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Audit Report Number 2010-HA-0003

TO: Jemine Bryon, Chief Procurement Officer, Office of the Chief Procurement Officer, N

FROM: //s//
Saundra G. Elion, Director, Headquarters Audit Division, GAH

SUBJECT: HUD Needs To Improve Controls Over Its Administration of Completed and Expired Contracts

HIGHLIGHTS

What We Audited and Why

We audited the Office of the Chief Procurement Officer's (procurement office) procedures for administering completed and expired contracts in compliance with applicable regulations. This audit was part of our 2010 audit plan. Our objective was to determine whether the procurement office performed contract closeout procedures on completed and expired contracts in a timely manner. We expanded our objective to determine whether the contract files were complete and properly maintained.

What We Found

The procurement office did not close contracts in a timely manner. Specifically, the procurement office did not close out more than 1,800 contract actions for which the performance period had expired or the work had been completed more than 6 months before our review. Of these actions, 35 contracts had outstanding balances totaling \$15.2 million that should have been deobligated. Also, the

procurement office did not maintain accountability over contract files. As a result, the procurement office could not locate 15 of the 94 files in our sample, and 11 files were incomplete because required documents were missing.

What We Recommend

We recommend that the procurement office deobligate the \$15.2 million in outstanding balances remaining on the contracts included in our review, increase the priority for closing expired and completed contracts and appropriately deobligate outstanding balances to avoid future backlogs, and establish adequate administrative controls to properly maintain and safeguard contract files.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We provided the discussion draft to the procurement office for comment on August 5, 2010. We provided a revised discussion draft, based on the exit conference, to the procurement office of September 3, 2010. We received written comments from the Chief Procurement Officer on September 10, 2010, that generally agreed with our findings and recommendations. The complete text of the auditee's response along with our evaluation of that response can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVES

The Office of the Chief of Procurement Officer (procurement office) is responsible for awarding and administering contracts and purchase orders for program offices to meet the U.S. Department of Housing and Urban Development's (HUD) operational needs and achieve its program mission. In addition to awarding contracts, the procurement office administers a large portfolio of contracts that have expired (the performance period has ended) or have been completed (products or services have been delivered). Procurement activities are performed at the headquarters procurement office as well as at the three field contracting offices located in Philadelphia, PA, Atlanta, GA, and Denver, CO.

Contract closeout refers to the administrative actions taken to retire completed contracts (contract for which all work has been finished, all deliverables have been received and accepted or otherwise disposed of, and all financial matters have been settled). The program office initiates the closeout process, but the procurement office has overall responsibility for closing out all contracts.

In September 2006, the headquarters procurement office implemented an aggressive closeout initiative to remedy the serious backlog of contracts, purchase orders, and interagency agreements that were complete but not closed out in the procurement and accounting systems. This initiative was implemented to reduce the backlog and liquidate millions of dollars remaining on HUD's books. The procurement office planned to accomplish this initiative by hiring a contractor and developing a closeout function within the headquarters procurement office to close approximately 9,500 actions that were in the HUD Procurement System and Small Purchase System (procurement systems). The priorities of the closeout initiative were to close (1) expired actions with outstanding balances that could be reprogrammed, (2) expired actions identified by the Chief Information Officer, (3) expired actions that need to be deobligated¹ per the Chief Financial Officer's open obligation review process, and (4) expired actions with no dollars remaining.

To date, the procurement office has hired three different contractors to accomplish this ongoing initiative but has not developed a closeout function at headquarters. As of January 2010, HUD reported that more than \$40 million had been deobligated and 11,330 actions closed².

Our objective was to determine whether the procurement office performed contract closeout procedures on expired and completed contracts in a timely manner. We expanded our objective to determine whether the contract files were complete and properly maintained.

¹ Deobligate: to remove remaining funds from a completed, terminated, or cancelled contract or project that had been previously set aside for the contract or project.

² The procurement office could not identify the specific contract actions that make up the 9,500 cited in the contract closeout initiative; therefore, we could not determine which of the 11,330 actions related to the 9,500 contract actions.

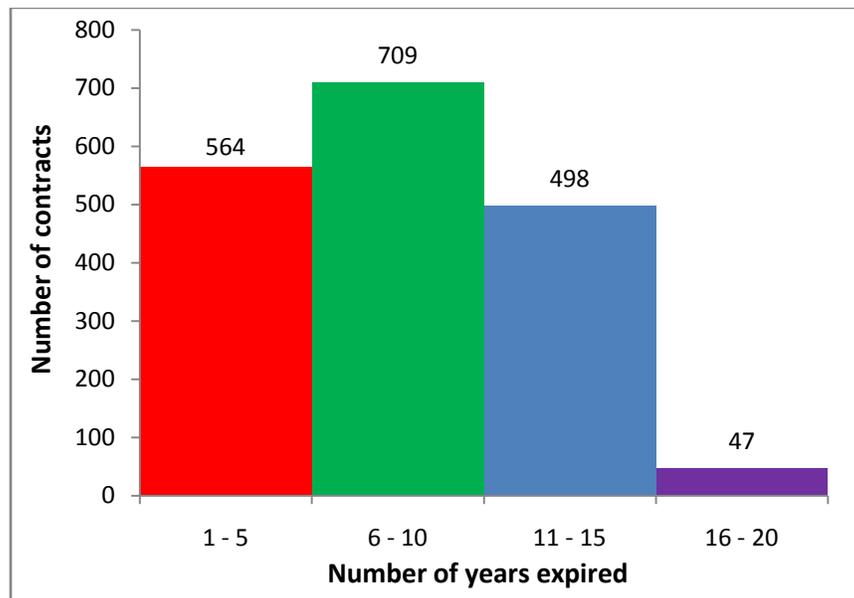
RESULTS OF AUDIT

Finding 1: The Procurement Office Did Not Close Out Contracts in a Timely Manner

The procurement office did not close out expired and completed contracts in a timely manner. Specifically, more than 1,800 contract actions had not been closed although some had expired or been completed for more than 15 years. This condition occurred because the procurement office (1) made closing out contracts a low priority and (2) experienced staff turnover, which contributed to a lack of continuity in managing and administering the contracts. As a result, outstanding balances of \$15.2 million remaining on these contracts could have been deobligated and potentially reprogrammed to further HUD's mission.

More Than 1,800 Expired and/or Completed Contract Actions Had Not Been Closed

In December 2009, HUD's procurement system showed that more than 1,800 contract actions had either expired or been completed but had not been entered into the closeout process. Contract actions with expiration dates as early as 1991 were still open in the procurement system.



Source: The procurement office. December 17, 2009

For years, the procurement office had placed a low priority on the contract closeout process as evidenced by the backlog that precipitated the 2006 closeout

initiative. Putting a low priority on closing contracts contributed to outstanding balances accumulating and remaining on contracts that have no expected future activity.

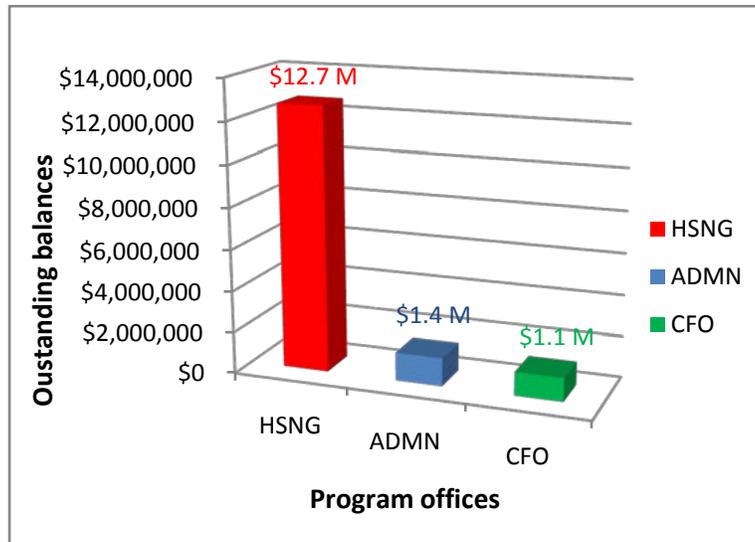
According to procurement officials, “management’s focus is on awarding and administering contracts,” and the large volume of new contracts leaves few resources with which to focus on and perform contract closeout. Delays in completing the closeout process were further compounded by a shortage of staff. The most recent management review completed by the procurement office in 2008 also reported that “HUD’s acquisition function has suffered significantly from workforce losses in recent years” and that the procurement office has experienced high levels of turnover on a continuous basis. The high staff turnover contributes to a lack of continuity in contract administration.

Even with the low priority assigned to the contract closeouts and workforce shortages in the procurement office, HUD has a process (the review of open obligations) in place to identify which funds should be deobligated or retained. This process is conducted on an annual basis for the express purpose of reducing the amount of the outstanding balances reported in HUD’s accounting system.

HUD’s Office of the Chief Financial Officer oversees the annual open obligations review so that HUD can certify to the Office of Management and Budget the total amount of funds remaining as obligations at the end of the year. To determine the total amount to certify, the Chief Financial Officer requires the program offices to review their obligated³ balances recorded in the accounting system. The program offices research the funds and associated projects and determine whether the outstanding balances should be deobligated or retained. Balances remaining on expired contract actions that are marked for deobligation during this review process should be sent to the procurement office for deobligation.

We identified that 35 of the 380 contracts we verified had expired between June 2004 and March 2009 and had \$15.2 million in outstanding balances remaining on them but had not been entered into the closeout process. As shown below, the majority of the outstanding balances were for the Office of Housing, and the Office of Administration and Office of the Chief Financial Officer comprised the remainder.

³ Obligate: when funds are set aside for a specific contract or project.



Source: The Office of Chief Financial Officer, as of March 12, 2010

HSNB = Office of Housing
 ADMIN = Office of Administration
 CFO = Office of the Chief Financial Officer

Of the 35 contracts comprising the chart above, one contract with a \$1.2 million outstanding balance had been marked for deobligation during the 2009 open obligations review process. However, as of March 12, 2010 (more than 1 year later), this balance was still recorded as an obligation in the accounting system. Although it is clearly the responsibility of the procurement office to deobligate the funds after receiving notification from the program office, we were unable to learn from the procurement office why this amount had not been deobligated.

After our review and initial inquiries about this contract, the procurement office initiated action to not only deobligate the \$1.2 million, but also deobligate \$7 million in outstanding balances on 19 other contracts as well as to begin closeout procedures on those contracts. Additionally, the procurement office was researching the 15 contracts that had remaining balances totaling nearly \$7 million to determine whether the funds could be immediately deobligated and either reprogrammed or returned to the U.S. Treasury.

Expired Funds Were Not Cancelled and Returned to Treasury

Section 1501 (d) of the Supplemental Appropriation Act of 1955 (Title 31, United States Code, Section 1107) provides that the nature of an appropriation or fund determines its period of obligational availability (i.e., one-year, multiple-year, no-year). Expired funds that are five years old are cancelled on September 30 of year five and are no longer available to be used by the agency. Of the remaining 34

expired contracts identified above, the funds (\$56,157) on one contract expired on September 30, 2009, and should have been returned to the U.S. Treasury. However, those funds were marked “retain” during the 2009 open obligations review, and as of March 12, 2010, those funds remained in HUD’s accounting system. We were unable to determine from the procurement and accounting offices why those funds had not been deobligated or cancelled and returned to Treasury after September 30, 2009. Funds remaining on the other 33 contracts are expected to expire between 2010 and 2014, at which time HUD will be unable to reprogram these funds, and the funds will have to be returned to Treasury. However, if the funds are deobligated before they expire HUD can reprogram them for similar program activities.

Conclusion

Contract closeout was given a much lower priority than awarding new contracts. By not closing out contract actions in a timely manner, HUD may miss the opportunity to use the \$15.2 million.

Subsequent to and during our audit, the procurement office deobligated \$8.2 of the \$15.2 million in outstanding balances from the 35 expired contracts. Although the procurement office has taken action to deobligate these outstanding balances, progress needs to be evaluated over a longer period of time to ensure that funds are deobligated before they expire so that HUD can reprogram them for similar program activities.

Recommendation

We recommend that the Chief Procurement Officer

- 1A Complete the deobligation of the \$15.2 million in outstanding balances remaining on expired contracts as of March 2010.⁴
- 1B Increase the priority for closing expired and completed contracts and appropriately deobligate funds in a timely manner to avoid future backlogs. The Chief Procurement Officer should also consider adding contract closeout as a performance measure in the contracting officers’ annual evaluation.

⁴ The procurement office has already begun to take action on our recommendation to deobligate funds remaining on expired and completed contracts. Subsequent to and during our audit, the procurement office deobligated \$8.2 million of the \$15.2 million in outstanding balances.

Finding 2: The Headquarters Procurement Office Did Not Properly Maintain Its Contract Files

The headquarters procurement office did not maintain accountability over contract files. Specifically, the procurement office could not locate 15 of the 94 files in our review and 11 of the available contract files were incomplete. This condition occurred because the procurement office did not establish adequate administrative controls to properly maintain and safeguard contract files. As a result, HUD had no assurance that contract files were complete or available to effectively monitor and support contract activity.

Contract Files Were Missing or Incomplete

The procurement office did not maintain accountability over contract files as required by Title 48 of the U.S. Code of Federal Regulations, the Federal Acquisition Regulation (FAR). According to FAR 4.802(c)(1)(2), contract files must be maintained at organizational levels that ensure effective documentation of contract actions and provide ready accessibility to principal users.

Of the 94 closed contracts included in our review, 15 contract files were missing and 11 did not contain adequate documentation. The procurement office staff assigned to search and retrieve the 15 missing contract files indicated that they could not locate the files because the contracts were old.

Eleven contract files were not being adequately maintained to ensure the files contained reliable and complete documentation. Documents that were missing or incomplete from the files included key documents such as contractor's release, final invoice, or the contract completion statement that should be evaluated before the contract is closed; the contract award document was not signed by all parties, and critical pages were missing from one contract. The critical pages that were missing were the supplies or services and price/costs; and the description, specifications, and/or work statements that are required sections as outlined in FAR 15.204.1. These sections contain information describing HUD's needs, the deliverables and cost for the contract.

Controls Over Contract Files Were Inadequate

The procurement office did not have a policy or procedures in place requiring contract files to be maintained or stored in a systematic manner. Instead, staff members were allowed to maintain records at their discretion.

Staff members opted for storing contracts in either their immediate areas or in one of the six Lektrievers (large storage/filing system) located in three areas of the building. Some contract files were put into unlabeled boxes and stacked on the floor or just placed on the floor (not in boxes) in the basement.

Because the files were missing or incomplete, HUD had no assurance that contracts were complete or contained adequate information to effectively monitor and support contract activity.

Conclusion

Since the procurement office did not have adequate controls over its contract files as required by the Federal Acquisition Regulation, documents could easily be misplaced, lost, or destroyed. Because the files were missing, HUD had no assurance that contracts were complete or contained adequate information to effectively monitor and support contract activity.

Recommendation

We recommend that the procurement office

- 2A. Establish a policy and appropriate procedures to ensure the proper maintenance, tracking and safeguarding of contract files.

SCOPE AND METHODOLOGY

We performed audit work at HUD headquarters, Washington, DC, between October 2009 and June 2010. Our audit generally covered the period January 1, 1990, through March 31, 2009, but was expanded when necessary to include other periods.

To accomplish our objectives, we

- Reviewed applicable laws, the Federal Acquisition Regulation, HUD acquisition regulations, HUD handbooks 2210.3 REV-9 and 1830.2 Rev5.
- Examined contract files awarded between January 1, 1990, through March 31, 2009.
- Examined contract history reports and data from the procurement and accounting systems.
- Examined reports from HUD's accounting system to determine contracts with outstanding balances.
- Conducted interviews with HUD employees from the Office of the Chief Procurement Officer and the Office of the Chief Financial Officer to determine roles and responsibilities related to contracts.

To achieve our objectives, we relied in part on computer-processed data in the procurement office's database. Although we did not perform a detailed assessment of the reliability of the data, we performed a minimal level of testing, and we found the data to be adequate for our purposes.

The procurement office provided a universe of 16,383 procurement actions that included interagency agreements and purchase orders for the period January 1, 1990, through March 31, 2009. We reduced the universe to 9,013 to reflect only contracts. We then separated the universe into the three categories (active/expired⁵, active/in closeout⁶, and inactive/closed⁷) that the procurement office used to describe contracts that had either expired or had been completed.

We initially selected a statistical sample of 69 contracts to determine whether the procurement office performed contract closeouts in a timely manner. We computed the sample size using attribute methodology and a random number generator to select the contracts. The sampling criteria used a confidence level of 85 percent, an estimated error rate of 3 percent, and precision range of 16 to 26 percent.

We expanded our sample when we determined that 4 of the 69 contracts had outstanding balances totaling \$1 million although the report from the Office of the Chief Financial Officer showed that all of the contract balances were zero. Because we had indicators that more contracts had outstanding balances remaining on them, we selected all contracts that had outstanding balances greater than \$1,000. This process resulted in the selection of an additional

⁵ Active/expired: when a contract's last option period has passed.

⁶ Active/in closeout: when a contract enters the close-out process

⁷ Inactive/Closed: when a contract has been administratively closed, after the contracting officer receives completion documents.

311 non-representative contracts. We verified the outstanding balances reported in HUD's accounting system for each contract in our sample. In addition to the 69 statistically selected contracts we included 25 of the 311 non-representative contracts (for a total of 94) for detailed testing of the contract closeout procedures. [See Finding 2] We did not project our results to the universe of expired and completed contracts.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

INTERNAL CONTROLS

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined that the following internal controls were relevant to our audit objectives:

- Effectiveness and efficiency of operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Compliance with applicable laws and regulations – Policies and procedures that management has in place to ensure that resource use is consistent with laws and regulations.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiencies

Based on our review, we believe that the following items are significant deficiencies:

- The procurement office did not have adequate controls in place to ensure that outstanding balances were properly deobligated when contracts expired or were completed (finding 1).
- The procurement office did not have adequate controls in place to ensure that contract files were properly stored and maintained (finding 2).

APPENDIXES

Appendix A

SCHEDULE OF FUNDS TO BE PUT TO BETTER USE

Recommendation number	Funds to be put to better use ^{1/}
1A	\$15.2 million

- ^{1/} Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in pre-award reviews, and any other savings that are specifically identified.

Appendix B

AUDITEE COMMENTS

Reference to OIG Evaluation

Auditee Comments

 U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-0001

CHIEF PROCUREMENT OFFICER

~~SEP 10 2010~~

MEMORANDUM FOR: Saundra G. Elion, Director, OIG HQ Audit Division, GAO

FROM: Jemine A. Bryon, Chief Procurement Officer, N

SUBJECT: Response to OIG Revised Draft Report on Administration of Completed and Expired Contracts

We have reviewed your draft audit report dated September 3, 2010, of the Office of the Chief Procurement Officer's administration of completed and expired contracts. First, thank you for acknowledging the extraordinary volume, 11,330, of contract actions closed by this office over the past few years. Such success was achieved through a concerted effort by staff and by utilizing contractor support. However, as your report points out, there still remains a backlog of some 1800 contract actions that we are working on with staff and by continuing to utilize contractor support.

Our response to specific findings in the report is as follows:

Finding 1:
The report states that more than 1800 contract actions had not been closed. These 1800 actions represent 13.7% of the eligible workload. It is important to emphasize the fact that 11,330 (86.3%) of HUD's actions have been closed out and funds deobligated as appropriate. HUD has not discontinued its efforts in this area and will eliminate this backlog as quickly as resources and priorities permit.

Of the 35 actions identified in the report, OCPO staff have now closed 22 of the actions and deobligated \$9.6M. One action for \$846K requires an audit by DCAA before closeout can be completed; the audit is in process. One other action for \$48K remains outstanding from a termination for convenience; the funds cannot be deobligated until a negotiated settlement agreement is reached.

Recommendation:

1A. We agree with this recommendation that the remainder of the \$7 million in outstanding balances must be deobligated as appropriate. To date, the outstanding amount has been reduced to \$5.6M. With the exception of the contract requiring an audit and the one awaiting settlement negotiations noted above, we anticipate closeout of all remaining actions by October 8, 2010.

1B. As noted in the report, we have already completed the deobligation process of the \$8.2M. It is not the responsibility of OCPO to ascertain if the funds may be reprogrammed for other program activities; that is an accounting and budget function that should automatically occur upon deobligation.

Comment 1

Comment 2

- 1C. Closing expired contracts and orders has already been given a priority, as established above. An Acquisition Instruction was issued in 2008 to ensure proper focus was established on this critical activity. Most manager and staff performance elements already include this as an item they are evaluated on. The element will be enhanced in FY 11 performance plans. This increased focus has already paid off by improving the rate of closeouts. Continued emphasis will improve our performance in this area. In addition, HUD is in the process of acquiring an integrated acquisition management system that will substantially streamline and improve the processing and oversight of the contract closeout function.

Finding 2:

It is unfortunate that due to physical space constraints, file storage has proven to be problematic and led to maintenance of files in boxes in various locations within OCPO office space and in storage space in the basement of HUD's building.

Recommendation:

- 2A. We agree that a standard policy and procedure is necessary and will be developed. While some OCPO offices' local policies have been successful, it is necessary that standardization occur within the OCPO. A policy will be issued by October 22, 2010.

I would note again that the upcoming purchase of the acquisition management system will likely alleviate this problem by creating electronic contract files and substantially minimizing the need for storage of paper files.

Thank you.

OIG Evaluation of Auditee Comments

- Comment 1 We combined recommendations 1A and 1B to reflect the entire \$15.2 million in outstanding balances that was identified during the audit. Additionally, we revised recommendation 1A to acknowledge that the Office of the Chief Procurement Officer is not responsible for reprogramming the deobligated funds.
- Comment 2 Recommendation 1C referred to in the auditee’s response was renumbered to 1B in the final audit report.