as outlined in the FAH[30] and the U.S. Code,[31] and those funds should be returned to IRM.

Fee-Setting Methodology Was Not Effective

Another factor contributing to the IT Cost Center collecting fees in excess of the amounts needed to support operations (including the replacement of capital assets) was that the Cost Center did not consider all relevant factors when setting the fee amount. According to GAO,[32] methodologies for establishing rates should be "transparent and equitable" and "allow agencies to ensure that rates charged recover agencies' actual costs and reflect customers' service usage."

During the creation of the IT Cost Center, from FY 2007 to FY 2008, the IT Consolidation Project Management Office determined that customers would be charged a flat rate of $1,883 for each desktop computer in use. This decision was based on an estimate of some operating costs and expected future capital needs. OIG reported that the initial fee amount was based on "limited data" and "the cost per desktop calculation was unclear, and that the costs had fluctuated throughout the consolidation schedule."[33] In response to the OIG audit findings, the amount of excess funds collected, and customer pressure, the IT Cost Center recalculated the fee and reduced the amount charged for each desktop computer to $1,790 beginning in FY 2011. The IT Cost Center's revised fee was calculated as an average rate that would be charged for a 4-year period (FY 2011 to FY 2014) to keep fluctuations in fees to a minimum and to better plan for server replacement costs. To determine the revised fee amount, the Cost Center estimated

---

[29] Citrix is used by certain ClassNet desktops, known as Thin Client desktops, and unclassified mobile devices to access the Department's remote servers via Internet connections. This enables employees to telework and access Department emails, computer files, and the Department's Intranet.
[30] 4 FAH-3 H-113.4-3, "Working Capital Fund."
[31] 22 U.S.C § 2684, "Capital Fund for Department of State."
[32] *Intragovernmental Revolving Funds* (GAO-12-56, Nov. 2012).
[33] *Evaluation of the Information Technology Consolidation Project* (AUD/IT-10-11, Feb. 2010).

certain costs of operations for FY 2011 to FY 2014 and applied the average costs to the anticipated number of desktop computers that would be billed each year.

The fee-setting methodology did not include the funds retained from excess collections in prior years, and the IT Cost Center did not sufficiently consider the future growth of customer needs. In addition, the Cost Center did not have an effective method to determine the number of desktop computers serviced, which is a key element to determine the correct per desktop computer fee amount.

Retained Funds Were Not Considered

According to GAO,[34] a fee-setting process must consider reserve balances (retained funds). Kearney reviewed the methodology used to reassess the IT Cost Center rate and noted that the Cost Center did not consider retained funds in the calculation. The Cost Center had retained funds of $19.6 million at the end of FY 2010, which should have been used to offset estimated future Cost Center expenses during the FY 2011 fee-setting calculation. By not including the $19.6 million balance in the calculation, the Cost Center did not set a rate that would bring the Cost Center to a breakeven position, as is required. Because the retained funds were not considered, the fee was too high, and the amount of retained funds had increased to almost $26 million as of the end of FY 2012.

Expected Growth Rate Was Not Considered

According to GAO,[35] fees "should also be set and adjusted to cover the intended share of costs over time," which means agencies must project and consider future costs or service increases. To calculate the 4-year average rate, certain operational costs were estimated for FY 2011 and projected over FY 2012 to FY 2014 using a standard rate of increase. Although the fee-setting methodology considered an increase in costs to cover inflation, Kearney found that the IT Cost Center had not sufficiently estimated the increase in the number of desktop computers that customers would require services for during the 4-year period, which would increase both costs and revenue.

The Department based its reassessment of the fee on the assumption that it would be providing services to 24,963 desktop computers each year during the 4-year period. IT Cost Center officials were unable to provide information on how the number of desktop computers was determined; however, it exceeded the number of desktop computers billed in FY 2010, when the fee was calculated. Since FY 2010, the average annual growth rate in the number of desktop computers billed by the IT Cost Center was approximately 5.5 percent, as shown in Table 12.

[34] *Interagency Contracting: Improvements Needed in Setting Fee Rates for Selected Programs* (GAO-11-784, Sept. 2011).
[35] *Federal User Fees: A Design Guide* (GAO-08-386SP, May 2008).

Table 12. Growth in Serviced Desktop Computers from FY 2010 – FY 2012

Fiscal Year	Number of Billed Desktop Computers	Percent of Annual Growth Rate
2010	24,084	--
2011	25,386	5.4
2012	26,782	5.5

Source: Prepared by Kearney based on the IT Cost Center Billing Trackers report.

Based on an average annual growth rate of 5.5 percent, the estimated number of desktop computers serviced would be 28,255 in FY 2013 and 29,809 in FY 2014, which would result in an average of 27,558 serviced desktop computers for the 4-year period from FY 2011 through 2014. Based on this calculation, the IT Cost Center underestimated its customer growth for the 4-year period, which would impact both the amount of expenses and revenue that should have been considered. In addition to normal customer growth, IT Cost Center officials indicated that they were aware of a plan to significantly expand the number of ClassNet computers that would be serviced during the 4-year period.

Methods To Determine Desktop Computer Counts Were Not Effective

According to GAO,[36] the rate charged by a WCF should "reflect the customers' service usage." However, the IT Cost Center did not have an effective method to accurately determine the number of desktop computers in use by its customers. The IT Cost Center used the number of in-service desktop computers as the method to allocate the costs of providing services to its customers. Kearney concluded that this was a reasonable cost allocation methodology since a significant portion of the services provided to customers were maintenance and support of the networks upon which the desktop computers resided. Additionally, while some services could be directly traced to a specific customer, such as IT Help Desk services, the number and variety of these services would make determining a per-service rate inefficient. Since the number of desktop computers was the only method used to recoup costs, the number must be accurate to determine an effective and equitable fee for customers.

The IT Cost Center used a variety of methods to determine the number of desktop computers it serviced for each bureau. The determination of which method to use depended on whether IRM or the customer "owned" the desktop computers and the type of desktop computer. The methods used by the IT Cost Center are listed in Table 13.

[36] *Intragovernmental Revolving Funds* (GAO-12-56, Nov. 2012).

Table 13. IT Cost Center Methodology Used to Determine Number of Desktop Computers

Asset Owner	Desktop Computer Type	Method of Determining Desktop Computer Count
IRM (IT Cost Center)	OpenNet	All active desktop computers per ILMS.
	ClassNet Thick Client	Active Directory information.
	ClassNet Thin Client	Desktop computers that have been logged into within the last 12 weeks according to Citrix.
Customer	OpenNet	iPost information.
	ClassNet Thick Client	Active Directory information.
	ClassNet Thin Client	Desktop computers that have been logged into within the last 12 weeks according to Citrix.

Source: Prepared by Kearney based on meetings with IT Cost Center officials.

For unclassified desktop computers that were owned by IRM, the IT Cost Center used information from ILMS. The IT Cost Center performed a physical inventory of the desktop computers and certified that the information in ILMS was accurate. For unclassified desktop computers owned by customers, the IT Cost Center used information from iPost, which is a Web-based tool that scans and reports on all active hardware attached to the network. The IT Cost Center did not use ILMS data for these computers because the Cost Center did not have access to the ILMS reports for other bureaus. In addition, the Cost Center was not sure that the data in ILMS for customer-owned computers was reliable because the IT Cost Center was not involved in the annual inventory process for these computers.

For classified Thick Client computers, the IT Cost Center used information from Active Directory, which is an application that tracks user accounts on networks. For classified Thin Client computers, the IT Cost Center used Citrix, which is an application that tracks user log-ins and can report on the number of users that have accessed the network within a certain period of time. Because Thin Client computers were not constantly attached to the network, the IT Cost Center used data on computer usage over a longer period of time—12 weeks.

To validate the IT Cost Center's methodologies, Kearney selected a statistical sample of 45 customer billings from FY 2009 to FY 2012 to test. (Information on the sampling methodology is provided in the section "Detailed Sampling Methodology" in Appendix A.) The IT Cost Center was unable to substantiate the number of desktop computers used to determine the total amount charged for any of the selected bills. Kearney attempted to independently validate the amount billed by obtaining a report of all in-service desktop computers from ILMS. However, Kearney was unable to align the computer owners in the ILMS report to the customers being billed. Kearney then requested reports from iPost and Active Directory for FY 2009 through FY 2012; however, iPost and Active Directory are tools used for monitoring current network data and do not have historical reporting capabilities.

Kearney then ascertained that in FY 2012 the IT Cost Center implemented a process in which it provided its count of desktop computers to each customer and asked that the customer confirm the count prior to billing. Since 13 of the original sample of 45 customer bills were from FY 2012, Kearney was able to use these samples to test the customer validation process.

Of the 13 customers tested, five customers agreed with the IT Cost Center count, five customers disagreed with the IT Cost Center count, and three customers did not respond to the Cost Center's request.

For instance, the IT Cost Center originally reported that the Diplomatic Telecommunications Service Program Office had a total of 906 in-service desktop computers. However, the Office responded that the number of in-service computers was much less—604—based on an iPost report. The IT Cost Center performed an inventory of desktop computers for that office and determined that the actual number of desktop computers was 614, almost 300 less than the IT Cost Center's original count. According to Diplomatic Telecommunications Service Program Office officials, the IT Cost Center's method for obtaining desktop computer counts was not transparent and, even after the completion of the physical inventory, the IT Cost Center did not provide a detailed listing of desktop computers to the Office. The FY 2012 count difference for this Office is provided in Table 14.

Table 14. Number of Diplomatic Telecommunications Service Program Office Desktop Computers in FY 2012

Source of Computer Count	Total Number of Computers
IT Cost Center – Original Number	906
IT Cost Center – Final Number	614
Difference	292

Source: Kearney prepared based on emails provided by the IT Cost Center and discussions with Diplomatic Telecommunications Service Program Office personnel.

In another instance in which a customer disagreed with the count proposed by the IT Cost Center, the IT Cost Center used the information provided by the customer without validating the information. The Bureau of Overseas Buildings Operations, the third largest IT Cost Center customer, reported that it had approximately 50 more desktop computers than identified by the IT Cost Center, as shown in Table 15. The IT Cost Center used the number of computers proposed by the Bureau of Overseas Buildings Operations without performing work to ensure that the number was correct.

Table 15. Bureau of Overseas Building Operations FY 2012 Desktop Counts

Source of Computer Count	Total Number of Computers
IT Cost Center – Original Number	1,396
Bureau of Overseas Buildings Operations – Proposed Number	1,443
Difference	47

Source: Kearney prepared based on emails provided by the IT Cost Center.

Kearney also identified one instance in which a customer's desktop computer counts had not changed over a 3-year period. When the Bureau of Political-Military Affairs became a customer of the IT Cost Center in FY 2009, it was charged for 576 desktop computers. The Bureau was still being charged for the same number of computers in FY 2012. According to Bureau officials, the IT Cost Center's count of the Bureau's desktop computers was incorrect for FY 2010. The IT Cost Center agreed to maintain the FY 2009 level of service until the asset counting methodology was improved. In FY 2013, after the completion of a physical inventory, the Bureau of Political-Military Affairs was billed for 636 desktops.

Because the IT Cost Center was unable to support the number of desktop computers charged for each customer and because other supporting data was not available, Kearney could not determine the full extent of inaccurate data. However, based on the specific examples of inaccurate computer counts, Kearney concluded that the methodologies used by the IT Cost Center to determine the number of computers during FY 2009 through FY 2012 were not effective. Kearney found that the IT Cost Center had modified its process to determine and communicate the number of desktop computers during FY 2013. Specifically, the IT Cost Center had provided detailed information on the specific desktop computers included in the fee to each customer. In addition, according to IRM officials, IT Cost Center staff was performing additional onsite validation of the number of desktop computers at customer locations, which would improve the reliability of the data.

Services Were Provided to Bureaus that Were Not Charged

The IT Cost Center had a responsibility to collect "payments…for supplies and services at rates which will approximate the expense of operations."[37] However, the IT Cost Center provided IT Help Desk services to personnel from bureaus and offices that were not Cost Center customers, and the Cost Center did not charge the non-customer bureaus and offices for these services. Kearney estimated that the IT Cost Center lost approximately $10.8 million in potential revenue, as shown in Table 16.

Table 16. Remedy Tickets Submitted by Customers and Non-Customers and Related Uncollected Revenue

Fiscal Year	Total Tickets	Customer Tickets		Tickets without an Identified Organization		Non-Customer Tickets		Estimated Uncollected Revenue (in millions)
		Number	Percent of Total	Number	Percent of Total	Number	Percent of Total	
2009	103,718	89,415	86	5,311	5	8,992	9	$3.1
2010	210,193	201,028	96	0	0	9,165	4	2.6
2011	248,930	243,186	98	26	0	5,718	2	2.1
2012	243,200	237,050	97	0	0	6,150	3	3.0
Total	**806,041**	**770,679**	**96**	**5,337**	**1**	**30,025**	**4**	**$10.8**

Source: Kearney prepared based on review of Remedy tickets related to the IT Cost Center serviced from FY 2009 to FY 2012.

In some cases, certain bureaus or offices that received services as a non-customer became IT Cost Center customers in later years. However, several bureaus or offices that submitted IT Help Desk tickets did not become IT Cost Center customers. For example, one bureau submitted over 13,000 Remedy tickets during FY 2009 to FY 2012 despite not being a customer. During FY 2009 through FY 2012, IT Cost Center management did not monitor the use of the IT Help

[37] 22 U.S.C § 2684, "Capital Fund for Department of State."

Desk services by non-customers to determine whether ad-hoc fees for assistance should be charged. According to IRM officials, during FY 2013 the IT Cost Center began working with non-customers to implement Service Level Agreements that included fees for ad hoc IT Cost Center services. The Cost Center also had three employees who were paid with appropriated funding to handle non-customer requests; however, there were no processes in place to assign all non-customer requests to these individuals or to prevent these individuals from working on customer requests.

Customer Charges Were Excessive and Funds Could Have Been Put to Better Use

Although the WCF financial reports showed that the IT Cost Center had generally been operating at a profit since its inception in FY 2009, those reports do not reflect a complete picture of the IT Cost Center's financial results. As a result, the Cost Center did not have a true understanding of its financial position and could not establish fees in a manner that covered, but did not greatly exceed, the total cost of Cost Center operations. Kearney estimated the IT Cost Center's adjusted profits or losses for FY 2009 to FY 2012, taking into consideration the impact of the unpaid expenses,[38] the transfer of $1.5 million in appropriated funds, and the lost revenue because it provided services to non-serviced bureaus. The IT Cost Center continued to operate at an overall profit for the periods covered, as shown in Table 17. Additionally, by recording revenue for amounts that are not earned by providing goods or services to customers, the Cost Center risks non-compliance with Federal regulations, such as the Antideficiency Act and appropriations law.

Table 17. IT Cost Center Adjusted Financial Results – FY 2009 to FY 2012

Fiscal Year	Adjusted Revenue (in millions)	Adjusted Expense (in millions)	Adjusted Profit/(Loss): Adjusted Amount (in millions)	Adjusted Profit/(Loss): Adjusted Percent
2009	$29.4	$21.9	$7.5	26
2010	47.7	35.2	12.5	26
2011	48.4	43.0	5.4	11
2012	51.2	52.3	(1.1)	(2)
Total	**$176.7**	**$152.5**	**$24.3**	**14**

Source: Prepared by Kearney based on GFMS Data Warehouse General Ledger Account Activity Extract report and an analysis of audit results.
Note: Numbers in this table may not add because of rounding.

Kearney concluded that the Cost Center was potentially overcharging its customers. Kearney independently recalculated the fee amount by considering all expenses that should have been included in the fee-setting process, as well as the retained funds, the actual desktop computer count used for billings in FY 2011 and FY 2012, a reasonable growth rate for desktop computers for FY 2013 and FY 2014, and unbilled revenue. Based upon this analysis, Kearney determined that the Cost Center fee would be $1,442 per desktop computer—approximately $350

[38] Kearney calculated the impact of expenses paid by non-Cost Center funds by multiplying the amount of those expenses identified for FY 2012, $2.8 million, by U.S. Department of Labor's Consumer Price Index information. In total, Kearney estimated that non-Cost Center funds were used to pay $10.8 million in Cost Center expenses for FY 2009 to FY 2012.

less per desktop computer than the amount that was being charged.[39] Although IRM officials stated that they agreed that the fee amount was too high for the current services provided, IRM has calculated the overage to be approximately $90 per computer, rather than the $350 calculated by Kearney.

In effect, to decrease the $25.8 million in available retained funds, the IT Cost Center would need to operate at a loss for several years. Based on the revised fee amount of $1,442 per desktop computer, Kearney calculated that the IT Cost Center had collected approximately $8.8 million in extra revenue in FY 2011 and approximately $9.3 million in extra revenue in FY 2012, totaling $18.2 million for these 2 years. The extra revenue exceeded the amount of the adjusted profit or loss for FY 2012 and FY 2011, as shown in Table 17, since the amounts would be offset by the available retained funds. One large bureau with 4,921 desktop computers in FY 2011 and 4,935 in FY 2012 may have been overcharged a total of $3.4 million for FY 2011 and FY 2012. Another large bureau with 1,336 desktop computers in FY 2011 and 1,443 in FY 2012 may have been overcharged a total of approximately $970,000 for the same 2-year period. As a result, customers did not have these funds available to use for other programmatic needs. In addition, the $2.8 million in expenses paid with non-Cost Center funds could have also been put to better use.

Rather than reduce the fee amount, IT Cost Center officials stated that it may use the excess retained funds to cover other IT-related costs that have been paid from appropriated funds in the past, such as the costs of operating SharePoint. These services were not included in the Service Level Agreement. In addition, the services being considered are used by all Department employees, not just the customers of the IT Cost Center. Therefore, using excess funds collected from customers to cover the costs of operating SharePoint would not be appropriate.

In addition to an excessive fee amount, the IT Cost Center might also have over- or undercharged its customers by billing for an inaccurate number of desktop computers. The insufficient process to determine the number of desktop computers could have also led to either over- or underpayment of fees to the contractor that operates the IT Help Desk, since a significant portion of payments to the contractor were based on the number of computers being serviced. In addition, the IT Help Desk contract provided for certain discounts if more than 30,000 desktop computers were serviced. Without a sufficient method to count desktop computers, the IT Cost Center and the contractor could not accurately estimate the value of the contract and ultimately the correct price per desktop computer. Because of the lack of supporting information, Kearney was unable to determine the actual impact of the incorrect computer counts to either specific customers or to the Department as a whole. Additionally, customers do not have a detailed record of their current or historical billings, and there is no audit trail for both the Cost Center and the customer to discuss past transactions.

Overall, the deficiencies noted in the fee-setting process could lead to the lack of customer confidence in the Cost Center billings as well as a lack of customer satisfaction with the Cost Center's performance.

[39] Kearney calculated this amount using the assumption that the retained funds would be distributed over a 4-year period, which is the IT Cost Center's schedule for updating the fee amount. At the end of the 4-year period, the retained funds should be significantly decreased, and the IT Cost Center would need to reassess the fee amount.

Recommendation 9. OIG recommends that the Bureau of Administration, Executive Office, Working Capital Fund Division, in coordination with the Bureau of Information Resource Management's Information Technology (IT) Cost Center, identify all IT Cost Center operating costs and implement a process to pay for these costs using IT Cost Center revenue.

Management Response: The A Bureau concurred with the recommendation and stated that it will "work with IRM to review the IT Cost Center operating costs on an annual basis."

OIG Analysis: OIG considers the recommendation resolved. This recommendation can be closed when OIG reviews and accepts documentation showing that the A Bureau has identified all IT Cost Center costs and has a process to pay these costs using IT Cost Center revenue.

Recommendation 10. OIG recommends that the Bureau of Administration, Executive Office, Working Capital Fund Division, align the funds received by the Information Technology Cost Center from the Bureau of Information Resource Management (IRM) for Citrix licenses in FY 2011 to specific expenditures and return unspent funds to IRM.

Management Response: The A Bureau concurred with this recommendation and stated that, at IRM's request, the A Bureau has already instructed that "the amount of $307,097 be returned to IRM."

OIG Analysis: OIG considers the recommendation resolved. This recommendation can be closed when OIG reviews and accepts documentation supporting the expenditures from the $1.5 million in appropriated funds provided by IRM to the IT Cost Center and the return of the unspent funds to IRM.

Recommendation 11. OIG recommends that the Bureau of Administration, Executive Office, Working Capital Fund Division, in coordination with the Bureau of Information Resource Management's Information Technology Cost Center, recalculate the fee amount. The methodology used when recalculating the fee should consider all relevant factors, including all expenses that should be supported by Cost Center revenue, retained funds in excess of scheduled capital needs, and a reasonable growth rate of the desktop computers. The results of the reassessment should be made available to customers.

Management Response: The A Bureau concurred with this recommendation and stated that IRM is currently recalculating the fee. The A Bureau will "review IRM's budget submission to ensure new fees reflect all relevant expenses." In its general comments, IRM noted that it "needs to retain 10 percent of annual invoices budget (roughly $5M) in risk reserve as carryover to ensure the smooth provision of service to IT Cost Center customers." In addition, IRM stated that it has developed a plan to fund "costs that had not previously been covered, including full Remedy system annual costs and equipment refresh and modernization."

OIG Analysis: OIG considers the recommendation resolved. This recommendation can be closed when OIG reviews and accepts documentation showing that the IT Cost Center fee has been recalculated; the recalculation considered all relevant factors; and the results of the recalculation have been made available to IT Cost Center customers. OIG concurs that retaining a reserve to cover the costs of periodic equipment refresh would be appropriate. However, this reserve should be included in IRM's fee recalculation, as should the current retained earnings of $25.8 million. Additionally, IRM should ensure that only costs associated with providing services to IT Cost Center customers are paid with fees collected from customers.

Recommendation 12. OIG recommends that the Bureau of Information Resource Management's Information Technology (IT) Cost Center, determine the most efficient and effective method for determining desktop computer counts for billing purposes. If a reliable method to produce desktop computer counts cannot be determined, the IT Cost Center should establish a different process to allocate IT Cost Center costs that can be supported.

Management Response: IRM concurred with this recommendation and stated that it is working with the A Bureau to "implement a single automated solution" prior to its annual invoicing cycle in FY 2014.

OIG Analysis: OIG considers the recommendation resolved. This recommendation can be closed when OIG reviews and accepts documentation showing that the IT Cost Center has an effective method for determining desktop computer counts.

Recommendation 13. OIG recommends that the Bureau of Information Resource Management's Information Technology Cost Center update the Service Level Agreement to outline the billing process by defining the methods of counting desktop computers and the sources that will be used by the Cost Center as well as defining the methods of recourse for customers that disagree with the Cost Center's desktop computer count.

Management Response: IRM concurred and stated that it "will update the Service Level Agreement in early FY14."

OIG Analysis: OIG considers the recommendation resolved. This recommendation can be closed when OIG reviews and accepts documentation showing that the Service Level Agreement has been updated to include a description of the method used to count desktop computers and the method of recourse for customers disagreeing with the count.

Recommendation 14. OIG recommends that the Bureau of Information Resource Management's Information Technology Cost Center provide supporting documentation to customers prior to the billing process, including the total number of desktop computers being billed, the source of the desktop computer count, and a detailed listing of the desktop computers included in the bill.

Management Response: IRM stated that it "began the process of providing documentation to its customers prior to the billing process in FY13 and will continue this process going forward."

OIG Analysis: OIG considers the recommendation closed based on IRM's actions to provide documentation to its customers prior to the billing process in FY 2013 as well as IRM's plans to implement "a single automated" method for determining desktop computer counts for billing purposes in response to Recommendation 12.

Recommendation 15. OIG recommends that the Bureau of Information Resource Management's Information Technology Cost Center develop a process to ensure that all non-customers are billed for Help Desk services on an ad-hoc basis or that non-customers do not receive Help Desk services.

Management Response: IRM concurred with this recommendation and stated that it has a team "working with the Help Desk to identify and document all processes and review all requests and services."

OIG Analysis: OIG considers the recommendation resolved. This recommendation can be closed when OIG reviews and accepts documentation showing that the IT Cost Center has a process to bill bureaus and offices that are not IT Cost Center customers for the Help Desk services these bureaus and offices receive.

List of Recommendations

Recommendation 1. OIG recommends that the Bureau of Administration, Executive Office, Working Capital Fund Division (A/EX/WCF), in coordination with the Secure Warehouses (SW) Cost Center, reassess the fee amount for each of the services provided to ensure that all Cost Center costs are covered. If officials determine that the new fees, which cover all required costs, would be too high to charge to customers, then A/EX/WCF should identify cost savings that would reduce overall expenses or reassess the decision to include the SW Cost Center as a Working Capital Fund function. The results of the reassessment should be made available to customers.

Recommendation 2. OIG recommends that the Bureau of Administration ensure that the formal organizational definition of the Secure Warehouses Cost Center and Freight Forwarding Service Center aligns to the operational management of these Cost Centers.

Recommendation 3. OIG recommends that the Bureau of Administration, Executive Office, Working Capital Fund Division, in coordination with the Secure Warehouses (SW) Cost Center, develop a policy that details how often the SW Cost Center fees will be formally reassessed.

Recommendation 4. OIG recommends that the Bureau of Administration, Executive Office, Working Capital Fund Division, in coordination with the Secure Warehouses Cost Center, perform an analysis to determine appropriate fees for each of the services provided to other agencies.

Recommendation 5. OIG recommends that the Bureau of Administration develop and implement a procedure to ensure that transportation expenses are recorded to the same Working Capital Fund Cost Center to which the related transportation revenues are recorded.

Recommendation 6. OIG recommends that the Bureau of Administration's Secure Warehouses Cost Center revise the methodology used to calculate the amount charged for Extended Storage to ensure that all Extended Storage charges incurred are billed to customers.

Recommendation 7. OIG recommends that the Bureau of Administration's Secure Warehouses Cost Center design and implement a process to review transactions excluded from automatic billing and ensure that all exclusions are properly documented.

Recommendation 8. OIG recommends that the Bureau of Administration, Executive Office, Working Capital Fund Division, in coordination with the Secure Warehouses (SW) Cost Center, identify all SW Cost Center costs and implement a process to pay for these costs using SW Cost Center revenue.

Recommendation 9. OIG recommends that the Bureau of Administration, Executive Office, Working Capital Fund Division, in coordination with the Bureau of Information Resource Management's Information Technology (IT) Cost Center, identify all IT Cost Center operating costs and implement a process to pay for these costs using IT Cost Center revenue.

Recommendation 10. OIG recommends that the Bureau of Administration, Executive Office, Working Capital Fund Division, align the funds received by the Information Technology Cost Center from the Bureau of Information Resource Management (IRM) for Citrix licenses in FY 2011 to specific expenditures and return unspent funds to IRM.

Recommendation 11. OIG recommends that the Bureau of Administration, Executive Office, Working Capital Fund Division, in coordination with the Bureau of Information Resource Management's Information Technology Cost Center, recalculate the fee amount. The methodology used when recalculating the fee should consider all relevant factors, including all expenses that should be supported by Cost Center revenue, retained funds in excess of scheduled capital needs, and a reasonable growth rate of the desktop computers. The results of the reassessment should be made available to customers.

Recommendation 12. OIG recommends that the Bureau of Information Resource Management's Information Technology (IT) Cost Center, determine the most efficient and effective method for determining desktop computer counts for billing purposes. If a reliable method to produce desktop computer counts cannot be determined, the IT Cost Center should establish a different process to allocate IT Cost Center costs that can be supported.

Recommendation 13. OIG recommends that the Bureau of Information Resource Management's Information Technology Cost Center update the Service Level Agreement to outline the billing process by defining the methods of counting desktop computers and the sources that will be used by the Cost Center as well as defining the methods of recourse for customers that disagree with the Cost Center's desktop computer count.

Recommendation 14. OIG recommends that the Bureau of Information Resource Management's Information Technology Cost Center provide supporting documentation to customers prior to the billing process, including the total number of desktop computers being billed, the source of the desktop computer count, and a detailed listing of the desktop computers included in the bill.

Recommendation 15. OIG recommends that the Bureau of Information Resource Management's Information Technology Cost Center develop a process to ensure that all non-customers are billed for Help Desk services on an ad-hoc basis or that non-customers do not receive Help Desk services.

Appendix A

Scope and Methodology

The objective of this audit was to determine whether the fees collected for the Working Capital Fund's (WCF) Secure Warehouses (SW) and Information Technology (IT) Cost Centers were sufficient to cover all costs required to sustain operations for those activities. In consideration of the WCF's mandate to be a not-for-profit revolving fund, the term sufficient is intended to mean effectively achieving a break-even position. As such, insolvent operations or excess profits were not sufficient results. An external audit firm, Kearney & Company, P.C. (Kearney), acting on behalf of the Office of Inspector General (OIG), performed this audit.

Kearney conducted fieldwork for this performance audit from December 2012 to April 2013 at the Bureau of Administration, Executive Office, Working Capital Fund Division. Kearney also performed work at the IT Cost Center, which is part of the Bureau of Information Resource Management, and the SW Cost Center, which is part of the Bureau of Administration. Kearney planned and performed this performance audit in accordance with requirements in the Government Accountability Office's Government Auditing Standards: 2011 Revision. Those standards require that Kearney plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. Kearney believes that the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objectives.

To obtain background information for this audit, Kearney researched and reviewed the Department's *Foreign Affairs Handbook*, the U.S. Code, Federal appropriations law, prior OIG and Government Accountability Office reports, and information available on the Department's Intranet. Kearney obtained the Washington Logistics Center Activity Based Costing Deliverable, issued in May 2005, to gain an understanding of the fee-setting process and the overall structure of the Cost Center's operations. Additionally, for the IT Cost Center, Kearney reviewed the Master Service Level Agreement, which outlined the Cost Center's in-scope services and performance criteria, to gain an understanding of the IT Cost Center's core operations.

Kearney met with IT and SW Cost Center personnel to gain an understanding of each Cost Center's operations, including services provided to customers, activities covered by the funds collected from customers, financial systems used, fee-setting methodologies, and operational and financial processes. Kearney met with Bureau of Administration, Executive Office, Working Capital Fund Division, officials to gain understanding of their role in Cost Center management. Kearney met with personnel and contractors who maintain the Remedy system used by the IT Cost Center to gain an understanding of the system design and its relationship to the IT Cost Center service model. Kearney also met with personnel and contractors that maintain the Integrated Logistics Management System (ILMS) to gain an understanding of the system's design and its relationship to the SW Cost Center's operational processes.

In order to draw conclusions regarding the sufficiency of the Cost Centers' fees, Kearney obtained a complete and accurate picture of each Cost Center's financial results and assessed the logical assumptions used to determine the fees.

Prior OIG Reports

In 2010, OIG reported[1] that the Bureau of Information Resource Management was unable to determine IT costs for bureaus' IT activities. Therefore, there was no baseline for comparing costs before and after the inception of the IT Cost Center. OIG also reported that bureau officials did not believe that there was sufficient transparency regarding the fee amount charged for the Cost Center. OIG concluded that the fee calculation was unclear and that the fee amount had fluctuated during the implementation of the Cost Center. Kearney leveraged this report to identify high risk areas related to the audit. Kearney did not perform audit work on the IT Cost Center fees charged prior to FY 2011. Instead, Kearney relied on the conclusions drawn by OIG in its 2010 report.

Use of Computer Processed Data

The audit team used computer-processed data from the Department during this audit. For each Cost Center, Kearney obtained revenue and expense detail from the Global Financial Management System's (GFMS) Data Warehouse.[2] For the SW Cost Center, Kearney obtained financial information covering FY 2005 through FY 2012 and for the IT Cost Center, Kearney obtained financial information covering FY 2009 through FY 2012. Kearney performed tests of controls and substantive testing of the expenditure and revenue information obtained from GFMS during the audit to assess the reliability of the data. In addition, GFMS is used to prepare the annual financial statements, which are audited. Kearney determined that, based on how the data would be used in the report, the assurances provided by the annual financial statement audit, and the procedures performed during this audit, that the data was sufficiently reliable for its needs.

Kearney also used computer-processed data from the ILMS to test that all services provided were recorded as revenues for the SW Cost Center. Specifically, Kearney obtained activity data for each warehouse with receipt date, warehouse location, and shipment number from FY 2007 to FY 2012. In order to assess the reliability of the ILMS data, Kearney ensured that the information was consistent by reviewing the number of transactions recorded to each warehouse during each year and ensuring that the distribution was consistent with expectations. Based upon procedures performed, Kearney concluded that the data was sufficiently reliable for its needs.

Any issues noted with the computer-processed data used are reported in the Audit Results section of the report.

---

[1] *Evaluation of the Information Technology Consolidation Project at the Department of State* (AUD/IT-10-11, Feb. 2010).

[2] Data Warehouse is a database tool that is used to create reports from the Department's financial records. All transactions recorded in the Department's GFMS are stored in the Data Warehouse and can be accessed, queried, downloaded, and analyzed.

Work Related to Internal Controls

Kearney divided the overall audit objective into four sub-objectives:

- whether the Cost Centers' revenue from fee collection was generally sufficient to cover the cost of providing services.
- whether the fee-setting methodology was sufficient.
- the financial impact of flaws noted in the fee-setting methodology.
- the potential for cost savings.

Based upon the information obtained during preliminary audit procedures, Kearney performed a risk assessment for each Cost Center that identified audit risks within each sub-objective and the controls in place to address those risks.

Where key controls were identified, Kearney reviewed documentation and performed procedures to assess the design of the controls. Where controls were found to be properly designed, Kearney performed procedures to test the operating effectiveness of the controls. Based upon the assessed level of risk for each audit sub-objective and the results of control testing, Kearney designed procedures that would enable Kearney to obtain sufficient and appropriate evidence to conclude upon the audit sub-objective. In certain instances, these procedures required sampling (see the Detailed Sampling Methodology section for additional information). Any significant internal control deficiencies noted during the audit are reported in the Audit Results section of the report.

Detailed Sampling Methodology

Kearney's sampling objectives were to obtain sufficient and appropriate evidence to conclude upon each audit objective by determining whether

- All warehousing services provided by the SW Cost Center were recorded as revenue in GFMS.
- The expenses recorded for the SW Cost Center were incurred in execution of Cost Center activities.
- The amount billed to customers and recorded as revenue for the IT Cost Center was accurate and supported.

Selection of SW Cost Center Revenue Sample

For testing whether all warehousing services provided by the SW Cost Center were recorded as revenue in GFMS, Kearney obtained the universe of ILMS receipt transactions, which should reflect the amount of revenue for the SW Cost Center by warehouse location for FY 2007 to FY 2012,[3] as shown in Table 1.

[3] The Department did not use ILMS prior to FY 2007. Kearney was unable to obtain sufficient information from the prior system for its SW Cost Center revenue testing. Therefore, Kearney tested the Cost Center revenue for FY 2007 through FY 2012.

Table 1. Number of ILMS Transactions by Warehouse Location

Fiscal Year	Warehouse SA-21	Warehouse SA-7C	Warehouse SA-10	Warehouse SA-7B
2007	2,506	1,178	0	0
2008	3,576	1,979	0	0
2009	2,522	1,106	0	0
2010	2,103	920	0	0
2011	1,928	706	0	0
2012	2,239	1,087	512	1,813
Total	**14,874**	**6,976**	**512**	**1,813**

Source: Prepared by Kearney based on receipts data from unclassified ILMS.

The universe from ILMS only contained transactions processed on the unclassified side of ILMS. Transactions for SA-7B and SA-10 were processed on the classified side of ILMS prior to the implementation of the Warehouse Management System module, which occurred in November 2011. The classified ILMS system did not produce useful reports on transactions processed and so Kearney was unable to obtain a universe of transactions for Warehouses SA-10 and SA-7B for FY 2007 to FY 2011.

For unclassified transactions, Kearney selected a judgment[4] sample of 45 items from the unclassified ILMS universe to test whether services were recorded as revenue in GFMS. Ensuring the inclusion of transactions covering all four warehouses was the primary criterion for sample selection. Additionally, transactions were selected to encompass the entire scope period, FYs 2007–2012. The items selected for testing by fiscal year and warehouse are shown in Table 2.

Table 2. Unclassified ILMS Transactions Selected for Testing

Fiscal Year	SA-21	SA-7C	SA-10	SA-7B	Total by Fiscal Year
	Items Selected	Items Selected	Items Selected	Items Selected	
2007	0	1	0	0	**1**
2008	2	1	0	0	**3**
2009	3	2	0	0	**5**
2010	3	0	0	0	**3**
2011	3	0	0	0	**3**
2012	5	0	12	13	**30**
Total	**16**	**4**	**12**	**13**	**45**

Source: Kearney prepared based on unclassified ILMS data.

For classified transactions, Kearney again selected a judgment sample of 45 items. To test these transactions, however, Kearney manually reviewed the data because a universe of transactions was not available from the classified ILMS system. The primary criterion for inclusion into the sample was again coverage of all warehouses. Kearney also ensured that the sampled items covered the entire period, FYs 2007–2011. Kearney selected transactions from each fiscal year for each of the two warehouses as shown in Table 3.

[4] Kearney used a non-statistical sampling method known as "judgment sampling," which uses discretionary criteria to effect sample selection.

Table 3. Classified ILMS Revenue Transactions Selected for Testing

Fiscal Year	SA-10	SA-7B	Total by Fiscal Year
	Items Selected	Items Selected	
2007	1	5	**6**
2008	6	5	**11**
2009	7	6	**13**
2010	2	1	**3**
2011	6	6	**12**
Total	**22**	**23**	**45**

Source: Prepared by Kearney based on review of data in classified ILMS.

For each ILMS transaction selected, Kearney determined whether the transaction had been properly recorded as revenue in GFMS. Kearney identified three unclassified and six classified transactions that were not recorded in GFMS. However, the amount of the unrecorded transactions was immaterial (approximately $3,000), so Kearney did not include this information in the Audit Results section of the report.

Selection of SW Cost Center Expense Sample

For SW expense testing, Kearney obtained the universe of expense transactions from the GFMS Data Warehouse GL Account Activity Extract report. This report was run by Kearney to include all activity recorded to expense accounts during FY 2005 through FY 2012 for the SW Cost Center (Treasury symbol 19X4519.0, allotment codes 8670 and 8637). Kearney adjusted the universe of expenses by excluding transactions within the expense population that were tested separately or were determined to be reasonable exclusions based on GFMS system logic and information gathered from the client.[5] The adjustments to the universe of SW Cost Center expenses totaled $13,356,493, leaving $55,268,095 remaining for sampling, as shown in Table 4.

[5] Specifically Kearney excluded: payroll accruals (which net to zero), inventory adjustments (which do not represent the initial expense transactions), and payroll expenses (which were tested separately). Kearney also excluded journal voucher transactions (which were reviewed separately); transactions that netted to zero; and credit transactions. In addition, Kearney excluded transactions for FY 2005 and FY 2006 because supporting documentation for FY 2005 and FY 2006 was not available due to the Department's document retention policies.

Table 4. GFMS Expense Transactions for the SW Cost Center – FY 2005 – FY 2012

Fiscal Year	Number of Transactions	Amount of Transactions	Number of Excluded Items	Amount of Excluded Items	Adjusted Number of Transactions for Sampling	Adjusted Amount of Transactions for Sampling
2005	2,507	$6,107,832	2,507	$6,107,832	0	$0
2006	2,379	4,403,803	2,379	4,403,803	0	0
2007	1,786	5,426,806	645	1,524,805	1,141	3,902,001
2008	2,313	6,536,631	843	800,638	1,470	5,735,993
2009	2,470	9,828,865	932	1,756,888	1,538	8,071,976
2010	2,574	11,952,402	1,016	(203,743)	1,558	12,156,145
2011	3,291	12,220,169	1,460	241,495	1,831	11,978,674
2012	3,224	12,148,080	1,900	(1,275,226)	1,324	13,423,306
Total	**20,544**	**$68,624,588**	**11,682**	**$13,356,493**	**8,862**	**$55,268,095**

Source: Prepared by Kearney based on GFMS data.
Note: Numbers in this table may not add because of rounding.

From the adjusted population, Kearney selected a sample using the statistical sampling technique known as Monetary Unit Sampling (MUS).[6] Kearney selected the sample using IDEA Data Analysis Software[7] to achieve a confidence level of 95 percent. Kearney used a tolerable error of 7 percent and expected misstatement of .50 percent. Based on these parameters, Kearney used IDEA to select 48 sample items with a value of $4,427,218, as shown in Table 5.

Table 5. SW Cost Center Expenses Selected for Testing

Fiscal Year	Number of Items Selected	Amount of Items Selected
2007	2	$172,119
2008	5	337,589
2009	5	250,113
2010	12	1,383,177
2011	12	876,000
2012	12	1,408,220
Total	**48**	**$4,427,218**

Source: Prepared by Kearney based on sample selection.

For each expense transaction selected for testing for the SW Cost Center, Kearney obtained supporting documentation, such as an invoice, and reviewed the documentation to

[6] Monetary Unit Sampling is a sampling technique used to select a sample based on the proportionate unit size of the sample to the overall universe. For purposes of this audit, the unit is the dollar value of the transaction. This means that every dollar in the population has an equal chance of being selected. If a particular dollar unit is selected, the entire transaction that is associated to the dollar unit will be selected for testing. Monetary Unit Sampling determines the number of samples required to obtain the planned level of accuracy, precision, or confidence level, and determines the unit intervals necessary to generate the total number of samples needed for testing. Misstatements, whole or partial, in the sample population are projected over the universe based on the proportion of the misstatement in the selected sample. This sampling technique is used when overstatements or low misstatements are expected in the population.
[7] IDEA Data Analysis Software is a computer program that automates the calculations necessary for selecting and analyzing samples. Based upon the parameters input by the user, IDEA will select a sample and aid in evaluating the results of the sample.

ensure that the costs were incurred to support Cost Center operations. Any findings related to this sample are included in the Audit Results section of the report.

Selection of IT Cost Center Revenue Sample

In order to determine whether each customer was billed correctly by the IT Cost Center, Kearney obtained the universe of customers from the IT Cost Center's Billing Tracker spreadsheet.[8] The Billing Tracker spreadsheet shows the number of desktop computers billed for each customer and the associated revenue, including amounts charged to customers for ad-hoc services. Kearney reconciled Billing Tracker data to data obtained from GFMS Data Warehouse to ensure that the use of the Billing Tracker as the universe for sampling was reasonable.

Prior to selecting revenue samples for the IT Cost Center, Kearney excluded $3,546,299 related to for non-standard desktop computer services. These transactions were analyzed separately; therefore, inclusion in sampling was not necessary. As shown in Table 6, the number of customers that received a bill for standard desktop computer services were 154, totaling $163,962,829.

Table 6. Billing Tracker Revenue Transactions for the IT Cost Center – FY 2009 – FY 2012

Fiscal Year	Number of Customers	Amount of Transactions	Number of Customers Receiving Non-Standard Services	Amount of Non-Standard Services	Adjusted Number of Customers	Adjusted Amount of Services
2009	23	$26,295,548	0	$0	23	$26,295,548
2010	54	45,113,605	12	929,990	42	44,183,616
2011	62	47,854,316	16	2,479,586	46	45,374,730
2012	57	48,245,658	14	136,723	43	48,108,935
Total	**196**	**$167,509,128**	**42**	**$3,546,299**	**154**	**$163,962,829**

Source: Prepared by Kearney based on Billing Tracker spreadsheet data.
Note: Numbers in this table may not add because of rounding.

From the adjusted population, Kearney selected a sample using the statistical sampling technique known as MUS. Kearney selected the sample using IDEA software to achieve a confidence level of 95 percent. Kearney used a tolerable error of 7 percent and expected misstatements of .50 percent. Based upon these parameters, IDEA selected a sample of 45 customers which comprised $99,156,440 of the universe amount, as shown in Table 7.

[8] The Billing Tracker is a Microsoft Excel file maintained by the IT Cost Center Budget Analyst.

Table 7. IT Cost Center Customers Selected for Testing Revenue

Fiscal Year	Number of Customers Selected	Amount Billed to Customers Selected
2009	6	$14,099,904
2010	12	24,388,066
2011	14	30,478,330
2012	13	30,190,140
Total	**45**	**$99,156,440**

Source: Prepared by Kearney based on sample selection.

For each IT Cost Center revenue item selected, Kearney conducted various procedures in an attempt to validate the amount billed to each customer. As documented in the Audit Results section of this report, Kearney could not validate any of the amounts billed for the selected transactions.

Appendix B

United States Department of State

Washington, D.C. 20520

August 27, 2013

MEMORANDUM

TO: OIG – Harold W. Geisel

FROM: A-IRM/EX – William S. S. Amoroso, Executive Director

SUBJECT: Audit of Selected Working Capital Fund Cost Center Financial Results

REF: OIG Memorandum's of August 9, 2013 to A-Joyce Barr and IRM-Steven Taylor

Thank you for the opportunity to review and comment on the subject draft Audit Report. As the Executive Office for both the Bureau of Administration and the Bureau of Information Resource Management, we have combined the comments from both organizations in this response. Mike Capozzi, Chief of the A/EX Working Capital Fund Division is the point of contact on this audit and can be reached by calling (202) 485-[redacted]

A Bureau Comments

A Bureau concurs with the majority of the Secure Warehouse study, but strongly disagrees with the proposal to include rent in the cost center's price structure. We believe that adding rent will increase prices to a point where our services will no longer be competitive from a pricing perspective. In response to Recommendation 1, the Bureau of Administration plans to conduct an Activity Based Costing (ABC) study to determine the appropriate fees that should be charged for WCF services. Until the results of this study are finalized, we are unable to determine the impact that the other recommendations in this report will have on Secure Warehouse operations. Our responses to all of the recommendations are documented below.

IRM Bureau Comments

IRM agrees with the OIG that there are changes necessary to the cost model and billing processes in the IT Cost Center. One aspect of these processes that warrants special attention is the fiscal carryover noted by the OIG. Because the billing cycle for consolidated desktops aligns in a way that spans fiscal years, IRM needs to retain 10 percent of annual invoices budget (roughly $5M) in risk reserve as carryover to ensure the smooth provision of service to IT Cost Center customers. IRM has taken action to reduce current carryover amounts by changing to a per year equipment refresh cycle approach, rather than performing a full refresh every fourth year. IRM has also developed a plan to fund approximately $5M of associated costs that had not previously been covered by the fund, including full Remedy system annual costs and equipment refresh and modernization. These actions will decrease the carryover noted by the OIG while leaving a fiscally healthy risk reserve for the Cost Center.

While IRM agrees that improving the management of the IT Cost Center is possible and desirable, the OIG's use of the terms used to describe the WCF's accounting practices could lead to an interpretation that under represents the significant controls and oversight used to manage the funds.

Recommendation Responses

Recommendation 1: OIG recommends that the Bureau of Administration, Executive Office, Working Capital Fund Division (A/EX/WCF), in coordination with the Secure Warehouses (SW) Cost Center; reassess the fee amount for each of the services provided to ensure that all Cost Center costs are covered. If officials determine that the new fees, which cover all required costs, would be too high to charge to customers, then A/EX/WCF should identify cost savings that would reduce overall expenses or reassess the decision to include the SW Cost Center as a Working Capital Fund function. The results of the reassessment should be made available to customers.

A Bureau Response: The Bureau of Administration agrees and will conduct an Activity Based Costing (ABC) study to determine the correct fees for each of the WCF services. As part of the ABC study, we will ensure that all appropriate costs are included.

Recommendation 2: OIG recommends that the Bureau of Administration ensure that the formal organizational definition of the Secure Warehouses Cost Center and Freight Forwarding Service Center aligns to the operational management of these Cost Centers.

A Bureau Response: The Bureau of Administration concurs and will separate the financial results of SW Cost Center from the Freight Forwarding Service Center.

Recommendation 3: OIG recommends that the Bureau of Administration, Executive Office, Working Capital Fund Division, in coordination with the Secure Warehouses (SW) Cost Center, develop a policy that details how often the SW Cost Center fees will be formally reassessed.

A Bureau Response: The Bureau of Administration agrees and will conduct the ABC studies on a regular basis.

Recommendation 4: OIG recommends that the Bureau of Administration, Executive Office, Working Capital Fund Division, in coordination with the Secure Warehouses Cost Center, perform an analysis to determine appropriate fees for each of the services provided to other agencies.

A Bureau Response: The Bureau of Administration agrees and will use the ABC study referenced in recommendation 1 to set appropriate fees for services provided to other agencies.

Recommendation 5: OIG recommends that the Bureau of Administration develop and implement a procedure to ensure that transportation expenses are recorded to the same Working Capital Fund Cost Center to which the related transportation revenues are recorded.

A Bureau Response: The Bureau of Administration agrees and will develop a process to show transportation revenue in the same cost center that is incurring the charge.

Recommendation 6: OIG recommends that the Bureau of Administration's Secure Warehouses Cost Center revise the methodology used to calculate the amount charged for Extended Storage to ensure that all Extended Storage charges incurred are billed to customers.

A Bureau Response: The Bureau of Administration agrees and will use the ABC study referenced in recommendation 1 to set appropriate fees for Extended Storage and will implement processes to bill storage regularly.

Recommendation 7: OIG recommends that the Bureau of Administration's Secure Warehouses Cost Center design and implement a process to review transactions excluded from automatic billing and ensure that all exclusions are properly documented.

A Bureau Response: The Bureau of Administration agrees and will implement a process to review transactions excluded from billing.

Recommendation 8: OIG recommends that the Bureau of Administration, Executive Office, Working Capital Fund Division, in coordination with the Secure Warehouses (SW) Cost Center, identify all SW Cost Center costs and implement a process to pay for these costs using SW Cost Center revenue.

A Bureau Response: The Bureau of Administration agrees and will use the ABC study referenced in recommendation 1 to identify all SW Cost Center costs. All appropriate costs will be included in the new rates developed through the ABC study.

Recommendation 9: OIG recommends that the Bureau of Administration, Executive Office, Working Capital Fund Division, in coordination with the Bureau of Information Resource Management's Information Technology (IT) Cost Center, identify all IT Cost Center operating costs and implement a process to pay for these costs using IT Cost Center revenue.

A and IRM Response: The Bureau of Administration concurs and will work with IRM to review the IT Cost Center operating costs on an annual basis.

Recommendation 10: OIG recommends that the Bureau of Administration, Executive Office, Working Capital Fund Division, align the funds received by the Information Technology Cost Center from the Bureau of Information Resource Management (IRM) for Citrix licenses in FY 2011 to specific expenditures and return unspent funds to IRM.

A and IRM Response: The Bureau of Administration concurs and at IRM's request, has already submitted a reimbursement memo to BP instructing that the amount of $307,097 be returned to IRM.

Recommendation 11: OIG recommends that the Bureau of Administration, Executive Office, Working Capital Fund Division, in coordination with the Bureau of Information Resource Management's Information Technology Cost Center, recalculate the fee amount. The methodology used when recalculating the fee should consider all relevant factors, including all expenses that should be supported by Cost Center revenue, retained funds in excess of scheduled capital needs, and a reasonable growth rate of the desktop computers. The results of the reassessment should be made available to customers.

A and IRM Response: The Bureau of Administration concurs, and will review IRM's budget submission to ensure new fees reflect all relevant expenses. IRM is currently recalculating the fee based on its eight year correcting budget, which will be reviewed annually by IRM senior management, Bureau of Budget and Planning, and Bureau of Administration Working Capital Fund Division.

Recommendation 12: OIG recommends that the Bureau of Information Resource Management's Information Technology (IT) Cost Center, determine the most efficient and effective method for determining desktop computer counts for billing purposes. If a reliable method to produce desktop computer counts cannot be determined, the IT Cost Center should establish a different process to allocate IT Cost Center costs that can be supported.

IRM Response: IRM concurs, and is working with the Bureau of Administration's Office of Program Management and Policy to implement a single automated solution to be executed in fiscal year (FY) 2014 two months prior to the annual invoicing cycle.

Recommendation 13: OIG recommends that the Bureau of Information Resource Management's Information Technology Cost Center update the Service Level Agreement to outline the billing process by defining the methods of counting desktop computers and the sources that will be used by the Cost Center as well as defining the methods of recourse for customers that disagree with the Cost Center's desktop computer count.

IRM Response: IRM concurs and will update the Service Level Agreement in early FY14 as defined by the outcome of Recommendation 12

Recommendation 14: OIG recommends that the Bureau of Information Resource Management's Information Technology Cost Center provide supporting documentation to customers prior to the billing process, including the total number of desktop computers being billed, the source of the desktop computer count, and a detailed listing of the desktop computers included in the bill.

IRM Response: IRM began the process of providing documentation to its customers prior to the billing process in FY13 and will continue this process going forward.

Recommendation 15: OIG recommends that the Bureau of Information Resource Management's Information Technology Cost Center develop a process to ensure that all noncustomers are billed for Help Desk services on an ad-hoc basis or that non-customers do not receive Help Desk services.

IRM Response: IRM concurs and has a team in place working with the Help Desk to identify and document all processes and review all requests and services. Once this is completed in the first quarter of FY14, IRM will initiate appropriate action to comply with this recommendation.

FRAUD, WASTE, ABUSE,
OR MISMANAGEMENT
OF FEDERAL PROGRAMS
HURTS EVERYONE.

CONTACT THE
OFFICE OF INSPECTOR GENERAL
HOTLINE
TO REPORT ILLEGAL
OR WASTEFUL ACTIVITIES:

202-647-3320
800-409-9926
oighotline@state.gov
oig.state.gov

Office of Inspector General
U.S. Department of State
P.O. Box 9778
Arlington, VA 22219