Office of Inspector General

July 16, 2004
Report No. 04-025

Regional Contract Operations

AUDIT REPORT

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Federal Deposit Insurance Corporation
801 17th St. NW Washington DC 20434-0002

Office of Audits
Office of Inspector General

DATE: July 16, 2004

MEMORANDUM TO: Arleas Upton Kea, Director
Division of Administration

FROM: Russell A. Rau
Assistant Inspector General for Audits

SUBJECT: *Regional Contract Operations*
(Report No. 04-025)

The Federal Deposit Insurance Corporation (FDIC) Office of Inspector General (OIG) has completed an audit of the FDIC's regional contract[1] operations. The audit objective was to determine whether regional contracts were awarded and administered in accordance with FDIC policies and procedures. As of March 1, 2004, the Division of Administration's (DOA) five regional offices[2] awarded and administered 508 contracts with related expenditures of about $37 million. Additional details on our objective, scope, and methodology are provided in Appendix I.

BACKGROUND

The Federal Deposit Insurance Act (12 U.S.C. § 1819) empowers the FDIC to enter into contracts with private sector firms to provide goods or services. The DOA Acquisition Services Branches (ASB) in Washington, D.C., and the DOA regional offices award and administer contracts required by the FDIC's program offices – the organizational units requiring the goods or services. With some exceptions, ASB:

- manages the solicitation, evaluation, and selection of contractors;
- executes and modifies contracts on behalf of the FDIC;[3] and
- ensures that contractual obligations are met by both the FDIC and the contractor.

As shown in Figure 1, although regional contracts account for only about 8 percent of the FDIC's costs for open contracts, about 44 percent of the FDIC's contracts are administered by the regional offices.

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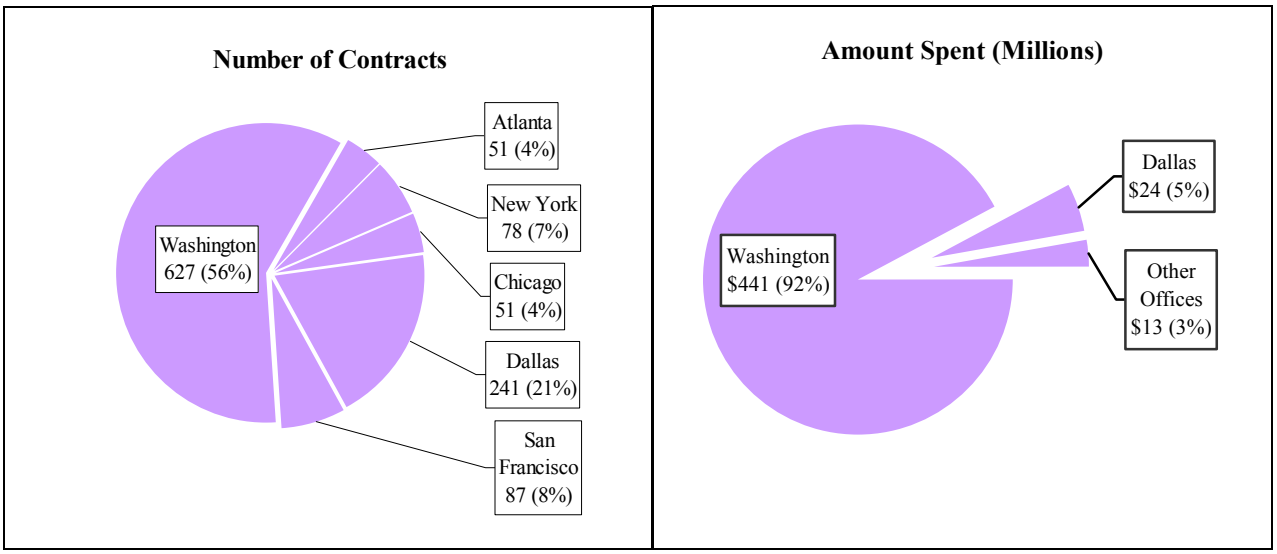
[1] As used in the FDIC *Acquisition Policy Manual*, the term contract includes any contractual instrument, including contracts, purchase orders, task orders awarded under basic ordering agreements, orders awarded under multiple-order requirements contracts, software licensing agreements, and all other contractual instruments issued by the FDIC's Division of Administration to acquire goods or services on behalf of the FDIC.

[2] The DOA has a headquarters office in Washington, D.C., and regional offices in Atlanta, Georgia; Chicago, Illinois; Dallas, Texas; New York, New York; and San Francisco, California.

[3] The ASB Associate Director in Washington, D.C., delegates contracting authority to FDIC contracting officers in both headquarters and the regional offices by means of contracting officer warrants.

Figure 1: FDIC Open Contracts, by FDIC Office, as of March 1, 2004

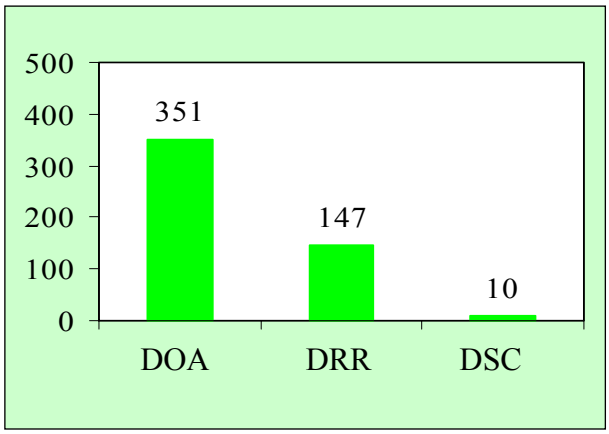


Source: DOA ASB Contract Monitoring Information Application (CMIA).*
*The CMIA system provides contract administration and oversight personnel timely and easy access to procurement data.

Regional Contract Activity

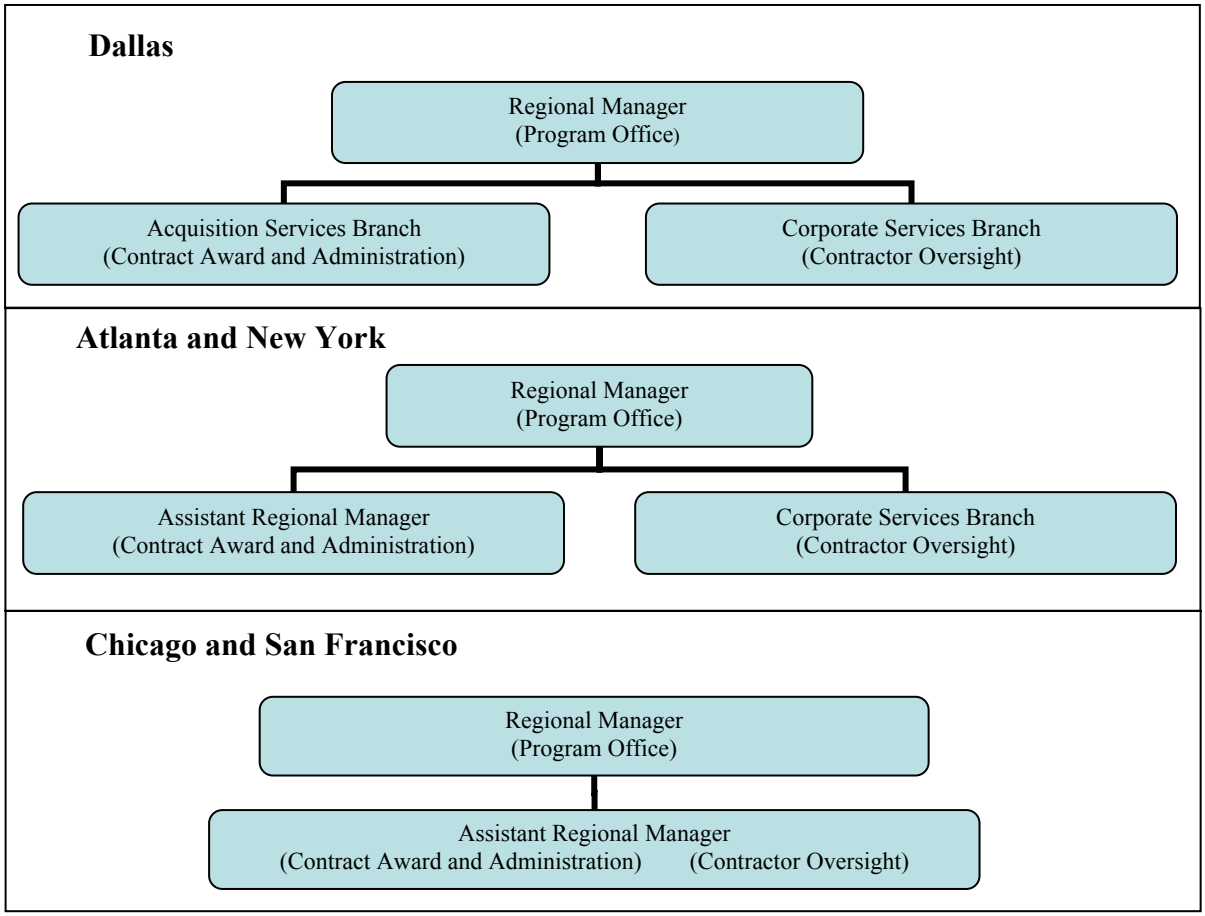
ASB regional staff award and administer contracts for DOA, the Division of Resolutions and Receiverships (DRR), and the Division of Supervision and Consumer Protection (DSC). As shown in Figure 2, DOA is the program office for 351 (69 percent) of the 508 open contracts awarded and administered by the ASB regional staffs as of March 1, 2004. The DRR Dallas office is the program office for 147 regional contracts awarded and administered by the Dallas ASB staff. The regional DSC offices are the program offices for a total of 10 contracts awarded and administered by the Chicago, Dallas, New York, and San Francisco ASB staffs. The DOA regional offices perform both ASB and program office contracting functions for the 351 DOA contracts. As shown in Figure 3, DOA has established three reporting structures for its regional contracting functions. DOA's regional program offices are ultimately responsible for contract award and administration and contractor oversight for DOA contractors.

Figure 2: Open Regional Contracts as of March 1, 2004



Source: ASB CMIA.

Figure 3: DOA Regional Office Structures



Source: OIG Analysis.

RESULTS OF AUDIT

Overall, based on our review of 30 contracts with expenditures totaling $11.8 million, we concluded that regional contracting controls are generally adequate to ensure that regional contracts are awarded and administered in accordance with the FDIC's *Acquisition Policy Manual* (APM). We did not identify any significant patterns or trends of noncompliance with APM provisions by the regional office contracting operations.[4] However, DOA regional ASB staffs are not fully independent of the regional program office. Consequently, DOA regional program office managers could influence the regional contract award and administration process. Therefore, we are recommending that DOA establish measures to promptly mitigate the lack of separation of duties and determine whether long-term organizational changes are required to more fully ensure regional ASB independence.

[4] We identified minor compliance issues that we brought to the attention of ASB-Dallas management and DOA's Management Support Section.

INDEPENDENCE OF THE REGIONAL CONTRACTING FUNCTION

The contract award and administration function for regional contracts reports to the regional program office that provides oversight of DOA contractors. Specifically, contracting officers for DOA contracts report to the DOA regional managers as second-level supervisors. This reporting structure conflicts with FDIC policy that the integrity and independence of the contracting function be preserved. Consequently, the potential exists for program office managers to influence the contract award and administration process for DOA contracts.

Control Environment for the Contracting Function

According to the APM, the location of the contracting function within the organizational structure should ensure that the integrity and independence of the contracting function are preserved. DOA's ASB is responsible for ensuring the integrity of the contracting process by independently managing, controlling, and directing all phases of the contracting process.

Chicago and San Francisco Regional Offices

The working relationship between the contracting officers and contractor oversight managers in the Chicago and San Francisco offices has sometimes been strained, in part, because the contracting officers are not independent of the regional program office. Two regional contracting officers expressed concerns that the effectiveness of the contract award and administration function is reduced by the influence of the regional DOA program office. Due to the sensitive nature of contracting actions, we are not including examples illustrating the contracting officers' concerns in this report. However, we discussed these examples with DOA management.

In addition, contract policies and procedures are established by the ASB in Washington, D.C.; however, the performance of regional office ASB personnel in relation to contract award and administration is evaluated by the DOA assistant regional managers. Consequently, contracting officers could attach more importance to achieving regional goals than to ensuring the integrity of the contracting process.

Atlanta, New York, and Dallas Regional Offices

The contract award and administration staff at the Atlanta, New York, and Dallas offices also report to their respective DOA regional manager as a second-line supervisor. The contracting officers in these offices did not express concerns about reporting to the program office, and we found no evidence of regional management influence. However, the potential still exists for the program office to influence the award and administration of DOA contracts.

Regional Managers' Perspective

The regional managers view their function as supporting the regional staff in performing all DOA functions. The regional managers rely on the regional contracting officers for contracting decisions and are rarely involved in a contracting issue. In cases requiring their involvement, regional managers make decisions based on FDIC guidelines, ASB advice, best value for the FDIC, and cost avoidance. In some offices, downsizing and restructuring have resulted in a lack

of a separation of contractor oversight functions; however, the regional managers believe that FDIC policies and procedures, including the APM and headquarters reviews of regional office activities, are adequate to ensure the integrity of the contracting process.

Additional Needed Controls

Established controls help to reduce the FDIC's risks and help ensure that contracting deficiencies are identified. For example, DOA's Management Services Branch performs annual administrative compliance reviews of each office in order to evaluate whether assets are protected and controls are working as designed. In addition, regional managers do not have the authority to approve contracts involving expenditures over $500,000, providing assurance that these contracts are reviewed and approved by senior management officials in Washington, D.C. As of March 1, 2004, 17 contracts, 4.8 percent of the 351 open DOA contracts, involved expenditures over $500,000. Nevertheless, to preserve the independence of the contracting process and avoid potential conflicts of interest for regional DOA contracts, the contract award and administration function should be separate from the contractor oversight function.

Regional Contracting Concerns

In conducting this audit, we noted that there has been a major reduction in DOA's regional contract activity workload without an equivalent decrease in staffing. From January 1, 1999 through December 31, 2003, the number of contract awards at the five regional offices decreased 80 percent, and the total dollar amount of the contracts awarded decreased 73 percent. During the same period, the regional contracting staff decreased 47 percent, from 36 to 17 employees. In addressing our recommendation, DOA should consider whether changes to the procurement process will result in further reductions in regional contracting staff. We are currently conducting an audit entitled, *FDIC's Procurement of Administrative Goods and Services* (Assignment Number 2004-031), which includes an analysis of contracting workload and alternatives to the current contracting process. We expect the audit results to provide additional insight into this issue.

Recommendations

We recommend that the Director, DOA:

(1) Establish measures to mitigate the lack of a separation of duties between the regional contracting functions and program offices.

(2) Determine, as part of ongoing corporate and DOA initiatives, whether long-term organizational changes are necessary to ensure the independence and integrity of the DOA regional contracting function.

CORPORATION COMMENTS AND OIG EVALUATION

On July 12, 2004, the Director, DOA, provided a written response to the draft report, which is presented in its entirety in Appendix II of this report. DOA generally agreed with both recommendations and has either completed or planned corrective action to address them. The following summarizes management's response to each recommendation.

1. Establish measures to mitigate the lack of a separation of duties between the regional contracting functions and program office.

DOA concurred with the recommendation. On July 6, 2004, the Director, DOA, issued a memorandum to all regional office contracting personnel, stressing the importance of preserving the integrity and independence of the contracting function and emphasizing that all regional office contracting personnel must feel free from conflicts of interest in performing their contracting duties. The memorandum also provides guidance to regional contracting personnel to seek resolution of any conflicts through the Associate Director, ASB, in Washington, D.C.

Management's action was responsive to the recommendation. The recommendation is resolved, dispositioned, and closed.

2. Determine, as part of ongoing corporate and DOA initiatives, whether long-term organizational changes are necessary to ensure the independence and integrity of the DOA regional contracting function.

DOA concurred with the recommendation. DOA will evaluate its organizational structure to ensure that it is organizationally aligned to best serve and support the administrative needs of the Corporation in a changing environment. As part of this evaluation, DOA will review whether changes are needed to the regional contracting structure. DOA expects to complete this evaluation within 12 to 18 months.

Management's planned action is responsive to the recommendation. The recommendation is resolved but will remain undispositioned and open until we have determined that agreed-to corrective action has been completed and is effective.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

The objective of the audit was to determine whether regional contracts were awarded and administered in accordance with FDIC policies and procedures. We performed our audit from September 12, 2003 through May 18, 2004 in accordance with generally accepted government auditing standards.

Scope

Originally, the scope of the audit covered 207 open and 49 closed contracts that were awarded and administered by the Dallas, Texas, regional office as recorded in the Contract Monitoring Information Application (CMIA) as of September 23, 2003.[5] We expanded the scope to include a total of 502 open contracts awarded and administered by the Atlanta, Georgia; New York, New York; Chicago, Illinois; Dallas, Texas; and San Francisco, California; offices as of January 28, 2004. The FDIC contracting activity summarized in the background of this report covers the 508 open contracts awarded and administered by the DOA regional offices as recorded in the CMIA as of March 1, 2004.

Methodology

To accomplish our objective, we interviewed regional managers, contracting officers, and contracting personnel in FDIC's regional offices in Atlanta, Dallas, Chicago, and San Francisco. Contracting for the New York region is administered by the Boston, Massachusetts, area office, and we interviewed the assistant regional manager and contracting officer in Boston and the regional manager in New York. We also reviewed contract documentation at the Atlanta, Dallas, Chicago, and San Francisco offices.

We reviewed the contract files and supporting contracting documentation for 30 contracts; 4 in Atlanta, 6 in Chicago, 14 in Dallas, and 6 in San Francisco. We selected a judgmental sample of 24 open contracts based on the amount of the contract, dates of disbursement activity, and other parameters recorded in the CMIA system. We selected our sample of 8 Dallas contracts from the 207 open Dallas contracts recorded in the CMIA as of September 23, 2003. We selected our sample of 4 Atlanta, 6 Chicago, and 6 San Francisco office contracts from the 502 open regional contracts recorded in the CMIA as of January 28, 2004. For review of the contract closeout activity, we selected 6 Dallas office contracts from 49 recently closed Dallas contracts recorded in the CMIA as of September 23, 2003.

Management Controls

To evaluate management controls for regional contract operations, we reviewed the Administrative Compliance Review reports prepared by the DOA Management Services Branch and corresponding review procedures and interviewed a Management Services Branch management analyst in Washington, D.C. We used the FDIC *Acquisition Policy Manual* (APM)

[5] CMIA recorded 2,273 closed Dallas contracts with final expiration dates ranging from 1995 through 2020. To work with recently closed contracts, we considered only those closed contracts with a final expiration date after August 31, 2003 and reduced the total number to 49 contracts.

as our criteria for evaluating regional contract operations. The APM divides the contracting process into the 5 phases and 25 management control activities illustrated below.

Phases and Activities of the Contracting Process

Phase	Activity
Pre-solicitation	Requirement identified Article 17, "Contracting Out" documentation Expenditure authority approved Statement of work prepared Price estimate Requirements packages to ASB Evaluation criteria developed Source selection plan Source list prepared
Solicitation	Identification of prospective offerors Solicitation distribution list prepared Solicitation issued Proposal receipt
Evaluation	Technical evaluation Price evaluation Competitive range decisions Call for best and final offers Contractor eligibility reviews
Award	Contract award
Administration	Performance Processing and paying invoices Tracking invoices against expenditure ceilings Executing modifications Audit resolution Closeout

Source: The FDIC *Acquisition Policy Manual.*

Computer-Processed Data

We used the CMIA system to provide lists of FDIC contracts and to provide background information about the FDIC's overall contract activity. We corroborated the CMIA information with information in the contract files for the sampled contracts. Although we used the CMIA processed data as general background information in the report, we did not use the CMIA information to support our findings, conclusions, and recommendations.

Fraud and Illegal Acts

Our audit procedures detected no fraudulent or illegal acts. The OIG Office of Investigations (OI) shared a Hotline complaint with us concerning contract operations at one regional office. OI determined that there was no investigative merit to the allegation. During our audit, we determined that the Hotline issues related to the independence of the contracting function as discussed in the finding section of this report.

Performance Measures

We reviewed the *FDIC 2003 Corporate Annual Performance Plan* and found no performance measures related to regional contract operations.

Laws and Regulations

No laws or regulations were relevant to our audit objective.

CORPORATION COMMENTS

FDIC
Federal Deposit Insurance Corporation
550 17th Street, NW, Washington, DC 20429

Division of Administration

July 12, 2004

MEMORANDUM TO: Stephen M. Beard
Deputy Assistant Inspector General

FROM: Arleas Upton Kea
Director, Division of Administration

SUBJECT: Management Response to OIG Draft Report entitled: Regional Contract Operations *(Assignment Number 2003-051)*

The Division of Administration (DOA) has completed its review of the subject Office of Inspector General (OIG) report. We are pleased to see that the OIG did not identify any significant concerns of noncompliance with the Acquisition Policy Manual (APM) and concluded that regional contracting controls are in place to ensure regional contracts are awarded and administered in accordance with the FDIC's APM.

Although the OIG found DOA's regional contracting operations to be sound, the OIG did report that DOA regional ASB staffs are not fully independent of the regional program office. As a result, the OIG noted that the DOA regional program office could potentially assert influence in the regional contract award and administration process. We generally agreed with the concerns raised by the OIG, and have outlined our planned corrective actions with respect to the two audit recommendations made by the OIG.

MANAGEMENT DECISION

OIG Condition - *Independence of the Regional Contracting Function*: The OIG stated that the contract award and administration function for regional contracts is organizationally responsible to the regional program office that provides oversight of DOA contractors. Specifically, the OIG noted that contracting officers for DOA contracts report to the DOA regional managers as second-level supervisors which the OIG believes conflicts with FDIC policy regarding preservation of the integrity and independence of the contracting function. Consequently, the OIG asserts that the potential exists for program office managers to influence the contract award and administration process for DOA contracts.

OIG Recommendation(s):

1) Establish measures to mitigate the lack of separation of duties between the regional contracting functions and program office; and

2) Determine, as part of ongoing corporate and DOA initiatives, whether long-term organizational changes are necessary to ensure the independence and integrity of the DOA regional contracting function.

Management Response: Although we agree with the OIG that regional contracting personnel could potentially be influenced by DOA regional managers or DOA program management officials, DOA believes that there are sufficient internal operating controls in place that mitigate the potential risk cited by the OIG. DOA has always been mindful that potential independence issues could arise since the DOA regional structure was first established in 1996. As a result, DOA implemented sound business operating processes from the beginning to minimize the likelihood of this occurrence and has been proactive in implementing operating improvement changes as deemed necessary. Specifically, the DOA Acquisition Services Branch (ASB) incorporates numerous internal controls into the contracting process that can be found throughout the APM; DOA Management Services Branch (MSB) conducts annual comprehensive internal compliance and risk based reviews[1] of DOA's operations; and DOA MSB conducts monthly variance analysis of the budget to actual expenditures incurred. Moreover, the DOA regional managers do not have the delegated authority to approve contract expenditures greater than $500,000. The review and approval for these contracts are made in Washington. With the above mentioned controls, DOA believes the potential independence issue presented in the OIG report is minimized.

As for DOA's position on the two OIG recommendations, DOA generally agrees with the recommendations:

- **Recommendation #1:** DOA agrees with the OIG's recommendation to establish measures to mitigate the lack of separation of duties between the regional contracting functions and program office. To address this recommendation, a memorandum dated July 6, 2004, was issued from DOA's Director to all Regional Office contracting personnel to articulate DOA's stand with respect to independence in decision making by the regional contracting staffs. Specifically, the memorandum stressed the importance of preserving the integrity and independence of the contracting function and emphasized the fact that all Regional Office contracting personnel must feel free to operate from potential conflicts of interest when performing their roles and responsibilities as contracting advisors. The memorandum also provides guidance to regional contracting personnel to seek resolution of any conflicts through the Associate Director, ASB, in Washington DC. This revised process should help to eliminate the perceived conflict of interest noted in the OIG's report.

- **Recommendation #2:** DOA agrees with the recommendation. As the landscape of the FDIC changes, DOA will continue to evaluate our own organizational structure to ensure that we are organizationally aligned to best serve and support the administrative needs of the Corporation. As part of this evaluation, DOA will review whether changes are

[1] Administrative Compliance Reviews (ACR) and Chief Financial Officer Act Reviews (CFOA) performed through the various DOA business operations – Acquisition Services Branch, Corporate Services Branch, Human Resources Branch, and DOA Regional Operations.

needed to the regional contracting structure. DOA expects to complete this evaluation within 12 to18 months.

If you have any questions regarding the response, our point of contact for this matter is Andrew Nickle, Audit Liaison for the Division of Administration. Mr. Nickle can be reached at (202) 942-3190.

cc: Glen Bjorklund, DOA
Ann Bridges Steely, DOA ASB
Paul K. Sherman, DOA MSB
James H. Angel Jr., OERM
Regional Managers

MANAGEMENT RESPONSES TO THE RECOMMENDATIONS

The information in this table is based on management's written response to our report. The table also presents the status of the recommendations as of the date of report issuance.

Rec. Number	Corrective Action: Taken or Planned/Status	Expected Completion Date	Monetary Benefits	Resolved:[a] Yes or No	Dispositioned:[b] Yes or No	Open or Closed[c]
1	The Director, DOA, issued a memorandum to all regional office contracting personnel, stressing the importance of preserving the integrity and independence of the contracting function. The memorandum also provides guidance to regional contracting personnel to seek resolution of any conflicts through the Associate Director, ASB, in Washington, D.C.	Completed July 6, 2004	None	Yes	Yes	Closed
2	As part of DOA's evaluation of its organizational structure, DOA will determine whether changes are needed to the regional contracting structure.	January 12, 2006	None	Yes	No	Open

[a] Resolved – (1) Management concurs with the recommendation, and the planned corrective action is consistent with the recommendation.
(2) Management does not concur with the recommendation, but planned alternative action is acceptable to the OIG.
(3) Management agrees to the OIG monetary benefits or a different amount, or no ($0) amount. Monetary benefits are considered resolved as long as management provides an amount.

[b] Dispositioned – The agreed-to corrective action must be implemented, determined to be effective, and the actual amounts of monetary benefits achieved through implementation identified. The OIG is responsible for determining whether the documentation provided by management is adequate to disposition the recommendation.

[c] Once the OIG dispositions the recommendation, it can then be closed.