

441 G St. N.W.  
Washington, DC 20548

## Accessible Version

May 13, 2021

The Honorable Jelena McWilliams  
Chairman, Federal Deposit Insurance Corporation

## Management Report: Improvements Needed in FDIC's Internal Control over Contract-Payment Review Processes

Dear Chairman McWilliams:

On February 18, 2021, we issued our report on the results of our audits of the 2020 and 2019 financial statements of the two funds the Federal Deposit Insurance Corporation (FDIC) administers: the Deposit Insurance Fund (DIF) and the Federal Savings and Loan Insurance Corporation Resolution Fund (FRF).<sup>1</sup> Our report states we identified deficiencies in FDIC's controls over contract-payment review processes. These deficiencies collectively represent a significant deficiency in FDIC's internal control over financial reporting that merits attention by those charged with FDIC governance.<sup>2</sup> Although it did not affect our opinion on the 2020 financial statements of the DIF and the FRF, because of this significant deficiency, misstatements may have occurred in unaudited financial information FDIC reported internally and externally. The purpose of this report is to present the deficiencies we identified during our audit testing of FDIC's 2020 non-payroll operating expenses internal controls, and our recommendations related to these deficiencies. GAO had no prior recommendations to FDIC related to the financial statement audit or internal controls over financial reporting. This report is intended for FDIC management use.

### Results In Brief

During our 2020 audit, we identified five deficiencies related to contract-payment review processes that collectively represent a significant deficiency in FDIC's internal control over financial reporting. Specifically, while FDIC management has properly designed internal control activities for established policies, procedures, and guidance, we found that FDIC did not consistently execute existing controls over contract-payment review processes, which increased the risks that FDIC could make improper payments and misstate operating expenses and accounts payable.

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<sup>1</sup>GAO, *Financial Audit: Federal Deposit Insurance Corporation Funds' 2020 and 2019 Financial Statements*, [GAO-21-284R](#) (Washington, D.C.: February 2021).

<sup>2</sup>A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. 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, to prevent, or detect and correct, misstatements on a timely basis.

We concluded that we could not obtain assurance the non-payroll operating expense internal control objectives were operating effectively. However, in our judgment, the risk of material misstatement resulting from these deficiencies in internal control over contractor payments is remote (less than reasonably possible), but is important enough to merit the attention of those charged with FDIC governance. Thus, these deficiencies represent a significant deficiency in FDIC's internal control over financial reporting as of December 31, 2020.

In this report, we are making two recommendations to address this significant deficiency. These recommendations are intended to improve FDIC's internal controls over financial reporting, as well as to bring FDIC into conformance with its own policies and *Standards for Internal Control in the Federal Government*.<sup>3</sup>

In commenting on a draft of this report, FDIC agreed with the two recommendations and described planned actions to address each recommendation. FDIC's comments are reproduced in enclosure I.

### Objective, Scope, and Methodology

Our objective was to evaluate FDIC's internal control over financial reporting relevant to the DIF and to the FRF as of December 31, 2020. We performed this work in connection with our audit of FDIC's financial statements for the years ended December 31, 2020 and 2019, to support our opinion on whether effective internal control over financial reporting was maintained, in all material respects.

As part of our 2020 financial statement audit of the FDIC, we performed substantive and internal control testing on a monetary unit sample of 45 transactions we selected from a universe of FDIC's non-payroll operating expenses for the interim period of January 1 through June 30, 2020. We reviewed supporting documentation (e.g., contracts, invoices, payment vouchers, and travel receipts) for appropriate authorizations and approvals prior to payment. We traced information (e.g., amount, vendor name, voucher number, fund, department and program codes, account, and journal entry date) extracted from FDIC's NFE financial system to supporting documentation. Our audit procedures included obtaining an understanding of the financial reporting process, as it relates to operating expenses, and determining whether the results of our tests of internal control indicated staff were performing their duties effectively.

During the course of our work, we communicated our findings to FDIC management. We performed our audit in accordance with U.S. generally accepted government auditing standards. We believe that our audit provides a reasonable basis for our findings and recommendations in this report.

### **Significant Deficiency in FDIC Internal Control over Contract-Payment Review Processes**

FDIC oversight managers are responsible for verifying that contractors deliver purchased goods or services and perform their work according to contracts and delivery schedules. Oversight managers also monitor the expenditures of funds in relation to contract dollar ceilings and

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<sup>3</sup>GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: September 2014).

approve invoices for payment. We identified five deficiencies in FDIC's implementation of these internal controls.

Condition.

During our 2020 audit, we identified deficiencies in contract-payment review processes that collectively represent a significant deficiency in FDIC's internal control over financial reporting. Specifically, FDIC did not consistently execute existing controls over contract-payment review processes, which increased the risks that FDIC could make improper payments and misstate operating expenses and accounts payable. The five deficiencies we identified are listed below.

- A Disbursement Operations Section processor incorrectly entered a manually calculated payment discount into FDIC's NFE financial system, which was in addition to the discount automatically applied by the NFE financial system. The oversight manager and Disbursement Operations Section approver did not detect the payment error,<sup>4</sup> and FDIC made an improper payment to the contractor.
- An oversight manager approved a contractor invoice, even though supporting documentation was inconsistent with FDIC's total payment. While we were able to obtain evidence that the proper amount was paid, the oversight manager did not investigate, resolve, or document the inconsistencies before approval and payment of the invoice. According to FDIC officials, the oversight manager only sampled ten percent of each invoice to validate costs, historically placed responsibility on the contractor to ensure it submitted proper backup documentation, and did not validate every time to ensure the invoice total was correct.
- An oversight manager approved and paid a contractor's invoice with higher labor rate categories that lacked support for the higher labor rates charged on the invoice. Specifically, the invoice included charges for the Project Manager and Technical Writer/Editor positions at the higher level-II rate without sufficient invoice details to support the rates approved for payment. Other billed labor positions on the invoice had descriptions indicating when the contractor was charging higher-level pay rates. While management subsequently determined that the positions were appropriate, the oversight manager did not validate the higher pay rates before approving the invoice for payment.
- A Division of Finance Senior Travel Specialist processor incorrectly entered a program code for a contracted relocation expense into FDIC's NFE financial system that did not agree with the supporting documentation. An oversight manager and Disbursement Operations Section approver did not detect the misclassified program code, resulting in a payment misclassification error.
- An oversight manager approved an invoice that did not agree with the contracted fixed monthly payment for the invoiced location. According to FDIC, the contractor incorrectly invoiced an investigator position under a different location that the same contractor also serviced, resulting in a payment error.

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<sup>4</sup>The Disbursement Operations Section approver is responsible for reviewing and approving the payment entered into FDIC's New Financial Environment for processing, which then automatically routes to the oversight manager for final approval.

### Criteria.

According to GAO's *Standards for Internal Control in the Federal Government*, agency management is responsible for establishing and maintaining effective internal control to serve as the first line of defense in safeguarding assets and preventing and detecting errors and fraud.

In addition, FDIC has an established *Acquisition Policy Manual (APM)* and *Acquisition Procedures Guidance and Information (PGI)*, which we determined FDIC properly designed to include internal control for processing FDIC contractor-related payments. The APM states oversight managers are responsible for (1) verifying that contractors deliver purchased goods or services, (2) ensuring contractors are performing their work according to contracts and delivery schedules, (3) monitoring the expenditures of funds in relation to contract dollar ceilings, and (4) approving invoices for payment. The PGI further states oversight managers are responsible for ensuring all charges contained on each invoice are within the contract terms and conditions, and documentation adequately supports the invoice.

### Cause.

While FDIC management has properly designed internal control activities for established policies, procedures, and guidance, we found that FDIC did not consistently implement nor effectively operate certain designed internal control activities related to oversight management and processing.

### Effect.

Without adequate contract payment review processes, FDIC cannot reasonably assure internal controls over contract payments are operating effectively, which increases the risks of improper payments and financial statement misstatements.

In assessing the magnitude of potential misstatements related to these deficiencies to the financial statements as a whole, we considered the following: (1) materiality levels for the FDIC financial statements, (2) magnitude of contractor payments on the financial statements, (3) additional compensating controls that help prevent a significant misstatement, (4) similar weaknesses in prior years, (5) the number of control exceptions identified, and (6) the importance of such controls. Based on these considerations, in our judgment, these deficiencies do not individually or collectively constitute a material weakness, but are important enough to merit the attention of those charged with governance of FDIC. Thus, these deficiencies represent a significant deficiency in FDIC's internal control over financial reporting as of December 31, 2020. Management commitment and attention will be essential to addressing these deficiencies and improving FDIC's controls over contract-payment review processes.

### Recommendations for Executive Action.

We are making the following two recommendations to FDIC:

- The Chief Financial Officer and the Chief Operating Officer should direct oversight managers and processing approvers to review and follow FDIC's existing policies and procedures for contract-payment review processes, to reasonably assure FDIC sufficiently documents and properly supports contract payments. (Recommendation 1)

- The Chief Risk Officer should establish a process to coordinate with the Division of Administration and the Division of Finance, as appropriate, to periodically train, monitor, and ensure that oversight managers and processing approvers sufficiently and accurately follow FDIC's existing policies and procedures for contract payments. (Recommendation 2)

### Agency Comments

In commenting on a draft of this report, FDIC stated that it is committed to a strong internal control program and is working to enhance the control activities and monitoring capabilities over the contract-payment review process. FDIC agreed with the two recommendations in this report and described actions it is taking or plans to take to address each one. FDIC's comments are reproduced in enclosure I.

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This report contains recommendations to FDIC. We would appreciate receiving a description and status of your corrective actions within 30 days of the date of this report. Please send your statement of corrective actions to me at [dalkinJ@gao.gov](mailto:dalkinJ@gao.gov) or Michael Hansen, Assistant Director, at [hansenm@gao.gov](mailto:hansenm@gao.gov).

This report is intended for the use of FDIC management, members of the FDIC Audit Committee, and the FDIC Inspector General. We are sending copies of this report to the Chairman of the FDIC Audit Committee, the Chairman of the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Secretary of the Treasury, the Director of the Office of Management and Budget, interested congressional committees and members, and other interested parties. In addition, the report is available at no charge on the GAO website at <https://www.gao.gov>.

We acknowledge and appreciate the cooperation and assistance FDIC officials and staff provided during our audit of FDIC's calendar years 2020 and 2019 financial statements. If you or your staff have any questions about this report, please contact me at (202) 512-3133 or [dalkinJ@gao.gov](mailto:dalkinJ@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in enclosure II.

Sincerely yours,



James R. Dalkin

Director  
Financial Management and Assurance

Enclosure(s) – 2



## Enclosure I: Comments from the Federal Deposit Insurance Corporation



**Federal Deposit Insurance Corporation**  
550 17th Street NW, Washington, D.C. 20429-9990

Deputy to the Chairman and CFO

April 28, 2021

James R. Dalkin  
Director  
Financial Management and Assurance  
U. S. Government Accountability Office  
Washington, D.C. 20548

Dear Mr. Dalkin:

Thank you for providing the U. S. Government Accountability Office (GAO) draft audit report titled: **Management Report: Improvements Needed in FDIC's Internal Controls Over Contract-Payment Review Processes (GAO 21-420R)**. The report discusses the matters that GAO identified during the audit of FDIC's 2020 and 2019 financial statements regarding improving internal controls over FDIC's contract-payment review processes. The FDIC appreciates GAO's findings and the opportunity to provide management comments.

FDIC is committed to maintaining a strong internal control program and immediately began working to enhance the control activities and monitoring capabilities over the contract payment review process. The FDIC is currently making significant enhancements to the contract oversight management program to strengthen controls to address exceptions discussed in the report. The FDIC has also implemented a process to review contractor payments to improve the FDIC's ability to identify and timely remediate weaknesses in key internal controls. The attached management response includes specific actions FDIC will take to address GAO's two recommendations.

The FDIC looks forward to continuing the positive working relationship with the GAO team during the upcoming 2021 financial statement audit engagement. Please direct any questions or comments on these matters to E. Marshall Gentry, Chief Risk Officer and Director, Office of Risk Management and Internal Controls, at (703) 562-6378.

Sincerely,

**BRET EDWARDS** Digitally signed by  
BRET EDWARDS

Bret D. Edwards  
Deputy to the Chairman and  
Chief Financial Officer

Attachment

## FDIC RESPONSE TO 2020 GAO MANAGEMENT REPORT

### **Recommendation 1:**

The Chief Financial Officer and Chief Operating Officer should direct oversight managers and processing approvers to review and follow FDIC's existing policies and procedures for contract payment review processes, to reasonably assure that FDIC sufficiently documents and properly supports contract payments.

### **Management Response:**

The FDIC concurs with this recommendation. The Chief Operating Officer and Chief Financial Officer will communicate to all oversight managers and contract payment processing approvers the importance of following FDIC's existing policies and procedures for contract payment review processes, emphasizing that contract payment decisions should be sufficiently documented and properly supported before making payments.

Estimated Completion Date: June 30, 2021

### **Recommendation 2:**

The Chief Risk Officer (CRO) should establish a process to coordinate with the Division of Administration and Division of Finance, as appropriate, to periodically train, monitor, and ensure that oversight managers and processing approvers sufficiently and accurately follow FDIC's existing policies and procedures for contract payments.

### **Management Response:**

The FDIC concurs with this recommendation. The Chief Risk Officer convened an interdivisional working group of key stakeholders to strengthen the FDIC's contract oversight management. This effort will improve the effectiveness, independence, and professionalism of the oversight manager program. Intended actions include enhancing oversight manager training with a focus on how to improve the review and approval of invoices for payment. Additionally, FDIC will begin conducting independent periodic reviews of contract payment transactions to monitor oversight manager and invoice processor compliance with existing policies and procedures and make recommendations, as appropriate, to address any issues identified.

Estimated Completion Date: June 30, 2021



Text of Enclosure I: Comments from the Federal Deposit Insurance Corporation

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April 28, 2021

James R. Dalkin Director

Financial Management and Assurance

U. S. Government Accountability Office Washington, D.C. 20548

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Bret D. Edwards

Deputy to the Chairman and Chief Financial Officer

Attachment

**Page 2**

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Intended actions include enhancing oversight manager training with a focus on how to improve the review and approval of invoices for payment. Additionally, FDIC will begin conducting independent periodic reviews of contract payment transactions to monitor oversight manager and invoice processor compliance with existing policies and procedures and make recommendations, as appropriate, to address any issues identified.

Estimated Completion Date: June 30, 2021

## **Enclosure II: GAO Contact and Staff Acknowledgements**

### **GAO Contact**

Jim R. Dalkin at (202) 512-3133 or [dalkinJ@gao.gov](mailto:dalkinJ@gao.gov)

### **Staff Acknowledgments**

In addition to the contact named above, the following individuals made major contributions to this report: Michael D. Hansen (Assistant Director), Lisa M. Galvan-Treviño, and Fabiola Torres.