



# Office of Inspector General

March 2006  
Report No. 06-010

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**FDIC's Consolidated Facilities  
Management Approach**

**AUDIT REPORT**

*Office of Audits*



**oig**



## Background and Purpose of Audit

As part of the FDIC's strategic goal to substantially reduce corporate operating costs, the Division of Administration (DOA) implemented the Consolidated Facilities Management (CFM) approach and awarded a \$30.4 million CFM contract to Consolidated Engineering Services, Inc. (CESI) in April 2003.

The CFM approach combined 13 facilities-related contracts into a single "bundled" contract designed to reduce administrative costs and simplify the management of various building services at FDIC-owned headquarters facilities and leased space. A bundled contract consolidates two or more procurement requirements for goods or services, previously provided under separate contracts, into a single contract that is likely to be unsuitable for award to a small business concern. To limit the impact of contract bundling on small businesses, statutory and regulatory requirements are designed to ensure that bundling is necessary and justified and that expected benefits of consolidation are quantified and substantial.

The audit objective was to determine whether the contract structure and FDIC contract management were adequate to ensure the economical and efficient management of the FDIC's Washington, D.C., area facilities.

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## FDIC's Consolidated Facilities Management Approach

### Results of Audit

The CFM contract structure (implementation of the CFM approach) and the FDIC's management of the contract were generally adequate to ensure the efficient operation of the FDIC's Washington, D.C., area facilities. An independent engineering firm determined that the facilities were well-maintained, and a customer satisfaction survey indicated that most FDIC employees were satisfied with the overall physical environment in FDIC building space. However, we could not determine whether the CFM contract resulted in more economical facilities management services due to weaknesses in certain procurement-related internal controls. Specifically:

- The internal control structure for making contract bundling determinations and compliance with applicable statutory and regulatory requirements needs improvement. The FDIC did not clearly demonstrate that contract bundling was necessary and justified and that small business participation was maximized.
- The FDIC did not have controls in place to monitor or periodically assess whether the intended benefits of the consolidated facilities maintenance contract were being achieved and small business participation was being safeguarded.
- The FDIC completed a major capital improvement project on one of its facilities using the CFM contract. However, a portion of the related costs were expensed rather than capitalized. As a result, the FDIC overstated facilities maintenance costs by \$1,220,023 and understated assets by the corresponding amount in its accounting records. Further, the capital improvement was awarded to the CFM contractor without a written justification for a noncompetitive procurement or documented market research indicating that a noncompetitive contract was required and is reasonably priced.
- The janitorial services incentive provisions of the CFM contract do not require performance that exceeds the standards in the contract Statement of Work. As a result, the FDIC paid janitorial incentives totaling \$193,131 through December 31, 2005 and may pay additional incentives of \$318,748 for the remaining contract period without obtaining any benefit beyond what is already required in the contract.

### Recommendations and Management Response

We made recommendations to improve internal control over the process for awarding and monitoring the benefits of bundled contracts, capitalizing costs, and structuring incentives on the CFM contract.

The FDIC generally agreed or provided responsive alternative corrective action to most of our recommendations. In particular, the FDIC agreed to amend policy guidance to include coverage of contract bundling and capitalize costs associated with a major capital improvement. The FDIC did not agree to specifically require market research and justifications for noncompetitive procurement for large-dollar-value work orders on existing contracts. We are continuing to work with FDIC management to resolve this recommendation. If this effort is unsuccessful, we plan to refer the recommendation to the designated audit follow-up official for a final management decision. Additionally, FDIC management did not agree with \$1,538,771 reported as funds put to better use or the \$193,131 in questioned costs. These monetary benefits together with management's final decision on them will be reported in the OIG's next *Semiannual Report to the Congress*.

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**DATE:** March 30, 2006

**MEMORANDUM TO:** Arleas Upton Kea, Director  
Division of Administration

Fred Selby, Director  
Division of Finance

**FROM:** Russell A. Rau [Electronically produced version; original signed by Russell A. Rau]  
Assistant Inspector General for Audits

**SUBJECT:** *FDIC's Consolidated Facilities Management Approach*  
(Report No. 06-010)

This report presents the results of our audit of the FDIC's consolidation of facilities management services. The consolidated services approach to facilities management represents a shift from FDIC management of multiple contractors to management of one contractor for building management, repair, and maintenance services. The overall objective of the audit was to determine whether the contract structure<sup>1</sup> and FDIC management of the contract were adequate to ensure the economical and efficient management of the Corporation's Washington, D.C., area facilities. Appendix I discusses our objective, scope, and methodology in more detail.

## **BACKGROUND**

As part of the FDIC's strategic goals to substantially reduce corporate operating costs and develop efficient and cost-effective processes, the Division of Administration (DOA) implemented the Consolidated Facilities Management (CFM) approach. CFM was designed to cut administrative costs and simplify the management of numerous building services in anticipation of staff decreases and increases in the number and complexity of service contracts for DOA's Corporate Services Branch (CSB) - Facilities Operation Section (FOS). The CFM approach combined 13 facilities-related contract services into 1 contract and includes the following services:

- building operations and maintenance and recurring repairs;
- electrical installations and maintenance;
- elevator maintenance and repair (2 contracts);
- environmental management system operation and maintenance (2 contracts);
- janitorial services;
- interior construction for space alterations;

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<sup>1</sup> The contract structure is the implementation of the Consolidated Facilities Management approach.

- painting;
- pest control;
- landscaping;
- interior plant maintenance; and
- supplemental air conditioning systems in leased buildings.

Effective April 1, 2003, the FDIC awarded its first CFM contract to Consolidated Engineering Services, Inc (CESI). The contract has a 2-year base period with three 1-year options and originally had a total contract ceiling of \$30.4 million. As of May 1, 2004, the contract ceiling increased to \$32.5 million.<sup>2</sup> The total authorized budget for the 5-year contract period was \$39.3 million.

As part of the CFM approach, the FDIC had the option to consolidate existing contracts into fewer contracts to streamline and reduce procurement and contract administration costs. Consolidated contracts, depending on size, are open to competition from small businesses. However, the FDIC implemented a more complex approach, a subset of contract consolidation referred to as contract bundling. Contract bundling is defined as the consolidation of two or more procurement requirements for goods or services previously provided or performed under separate, smaller contracts into a solicitation of offers for a single contract that is likely to be unsuitable for award to a small business concern due to:

- the diversity, size, or specialized nature of the elements of the performance specified;
- the aggregate dollar value of the anticipated award;
- the geographic dispersion of contract performance sites; or
- any combination of these three criteria.

The FDIC selected the contract bundling approach due to the multitude of services required, aggregate dollar value, and complexity of the requirements as delineated in the contract's Statement of Work. Contract bundling is subject to certain laws and regulations that protect small businesses.

As a result of the potential adverse effect of bundled contracts on small businesses, the Congress and small business advocates expressed concern about the extent of contract requirements for bundling and the effect that such bundling has on the ability of small businesses and small, disadvantaged businesses to participate in federal procurements. In light of these concerns, in 1997, Congress enacted amendments to the Small Business Act related to contract bundling. The Small Business Reauthorization Act of 1997 (SBRA<sup>3</sup>) requires federal agencies (including the FDIC) to:

- comply with congressional intent to foster the participation of small business concerns as prime contractors, subcontractors, and suppliers;

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<sup>2</sup> Modification 1, dated June 1, 2003, increased the contract ceiling to \$31 million. Modification 4, dated May 1, 2004, increased the contract ceiling to \$32.5 million.

<sup>3</sup> We use SBRA to refer the Small Business Act, as amended by the SBRA or other laws.

- structure contracting requirements to facilitate competition by and among small business concerns, taking all reasonable steps to eliminate obstacles to their participation; and
- avoid unnecessary and unjustified bundling of contract requirements that precludes small business participation in procurements as prime contractors.

Furthermore, the SBRA requires the Small Business Administration (SBA) to review all proposed consolidated acquisitions for goods or services that small businesses were currently providing but that may be unsuitable for award to a small business. According to the SBRA, if SBA decides the proposed procurement will render small business contract participation unlikely, SBA can recommend alternate procurement methods to the procurement activity to increase small business participation.

The FDIC has concluded that the contract bundling provisions of the SBRA apply to the FDIC. Therefore, the FDIC may not proceed with an acquisition strategy that would lead to contract bundling without first conducting market research to determine that the bundling is necessary and justified. Further, when the FDIC's acquisition strategy includes substantial contract bundling,<sup>4</sup> the FDIC must identify the anticipated benefits, provide an assessment of the impediments to small businesses, specify actions to be taken to maximize small business participation as a subcontractor, and make a specific determination that the anticipated benefits of the proposed bundled contract justify its use. Recently, the FDIC also concluded that SBA regulations governing contract bundling are also applicable to the FDIC.

## RESULTS OF AUDIT

The CFM contract structure and FDIC's management of the contract were generally adequate to ensure the efficient operation of the Corporation's Washington, D.C., area facilities. An independent engineering firm determined that the facilities were well-maintained, and a customer satisfaction survey indicated that most FDIC employees were satisfied with the overall physical environment in FDIC building space. However, we could not determine whether the CFM contract resulted in more economical facilities management services due to weaknesses in certain procurement-related internal controls. Specifically:

- The internal control structure<sup>5</sup> for making contract bundling determinations needs improvement. The market research performed to support bundling decisions had significant limitations, and minimal consideration was given to small business participation. As a result, the FDIC could not clearly demonstrate that contract bundling was necessary and justified before award of the CFM contract and that small business participation was maximized (Finding A).
- The FDIC did not have controls in place to monitor or periodically assess whether the intended benefits of the CFM contract were being achieved and small business

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<sup>4</sup> Substantial contract bundling is not defined by statute but is defined by regulation as discussed further in Finding A.

<sup>5</sup> Internal control structure refers to the application of the five internal control standards in the Government Accountability Office's (GAO) *Standards for Internal Control in the Federal Government*, dated November 1999.

participation was being safeguarded. As a result, it is unclear whether the CFM contract is achieving intended benefits, including small business participation levels (Finding B).

- The FDIC completed a major capital improvement project on one of its facilities, using the CFM contract. However, a portion of the related costs were expensed rather than capitalized. As a result, FDIC accounting records overstated facilities maintenance costs by \$1,220,023 and understated assets by the corresponding amount. We plan to report this amount as funds put to better use in the next Office of Inspector General (OIG) *Semiannual Report to the Congress*. Further, the capital improvement was awarded to the CFM contractor without a written justification for noncompetitive procurement or documented market research. The CFM contractor competed subcontracts for the required work which at least partially mitigated the pricing risk. However, absent the justification or market research, there is limited assurance that a noncompetitive procurement is required or that overall pricing is fair and reasonable (Finding C).
- The janitorial services incentive provisions of the CFM contract do not require performance that exceeds the standards in the contract Statement of Work. As a result, the FDIC paid janitorial incentives totaling \$193,131 through December 31, 2005 and may pay additional incentives of \$318,748 for the remaining contract period without obtaining any benefit beyond what is already required in the contract. If the contract provisions are modified as part of an upcoming option exercise, there may be opportunities to reduce costs and improve performance. We plan to report the \$193,131 as questioned costs and the \$318,748 as funds put to better use in the next OIG *Semiannual Report to the Congress* (Finding D).

## **FINDINGS AND RECOMMENDATIONS**

### **FINDING A: NECESSITY AND JUSTIFICATION OF CFM APPROACH**

The FDIC internal control structure for making contract bundling determinations needs improvement. Concerning the CFM contract, the FDIC's market research<sup>6</sup> considered the costs for facilities maintenance under 13 separate contracts compared to estimated costs for a bundled contract. However, the research had significant limitations.

- The quantification of measurably substantial benefits that would be derived was incomplete, inaccurate, and lacked support for several key estimates.
- Consideration of the contract bundling effects on small business participation in facilities maintenance was minimal.
- The FDIC's market research was not submitted for SBA review before contract award.

The FDIC Acquisition Policy Manual (APM) does not contain guidance on the performance of market research in support of determinations on contract bundling that includes controls related to the identification and quantification of benefits, an assessment of ways to maximize small business participation, and review by SBA. As a result, the FDIC did not clearly demonstrate through its market research and analysis that bundling was necessary and justified for the consolidation of facilities maintenance contracts and that the impact on small businesses had been addressed to the extent practicable. The market research and analysis was essential for ensuring compliance with applicable statutory and regulatory requirements and justifying the expenditure of contract funds to the FDIC Board of Directors.<sup>7</sup>

### **Bundling Requirements and Guidance**

The SBRA requires that market research be performed before proceeding with an acquisition strategy that could lead to a contract containing bundled procurement requirements. According to the SBRA, the purpose of market research is to determine whether bundling of the requirements is necessary and justified by measurably substantial benefits. Measurably substantial benefits include a combination of the following:

- cost savings,
- quality improvements,
- reduction in acquisition cycle time,
- better terms and conditions, and
- any other benefits.

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<sup>6</sup> Market research is a systematic, objective collection and analysis of general data to obtain information and knowledge about the availability and types of goods or services in the commercial marketplace.

<sup>7</sup> The approval process for expenditure authority in effect at the time the CFM contract was awarded (details are provided on the next page) was significantly modified by FDIC Board resolutions in December 2004 and May 2005. Specifically, the Board delegated resource allocation decisions to senior FDIC management.

The SBRA also specifies requirements for acquisition strategies that involve substantial contract bundling. These requirements include identification of the benefits from bundling, assessment of impediments to small business concerns, and actions to maximize small business participation. The SBRA further states that a reduction of administrative or personnel costs alone shall not be a justification for bundling contract requirements unless the cost savings are expected to be substantial in relation to the estimated dollar value of the requirements to be consolidated.

As previously stated, the APM does not contain guidance related to contract bundling. The SBA regulations and Federal Acquisition Regulation (FAR)<sup>8</sup> contain a number of requirements specifically related to contract bundling that are illustrative of the controls that can be established to implement the SBRA. For example, the SBA regulations:

- define measurably substantial benefits as an amount, in general, equal to 10 percent of the estimated contract value if the value is \$75 million or less;
- establish additional small-business-related requirements for situations involving substantial contract bundling (whose average annual value is \$10 million or more); and
- require acquisition strategies that include contract bundling to maximize small business participation.

Because the FDIC has recently decided that SBA regulations related to contract bundling are applicable to the FDIC, contract bundling guidance should be included in the FDIC's APM. These regulations also address reporting to the SBA in relation to contract bundling.

The FDIC had established controls for requesting contract expenditure authority approval from its Board of Directors for planned contracts that exceed authority delegated to Division Directors and Deputies to the Chairman. Approval by the FDIC Board of Directors authorized contract award and set the funding level for each contract. These procedures were followed in the case of the CFM contract. Since award of the CFM contract, the FDIC Board of Directors has substantially modified the authority delegations.<sup>9</sup>

### **Quantification of Measurably Substantial Benefits**

FOS conducted market research to determine whether contract bundling to meet facilities maintenance requirements was necessary and justified by measurably substantial benefits. FOS documented its research results in its *Rationale Supporting CFM* (Rationale), dated October 2002. Additionally, FOS indicated a total savings of \$713,269 to be realized over the first 3 years of a CFM contract (see Table 1 on the next page). Moreover, FOS stated that the reduction represented a 9.7 percent decrease in comparison to 2002 contract costs.

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<sup>8</sup> The FAR is not generally applicable to the FDIC but is used to implement the SBRA at other federal agencies, including the Department of Defense, National Aeronautics and Space Administration, and the General Services Administration.

<sup>9</sup> See footnote 7.

**Table 1: DOA-estimated Cost Savings Rationale**

| Estimated Costs for 13 Contracts | Estimated Costs Under CFM       |                                 |                                   | Estimated Cost Savings |
|----------------------------------|---------------------------------|---------------------------------|-----------------------------------|------------------------|
|                                  | Base Year 1<br>4/1/03 – 3/31/04 | Base Year 2<br>4/1/04 – 3/31/05 | Option Year 1<br>4/1/05 – 3/31/06 |                        |
| \$7,333,628                      | \$6,879,541                     |                                 |                                   | <b>\$454,087</b>       |
| \$7,333,628                      |                                 | \$7,194,231                     |                                   | <b>139,397*</b>        |
| \$7,333,628                      |                                 |                                 | \$7,213,844                       | <b>119,784</b>         |
| <b>Estimated Total Savings</b>   |                                 |                                 |                                   | <b>\$713,268</b>       |

Source: OIG Analysis.

\* There is a mathematical error in the Rationale. The correct amount is \$139,397, but the document shows \$139,398. As a result, the total estimated savings is \$713,268 rather than \$713,269 as per DOA’s calculation.

FOS attributed the estimated cost savings to reductions in the number of:

- Key personnel required under the CFM contract as compared to the number of key personnel required under the 13 separate contracts.
- Interior space alterations as a result of extensive space consolidation due to corporate reorganizations.
- Electrical repairs due to the completion of a large number of electrical repair projects in 2001 and 2002.

The quantification of the benefits in the FOS Rationale was incomplete, inaccurate, and lacked support for several key estimates. We attribute these conditions to the lack of APM guidance on performing market research and analysis in support of contract bundling decisions.

**Completeness of the Rationale.** The FOS Rationale was incomplete because the analysis did not quantify the dollar impact of the reduction in key personnel under the CFM contract and the differences in procurement and contract oversight resources for the 13 individual facilities management contracts compared to a bundled CFM contract. This quantification should have been a part of the determination with regard to the benefits of contract bundling.

The Rationale attributes savings, in part, to a reduction in the number of key personnel required but did not quantify this reduction. Rather, estimated costs under the CFM contract are based on estimated costs for the 13 individual contracts. For example, the Rationale shows that the first option year budget of \$7,213, 844<sup>10</sup> under the CFM contract is the amount of expected costs on the 13 contracts proposed for consolidation. There is no reduction in estimated costs due to a reduction in key personnel as a result of the CFM contract for this option year.

<sup>10</sup> There is a mathematical error in the Rationale. The amounts total \$7,189,974, but the document shows a total of \$7,213,844, which we used in our analysis.

The Rationale mentioned that significant staff resources were required to develop procurement packages associated with the 13 contracts. However, resulting savings, if any, from contract bundling were not estimated and quantified in dollar terms based on the implied reduction in staff resources required for a bundled contract compared to the individual contracts. Also, the Rationale showed an estimated savings in staff resources of 4,200 hours per year based on the total hours estimated to have been used to provide contract oversight for 7 of the 13 contracts. These seven contracts were determined to be complex because the dollar value exceeded \$100,000. The estimated cost savings were not quantified, and there were no estimates for oversight of either the remaining six contracts or the bundled CFM contract. The estimate for oversight of the bundled contract would have at least partially offset the savings resulting from contract bundling.

***Accuracy of the Rationale.*** The FOS Rationale was inaccurate because FOS overstated the percentage of expected savings from the CFM contract. The 3-year estimated savings under the CFM approach of \$713,268, as shown in Table 1, should have been compared to the total estimated expenses of about \$22 million (\$7,333,628 x 3) for the 3-year period had the contracts not been bundled. Such a comparison would have resulted in about a 3.2 percent estimated savings over the 3-year period rather than the 9.7 percent savings shown in the Rationale.

***Support for Key Estimates.*** The FOS Rationale did not contain support for key estimates. First, the estimated cost per year of \$7,333,628 for the 13 individual contracts in base years 1 and 2 and the first option year was derived using an estimate of 2002 costs for the 13 contracts. The costs in calendar year 2002 were well over \$1 million more than each of the preceding years (calendar years 2000 and 2001)<sup>11</sup> due to extensive interior space alterations and electrical repairs that were not expected to be recurring expenses. The Rationale states that CFM cost savings can be attributable to these reductions in interior space alterations and electrical repairs, but such savings are not quantified and would have been realized regardless of which contracting method was used. For comparison, we calculated that the 2-year average costs for the 13 contracts for calendar years 2001 and 2002 totaled \$6,607,488. This estimate is also impacted by \$1 million for nonrecurring interior space alterations and electrical repairs. However, the estimate illustrates the impact of the nonrecurring repairs on the individual contract estimate and, potentially, the resulting savings calculations. The Rationale provides no support for using the \$7,333,628 cost without adjustment for nonrecurring costs.

Second, the cost estimates for the 2 base years and 1 option year under the CFM approach are those shown in Table 1, but the underlying support for these estimates is not provided in the Rationale. For example, support such as an analysis of historical costs, forecast of future work requirements, and cost comparison to existing facilities maintenance contracts was not included in the Rationale. Further, no apparent adjustment was made to the costs for the impact of inflation. Additional support for the estimates in the Rationale would have helped ensure that bundling was necessary and justified for the consolidation of facilities maintenance contracts. We discuss the comparison of estimated to actual savings achieved on the CFM contract in detail in Finding B.

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<sup>11</sup> Actual interior space alteration expenses decreased from over \$1.3 million in 2002 to under \$300,000 during base year 2 of the CFM contract.

The combined effect of the various weaknesses in the FOS Rationale is that the FDIC did not clearly demonstrate through its market research and analysis that bundling of facilities maintenance contracts was necessary and justified based on measurably substantial benefits from a cost perspective. Similarly, although the Rationale identifies the potential for improving the overall quality of facilities maintenance services by having a single contractor, the Rationale contains little support for this conclusion. For example, the Rationale lists other governmental and private-sector organizations that have implemented a consolidated approach to facilities maintenance as an indication of an industry trend in this direction, but there is no discussion of costs, risks, benefits or best practices that could assist in the FDIC's analysis of alternatives.<sup>12</sup> Accurate and complete market research and analysis is also essential for ensuring compliance with applicable statutory and regulatory requirements related to protecting small business interests and for justifying the expenditure of funds to the FDIC Board of Directors.

***Board of Directors Approval.*** The 2003 Contract Expenditure Authority Request was approved by the FDIC Board of Directors on February 11, 2003 and included a request for authority to proceed with the CFM contract. The justification for the CFM contract states that it will improve contractor performance and efficiency, but further information was not included in the request. We found no support for this conclusion beyond the market research that was performed in support of contract bundling. To the extent that market research and analysis do not clearly demonstrate the benefits associated with a bundled contract and, in turn, are used to make resource allocation decisions, such decisions may lack required support. These decisions are now delegated by the FDIC Board of Directors to senior FDIC management. However, the importance of the underlying support for proceeding with a procurement and, in particular, a bundled contract, remains the same.

### **Impact of Contract Bundling on Small Business Participation in Facilities Maintenance**

The FOS Rationale does not address the impact of contract bundling on small business participation in FDIC facilities maintenance activities. Additionally, we found limited evidence of the FDIC's efforts to maximize small business participation in facilities maintenance as part of its market research on bundling the existing contracts for these services. For example, we did not find evidence of:

- An assessment of impediments to small business participation or specified actions to maximize small business participation as subcontractors. Such actions could include alternative acquisition strategies that reduce or minimize the scope of contract bundling.
- A determination of current or projected small business participation in facilities maintenance contracts based on dollar value.
- An analysis of contractual terms and conditions that would facilitate small business participation. In this regard, the CFM contract includes an approved subcontractor

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<sup>12</sup> In June 2002, FDIC representatives visited one government facility that was deemed comparable to FDIC-owned buildings. However, the results of the visit are not included in the FOS Rationale, and other evidence indicates that the visit was limited in scope and duration.

list and requires that any changes in subcontracting arrangements must result in the same or greater small business participation.

- Benchmarking as part of market research to determine how other federal entities encourage small business participation in bundled contracts.

The objective of these activities is to ensure that the potential impact of contract bundling on small business is considered in the determination that anticipated benefits justify the use of a bundled contract and that these benefits are substantial. Also, to the extent practicable, this impact should be minimized.

### **Reporting to the SBA**

The SBRA requires that agencies give the SBA's Procurement Center Representative (PCR) an opportunity to review bundled contract requirements before contract award. The review is needed to ensure that a government agency has identified specific benefits anticipated to be derived from the bundling. If it is determined that the bundling is averse to small business, the SBRA allows the PCR to ask the government agency to provide alternative strategies that would increase small business participation opportunities.

The FDIC did not comply with the SBA reporting requirements. However, according to an SBA representative, the FDIC did not have a currently assigned PCR which could have had an impact on whether a review was performed. Nevertheless, the FDIC was required to notify SBA of the proposed bundling and to mitigate effects on small businesses to the maximum extent practicable.

### **Conclusion**

The FDIC APM can be used to provide an appropriate internal control structure related to contract bundling. Such an approach is consistent with how other federal agencies have implemented statutory and regulatory requirements related to contract bundling. The additional controls will help ensure that market research clearly demonstrates the benefits from contract bundling, supports decisions regarding small business participation and resource allocation, and provides a record of FDIC action to comply with statutory and regulatory requirements. In February 2006, the FDIC concluded that the regulations issued by SBA to implement the contract bundling provisions of the SBRA are applicable to the FDIC. This includes the market research requirement, the "measurably substantial benefits" test, and the percent-of-contract provisions that define substantial bundling. This recent development should be considered in developing the recommended amendments to the APM.

### **Recommendation**

(1) We recommend that the Director, DOA, amend the APM to provide guidance on contract bundling in accordance with statutory and regulatory requirements, including:

- Performing market research in support of contract bundling decisions.

- Maximizing participation of small business concerns in bundled contracts to include identifying impediments to, and alternative strategies for, small business participation.
- Assessing whether proposed contract bundling will result in measurably substantial benefits to the FDIC and is necessary and justified.
- Providing SBA the opportunity to review proposed contract bundling.

## **FINDING B: BENEFITS OF THE CFM CONTRACT**

The FDIC did not have controls in place to monitor or periodically assess whether the intended benefits of the CFM contract were being achieved and small business participation was being safeguarded. Specifically:

- The FDIC concluded that contract cost savings would be achieved and that there would be an increase in efficiency of internal operations and quality of facility services through the CFM contract. This determination is similar to an SBRA requirement to ensure that the anticipated benefits of contract bundling justify its use. However, the achievement of those cost savings, particularly those resulting from internal efficiencies such as reductions in staff resources due to eliminating numerous separate facilities maintenance contracts, and other intended benefits were not periodically assessed.
- The CFM contract requires that any changes in subcontracting arrangements must result in the same or greater extent of small business participation. The FDIC had not periodically assessed small business participation in the CFM contract to determine compliance with this requirement or statutory and regulatory requirements related to maximizing small business participation in bundled contracts. This is particularly important in anticipation of the exercise of the upcoming contract option that will include the Virginia Square Phase II facilities.<sup>13</sup>

The APM does not require a periodic assessment of whether intended benefits and small business participation are, in fact, being achieved on bundled contracts. Such a determination is useful in (1) monitoring contractor performance, (2) making decisions on whether to exercise contract options or to reprocure existing bundled contracts, and (3) assessing future contract bundling approaches.

In the absence of specific FDIC information on the achievement of cost savings or other intended benefits on the CFM contract, we performed an analysis, which concluded that actual costs for the 2 base years of the CFM contract closely matched the FDIC's estimated costs. We did not assess the quality of contractor performance but noted that external assessments indicated that the quality of the services was acceptable.

Our contract cost analysis alone does not demonstrate that measurably substantial benefits would be achieved, in part, because it excludes the impact of internal cost reductions and other factors

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<sup>13</sup> The CFM contract has 3 option periods with Option 2 extending from April 1, 2006 through March 31, 2007. Option 2 will include the newly constructed facilities at the FDIC's Virginia Square location. The additional cost of serving the new facilities is under negotiation with CESI, Inc., the CFM contractor.

such as quality of service. Also, such an assessment should extend over the life of the CFM contract, whereas our analysis covered only the first 2 years of CFM contract performance. Finally, without periodic assessments of small business participation, there is limited assurance that participation levels will at least remain the same on the CFM contract or that greater participation is encouraged.

## Background

The concept of monitoring compliance with established requirements is fundamental to a sound internal control structure. GAO has issued *Standards for Internal Control in the Federal Government*. One of the five standards addresses monitoring. Internal control generally should be designed to assure that ongoing monitoring occurs in the course of normal operations. Monitoring should assess the quality of performance over time. With regard to contract bundling, monitoring activities can include achievement of intended benefits as well as small business participation.

## Achievement of Intended Benefits

The FOS did not compare intended benefits to actual benefits of the CFM contract. We found no evidence of a determination that an increase in efficiency of internal operations or quality of facility services through the CFM had been achieved. We also found no comparison of costs before and after CFM implementation, including contract costs. Therefore, we compared actual facilities management costs under the CFM contract to originally estimated costs to justify the contract bundling strategy on this procurement. Our review showed that for the first 2 years of the CFM contract (April 1, 2003 through March 31, 2005), actual contract costs were slightly higher than estimated costs. The difference of \$171,604, as shown in Table 2, was about 1.2 percent greater than the original estimate.

**Table 2: Comparison of Actual and Estimated CFM Contract Costs**

| Time Period  | Actual CFM Costs | FDIC-estimated Costs | Actual Costs in Excess of Estimate |
|--|------------------|----------------------|------------------------------------|
| Consolidated Contract Base Years 1 and 2<br>4/1/03 through 3/31/05 | \$16,308,837     | \$14,073,772         | \$2,235,065                        |
| Less: F Street Capital Improvement Project*                        | (2,063,461)      |                      | (2,063,461)                        |
| Adjusted Costs   | \$14,245,376     | \$14,073,772         | \$171,604                          |

Source: OIG Analysis.

\* The CFM was used for a capital improvement project for which the CFM was not intended. Therefore, we reduced the adjusted costs amount by the \$2.1 million spent on the project in the first 2 years of the CFM. The capital improvement project is explained in detail in Finding C.

Actual contract costs compare favorably with estimates in that there is a variance of only about 1.2 percent. However, as discussed in Finding A, in determining the benefits of the CFM contract, the estimated costs for the 13 separate facilities maintenance contracts need to be

considered. We consider prior FDIC estimates of these costs to be excessive due to the inclusion of certain nonrecurring costs. If contract costs for the 13 contracts for the 2 years prior to the CFM contract are used as a comparison, actual contract costs have increased by over \$1 million (\$13,214,976 for the 13 contracts compared to \$14,245,376 for the CFM contract). This difference does not reflect either the impact of inflation or reductions in staff resources associated with the award and oversight of a single bundled contract rather than the multiple contracts. These cost factors should be included in the assessment as well as other benefits intended to be derived.<sup>14</sup> Therefore, the FDIC should perform an assessment prior to the exercise of the next annual CFM contract option to determine if measurably substantial benefits are being achieved. Additionally, periodic assessments should be performed over the life of the CFM contract.

The assessments discussed above can take the form of market research. The FDIC Interim Acquisition Policy #2003-1, *Market Research*, dated April 30, 2003, emphasizes the importance of market research prior to exercising a contract option to confirm that existing pricing for the contract option represents current competitive pricing. The policy highlights the importance of determining if the FDIC is receiving the most favored price from the contractor and to validate that the contract option price is competitive. The policy states that this market research must be completed 60 days prior to exercising the option and can result in negotiations to reduce the option price or establish a bridge contract modification to allow for a new competitive solicitation.

***FOS Study of Facilities Costs.*** The need for an assessment of the benefits resulting from the CFM contract approach is also evidenced in a more recent study by FOS. FOS performed a study in 2004 of FDIC facilities operating costs compared to industry standards. The study showed that after implementation of the CFM contract, the FDIC's costs rose in 2003 and 2004 in comparison to costs prior to the CFM approach. The comparison to industry standards was inconclusive because it did not include costs for facilities that were directly comparable to those of the FDIC. Table 3 on the next page shows the range of FDIC costs for the three buildings it owns.

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<sup>14</sup> FOS stated it reduced contract administration personnel from 8 oversight managers responsible for the 13 facilities-related contracts to 1 oversight manager and 5 technical monitors responsible for the CFM contract. However, the cost savings associated with this reduction were not quantified. Similarly, FOS concluded that there were savings, including in acquisition cycle time, associated with awarding 1 contract rather than 13 contracts but did not quantify the dollar amount.

**Table 3. FDIC Study of Facilities Operating Costs**

| <b>Contract Type and Year</b> | <b>Range of FDIC Costs for the Three Facilities (Per Square Foot)</b> |
|-------------------------------|---|
| Unbundled Contracts           |   |
| 2002                          | \$4.59 - \$8.83   |
| CFM Contract                  |   |
| 2003                          | \$6.52 - \$9.56   |
| 2004                          | \$8.02 - \$10.54  |

Source: OIG Analysis.

According to the FOS study, the FDIC facilities costs increased from 19 to 74 percent in the 2 years after the CFM contract was awarded. The increase in costs per square foot shown in the FOS analysis is not consistent with the expectation that the CFM contract would result in increased efficiency in facilities management and a reduction in contract costs. An assessment by FOS would provide valuable insight into the actual benefits of the CFM contract.

**Maintenance of Buildings.** Under the CFM contract and the prior 13 separate contracts, the FDIC has been successful in maintaining its Washington, D.C., area buildings in good working order. DOA's 2005 independent building condition surveys for the 1776 F Street and the 550 17<sup>th</sup> Street buildings confirm that the buildings have been maintained well. For example, the independent engineering firm Facility Engineering Associates, P.C. (FEA), hired to provide assessments of the condition of FDIC-owned buildings, observed that overall maintenance practices were good. FEA's October 2005 *Facility Condition Assessment Reports* for the 550 17<sup>th</sup> Street and 1776 F Street buildings stated that the properties were well-maintained, with machinery and equipment in good condition with an expectation that most maintained elements would exceed industry-standard expected useful life. Additionally, the reports stated that in some cases, equipment has exceeded expected useful life due to maintenance practices in place. To continue a high level of facility maintenance performance, FOS plans to use the building condition survey recommendations as the basis for future scheduled maintenance projects.

Another indicator that the buildings are well-maintained is the 2004 Second Annual Inter-Divisional Customer Satisfaction Survey. The results of the survey showed that over 80 percent of the FDIC's employees were satisfied with the overall physical environment of the Corporation's Washington, D.C., area buildings. The survey addressed cleanliness of the lobby, common areas, conferences rooms, and offices.

### **Small Business Participation**

The CFM contract requires that the contractor notify the FDIC of changes in subcontracting arrangements with small businesses and that any changes must result in the same or greater extent of small business participation. Prior to award of the CFM contract, 6 of the 13 contractors performing facilities maintenance were small businesses. Of the eight subcontractors participating in the CFM contract, two are small businesses. However, the dollar value of work performed by the two subcontractors and by lower subcontracting tiers for all eight subcontractors was not monitored or periodically assessed by FOS for the purpose of

determining if further action is required regarding small business participation. The SBRA contains provisions related to addressing impediments to small business participation and requires, for a substantially bundled contract, specific action to maximize such participation by subcontractors at various tiers. The periodic assessment of small business participation in a bundled contract is an important control for ensuring that the intent of the SBRA is achieved and that there is compliance with related contract requirements.

Also, the FDIC recently concluded that SBA regulations issued to implement the contract bundling provisions of the SBRA are applicable to the FDIC. The SBA guidance should be considered in determining the nature and extent of the recommended APM guidance for assessing the achievement of intended benefits and small business participation on bundled contracts.

## **Recommendations**

We recommend that the Director, DOA:

- (2) Amend the APM to require monitoring and periodic assessments of whether intended benefits and small business participation are being achieved in bundled contracts for use in procurement decisions.
- (3) Prior to the next contract option period, perform an assessment to determine if the CFM contract is achieving intended benefits, including small business participation.

## **FINDING C: CFM CAPITAL IMPROVEMENT PROJECT**

The FDIC completed a major capital improvement project, column collar installation, on one of its facilities using the CFM contract. However, as part of the CFM contract, a portion of the related costs were expensed rather than capitalized. As a result, the FDIC overstated facilities maintenance costs by \$1,220,023 and understated assets by the corresponding amount in its accounting records. We plan to report the \$1,220,023 as funds put to better use in the OIG's next *Semiannual Report to the Congress*.

Further, the capital improvement was awarded to the CFM contractor without a written justification for a noncompetitive procurement or documented market research. The CFM contractor competed subcontracts for the required work which at least partially mitigated the pricing risk associated with a noncompetitive procurement. However, a justification for noncompetitive procurement supported by documented market research is an important control for ensuring that fair and reasonable prices are obtained on large-dollar-value procurement actions such as the column collar installation. Absent the justification, there is limited assurance that a noncompetitive procurement is required or that overall pricing is fair and reasonable.

## Capitalization of Project Costs

On July 30, 2004, DOA signed Work Order No. F-C01 authorizing \$2.3 million<sup>15</sup> for the capital improvement project, *Column Collar Installation for 1776 F Street*. The project was a firm fixed-price work order for column collar installation and all associated work in removing and reinstalling utilities and interior finishes, including drywall covering columns, paint, crown molding, and ceiling tiles, at the FDIC-owned building at 1776 F Street, N.W., Washington, D.C. Although the work order was signed in July 2004, the stated period of performance was from June 16, 2004 through April 5, 2005. The FDIC reported that the F Street column work was one of five capital improvements performed at Headquarters during 2001 through 2005.

At the start of the F Street column collar installation project, the Division of Finance (DOF), at the request of DOA, established a project in the FDIC accounting system to account for and capitalize the costs associated with the column project. As costs were incurred on the project, a work-in-progress account was used to accumulate and track costs until the project was completed. DOA was responsible for ensuring that all invoices related to this project were coded correctly so that costs associated with the project were accurately classified in the FDIC's accounting system. DOA was also responsible for informing DOF when the project was completed and all invoices had been paid. As of February 2006, DOF had capitalized only \$843,438 of the \$2,063,461 incurred on the F Street column collar installation project.

Costs totaling \$1,220,023 for the column collar installation under the CFM contract were accounted for as facilities maintenance expenses rather than being capitalized and added to the basis of the 1776 F Street Building. This accounting treatment is not supported by FDIC Statement of Accounting Policy (SAP) Number 25, *Accounting for Property, Plant and Equipment*, effective February 12, 2003. The SAP states that expenditures related to capital assets that are expected to produce benefits beyond the current year<sup>16</sup> are to be capitalized and that expenditures that simply maintain a given level of benefits are expensed in the period they are incurred. The SAP specifically defines improvements and replacements that should be capitalized, stating that improvement substitutes a better asset, while replacement substitutes a similar asset. To be capitalized, the improvement must increase the future service potential of the asset.

The column weaknesses were identified in an April 2002 contractor-prepared building assessment report entitled, *Floor Slab Strength Evaluation Report-FDIC Support Building 1776 F Street*. The report also referred to an earlier *Facility Assessment Report* of January 2002, which states that the floor-slab-column joints do not meet requirements in the District of Columbia Code or Building Officials and Code Administrators International Incorporated. In March 2004, based, in part, on a contractor report entitled, *Column Reinforcement Project*, the FDIC concluded that installation of reinforcing collars on certain columns would increase floor-loading capacity up to current code standards and strengthen physical security characteristics of

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<sup>15</sup> We determined that \$2,063,461 was paid to the CFM contractor to complete the work.

<sup>16</sup> Expenditures related to capital assets can increase future benefits by (1) extending the useful life of the asset or (2) increasing the operating efficiency of the asset. An increase in operating efficiency results in either an increase in the quantity of goods or services produced, a decrease in future operating costs, or an increase in the quality of the goods or services produced by the asset.

the 1776 F Street Building. The study's conclusion supports capitalization of associated costs because the service potential of the building was increased in accordance with established accounting policy, as was the account established to capitalize the costs and the partial capitalization that occurred.

### **Justification for Noncompetitive Procurement**

The FDIC did not prepare a justification for noncompetitive procurement for the column collar installation project. The APM requires the justification supported by documented market research before an award for a noncompetitive contract. Justification for the noncompetitive award of large-dollar-value work orders is not specifically addressed in the APM. DOA management concluded that the project was not anticipated and that completion under the CFM contract was necessary due to the gravity of the situation and the need to complete the work within a short period. The APM provides for justifying noncompetitive procurements based on urgency, but it also requires market research to identify possible sources for the goods or services required before the justification is submitted for approval by the contracting officer. FDIC Interim Acquisition Policy #2003-1, *Market Research*, dated April 30, 2003, emphasizes the importance of market research in obtaining approvals for capital investment projects by supporting the development of a cost-benefit analysis. Such research, if performed, was not documented in the contract file, and no written justification was prepared. The CFM contractor adequately competed the subcontracts to perform the work which reduced the pricing risk associated with noncompetitive procurements. However, without competition at the prime-contract level, the FDIC has limited assurance that the overall price is fair and reasonable, unless other controls such as market research and cost or price analysis<sup>17</sup> are used.

The CFM contract provided that subcontract costs were eligible for up to a 10-percent markup and that the contractor was eligible for up to an additional \$25,000 incentive fee in the column collar installation project. The contract generally set cost limitations for work orders, such as for interior construction and maintenance repairs of \$250,000 and \$75,000, respectively. These terms and limitations indicate that the contract was not designed for large-dollar-value capital improvements such as the column collar installation project. Documented market research may have aided the FDIC in the determination whether: (1) a noncompetitive procurement was justified and (2) the CFM contract terms were appropriate for a work order with an estimated overall price in excess of \$2 million.

### **Recommendations**

- (4) We recommend that the Director, DOF, identify and capitalize all the costs for the column collar installation project.
- (5) We recommend that the Director, DOA, amend the APM to establish requirements associated with documented market research and justification of noncompetitive procurements for large-dollar-value work orders on existing contracts.

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<sup>17</sup> The FDIC's APM discusses the use of cost and price analysis as part of the procurement process to assist the contracting officer in evaluating contractor proposals.

## **FINDING D: CFM JANITORIAL SERVICES INCENTIVE PROVISIONS**

The janitorial services incentive provisions of the CFM contract do not require performance that exceeds the standards in the contract Statement of Work. The APM does not provide sufficient guidance on structuring incentive clauses to encourage performance that exceeds target expectations. As a result, the FDIC paid janitorial incentives totaling \$193,131 through December 31, 2005 and may pay additional incentives of \$318,748 for the remaining contract period without obtaining any benefit beyond what is already required in the contract. If the contract provisions are modified as part of an upcoming contract option exercise, there may be opportunities to reduce costs and improve performance. We plan to report the \$193,131 as questioned costs and the \$318,748 as funds put to better use in the OIG's next *Semiannual Report to the Congress*.

### **Incentive Provision Structure**

According to the Statement of Work, Exhibit G, *FDIC Janitorial Services Incentive Program*, the objective of the incentive program is to apply evaluation criteria that are easily measurable and objective. The CFM contract further states that each month, based on certain specified janitorial services performed, the contractor may earn an incentive in the form of a bonus management fee payment. The incentive payment is 10 percent or less of the monthly fixed fee amount for those janitorial services computed for each of the three FDIC buildings maintained by the CFM contractor. The contractor may also be subject to a penalty applied to the janitorial services portion of its monthly fixed fee for each building up to 10 percent of the fixed fee if performance standards are not met. Both the incentive payments and the penalties are based on FDIC inspections of work and qualitative factors related to the contractor's cooperation, responsiveness, and support as well as any complaints or commendations. The inspections are based on janitorial performance standards in the contract, which requires 100-percent compliance.

The incentive fee structure does not establish specific targets related to the janitorial performance standards. Instead, it allows the contractor to earn an incentive even when the janitorial standards are not met. For example, the contractor can earn the maximum 10-percent incentive fee even though the contractor has not met the janitorial standards by performing well on the qualitative factors.

The APM does not specifically require the establishment of performance targets for incentive fee payments. Although not applicable to the FDIC, the FAR contains guidance specifically related to structuring incentive contracts that is illustrative of the controls that can be established. Specifically, FAR Subpart 16.4 – *Incentive Contracts*, states that incentives are provided only for achievement that surpasses targets and that decreases are provided for to the extent that such targets are not met. The incentive increases or decreases should be applied to the performance targets rather than minimum performance requirements.

The incentive fees on the CFM were earned for performance levels already required by the contract, thus providing limited incentive to the contractor for exceptional service and little benefit to the FDIC for the payments made. By establishing targets and tying incentive fees to

the achievement of those targets, exceptional service can be further encouraged and recognized. Under the contract Statement of Work, the FDIC reserved the right to modify and/or discontinue the incentive program at any time in the future. Restructuring the incentives to provide greater value to the FDIC is warranted.

## **Recommendations**

We recommend that the Director, DOA:

(6) Amend the APM to provide guidance on structuring incentive fee provisions, including clearly establishing the performance standards and services that are considered above and below standard.

(7) Seek modification of the incentive fee provisions in the CFM contract to provide specific performance targets that must be exceeded to earn incentive fees.

## **CORPORATION COMMENTS AND OIG EVALUATION**

The Directors of DOA and DOF provided a written response, dated March 24, 2006, to a draft of this report. The FDIC response is presented in its entirety in Appendix II. A summary of management's response to the recommendations is in Appendix III.

The FDIC agreed with recommendations 1, 2, 3, and 4. The FDIC's actions planned and taken are sufficient to resolve these recommendations. However, recommendations 1, 2, and 3 will remain open for reporting purposes until we have determined that the agreed-to corrective actions have been completed and are effective. For recommendation 4, the corrective actions taken by DOF are responsive, and the recommendation is closed for reporting purposes. Although DOF promptly implemented corrective action on this recommendation, DOF did not agree with our position that the costs that were not capitalized should be reported as funds put to better use. Our position remains unchanged that the increase in value of an asset and corresponding decrease in expenses result in funds available to be put to better use.

Concerning recommendation 2, DOA agreed with the intent of the recommendation but did not concur with the specific recommendation to amend the APM to require monitoring and periodic assessments of whether intended benefits and small business participation are being achieved on bundled contracts. Based on statutory and regulatory requirements that have also been determined by the FDIC to generally apply to the Corporation, the FAR provides guidance to other federal agencies that handle bundled procurements. Specifically, the FAR requires agencies to conduct annual reviews to assess the adequacy of contract bundling documentation and justification and actions taken to mitigate the effects of necessary and justified contract bundling on small businesses. In response to recommendation 1, DOA agreed to amend the APM to include language on contract bundling using the FAR as a guideline. Consistent with that approach, DOA management agreed, in a subsequent discussion, to consider all FAR

provisions related to contract bundling as guidelines for amending the APM, including those related to assessing whether the intended benefits and small business participation are being achieved on bundled contracts.

The FDIC partially concurred with recommendations 5 and 6. For recommendation 5, DOA agrees with the intent of the recommendation but does not concur with the specific recommendation to amend the APM. No alternative action was provided for achieving the intent of our recommendation. DOA stated that the APM currently contains language that requires market research and justifications of noncompetitive procurements when the value of the procurement is greater than \$100,000. DOA indicated that these APM requirements apply only to work outside the scope of the original contract. DOA indicated that the large-dollar-value work order reviewed under the audit was determined by the contracting officer to be within the scope of the contract because the contract made provisions for work orders. DOA stated that, therefore, a justification for noncompetitive procurement was not necessary.

Our position remains unchanged that market research and written justifications supporting decisions on the award of large-dollar-value work orders on existing contracts should be specifically required, under certain circumstances, to ensure that fair and reasonable prices are obtained. For example, the Statement of Work on the CFM contract provides that the FDIC will solicit bids for repairs over \$75,000 on a separate contract. Similarly, the CFM contract limits work orders for interior office construction to \$250,000. The dollar limitations on “in scope” work support the use of competition for large-dollar-value procurement actions. However, the FDIC decided not to pursue competition through soliciting bids but rather to noncompetitively award the capital improvement project at an estimated cost of \$2.3 million to the CFM contractor without documented market research and a justification for a noncompetitive procurement. For such large-dollar-value efforts in excess of contractual dollar limits, the decision to proceed with a noncompetitive procurement should be better supported. Therefore, we reaffirm our recommendation to revise the APM to address market research and justifications for noncompetitive procurements on existing contracts. This recommendation is unresolved and will be referred to the designated audit follow-up official for a final management decision.

For recommendation 6, DOA agrees with the intent of the recommendation but does not concur with the specific recommendation to amend the APM. Since the award of the CFM contract, DOA/ASB has addressed the need for increased understanding of performance-based contracts by providing training to the contract specialists on performance-based contracting, incentives, and performance management. DOA stated that to improve contract specialist and project manager access to available information on this topic, DOA will modify its Web site for *Procuring Goods and Services* to establish links to guidance and best practice information from sources such as the Office of Federal Procurement Policy. The links were added to the Web site on March 16, 2006. We verified that the links had been added and agree that the additional training should increase the understanding of structuring incentive fee provisions. For recommendation 6, the corrective actions taken by the FDIC are responsive, and the recommendation is closed for reporting purposes.

The FDIC did not concur with recommendation 7. The FDIC responded that the next CFM contract option must be exercised on April 1, 2006. Additionally, DOA does not believe that the

current structure harms the FDIC. DOA believes that an attempt to renegotiate the incentive provisions while attempting to exercise the next option would not be appropriate and could result in a break in service of the current contract. Based on DOA's recognition that the current incentive structure could be improved and DOA's commitment to consider this OIG report as the acquisition strategy for the follow-on contract is formulated, we consider DOA's actions to be responsive to the intent of our recommendation, which is closed for reporting purposes.

## OBJECTIVE, SCOPE, AND METHODOLOGY

### Objective and Scope

The overall objective of the audit was to determine whether the contract structure and the FDIC's management of the contract were adequate to ensure the economical and efficient management of the Corporation's Washington, D.C., area facilities. The scope of our review included CFM-related expenditures for the period January 1, 2002 through March 31, 2005. The CFM-related expenditures included the 2002 expenditures for 13 individual contracts that were bundled and expenditures for the CFM/CESI contract covering the 2 contract base years from April 1, 2003 through March 31, 2005. Our audit was conducted from March 2005 through February 2006 in accordance with generally accepted government auditing standards.

### Methodology

To accomplish our objectives, we:

- Gained an understanding of the relevant internal controls by reviewing the following:
  - FDIC's *Acquisition Policy Manual*
  - FAR
  - Small Business Reauthorization Act of 1997
  - Small Business Administration Regulations
  - FDIC's Legal Division Determinations on Contract Bundling
  - October 2002, Executive Office of the President, Office of Management and Budget, and Office of Federal Procurement Policy, Report, *Contract Bundling, A Strategy for Increasing Federal Contracting Opportunities for Small Business*
  - May 2004, GAO Report 04-454, *Contract Management, Impact of Strategy to Mitigate Effects of Contract Bundling on Small Business Is Uncertain*
  - March 2003, GAO Report 03-559T, *Small Business Contracting, Concerns About the Administration's Plan to Address Contract Bundling Issues*
  - March 2000, GAO/GGD Report 00-82, *Small Businesses, Limited Information Available on Contract Bundling's Extent and Effects*
- Gained an understanding of the CFM contractor by reviewing the following OIG Reports:
  - Audit Report No. 05-010, *Billing Review of Consolidated Facilities Management Services Contract Number 02-00349-C-CD*, March 2005
  - Audit Report No. 03-011, *Billing Review of Consolidated Engineering Services, Inc. Contract 98-01330 C-BK*, January 2003

- Determined if the contract structure under the contract bundling methodology was properly justified in accordance with statute, SBA regulations, and the FAR, by:
  - Reviewing the FDIC's market research efforts to determine whether contract bundling was necessary and justified, including identification of measurably substantial benefits and consideration of small business participation.
  - Interviewing DOA facilities management and contracting officials to determine if the FDIC developed a rationale to justify implementation of contract bundling and periodically monitored benefits achieved.
  - Examining DOA Acquisition Services Branch contract files to identify documentation supporting contract bundling and noncompetitive procurement.
  - Recalculating the FDIC's expected cost savings from contract bundling over a 2-year period from April 1, 2003 through March 31, 2005 to determine reasonableness.
  - Reviewing invoices and payments to ensure that there was no duplication with the CFM contract.
  
- Determined if the FDIC achieved economy through expected cost savings, by:
  - Identifying the 13 individual facilities contracts that existed prior to bundling and comparing individual costs (from the Accounts Payable Purchase Order System), by fiscal year and contract period, to determine whether the single CFM contract was more cost-effective than the 13 individual contracts.
  - Identifying general ledger account applications compared to invoice cost data to ensure proper application and financial transparency in corporate spending.
  - Interviewing DOF officials and examining financial data related to payments to the CFM contractor.
  
- Determined how the facilities managers monitored costs and contract terms by:
  - Assessing whether the FDIC identified other organizations comparable to the FDIC and benchmarking costs and other contract terms to identify best practices.
  - Performing benchmarking analyses with two other agencies and comparing the results concerning facilities management with the FDIC CFM approach.
  - Determining if the FDIC performed benchmarking analysis by comparing FDIC-owned building cost data to industry norms taken from the Building Owners and Managers Association (BOMA) statistics to ensure the FDIC's costs were comparable to industry norms.
  - Recalculating FDIC computations and verifying BOMA data to ensure accuracy.
  - Reviewing GAO reports on contract bundling to determine how other government agencies implement contract bundling as compared to the FDIC.

- Determined efficient monitoring and oversight by FDIC management of the Corporation's Washington, D.C., facilities by:
  - Comparing independent contractors' facility condition assessment reports of each FDIC-owned building to the capital improvement listing to ensure that recommended building improvements were being implemented to ensure a safe and well-maintained work environment and the continuity of the building management program.
  - Determining whether the Oversight Manager monitored the number of small business subcontractors contracted by the CFM contractor in order to avoid adverse effects of contract bundling on small business.
  - Assessing the Oversight Manager's review of task orders for subcontractor costs and janitorial services to ensure that proper contract implementation and performance standards were achieved.
  - Reviewing prior audits regarding procurement and FDIC implementation of audit recommendations.

### **Reliance on Computer-based Data, Internal Controls, Fraud and Illegal Acts, and Compliance with Laws and Regulations**

We tested CESI's computer-based invoice/cost data for the *F Street Column Project* by comparing invoices data to comparative data from the FDIC's Accounts Payable Purchase Order (APPO) system to ensure that CESI's invoice data were consistent with FDIC data. Also, we performed full-population testing on data from the FDIC's APPO system to determine the accuracy and reliability of computer-generated data. We compared control totals to ensure the population was complete and to identify any anomalies. As a result, we verified that the computer-generated data from the APPO system were reliable, accurate, and consistent. Detailed testing of contractor invoices was performed in the billing review of Audit Report No. 05-010, *Consolidated Facilities Management Service Contract*.

We gained an understanding of the FDIC's control environment over the CFM contract and bundling process by developing an internal control test program, which identified risks, control objectives, control techniques, and testing methodologies. Additionally, we reviewed the FDIC's *2005 Agenda: Corporate Performance Objectives and Results*, and the *2005-2010 Strategic Plan* to determine whether the FDIC had established performance goals related to budgeted resources, cost controls, and related benchmarks. The FDIC established the goal of reduced corporate operating spending and continued support for a strong internal control risk management program.

Additionally, our audit program included audit steps for providing reasonable assurance of detecting fraud and illegal acts. None were identified.

We identified, considered, and tested compliance, as appropriate given our audit objectives, with the following laws, regulations, policies, and procedures that were applicable to the CFM, contract bundling, and performance-based contracts:

- Small Business Act, as amended;
- Small Business Reauthorization Act of 1997;
- SBA Regulations contained in Title 13 of the Code of Federal Regulations (C.F.R.); and FAR, Title 48, C.F.R.

## CORPORATION COMMENTS



**Federal Deposit Insurance Corporation**  
3601 N. Fairfax Drive, Arlington, VA, 22226

Division of Administration  
Division of Finance

March 24, 2006

**TO:** Russell A. Rau  
Assistant Inspector General for Audits

**FROM:** Arleas Upton Kea [Electronically produced version; original signed by Arleas Upton Kea]  
Director, Division of Administration

Fred Selby [Electronically produced version; original signed by Fred Selby]  
Director, Division of Finance

**SUBJECT:** Response to OIG Draft Report Entitled,  
*FDIC's Consolidated Facilities Management Approach*  
(Assignment No. 2005-024)

Thank you for the opportunity to respond to your draft audit report entitled *FDIC's Consolidated Facilities Management Approach*. We appreciate the OIG for its acknowledgement that the Consolidated Facilities Management (CFM) contract structure and the FDIC's management of the contract were generally adequate to ensure the efficient operation of the FDIC's Washington, D.C., area facilities.

Although the OIG identified efficiencies in the facilities operations, the report did include seven recommendations. Six recommendations pertained to the Division of Administration (DOA) while the one remaining recommendation was made to the Division of Finance (DOF) on the appropriateness of costs that were expensed rather than being capitalized.

We have carefully reviewed the OIG's report, considered each of your recommendations, and have provided a detailed "Management Response" that includes planned corrective actions and expected completion dates as appropriate. Also, we have included a section that provides clarification to some of the report's findings. We believe these comments are necessary to provide a more balanced perspective. Our full response is provided below.

#### MANAGEMENT DECISION

**Recommendation #1.** That the Director, DOA, amend the APM to provide guidance on contract bundling in accordance with statutory and regulatory requirements, including:

- Performing market research in support of contract bundling decisions.
- Maximizing participation of small business concerns in bundled contracts to include identifying impediments to, and alternative strategies for, small business participation.
- Assessing whether proposed contract bundling will result in measurably substantial benefits to the FDIC and is necessary and justified.
- Providing SBA the opportunity to review proposed contract bundling.

**Management Response.** DOA concurs with the recommendation. The DOA Acquisition Services Branch (ASB) will amend the APM to include language on contract bundling using the FAR implementation as a guideline. ASB will issue Interim Policy Guidance by May 15, 2006.

**Recommendation #2.** That the Director, DOA, amend the APM to require monitoring and periodic assessments of whether intended benefits and small business participation are being achieved in bundled contracts for use in procurement decisions.

**Management Response.** DOA agrees with the intent of the recommendation, but does not concur with the specific recommendation to amend the APM. It is the on-going responsibility of each program office to assess the progress and performance of various projects and make determinations as to whether those projects are achieving their intended objectives. We do not believe this issue is appropriate for inclusion in acquisition policy.

**Recommendation #3.** That the Director, DOA, prior to the next contract option period, perform an assessment to determine if the CFM contract is achieving intended benefits, including small business participation.

**Management Response.** DOA concurs with this recommendation. The DOA Corporate Services Branch will assess whether the CFM contract is achieving intended benefits against established benchmarks and will review the level of small business participation with the Acquisition Services Branch. However, this review will not be completed prior to the exercise of the next option due to time constraints. CSB expects to complete this review by June 30, 2006.

**Recommendation #4.** That the Director, DOF, identify and capitalize all the costs for the column collar installation project.

**Management Response.** The Division of Finance (DOF) agrees with the recommendation that all of the costs associated with the F Street Column Project should be capitalized. An asset for the F Street Column Project was established in the Asset Management module in September 2005. The total cost associated with the F Street Column Project at that time was \$843,438.00. Based on a subsequent review of the invoices associated with the project by the DOA and DOF it was determined that an additional \$1,322,873.00 in costs should also be capitalized. The review of invoices determined that the costs associated with the project which were not capitalized were coded to the Miscellaneous Operating Expense account when the invoices were submitted to DOF for payment. On March 15<sup>th</sup> an adjusting entry was recorded by DOF which increased the amount of the F Street Column capitalized asset by \$1,322,873.00.

DOF does not feel that the costs of the F Street Column Project which were not capitalized should be reported as "Funds Put To Better Use". The costs to be capitalized do not constitute a reduction in outlays, unnecessary expenditures or any other specifically identified savings to the

Corporation, in relation to the project. Furthermore, the designation of “funds put to better use,” as applied, does not fall within one of the six actions identified in the Inspector General Act.<sup>1</sup>

**Recommendation #5.** That the Director, DOA, amend the APM to establish requirements associated with documented market research and justification of noncompetitive procurements for large-dollar-value work orders on existing contracts.

**Management Response.** DOA agrees with the intent of the recommendation, but does not concur with the specific recommendation to amend the APM. The APM currently contains language in Chapter 2, Paragraphs 2.J.1 and 2.J.2 that require market research and justifications of noncompetitive procurements when the value of the procurement is greater than \$100,000. This language would apply to any work outside of the scope of the original contract.

The large dollar work order reviewed under this audit was determined to be within the scope of the contract by the contracting officer. Since the contract made provisions for work orders to be written against the contract, the contracting officer determined that writing the work order was within the original scope of the contract and did not require a justification. This decision was consistent with the contract and with acquisition guidance, and was within the scope of the contracting officer’s authority.

**Recommendation #6.** That the Director, DOA, amend the APM to provide guidance on structuring incentive fee provisions, including clearly establishing the performance standard and service that are considered above and below standard.

**Management Response.** DOA agrees with the intent of the recommendation, but does not concur with the specific recommendation to amend the APM. Incentive structures for specific requirements are highly unique and based upon project needs. Prescriptive policies as to how to structure incentives would not be appropriate. Since the award of the CFM contract, DOA/ASB has addressed the need for increased understanding of performance based contracts by providing training to the contract specialists on performance based contracting, incentives and performance management. For example, in 2004, a class was presented on-site for ASB contract specialists. In order to improve contract specialist and project manager access to available information on this topic, we will modify the DOA website for “Procuring Goods and Services” to establish links to guidance and best practice information from sources such as the Office of Federal Procurement Policy. These links were added to the website on March 16, 2006.

<sup>1</sup> The Inspector General Act, 5 U.S.C. app., § 5(f)(4)(the phrase “recommendation that funds be put to better use” is defined as “a recommendation by the Office that funds could be used more efficiently if management of an establishment took actions to implement and complete the recommendation including: (A) reduction in outlays; (B) deobligation of funds from programs or operations; (C) withdrawal of interest subsidy costs on loans or loan guarantees, insurance or bonds; (D) costs not incurred by implementing recommended improvements related to the operations of the establishment, a contractor or grantee; (E) avoidance of unnecessary expenditures noted in preaward review of contract or grant agreements; or (F) any other savings which are specifically identified.”).

**Recommendation #7.** That the Director, DOA, seek modification of the incentive fee provisions in the CFM contract to provide specific performance targets that must be exceeded to earn incentive fees.

**Management Response.** DOA does not concur with this recommendation. The next option must be exercised on April 1. Although it might be possible to improve the incentive structure of the current contract, DOA does not believe the current structure harms the FDIC. An attempt to renegotiate the incentive provisions while attempting to exercise the next option would not be appropriate and could result in a break in service of the current contract. Based on current utilization rates, the contract ceiling is estimated to be reached by the first quarter of 2007 and market research for a new contract will be initiated in the near future. DOA will consider the input of this OIG report as we formulate the acquisition strategy for the follow-on contract.

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 (703) 562-2126.

cc: James H. Angel, Jr., OERM  
Glen Bjorklund, DOA  
Ann Bridges Steely, DOA ASB  
Michael J. Rubino, DOA CSB

## MANAGEMENT RESPONSE TO RECOMMENDATIONS

This table presents the management response on the recommendations in our report and 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: <sup>a</sup> Yes or No | Open or Closed <sup>b</sup> |
|-------------|--|--------------------------|---|----------------------------------|-----------------------------|
| 1           | DOA concurred with the recommendation and will amend the APM. DOA will issue Interim Policy Guidance.  | May 15, 2006             | 0   | Yes                              | Open                        |
| 2           | DOA concurred with the intent of the recommendation but did not concur with the specific recommendation to amend the APM to require monitoring and periodic assessments of bundled contracts. However, DOA management agreed, in a subsequent discussion, to consider all FAR provisions related to contract bundling as guidelines for amending the APM, including those related to assessing whether the intended benefits and small business participation are being achieved on bundled contracts. | May 15, 2006             | 0   | Yes                              | Open                        |
| 3           | DOA concurred with the recommendation and will assess whether the CFM contract is achieving intended benefits.   | June 30, 2006            | 0   | Yes                              | Open                        |
| 4           | DOF concurred with recommendation to capitalize the cost of the F Street column collar installation project.   | March 15, 2006           | \$1,220,023 <sup>c</sup><br>Funds Put to Better Use             | Yes                              | Closed                      |
| 5           | DOA concurred with the intent of the recommendation but did not concur with the specific recommendation to amend the APM to include language for large-dollar-value work orders on existing contracts.   |                          | 0   | No                               | Open                        |
| 6           | DOA concurred with the intent of the recommendation but did not concur with the specific recommendation to amend the APM to provide guidance on structuring the incentive fee provision. Instead, DOA has established a training link on the DOA Web site to guidance and best practice information.   | March 16, 2006           | 0   | Yes                              | Closed                      |
| 7           | DOA did not concur with the recommendation to seek modification of the incentive fee provision. DOA agreed that the incentive provision might be improved but decided not to renegotiate the incentive provision before the next contract option exercise. However, DOA will consider this OIG report in formulating the acquisition strategy for the follow-on contract. The proposed alternative action is responsive.   | March 24, 2006           | \$193,131 Questioned Costs<br>\$318,748 Funds Put to Better Use | Yes                              | Closed                      |

<sup>a</sup> 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.

<sup>b</sup> Once the OIG determines that the agreed-upon corrective actions have been completed and are effective, the recommendation can be closed.

<sup>c</sup> Based on a subsequent DOA and DOF review of the invoices associated with the F Street column collar installation project, DOA and DOF determined that \$1.32 million in associated costs should be capitalized.