



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

Accessible Version

May 19, 2022

The Honorable Martin J. Gruenberg
Acting Chairman, Federal Deposit Insurance Corporation

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

Dear Mr. Gruenberg:

On February 17, 2022, we issued our report on the results of our audits of the 2021 and 2020 financial statements of the two funds that the Federal Deposit Insurance Corporation (FDIC) administers: the Deposit Insurance Fund (DIF) and the Federal Savings and Loan Insurance Corporation Resolution Fund (FRF).¹ As we reported in connection with our audits, in our opinion, although internal controls could be improved, FDIC maintained, in all material respects, effective internal control over financial reporting relevant to the DIF and the FRF as of December 31, 2021, based on criteria established under 31 U.S.C. § 3512(c), (d), commonly known as the Federal Managers' Financial Integrity Act. Those controls provided reasonable assurance that FDIC would prevent, or detect and correct, misstatements material to the DIF and the FRF on a timely basis.

However, we continued to identify deficiencies in FDIC's controls over contract documentation and 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.² Although it did not affect our opinions on the 2021 financial statements of the DIF and the FRF or on the effectiveness of FDIC's internal control over financial reporting relevant to 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 (1) the internal control deficiencies we identified during our audit testing of FDIC's 2021 nonpayroll operating expenses, (2) our recommendations

¹GAO, *Financial Audit: Federal Deposit Insurance Corporation Funds' 2021 and 2020 Financial Statements*, [GAO-22-104601](#) (Washington, D.C.: Feb. 17, 2022).

²A 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.

related to these new deficiencies, and (3) the status of corrective actions FDIC took to address our prior-year recommendations.³ This report is intended for FDIC management's use.

Results In Brief

During our 2021 audit, we identified 11 deficiencies related to contract documentation and payment-review processes that collectively represent a significant deficiency in FDIC's internal control over financial reporting. Specifically, as in the prior year, FDIC management has properly designed and established policies, procedures, and guidance over contract documentation and payment-review processes, but FDIC did not consistently execute these existing controls, which increased the risks that FDIC could make improper payments and misstate the financial statements. While this significant deficiency did not affect our opinions on the effectiveness of FDIC's internal control over financial reporting relevant to the DIF and the FRF, it is important enough to merit the attention of those charged with FDIC governance.

In this report, we are making two new recommendations to address this significant deficiency. For one of the two recommendations from our prior-year report related to FDIC's contract payment-review processes, we found that FDIC implemented corrective actions during 2021 to resolve the deficiency. As a result, this recommendation was closed. Therefore, FDIC currently has three GAO financial audit recommendations to address. We intend these recommendations 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*.⁴

In commenting on a draft of this report, FDIC agreed with the two new recommendations and described planned actions to address each recommendation. FDIC's comments are reproduced in enclosure I. FDIC also provided technical comments, which were incorporated as appropriate.

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, 2021. We performed this work in connection with our audit of these funds' financial statements for the years ended December 31, 2021, and 2020, to support our opinion on whether effective internal control over financial reporting was maintained, in all material respects.

As part of our 2021 financial statement audit of the DIF and the FRF, we performed substantive and internal control testing on a monetary-unit sample of 49 transactions we selected from a universe of FDIC's nonpayroll operating expenses for the interim period of January 1 through June 30, 2021. We reviewed supporting documentation (e.g., contracts, invoices, and payment vouchers) 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 New Financial Environment 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.

³GAO, *Management Report: Improvements Needed in FDIC's Internal Control over Contract-Payment Review Processes*, [GAO-21-420R](#) (Washington, D.C.: May 13, 2021).

⁴GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: September 2014).

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 Documentation and Payment-Review Processes

FDIC oversight managers are responsible for verifying that contractors deliver purchased goods or services and perform their work according to contract terms and delivery schedules. Oversight managers also monitor the expenditures of funds in relation to contract dollar ceilings and approve invoices for payment. FDIC contracting officers, acting within the scope of their authority to contract on behalf of FDIC, are responsible for entering into, administering, and terminating contracts; making related decisions; and executing contract modifications. We identified 11 deficiencies in FDIC's implementation of these internal controls.

Condition. During our 2021 audit, we identified 11 deficiencies in contract documentation and payment-review processes that collectively represent a significant deficiency in FDIC's internal control over financial reporting. Specifically, as in the prior year, FDIC did not consistently execute existing controls over contract documentation and payment-review processes, which increased the risks that FDIC could make improper payments and misstate the financial statements. The deficiencies we identified are listed below.⁵

- We found five instances where oversight managers approved and paid a contractor invoice that did not agree with the terms of the contract, resulting in an improper payment. The five instances related to managers who approved and paid (1) two invoices with incorrect life-insurance premium rates, (2) an invoice with incorrect teleconference rates, (3) an invoice with an incorrect labor rate, and (4) an incorrectly billed technology license subscription expense.
- We found three instances where oversight managers approved contract payments without obtaining or reviewing sufficient documentation to support the invoices. The three instances related to managers who approved and paid a contractor payment without (1) reviewing sufficient support to validate rates on a wireless telecommunication services invoice; (2) sufficient support for the contractor's invoiced hourly split between total corporate and receivership charges; and (3) sufficient support for multiple billed employees with no job descriptions, the primary criterion the contract pricing schedule uses.
- We found three instances of ineffective controls over contract-modification documentation because contracting officers did not implement existing FDIC acquisition policies and procedures. The three instances related to (1) a contracting officer who had insufficient warrant authority to sign a contract modification; (2) a lack of contract-modification documentation for a contract ceiling increase correction; and (3) a lack of contract-modification documentation reflecting a contract's expired status, as another contract superseded it before its initial expiration date and before it was closed out.

Criteria. FDIC established its *Acquisition Policy Manual (APM)* and *Acquisition Procedures Guidance and Information (PGI)*, which we determined were properly designed to include

⁵We identified a total of 10 sample items with errors in our testing. However, we describe 11 deficiencies because one sample item tested had two deficiencies identified involving an oversight manager-approved improper payment that also lacked contract-modification documentation for a change in the contract's expired and superseded status before being closed out. Therefore, this sample item is included in the first and last category of deficiencies.

internal control for processing FDIC contractor-related payments. According to the APM, oversight managers are responsible for (1) verifying that contractors deliver purchased goods or services, (2) ensuring contractors are performing their work according to contract terms and delivery schedules, (3) monitoring the expenditures of funds in relation to contract dollar ceilings, and (4) approving invoices for payment. Further, the PGI states that oversight managers are responsible for ensuring that all charges contained on each invoice are within the contract terms and conditions and documentation adequately supports the invoice.

FDIC's APM states that contracting officers are responsible for entering into, administering, and terminating contracts; making related decisions; and executing contract modifications. FDIC's APM and PGI state that contracting officers are responsible for issuing bilateral and unilateral modifications,⁶ including changes to delivery schedules, performance requirements, typographical errors, and dollar amount.

In addition, the PGI states that contracting officers are delegated contracting authority for specified contracting dollar thresholds based on training and experience, which range from level I (up to \$100,000) to level V (unlimited). The PGI further states that when it is in the best interest of FDIC, modifications that increase or decrease the contract schedule or period of performance must be issued bilaterally prior to the completion of the contract.

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.⁷ Further, GAO's *Framework for Assessing the Acquisition Function for Federal Agencies* states that when financial data are not useful, relevant, timely, or reliable, the acquisition function is at risk of inefficient or wasteful business practices.⁸

Cause. While FDIC management has properly designed and established policies, procedures, and guidance over contract documentation and payment-review processes, we found that FDIC did not consistently implement them. In addition, FDIC did not have an effective process to monitor and reasonably assure that contracting officers sufficiently and accurately follow existing policies and procedures for contracts.

Effect. Without maintaining adequate contract documentation, consistently following contract payment-review processes, and effective monitoring, FDIC cannot reasonably assure that internal controls over contract payments are operating effectively, which increases the risks of improper payments and misstatements in the financial statements.

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)

⁶A bilateral modification is signed by the contractor and the contracting officer, and involves changes that are substantive in nature and alter the rights and obligations of the parties in the contract, such as a change in dollar amount, delivery schedule, and performance requirements. A unilateral modification is signed only by the contracting officer and involves changes that do not require agreement of the contractor, such as appointing a new contracting officer or oversight manager, and administrative changes, such as corrections of typographical errors not affecting the substance of the contract.

⁷[GAO-14-704G](#)

⁸GAO, *Framework for Assessing the Acquisition Function at Federal Agencies*, [GAO-05-218G](#) (Washington, D.C.: September 2005).

additional compensating controls that would help prevent a significant misstatement, (4) similar weaknesses reported in prior years, (5) the number of control exceptions we 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, 2021. Management commitment and attention will be essential to addressing these deficiencies and improving FDIC's controls over contract documentation and payment-review processes.

Status of Prior-Year Recommendations Related to Contract Payment-Review Processes

In May 2021, we issued a management report that included the two recommendations to FDIC related to its contract payment-review processes.⁹ Our 2021 audit included following up on the status of FDIC's corrective actions to address these two recommendations. Our recommendations and a summary of the status are provided below.

- The Chief Financial Officer (CFO) and the Chief Operating Officer (COO) 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)

During calendar year 2021, FDIC notified oversight managers and supervisors responsible for contract-payment review processes of the deficiencies that we identified, and directed them to review and follow FDIC's existing policies and procedures for contract-payment review processes. Based on our review of the notification, we determined that FDIC took sufficient corrective actions to close this recommendation.

- 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)

During calendar year 2021, FDIC began to implement additional training and began developing a monitoring process to conduct transaction testing of contract-related expense transactions. FDIC is continuing to implement corrective actions to address this recommendation.

Recommendations for Executive Action

We are making the following two recommendations to FDIC:

- The Deputy Director of the Acquisition Services Branch of the Division of Administration should direct contracting officers to review and follow FDIC's existing policies and procedures for documenting and approving contract modifications to reasonably assure that FDIC sufficiently documents and properly supports contracts. (Recommendation 1)
- The Deputy Director of the Division of the Acquisition Services Branch of Administration should establish a process to periodically monitor the operating effectiveness of existing

⁹[GAO-21-420R](#).

policies and procedures to reasonably assure that contracting officers sufficiently and accurately follow existing policies and procedures for contracts. (Recommendation 2)

Agency Comments

In commenting on a draft of this report, FDIC agreed with the two new recommendations in this report and described actions it has taken, or plans to take, to address the new recommendations related to contract documentation and payment review process. 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 padillah@gao.gov or Michael Hansen, Assistant Director, at 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 2021 and 2020 financial statements. If you or your staff have any questions about this report, please contact me at (202) 512-5683 or padillah@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,



M. Hannah Padilla
Director, Financial Management and Assurance

Enclosures – 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

May 3, 2022

M. Hannah Padilla
Director
Financial Management and Assurance
U. S. Government Accountability Office
Washington, D.C. 20548

Dear Ms. Padilla:

Thank you for providing the U. S. Government Accountability Office (GAO) draft audit report titled: *Management Report: Improvements Needed in FDIC's Internal Control over Contract Documentation and Payment-Review Processes* (GAO-22-105824). The report discusses matters discovered during the audit of FDIC's 2021 and 2020 financial statements. The FDIC appreciates GAO's findings and the opportunity to provide comments.

During 2021 and extending into 2022, the FDIC took several actions to strengthen controls over contract documentation and invoice payment-review processes by:

- Forming an interdivisional project team to propose strengthened and repeatable controls,
- Reiterating management's expectation for robust contract administration and oversight,
- Increasing the independence and professionalism of oversight managers,
- Reestablishing a community of practice for oversight managers and increasing program support resources,
- Enhancing acquisition planning training for contracting officers and oversight managers and delivering targeted training on audit and internal review finding topics,
- Clarifying policy for non-competitive procurements and better monitoring their frequency and use,
- Enhancing controls over invoice review and payment, and
- Conducting billing and compliance reviews of samples of invoice payments and individual contracts.

Next month, the FDIC will be launching the FDIC Acquisition Management System (FAMS), which will be used to facilitate the management of acquisitions from early acquisition planning through contract closeout. This full lifecycle integrated capability will provide enhanced oversight and reporting for portfolio-level risk analysis.

The FDIC also hired a new Acquisition Services Branch Deputy Director in 2022 with experience leading large acquisition programs at other federal agencies. The FDIC understands that sustained management focus is vital to implementing an effective acquisition program with strong internal controls.

I look forward to continuing the positive working relationship with the GAO team during the upcoming 2022 financial statement audit engagement. Please direct any questions or comments 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
Date: 2022.05.03 16:49:23 -04'00'

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

Attachment

FDIC RESPONSE TO 2021 GAO MANAGEMENT REPORT

Recommendation 1:

The Deputy Director, Acquisition Services Branch of the Division of Administration should direct contracting officers to review and follow FDIC's existing policies and procedures for documenting and approving contract modifications, to reasonably assure that FDIC sufficiently documents and properly supports contracts.

Management Response 1:

Concur. On December 30, 2021, Scott Christensen, Acting Deputy Director, Acquisition Services Branch of the Division of Administration, issued an email entitled "Importance of Adequate Modification Documentation" to the ASB staff (including Contracting Officers and ASB managers). Concurrent with the effort to update the Acquisition Policy Manual, the Deputy Director will reiterate the importance of contracting officers following policies and procedures for documenting and approving contract modifications.

Estimated Completion Date: June 30, 2022

Recommendation 2:

The Deputy Director, Acquisition Services Branch of the Division of Administration should establish a process to periodically monitor the operating effectiveness of existing policies and procedures to reasonably assure that contracting officers sufficiently and accurately follow existing policies and procedures for contracts.

Management Response 2:

Concur. The FDIC has instituted recurring independent reviews of contract billing transactions and individual contracts to assess contract administration, oversight management, and invoice review and payment, and to ensure that contracting officers and oversight managers comply with existing policies and procedures. In addition, the Division of Administration is working to implement a quality review process to provide reasonable assurance that contracting officers follow acquisition policies and procedures. This process will include periodically reviewing contracting officer awards or modifications for compliance, documenting and providing findings and corrective actions to contracting officers and ASB Assistant Directors, and briefing the Chief Operating Officer and ASB Deputy Director on trends and the operating effectiveness of acquisition policies and procedures.

Estimated Completion Date: October 31, 2022.

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

May 3, 2022

M. Hannah Padilla Director

Financial Management and Assurance

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

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- Reestablishing a community of practice for oversight managers and increasing program support resources,
- Enhancing acquisition planning training for contracting officers and oversight managers and delivering targeted training on audit and internal review finding topics,
- Clarifying policy for non-competitive procurements and better monitoring their frequency and use,
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Next month, the FDIC will be launching the FDIC Acquisition Management System (FAMS), which will be used to facilitate the management of acquisitions from early acquisition planning through contract closeout. This full lifecycle integrated capability will provide enhanced oversight and reporting for portfolio-level risk analysis.

The FDIC also hired a new Acquisition Services Branch Deputy Director in 2022 with experience leading large acquisition programs at other federal agencies. The FDIC understands that sustained management focus is vital to implementing an effective acquisition program with strong internal controls.

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Sincerely,

Bret D. Edwards

Deputy to the Chairman and Chief Financial Officer

Attachment

FDIC RESPONSE TO 2021 GAO MANAGEMENT REPORT

Recommendation 1:

The Deputy Director, Acquisition Services Branch of the Division of Administration should direct contracting officers to review and follow FDIC's existing policies and procedures for documenting and approving contract modifications, to reasonably assure that FDIC sufficiently documents and properly supports contracts.

Management Response 1:

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Estimated Completion Date: June 30, 2022

Recommendation 2:

The Deputy Director, Acquisition Services Branch of the Division of Administration should establish a process to periodically monitor the operating effectiveness of existing policies and procedures to reasonably assure that contracting officers sufficiently and accurately follow existing policies and procedures for contracts.

Management Response 2:

Concur. The FDIC has instituted recurring independent reviews of contract billing transactions and individual contracts to assess contract administration, oversight management, and invoice review and payment, and to ensure that contracting officers and oversight managers comply with existing policies and procedures. In addition, the Division of Administration is working to implement a quality review process to provide reasonable assurance that contracting officers follow acquisition policies and procedures. This process will include periodically reviewing contracting officer awards or modifications for compliance, documenting and providing findings and corrective actions to contracting officers and ASB Assistant Directors, and briefing the Chief Operating Officer and ASB Deputy Director on trends and the operating effectiveness of acquisition policies and procedures.

Estimated Completion Date: October 31, 2022.

Enclosure II: GAO Contact and Staff Acknowledgements

GAO Contact

M. Hannah Padilla, (202) 512-5683 or padillah@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 Aleman.

(105824)