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TO: Joseph Neurauder, Chief Procurement Officer, AC

James D. McKay

FROM: James D. McKay, Regional Inspector General for Audit, 4AGA

SUBJECT: HUD Needs to Improve Controls over Its Contract Administration Processes

HIGHLIGHTS

What We Audited and Why

As part of U.S. Department of Housing and Urban Development (HUD), Office of the Inspector General's (OIG) strategic plan, we audited HUD's contract administration process. Our primary objective was to determine whether HUD had adequate controls to ensure that it effectively and efficiently administered its contracts and ensure that it followed requirements.

What We Found

While HUD has implemented or is in the process of implementing several improvements, additional improvements are needed. Because HUD did not have adequate controls over some processes, (1) contract statements of work were sometimes poorly written, (2) it did not adequately assess whether there was a continuing need for goods and services, (3) it paid contractors for questioned costs, and (4) it did not properly evaluate or report contractor performance. As a result, for the 17 contracts we reviewed, HUD paid about \$8 million for services without obtaining the desired outcome and will spend \$900,000 more than necessary by September 30, 2007, for other services that are not needed. In addition, HUD

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unnecessarily paid about \$197,000 for a contract that had an overstated estimated need and then exercised an unnecessary option year for which it will pay the contractor another \$250,000.

What We Recommend

Our recommendations include implementing initiatives currently planned by the chief procurement officer. These planned actions include, but are not limited to, an acquisition planning policy and the “HUD Procurement Transformation” initiative, including developing a HUD Integrated Acquisition Management System. In addition, we recommend implementing additional policies and procedures that (1) improve HUD’s ability to adequately express its needs, provide guidance to contractors, and employ appropriate contracting strategies in its contract statements of work; (2) ensure that the required analyses of contracts are performed to assess the continued need and the cost appropriateness before exercising option periods; (3) provide for the formal review of government technical representatives and government technical monitors; and (4) ensure that staff comply with contractor performance reporting requirements by implementing systems such as automated alerts that notify staff when evaluations are due. Further, HUD should not exercise the final option year for contract C-FTW-00398.

Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee’s Response

We discussed the findings with HUD officials during the audit. We provided HUD officials a copy of the draft report on August 15, 2007, for their comments and discussed the report with the officials at the exit conference on August 23, 2007. HUD provided its written comments to our draft report on August 31, 2007.

HUD generally agreed with the finding and recommendations. The Chief Procurement Officer stated that his staff had been reduced by 30 full-time equivalent positions from the staffing level approved with HUD’s reorganization. He believed it will be difficult, if not impossible, to maintain or improve the current level of performance unless HUD supports the procurement function with adequate staffing. HUD’s response, along with our evaluation of that response, can be found in appendix B of this report. The response included an attached corrective action plan. We reviewed and considered the plan, but did not include it in the report as it pertained to the audit closeout/management decision process.

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BACKGROUND AND OBJECTIVES

The Office of the Chief Procurement Officer (Procurement Office) is responsible for awarding and administering contracts and purchase orders to achieve the U.S. Department of Housing and Urban Development's (HUD) mission, goals, and objectives. As part of a reorganization of the procurement function, effective February 1, 2005, the Secretary of HUD delegated the Deputy Secretary as HUD's Chief Acquisition Officer and all procurement authority to the Chief Procurement Officer, who reports directly to the Deputy Secretary. The Procurement Office provides vital procurement and logistic services to HUD's program and support offices and leadership in applying fundamentally sound business practices to the acquisition of goods and services. Contracting is conducted in the Procurement Office in Washington, DC, or by one of HUD's three field contracting offices located in Philadelphia, Pennsylvania; Atlanta, Georgia; and Denver, Colorado.

The Procurement Office executes thousands of contract actions each fiscal year, such as awarding or modifying contracts, exercising contract options, and issuing task orders. In fiscal year 2006, for example, the Procurement Office awarded 4,162 contract actions with total procurement obligations exceeding \$1 billion. In addition to new contract actions, the office administers a large portfolio of existing contracts. As shown in the following table, HUD's contract obligations for fiscal years 2002 through 2005 were more than \$4.2 billion.

Fiscal year	Obligations
2002	\$ 937,002,973
2003	986,220,666
2004	1,232,557,155
2005	<u>1,049,053,842</u>
Total	<u>\$ 4,204,834,636</u>

In 1997, the Office of Inspector General (OIG) issued a comprehensive audit report of HUD's contract administration.¹ OIG also issued a follow-up report in 1999.² Those reports identified deficiencies in areas such as contractor oversight and monitoring, performance of government technical representatives, needs determinations, planning, and assessments.

¹ HUD Contracting Activity, 97-PH-163-0001, September 30, 1997.

² Follow-up Review of HUD Contracting, 99-PH-163-0002, September 30, 1999.

In addition, in November 2002, the Government Accountability Office (GAO) issued a report on HUD's acquisition management.³ That report revealed deficiencies related to HUD's acquisition workforce, information systems, and contractor monitoring. HUD informed GAO that it had implemented corrective actions; however, GAO has not yet officially closed the recommendations.

The objective of our review was to determine whether HUD had adequate controls to ensure that it effectively and efficiently administered its contracts in accordance with requirements.

³ U.S. Government Accountability Office, Actions Needed to Improve Acquisition Management, GAO-03-157 (Washington, DC; November 2002).

RESULTS OF AUDIT

Finding 1: HUD Did Not Have Adequate Controls over Its Contract Administration Processes

While HUD has implemented or is in the process of implementing several improvements, additional improvements are needed. Because HUD did not have adequate controls over some processes, (1) contract statements of work were sometimes poorly written, (2) it did not adequately assess whether there was a continuing need for goods and services, (3) it paid contractors for questioned costs, and (4) it did not properly evaluate or report contractor performance. As a result, for the 17 contracts we reviewed, HUD paid about \$8 million for services without obtaining the desired outcome and will spend \$900,000 more than necessary by September 30, 2007, for other services that are not needed. In addition, HUD unnecessarily paid about \$197,000 for a contract that had an overstated estimated need and then exercised an unnecessary option year for which it will pay the contractor another \$250,000. Further, since HUD did not evaluate and report contractor performance in the Contractor Performance System database, HUD and other federal agencies that rely on information in the database risk selecting contractors that should have been reported as poor performers.

Criteria

HUD's contracting operations are governed by the Federal Acquisition Regulation, Title 48, chapter 1, of the *Code of Federal Regulations*. The Federal Acquisition Regulation establishes uniform policies and procedures for acquisitions by all executive agencies. It establishes procedures for all aspects of the contracting process, from solicitation to postaward monitoring, including responsibilities for acquisition team members such as contracting officers. HUD supplements the Federal Acquisition Regulation through its HUD Acquisition Regulations, Title 48, chapter 24. HUD's procurement handbook prescribes its procurement policies and procedures for administering contracts.⁴ In addition, in February 2007, the Procurement Office implemented a contract-monitoring desk guide that provides detailed instructions on how to do risk-based analysis to determine the extent and nature of monitoring, as well as how to use the analysis to formulate and format a plan for use in administering the contract from beginning to end.

Contracting officers are ultimately responsible for ensuring performance of all necessary actions for effective contracting including contract administration.

⁴ Handbook 2210.3, REV-9, Procurement Policies and Procedures.

However, the contracting officers can delegate some duties to government technical representatives and government technical monitors who are nominated by HUD's program managers for each specific contract. The responsible contracting officer evaluates the qualifications of nominees and approves or rejects their nomination. Duties for approved nominees are outlined in appointment letters issued by the contracting officer.

The procurement handbook, chapter 5, provides general guidance on statement of work requirements. The work or services to be performed under a proposed negotiated contract should be fully described in a statement of work or a performance work statement. At HUD, the statements of work historically provided contractors detailed instructions for performing the work required to achieve the desired results. More recently, the trend has been toward HUD's awarding performance-based contracts. These contracts have performance work statements rather than statements of work. Performance-based contracts are structured around the results to be achieved as opposed to the manner by which the work is to be performed. For this report, unless stated otherwise, the term "statement of work" will refer to both traditional statements of work and performance work statements.

The Federal Acquisition Regulation requires agencies to provide for adequate acquisition planning. Part 7.103(r) requires the agency head or a designee to prescribe procedures for ensuring that knowledge gained from prior acquisitions is used to further refine requirements and acquisition strategies. Subpart 7.105(a) requires the plan to include a statement of need. This statement should introduce the plan by a brief statement of need; summarize the technical and contractual history of the acquisition; and discuss feasible acquisition alternatives, the impact of prior acquisitions on those alternatives, and any related in-house effort.

The program offices are responsible for preparing the statements of work for their contracts. The Procurement Office provides technical assistance to the program offices in drafting or revising statements of work as requested. There is no mandatory format for statements of work. However, since the statement of work is the contractor's primary source of direction for performing the contract, it must clearly and accurately outline HUD's needs as well as the contractor's responsibilities. The statement of work should include information such as information needed to help potential offerors better understand the requirements, the description of the work and related requirements, clearly defined desired outcomes, specific milestones, and reporting requirements. Performance-based contracts must include clear measurement criteria for HUD's use in evaluating the contractors' performance.

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Deficiencies in All 17 Contracts Reviewed

We found deficiencies in all 17 of the contracts reviewed. The deficiencies included poor planning, inadequate contract statements of work, unnecessary contracts, inadequate assessments of the continuing need for some goods and services, inadequate review of contractor invoices, and failure to evaluate contractor performance. These deficiencies occurred for several reasons, including

- Lack of technical expertise in developing adequate contract statements of work.
- Inadequate guidance for how to write statements of work.
- Inadequate oversight of government technical representatives and government technical monitors.
- Failure to perform required analyses to support decisions.
- Failure to perform adequate reviews of contractor invoices.
- Failure to follow requirements for performing contractor evaluations.

Additional details for the contracts discussed in the following sections, as well as a table showing results for all 17 contracts we reviewed, are presented in Appendix C.

Statements of Work Were Poorly Written

For four contracts, HUD did not adequately plan the procurements resulting in inadequate statements of work and failure to achieve the desired goods and services. Three of these contracts concerned the implementation of HUD's planned single-family integration system. The remaining contract was for marketing FHA products and warning consumers about the dangers of predatory lending practices. As of May 17, 2007, HUD had spent about \$8 million for the four contracts.

Single-Family Integration Systems Project

The single-family systems integration project was implemented because HUD desired to replace about 40 of its single-family legacy systems and applications that were past their design life or that did not provide needed functionality. HUD planned to consolidate the legacy systems into a more manageable group of related systems that would improve system capability by using a common software platform. The integration efforts were intended to help HUD comply with federal legislation, address audit weaknesses, improve overall monitoring

and oversight, and adhere to HUD's enterprise architecture framework.⁵ In addition, the modernization of the systems would simplify system administration, reduce the total costs of ownership, provide flexible and adaptable business systems, and improve program support and oversight. To accomplish its goals, HUD executed three contracts with different small business contractors. All three contracts were awarded as firm-fixed price, Section 8(a),⁶ sole-source contracts. The total value of the contracts was about \$7.5 million.

On February 4, 2004, HUD executed the initial single-family integration contract (Contract C-OPC-22564). Generally, the one-year contract was for designing the new system. Sub-objectives in the statement of work required the contractor to identify and document aspects of the current systems while quantifying the costs and benefits of improvements, analyze the systems to establish a baseline, and develop strategies for system migration. Finally the contractor was to help define the organization structure needed to effectively plan, develop and deploy the new system. Two follow-on contracts to be awarded later would build upon this work and complete the project.

Within a week of executing the contract, HUD began to experience problems when the contractor hired a project manager that was not acceptable to HUD. Between February and April 2004, the contractor advised HUD that it was pressed to meet its deliverable schedule and was ill prepared for the complexity and scope required within the firm-fixed price agreement. On March 17, 2004, the contract specialist was advised that it was unlikely that the contract deliverables would be received in an acceptable condition due in part to unforeseen delays in providing the contractor access to HUD systems and documentation. HUD had not foreseen that the contractor would be unable to access the single-family systems' code and development servers, thus impeding adequate analysis of the systems.

On April 28, 2004, the contractor submitted several draft documents including its feasibility study and analysis of alternatives, risk analysis for systems security, cost benefit analysis, and post-implementation plan deliverable. According to the then-acting deputy assistant secretary for single-family housing, each of the draft documents was unsatisfactory and in unacceptable condition.

The acting deputy assistant secretary for single-family housing described several of the problems in a June 18, 2004, memorandum to the responsible contracting officer. In the memorandum, which requested a stop work order on the contract, he stated that HUD awarded the contract before undertaking required project planning, which directly impacted the usefulness of contract deliverables. He also stated that this lack of planning was "...exacerbated by ambiguities in the

⁵ Framework for organizing data and their interrelationships to support HUD's business processes and align them with HUD's mission, functions, and goals.

⁶ Small Business Administration's Section 8(a) Business Development Program.

contract’s scope of work [and] a lack of specificity in describing deliverables...” He further stated, “Prior to undertaking this contract it was incumbent upon the government to undertake adequate project planning to address the orderly sequencing and handling of legacy system conversion, consolidation, elimination, maintenance, development, budgeting, expense planning, contract coordination, and the policy development necessary for design validation and implementation. Unfortunately, this did not occur which significantly diminishes the usefulness of any contract deliverables.”

HUD did not terminate the contract because staff believed the appeals process would have consumed the remainder of the obligated funds and HUD would end up with nothing of value. Also, HUD staff believed that there was too much culpability on both sides to just stop work. Rather, HUD revised the statement of work to reduce the scope in an attempt to obtain some benefit from the contract.

The contractor did not satisfactorily complete the tasks, in part due to poor performance of the contractor, but also because of poor planning by HUD and a poor statement of work. HUD staff stated that, at the time, they did not have the technical expertise to develop an accurate statement of work for this contract. Further, staff assumed that the contractor had the technical proficiency to accomplish the objectives without a detailed statement of work. Because HUD did not obtain the desired outcome from the initial contract, the follow-on contracts were also adversely affected.

On October 1, 2004, HUD executed the second integration contract (Contract C-DEN-01959), and on September 30, 2005 executed the third and final contract (Contract C-DEN-02045). Unfortunately, the statements of work for the follow-on contractors also contained invalid assumptions and other deficiencies. Most important among these, since the follow-on contracts were to build upon the design analysis provided by the initial contractor, the design provided by the initial contractor had to be usable. However, within the first few months of the second contract, the contractor determined that the design was not usable. The contractor also found that system documentation HUD assumed would be available was not sufficient to analyze the systems and move forward with the project. As a result, HUD modified the statement of work several times in order to obtain something usable from the contract.

The third contractor determined the work provided by the second contractor was also unusable. HUD again modified the statement of work to reduce the scope in order to obtain something of value from this contract. Ultimately, HUD paid the three contractors about \$6.7 million although it received only a few of the desired deliverables and failed to complete the integration project.

Because this project was unsuccessful, HUD planned a new multiyear contracting effort, beginning in fiscal year 2008, to build the Single Family Integration System. HUD estimated this effort will cost an additional \$40.5 million.

FHA Marketing Contract

During 2005 HUD awarded a marketing contract (Contract C-OPC-22898) in support of its initiative to expand homeownership opportunities to all low- and moderate-income individuals, and to expand consumer education about predatory lending. HUD believed that individuals who would qualify for FHA-insured mortgages were instead being steered to subprime mortgage products. In support of this effort, the statement-of-work required the contractor to develop and air short radio commercials known as spots. The spots were to be aired nationwide for nine months beginning in October 2005.

As with the integration systems contracts, statement of work deficiencies, as well as contractor performance issues, negatively impacted results. Contract modifications delayed airing the spots, and also allocated more of the available funds to development leaving less for purchasing air time. Airing the advertisements was cut to eight weeks in only limited markets for 2006. HUD blamed developments and needs that were not anticipated in the original statement-of-work, as well as contractor performance issues.

Despite the first year results, HUD exercised the option year. However, HUD did not perform required analysis to support its decision.⁷ After exercising the option year, HUD made two additional modifications. Both modifications shifted available option year funds from airing the spots during 2007 to more development work.

As a result of the poorly written statement of work, coupled with other issues such as mediocre contractor performance, HUD did not obtain its intended benefit of warning persons nationwide regarding predatory lending despite having spent over \$1.2 million. Although HUD aired the advertisements in 15 markets, given recent events regarding subprime lending and the high rate of foreclosures, HUD likely missed a prime opportunity to provide a meaningful service to the public nationwide.

⁷ Office of the Chief Procurement Officer Acquisition Instruction 06-4.

Need was not Adequately Assessed

Two of the contracts were awarded based on an overstated assessment of need. Since both contracts were awarded as fixed price, HUD overpaid by about \$900,000 for one contract and \$197,000 for the other for services received under the contracts. HUD would have been better served to have used indefinite-delivery/indefinite-quantity type contracts that are based on actual use.⁸ This inefficient use of funds was made worse when HUD exercised options for the contracts without performing the analysis of need that is required prior to exercising option periods. The analysis would have shown the underutilization and the need to consider alternative action. The table of results in Appendix C shows that the required analysis of need was not performed for most of the contracts with exercised option periods.

Credit Report Contract

HUD's Office of Lender Activities and Program Compliance had a need to obtain credit report and/or background check information on key members of mortgage lenders and loan correspondents who applied to become approved lenders, or for existing approved lenders who were required to recertify annually. Previously, lenders paid for and submitted credit report information directly to HUD. The procurement request was initiated by a former program director who was concerned that advances in computer technology made it easier to create counterfeit credit reports.

To accomplish its objectives, on September 30, 2004, HUD executed a one-year, firm-fixed price, Section 8(a), sole-source contract (Contract C-FTW-00398). The contract was originally valued at about \$1.4 million including the base year and three option years. The contractor was to provide a secure Internet interface, credit report access/background checks, Dun & Bradstreet monitoring service, and administrative/technical support.

The statement of work did not appear to be based on a valid need and did not accurately describe the workload. The contract provided for an estimated 9,000 reports annually. Actual use under the contract averaged 86 reports per month or 1,032 reports annually. Further, HUD could have obtained the credit reports directly from the credit reporting agencies for about \$30 each or less than \$31,000 annually.

⁸ Indefinite-quantity contracts allow flexibility in both quantities and delivery scheduling. These contracts may be used when the government cannot predetermine the precise quantity of services that will be needed during the contract period.

Although HUD did not perform the required analysis to determine whether it should execute the options, it exercised the first of two one-year option periods. At expiration of the second option period, on September 30, 2007, we estimate HUD will have paid over \$900,000 more than was necessary to obtain the credit reports. We also estimate that HUD can save \$368,283 in fiscal 2008 if it does not exercise the final option year.

Audit Report Review Contract

HUD's Office of Lender Activities and Program Compliance had a need to obtain assistance in reviewing audit reports and related information that was submitted by mortgage lenders. HUD estimated that financial statements from 7,500 lenders were submitted annually. HUD's Lender Assessment Subsystem receives, collects, assesses, and scores financial, compliance, and performance-related information submitted by the lenders. HUD needed a contractor to assist in reviewing the financial statements and supplemental reports for audits that were flagged by the system.

To accomplish its objective, in July 2005, HUD executed a one-year, firm-fixed price, Section 8(a), sole-source contract (Contract C-OPC-22899) with a one-year option period. The first year of the contract was valued at \$699,000 based on an estimated need of 2,000 audit reports annually plus other related deliverables. The contractor was to perform comprehensive reviews of each flagged audit to include reviewing and analyzing the audit reports to determine that mortgage lenders met HUD's financial requirements and identifying any noncompliance or internal control issues raised in the audit reports.

During the first year, only 423 audit reports were assigned to the contractor for review. At an estimated cost of \$125 to review each audit report, HUD unnecessarily spent an estimated \$197,000 [(2,000 estimated reports – 423 actual reports] x \$125) for the base year of the contract.

Although HUD did not perform the required analysis, it exercised the one-year option period for another 2,000 audit reports at a price of \$250,000 or \$125 per report. If HUD had performed the required analysis, it should have found that the estimated use was overstated and renegotiated the contract or taken other measures to avoid wasting additional funds. Five months into the current option period, the contractor had reviewed only 57 audit reports. HUD has determined that it will not renew the contract.

Inadequate Review of Support for Payments to Contractors

Contracting officers are responsible for administering contracts once the contracts are awarded. However, contracting officers are permitted to delegate some of their duties. For the contracts we reviewed, the government technical representatives and government technical monitors were responsible for reviewing and approving contract deliverables and invoices. The procurement handbook and the new Contract Monitoring Desk Guide contain detailed guidance for reviewing contractor deliverables and invoices.

Our review of the six most recent invoices for the 17 contracts found internal control weaknesses over the review process. Our contracts consisted entirely of fixed-price and hybrid contracts that typically do not require detailed reviews of supporting documents because the payments are fixed amounts. However, some of the contracts had cost-reimbursable items, such as contractor travel, that required review of supporting documents. Our review of payments for contract number C-OPC-22947 found that HUD paid the contractor \$13,500 for a duplicate invoice and \$7,976 for invoices that were not adequately supported. This condition occurred because the former government technical representative did not require the contractor to provide support for reimbursable travel expenses. Further, the government technical monitor admitted that he did not review or recalculate the amounts on the supporting documents before approving the documents for payment.

In addition, the government technical representative for two contracts denied being the representative. Further, she did not maintain contract administration files and did not perform assigned invoice approval duties. Since the representative did not approve the invoices, the government technical monitor both reviewed and approved the invoices—a breakdown in the control procedures.

Another government technical representative gave invoices to the assigned government technical monitor to review and approve. However, the government technical monitor signed the invoice packages and returned them to the government technical representative without knowing whether the work represented by the invoices had been satisfactorily completed. She stated that she assumed the work was satisfactory; otherwise someone would have complained. Another government technical representative told us that she also sent invoices to a government technical monitor for approval; however, the government technical monitor told us that she had not seen any invoices.

Since our contracts did not include significant cost-reimbursable items, we did not identify significant errors. However, if these weaknesses are systemic, the risk of erroneous payments for cost-reimbursable contracts could be significant.

Contractor Performance Not Always Reported

The procurement handbook provides that staff will evaluate contractor performance using the Internet-based Contractor Performance System maintained by the National Institutes of Health. The system is a government-wide database that contains information about contractors' past performance. The procurement handbook requires that multiyear contracts be evaluated annually. Evaluations for contracts with option periods are to be completed at least 120 days in advance of the end of the contract period to permit timely consideration of contractor performance before exercising options. The contracting officer or contracting specialist is responsible for initiating the process for each contract by sending a form to the government technical representative for completion.

For 16 of the 17 contracts, HUD either did not perform the required evaluations or did not perform them in a timely manner. The performance review for the remaining contract was not yet due at the time of our review. Based on our interviews, staff were aware of the requirements but did not follow them. We found that the contracting officers/specialists did not always send the forms to the government technical representatives to initiate the process. We also found that HUD did not have a system, such as a tickler or other type of prompt, to remind staff to perform the evaluations or an effective system to verify that the evaluations were performed.

The evaluation and reporting of a contractor's performance is a critical task. Contractor performance reports enable the contracting officers to determine whether contractual terms are being met and if not, what action is required on their part. The reports also provide program office management information needed to determine whether a contract is yielding what was required (and in some cases anticipated) and if not, what affect it will have on the program mission. Performance reports also provide a record of the contractor's performance, which can be used in evaluations of the contractor for future contract awards.

Because HUD did not perform the evaluations, it, as well as other federal agencies, risks awarding contracts to poor-performing contractors. Further, HUD exercised contract option years without performing the required evaluations. If HUD had performed the evaluations, it could have avoided some of the unnecessary costs and identified and reported problems with the statements of work and contractor performance.

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Inadequate Oversight

Although the tasks performed by the government technical representatives and government technical monitors are critical to contract administration, HUD did not have adequate procedures for oversight of their work. Pursuant to prior OIG audit reports, HUD implemented several improvements, including strengthening the roles of the government technical representatives and holding them formally accountable. In response to OIG's 1997 audit of HUD's procurement, HUD implemented an oversight program for review of government technical representatives/monitors. Unfortunately, some of those improvements now appear to have been temporary. None of the policies or procedures in effect during our review provided for adequate oversight of government technical representatives/monitors. The only guidance for oversight of government technical representatives/monitors was in the procurement handbook, which states that the program offices are responsible for ensuring that they perform their assigned duties. We found a 1982 acquisition instruction (AI 82-5) that provided for reviews, but it was rescinded in 2002.

With the exception of one review of a government technical representative, the Procurement Office did not review the work of any of the government technical representatives/monitors, although the contracting officers are ultimately responsible for all contract activities. The lack of oversight contributed significantly to the problems identified.

The director of the Housing Procurement Management Division recently took steps to improve oversight in that division. The director, along with an internal auditor, developed and implemented detailed monitoring checklists. Also, the Procurement Office has developed a draft review checklist that requires the Procurement Office to perform annual reviews of government technical representatives/monitors for all contracts over \$500,000. However, the process had not been initiated when we completed our fieldwork.

Improvements Made

We discussed our concerns with the chief procurement officer during the review. He generally agreed with our concerns and advised us of several initiatives that he has implemented and other initiatives that are underway that should improve the contract administration process. At the conclusion of our fieldwork, the chief procurement officer had implemented the following initiatives:

- Reorganized the Procurement Office to create several new management positions and align all field contracting staff and functions under the Procurement Office.

- Implemented the Acquisition Council to strengthen acquisition management, as well as address acquisition workforce issues.
- Issued a contract monitoring desk guide that provides comprehensive guidance for monitoring contracts.
- Established the Procurement Management Review Team. The team will visit all major contracting offices (including the field) and examine files, review processes, and interview contracting officers and specialists to identify areas of noncompliance as well as best practices that can be shared. The team will also develop new policies and make suggestions to help improve Procurement Office operations.

The chief procurement officer also has other initiatives underway that should further improve operations if implemented. These include:

- Developing a system to match the program area’s submissions of its yearly strategic procurement plan with its respective planning processes for each fiscal year. For example, each program area’s fiscal year 2009 strategic procurement plan should be prepared at the same time it submits its respective justification for its fiscal year 2009 budget to the Procurement Office.
- Establishing the “HUD Procurement Transformation” initiative. Key components of this initiative include providing for the recruitment and training of a skilled workforce and developing a HUD Integrated Acquisition Management System—a “cradle to grave” contract writing system.
- Implementing an acquisition planning policy, currently in the draft stage, designed to improve contract oversight to better ensure that goods and services are received at the best value for the money spent.
- Implementing a new automated performance system that contains specific contract administration-related performance standards.

Additional Improvements Needed

HUD’s automated systems were not fully integrated and did not interface with all of HUD’s financial systems. Thus, responsible staff did not always have access to critical information. We first reported this weakness in our 1997 audit report. We again cited this weakness in a January 25, 2007, report on HUD’s procurement systems.⁹ In addition, in its 2002 report, GAO cited the issue as a serious deficiency. GAO stated that HUD’s contract information system and various financial management systems lacked complete, consistent, and accurate information needed to adequately manage and monitor contracts. The report

⁹ Review of HUD’s Procurement Systems, 2007-DP-0003.

further stated that the system deficiencies meant that HUD managers lacked reliable information needed to oversee contracting activities, make informed decisions about the use of resources, and ensure accountability in HUD's programs.

Due to lack of consistent and reliable financial information in the procurement systems, some staff members who are responsible for contract administration resorted to devising their own personal systems for tracking information, such as spreadsheets showing contractor payment information.

To address these deficiencies, the Procurement Office has proposed the HUD Integrated Acquisition Management System. This system would provide "cradle to grave" acquisition management and provide much needed improvement over HUD's current paper-based duplicative system. The Procurement Office staff told us that paper documents, including entire procurement packages, have been lost. Recreating and rerouting paper documents leads to unnecessary delays, increased opportunity for errors, and duplication of effort. With the proposed system, procurement documents would be created, routed, reviewed, and approved online.

In addition to developing better automated systems, the Procurement Office needs to make other improvements. Needed improvements include implementing policies and procedures that (1) improve HUD's ability to adequately express its needs, provide guidance to contractors, and employ appropriate contracting strategies in its contract statements of work; (2) ensure that the required analyses of contracts are performed to assess the continued need and the cost appropriateness before exercising option periods; (3) provide for the formal review of government technical representatives and government technical monitors to ensure that they adequately perform their contracting tasks; and (4) ensure that staff comply with contractor performance reporting requirements.

Unless HUD improves its planning, preparation of statements of work, and oversight of government technical representatives/monitors; implements effective automated systems; and implements other improvements, it will likely continue to experience difficulties in obtaining the desired benefits from its contracting efforts.

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Summary

Because HUD did not have adequate controls over some contract administrative processes, staff could not always be relied upon to develop appropriate statements of work employing the appropriate contracting strategies. In addition, staff did not always comply with requirements such as assessing the continuing need for contracts, performing proper reviews of contractor invoices and performing contractor evaluations. Further, HUD's procedures for monitoring the work of government technical representatives/monitors were inadequate. Implementing the report recommendations will improve internal controls over the procurement process. Improved internal controls will better assure that, in the future, HUD procures needed goods and services more efficiently and effectively.

Recommendations

We recommend that the chief procurement officer

- 1A. Implement the following ongoing and planned initiatives to improve contract oversight to better ensure that goods and services are received at the best value for the money spent by:
 - Developing a system to match the program area's submissions of its yearly strategic procurement plan with its respective planning processes for each fiscal year;
 - Establishing the "HUD Procurement Transformation" initiative, including developing a HUD Integrated Acquisition Management System—a "cradle to grave" contract writing system;
 - Implementing an acquisition planning policy; and
 - Implementing a new automated performance system that contains specific contract administration-related performance standards.
- 1B. Implement procedures that improve HUD's ability to adequately express its needs, provide guidance to contractors, and employ appropriate contracting strategies in its contract statements of work.
- 1C. Implement procedures to ensure that the required analyses of contracts are performed to assess the continued need and the cost appropriateness before exercising option periods.
- 1D. Not exercise the final option year for contract C-FTW-00398, thereby saving an estimated \$368,283 by avoiding unnecessary costs.

- 1E. Implement policies and procedures providing for the formal review of government technical representatives and government technical monitors to ensure that they adequately perform their contracting tasks.
- 1F. Ensure that staff comply with contractor performance reporting requirements by implementing systems such as automated alerts that notify staff when evaluations are due.

SCOPE AND METHODOLOGY

Our primary objective was to determine whether HUD had adequate controls to ensure that it effectively and efficiently administered its contracts and ensure that it followed requirements.

To accomplish our objective, we

- Assessed internal controls applicable to contract administration in the following categories:
 - Program Operations;
 - Reliability of Information;
 - Laws and Regulations; and
 - Safeguarding Assets.
- Reviewed applicable laws, regulations, and other HUD requirements, including but not limited to applicable sections of 24 CFR [*Code of Federal Regulations*]; the Federal Acquisition Regulation; HUD Acquisition Regulations; HUD Handbook 2210.3, REV-9; and HUD's Contract Monitoring Desk Guide.
- Interviewed HUD management and staff.
- Reviewed contract files and related documentation for 17 contracts.
- Reviewed applicable contracting data in the HUD Procurement System.
- Performed other reviews and tests as needed to accomplish our objective.

We selected 17 contracts for review. Each of the contracts was valued at more than \$100,000 with a total value of about \$40 million and included contracts awarded during fiscal years 2002 through 2005. According to HUD's data, its total contract obligations of contracts valued at more than \$100,000 for fiscal years 2002 through 2005, were about \$4.2 billion with an average of about \$1 billion per year.¹⁰ We included at least one contract from each of HUD's major divisions (Offices of Public and Indian Housing, Housing, and Community Planning and Development). However, the selected contracts are not representative of HUD's contracting as a whole; thus, we did not extrapolate our results to all of HUD's contracting activity. We selected contracts as follows:

- We randomly selected 10 contracts from 50 Section 8(a) contracts awarded by HUD headquarters during fiscal year 2005.
- We selected six contracts based on information obtained during interviews with HUD staff.
- One contract was referred to us through an OIG hotline complaint.

We reviewed the contracts, performance reports, invoices, and other related documents to determine whether (1) the statements of work were adequate, (2) HUD properly evaluated contractors, and (3) HUD adequately reviewed invoices.

¹⁰ Includes only contract obligations over \$100,000 based on data in HUD's Procurement System.

We conducted our fieldwork from October 2006 through May 2007 at HUD headquarters offices in Washington, DC. Our audit period was from October 1, 2004, through September 30, 2006. We expanded our audit period to include contract C-OPC-22172, dated April 15, 2002, which was referred to us by HUD staff.

We performed our review in accordance with generally accepted government auditing standards.

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FOLLOW-UP ON PRIOR AUDITS

In November 2002, GAO issued its audit report GAO-03-157, Actions Needed to Improve Acquisition Management. GAO recommended that the secretary of HUD implement four recommendations to address weaknesses identified in the report. The four recommendations and current status are as follows:

Recommendation 1: Implement a more systematic approach to HUD contract oversight that (1) uses monitoring/contract administration plans; (2) uses a risk-based approach for monitoring to assist in identifying those areas in which HUD has the greatest vulnerabilities to fraud, waste, abuse, and mismanagement; and (3) tracks contractor performance.

Status: In March 2005, HUD issued a draft Desk Guide for Contract Administration to resolve GAO's recommendation. Additional GAO follow-up work is needed to verify that HUD has implemented its new plans and guidance.

Recommendation 2: Clarify the roles and responsibilities of the multifamily housing government technical representatives and government technical monitors, including the need to (1) clearly define reporting lines and (2) reduce overlap of responsibilities consistent with HUD guidance.

Status: To improve contract oversight, HUD's chief procurement officer and chief information officer created a joint program management task force to increase, within the acquisition workforce, the appreciation of the roles and responsibilities associated with and the importance of contract oversight. Because this effort is in the early stages of implementation, the recommendation remains open at this time.

Recommendation 3: Improve management of HUD's acquisition workforce by (1) addressing workload disparities, (2) finalizing and implementing the acquisition management career plan, (3) assessing the skills and capabilities of the existing acquisition workforce, and (4) ensuring that appropriate training is provided to staff with contract oversight responsibilities and that staff meet federal training requirements.

Status: To address workload disparities, HUD reorganized its Procurement Office to align it directly under the deputy secretary, placing that office at an organizational level commensurate with its strategic importance in meeting HUD's mission needs. HUD believes that this will help achieve several vital objectives by increasing full-time-equivalent positions approved by the secretary and supported by HUD's resource estimation and allocation process study results. In October 2004, HUD also finalized and implemented its Acquisition Career Management Program, which established training requirements for HUD's acquisition workforce. To assess the skills and capabilities of the existing workforce, the Procurement Office is tracking the training status of officials employed by that office and is using individual development plans to identify training needs and ensure that employees obtain the required skills and keep them

current. Because the reorganization is ongoing and additional GAO follow-up work is needed to verify implementation of HUD's efforts, this recommendation remains open.

Recommendation 4: Improve the usefulness of HUD's centralized contracting management information system by (1) providing training to staff on the definitions of data intended to be captured; (2) providing training to program office staff on the functions, such as tracking milestones, deliverables, and contractor performance, of the system; and (3) developing and implementing verification procedures.

Status: HUD revised its training program to incorporate GAO's recommendations and conducted the training in December 2003 and on several other occasions. The training covered the use of the contracting system by program staff for contract management and oversight. In addition, the contracting system was upgraded with new data verification edits in December 2003. Because additional GAO follow-up work is needed to verify the content of the training courses and the number of staff trained, this recommendation remains open.

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS AND FUNDS TO BE PUT TO BETTER USE

<u>Recommendation</u>	<u>Funds to be put to better use 1/</u>
1D	\$368,283


- 1/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an OIG recommendation is implemented. This includes reductions in outlays, deobligation of funds, withdrawal of interest subsidy costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings which are specifically identified. In this instance, if HUD implements our recommendation, it will put an estimated \$368,283 to better use.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

	<p>U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT WASHINGTON, DC 20410-3000</p>
OFFICE OF THE CHIEF PROCUREMENT OFFICER	AUG 31 2007
MEMORANDUM FOR:	James D. McKay, Regional Inspector General for Audit, 4AGA
FROM:	Joseph Neuraater, Chief Procurement Officer, N
SUBJECT:	Discussion Draft Audit Report - HUD Needs to Improve Controls Over Its Contract Administration Processes
<p>Thank you for allowing us the opportunity to respond to the draft report. The Office of the Chief Procurement Officer (OCPO) Leadership Team thoroughly reviewed the draft report and generally concurs with the findings.</p>	
Comment 1	<p>We wish to update a statement on pages 4 and 5 of the report pertaining to the November 2002 Government Accountability Office (GAO) report on HUD's acquisition management. The statement is, "HUD informed GAO that it had implemented corrective actions; however, GAO has not verified the corrective actions. Thus, the recommendations remain open." We are pleased to report that the GAO representatives informed OCPO by e-mail dated February 9, 2007 that the three open recommendations were in the process of being closed. Accordingly, the Audit Resolution and Corrective Actions Tracking System (ARCATS) have been updated to reflect the current status.</p>
Comment 2	<p>Your report acknowledges that HUD has implemented or is in the process of implementing several improvements, but that additional improvements are still needed. We thank you for recognizing and acknowledging the improvements we have implemented and we concur with your recommendations and have prepared a corrective action plan that will ensure that adequate controls are in place to effectively monitor the contract administration process, improve our performance, and enhance customer service. In response to your recommendations, our corrective actions include:</p> <p>Recommendation 1A:</p> <ul style="list-style-type: none">• Continuation of the HUD Procurement Transformation initiative, which has been underway since the OCPO reorganization in April 2006.• A task order for an enterprise architecture study that will lead to the HUD Integrated Acquisition Management System (HIAMS) function requirements definition was issued in August 2007. A contract for HIAMS development is anticipated to take place in late FY 08, with full implementation taking place in FY 09.• Chapter 4 of HUD Handbook 2210.3, Procurement Policies and Procedures, along with Appendix 4-1 on acquisition planning, has been updated, is currently being routed for clearance, and is expected to be issued no later than October 31, 2007. The update will

require that written acquisition plans be prepared for contracts and orders exceeding \$100,000. A copy is attached.

- As part of the Contract Management Review Board process, Program offices will be required to provide their annual strategic procurement plans earlier in the fiscal year. Annual strategic procurement plans for FY 2009 will be required to be submitted by February 29, 2008. Information about the process may be obtained from the following web address: http://hudatwork.hud.gov/po/arc/guidance/cmrb/cmrb_rules.doc.
- A Procurement Management Review (PMR) Team was established during FY 2007 to review and assess compliance with applicable regulations and guidance of each major contracting office within OCPO. The entire OCPO staff will be briefed on the overall findings of the PMRs and corrective actions.
- The Contract Monitoring Desk Guide for Government Technical Representatives (GTRs) and Government Technical Monitors (GTMs) was issued in February 2007 and updated in May 2007. The Guide provides detailed instructions and guidance to GTRs and GTMs on the fulfillment of their contract-monitoring duties.

Recommendation 1B:

- Six classes of basic training for GTRs and GTMs, and one class on Performance-Based Acquisitions, are scheduled by the end of FY 2007. Approximately 230 GTRs and GTMs will be trained in these classes.
- Continue implementing Acquisition Career Management Programs as required by OFPP Letter 05-01: the Federal Acquisition Certification – Contracting (FAC-C) was implemented in February 2006; the Federal Acquisition Certification – Program/Project Management (FAC-P/PM) will be implemented by January 31, 2008; and the Contracting Officer Representative Certification Program will be implemented by March 31, 2008.
- Conduct Competency Gap Analysis for employees in the GS-1102 job series and provide needed training to close that gap by June 2008. The Competency Gap Analysis will identify knowledge, skills, abilities needed to meet the types of contracts at HUD.
- Develop a statement of work template and checklist. OCPO will conduct training for contracting officers and GTMs/GTRs on the use of the template and checklist by January 2008.
- The Office of Housing will add to its Standard Operating Procedures an Integrated Program Team (IPT) checklist that will assist the GTR in analyzing contract needs.

Recommendation 1C:

- Acquisition Instruction (AI) 06-4, Use of Options, was issued in July 2006, and the OCPO staff was briefed in July 2006 on the proper use, evaluation, and execution of options. The briefing will be conducted periodically for new contracting personnel. A copy of AI 06-4 is attached.
- To ensure proper procedures have been followed, peer reviews will be required before exercise of any option.

- The review of option exercise supporting documents will be made a standard item for Procurement Management Reviews (PMRs).

Recommendation 1D: The final option year for contract C-FTW-00398 will not be exercised.

Recommendation 1E:

- Handbook 2210.3, Procurement Policies and Procedures, will be revised to provide that the contracting officer is responsible for ensuring that GTRs and GTMs perform their assigned duties. It should be noted that at this time, HUD does not have an automated system that has the capability of sending our electronic alerts.
- The Contracting Monitoring Desk Guide will be revised to address OCPO's right to establish a GTR/GTM oversight program.
- Office of Housing will require its GTRs to provide weekly reports summarizing Integrated Program Team (IPT) meetings.
- Office of Housing will implement an invoice review procedure for tracking each contract. GTRs will be required to maintain the following information, at a minimum: obligated balance; terms; payment conditions; invoice date, number, and amount; and remaining balance. Prior to approving an invoice for payment, the GTR will compare the invoice to the contract terms and payment conditions, and ensure that adequate supporting documentation for the invoice has been received.

Recommendation 1F:

- OCPO staff will conduct another briefing on AI 03-1, Procedures for Contractor Performance Evaluations, by April 2008. A copy of AI 03-1 is attached.
- Using information in the HUD Procurement System and the Small Purchase System (HPS/SPS), contracting officers will notify contractors and GTRs 90 days prior to the milestones established in AI 03-1 that performance evaluations will be due.
- The entry of performance evaluations into Past Performance Information Retrieval System (PPIRS), as well as compliance with FAR Subpart 42.15 and AI 03-1 will become a standard item for PMRs.

These initiatives, and others identified in the proposed corrective action plan, will go a long way to ensuring HUD contracting becomes, and continues to be, world-class. While this is an ambitious agenda, it is well underway and already achieving results. However, it cannot be maintained and brought to fruition without adequate staffing. Though the reorganization approved 144 S&E full-time equivalents (FTE), the authorized total has been reduced to 114 FTE. These S&E reductions have had a significant impact in our ability to fully implement the systemic, cultural, and operational changes envisioned with the reorganization. Without full staffing, it will be difficult, if not impossible, to maintain the level of performance we currently have, let alone improve it.

We sincerely appreciate for the opportunity to review the draft report and provide clarification where needed. We are looking forward to seeing our comments included in the final

Comment 3

Ref to OIG Evaluation

Auditee Comments

4

report and working with you and your staff to resolve and close out the recommendations. If you have any questions concerning our comments or the proposed corrective action plan, please contact me at (202) 402-5208 or you can contact my Audit Liaison Officer, Linda Hooks at (202) 402-5474.

Please find attached our proposed Corrective Action Plan.

Attachments

OIG Evaluation of Auditee Comments

- Comment 1 HUD stated that GAO informed OCPO by e-mail dated February 9, 2007 that three open recommendations were in the process of being closed. Since GAO has not officially notified HUD the recommendations are closed, and GAO's website showed all four as remaining open as of September 7, 2007, we did not modify the Follow-up on Prior Audits section of the report.
- Comment 2 The ongoing and planned corrective actions outlined in the comments and the attached OCPO Corrective Action Plan are responsive to the recommendations. We concur with the management decisions for each recommendation in the report. In addition, since the final option year for contract C-FTW-00398 will not be exercised, we consider recommendation 1D closed.
- Comment 3 The procurement function supports all HUD's divisions and it is crucial that HUD provide the staffing resources needed for its operation. However, we are unable to comment on the number of staff actually needed since our audit did not include work in that area.

Additional Contract Information

Contract C-OPC-22564

On February 4, 2004, HUD executed the initial contract, a one-year, firm-fixed price, Section 8(a), sole-source contract for almost \$2 million. Generally, the contractor was to design the new system. The objective of the statement of work was to (1) further refine the target architecture by identifying and documenting the functions, processes, activities, information, data, and systems for single-family housing and quantifying the costs and benefits of functional process improvements; (2) analyze the current single-family systems to establish a functional and technical baseline from which to migrate to the target architecture; (3) develop a single-family enterprise systems migration strategy; (4) analyze HUD's operating infrastructure, which consists of organizations, personnel, and the internal mechanisms required for effective and efficient operations, against single-family target architecture; and (5) help define the organizational structure needed to effectively plan, develop, and deploy the single-family target systems.

To accomplish the objectives, the contractor was required to perform several tasks, including

- Using modeling techniques to perform an “as-is” (baseline) and “to-be” (target) analysis for the overall integration system and developing a functional prototype for the first module (the loan origination module) in the system.
- Developing a “requirements traceability matrix” to trace the requirements of the new system from beginning to end.
- Documenting the results of these tasks. Once approved by HUD, these requirements were to form the operational concept for the new system.
- Benchmarking existing enterprise resource planning applications, comparing them to the target system operational concept, and determining which best matched requirements.
- Designing the integrated system architecture that would satisfy the operation concept.
- Developing a design traceability matrix.
- Developing system/subsystem, database and program specifications, and software test plan.
- Capturing the complete detailed design, including a description of the computer processes and the detailed data to be processed in a repository.
- Documenting the business rules and logic for the new system.

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Among other items, the completed design was to provide the ability to track systems-related legislation and costs and be in sufficient detail to enable the follow-on contractors to build the new system.

Ultimately, the contractor did not satisfactorily complete the tasks, in part due to poor performance of the contractor, but also because of poor planning by HUD and a poor statement of work. HUD staff stated that at the time, they did not have the technical expertise to develop an accurate statement of work for this contract. Further, staff assumed that the contractor had the technical proficiency to accomplish the objectives without a detailed statement of work.

The acting deputy assistant secretary for single-family housing at that time described several of the problems in a June 18, 2004, memorandum to the responsible contracting officer. In the memorandum, which requested a stop work order on the contract, he stated that HUD awarded the contract before undertaking required project planning, which directly impacted the usefulness of contract deliverables. He also stated that this lack of planning was "...exacerbated by ambiguities in the contract's scope of work [and] a lack of specificity in describing deliverables...." He further stated, "Prior to undertaking this contract it was incumbent upon the government to undertake adequate project planning to address the orderly sequencing and handling of legacy system conversion, consolidation, elimination, maintenance, development, budgeting, expense planning, contract coordination, and the policy development necessary for design validation and implementation. Unfortunately, this did not occur which significantly diminishes the usefulness of any contract deliverables."

Within a week of executing the contract, HUD began to experience problems when the contractor hired a project manager that was not acceptable to HUD. Between February and April 2004, the contractor advised HUD that it was pressed to meet its deliverable schedule and was ill prepared for the complexity and scope required within the firm-fixed price agreement. On March 17, 2004, the contract specialist was advised that it was unlikely that the contract deliverables would be received in an acceptable condition due in part to unforeseen delays in providing the contractor access to HUD systems and documentation. HUD had not foreseen that the contractor would be unable to access the single-family systems' code and development servers, thus impeding adequate analysis of the systems.

Additional Contract Information

On April 28, 2004, the contractor submitted several draft documents including its feasibility study and analysis of alternatives, risk analysis for systems security, cost benefit analysis, and postimplementation plan deliverable. According to the then-acting deputy assistant secretary for single-family housing, each of the draft documents was unsatisfactory and in unacceptable condition.

In May 2004, HUD clarified the original statement of work. It arranged the deliverables in a more logical order and clarified HUD's expectations for transparency in systems design. Based on the clarifications, the contractor requested a reduction in the scope of the contract and an extension to the period of performance. The contractor rewrote the statement of work to restart the work from the beginning with a revised scope.

In his memorandum, the acting deputy assistant secretary for single-family housing concluded that it would be in the best interest of the government to discontinue the agreement for convenience, to avoid incurring costs for unacceptable contract performance, and to reserve funds for project planning. He requested that the work be stopped immediately.

HUD ultimately did not terminate the contract because staff believed the appeals process would have consumed the remainder of the obligated funds and HUD would end up with nothing of value. Also, HUD staff believed that there was too much culpability on both sides to just stop work. Rather, HUD revised the statement of work to reduce the scope in an attempt to obtain some benefit from the contract. As a result, the contractor only provided the "as-is" design analysis for the loan origination module to HUD.

Because HUD did not obtain the desired outcome from the initial contract, the follow-on contracts were also adversely affected.

Contract C -DEN-01959

On October 1, 2004, HUD executed the second integration contract. This contract was a two-year, firm-fixed price, Section 8(a), sole-source contract for more than \$2.5 million. Generally, the purpose of the contract was to continue the effort of designing, developing, and building the single-family integration system. The contractor was to complete the system design phase for the loan origination module, perform the requirements definition phase for the "to-be" target system,

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and provide project management support. The contractor was to build upon the design analysis provided by the initial contractor.

Within the first few months of the contract, the contractor determined that the design developed by the initial contractor was unusable. For the first few months of the contract period, the contractor tried to resolve deficiencies in the initial design. The contractor also determined that the documentation provided by the initial contractor was incomplete and did not provide appropriate information to allow the contractor to move forward with the project. In addition, it was determined that there was not sufficient documentation available regarding the legacy systems' source code for the contractor to analyze the systems.

Throughout the contract period, HUD modified the scope of the work nine times. While some of the modifications were for administrative purposes, several of the modifications changed the scope of the work. For example, one modification removed the contractor's system analysis requirements for eight of the systems because they were being removed from the integration project. About four months later, HUD modified the scope to include the eight previously removed systems.

HUD further revised the scope whereby the contractor would not provide the requirements and design originally planned for the loan origination module but would, instead, develop the requirements and design to move another system that was not connected to other systems, the Federal Housing Administration (FHA) Connection, to the new target system environment. The contractor would then move some other small systems that were not connected to others. As the contractor began this work, HUD changed priorities and decided that it wanted to move another system first. However, it was later determined that this system was proprietary, so HUD could not provide system documentation to the contractor. Therefore, HUD and the contractor went back to the previous plan to move the other systems. However, the contractor then determined that the FHA Connection system had been modified over the years to be more complex and tightly interwoven with another system. Thus, the task was more complicated than expected. Because of this and delays in obtaining the system documentation and source code, HUD again revised the scope to just providing the requirements and design for one part of the FHA Connection.

Additional Contract Information

Contract C -DEN-02045

On September 30, 2005, HUD executed the third integration contract. This contract was a one-year, firm-fixed price, Section 8(a), sole-source contract for about \$3 million. The overall scope of the contract encompassed the full range of software lifecycle development of the loan origination module. The contractor was to provide the design, documentation, and analysis of requirements to build, evaluate, and implement the loan origination module. This included completing module one that was already in progress and designing and completing the remaining four loan origination modules. To move forward, the contractor had to work with the second contractor, which developed the design for module one. The contractor for this phase of the integration project claimed that the module one design was unusable. According to HUD staff, the two contractors were uncooperative with each other, and HUD was unable to resolve the issues between them. Thus, HUD modified the third contract to reduce the scope. Ultimately, the contractor built and implemented “middleware.” The remaining services were not provided, and the contract was reduced by \$1.2 million.

Contract C-OPC-22898

In support of its initiative to expand homeownership opportunities to all low- and moderate-income individuals and to expand consumer education about predatory lending, HUD wanted to target advertising in two areas: (1) FHA mortgage insurance products and (2) developing borrowers’ awareness and avoidance of predatory lending in the home mortgage markets. HUD believed that individuals who would qualify for FHA-insured mortgages were being steered to subprime mortgage products.

To accomplish its objective, on July 13, 2005, HUD executed a one-year, firm-fixed price, Section 8(a), sole-source marketing contract. The base year of the contract was for \$749,225 and provided for a one-year option period valued at \$595,750. The contractor was to create and strategically place radio advertisements in English and Spanish to target African-American and Hispanic audiences. The advertisements were to be placed in markets nationwide through nationally syndicated shows. The advertisements were to include information on the benefits of homeownership, the advantages of FHA mortgage insurance products, and how to identify and avoid predatory lending. In addition to radio advertisements, the contractor was to arrange and coordinate several radio talk shows and produce and place editorials and articles in minority newspapers. For the first year of the contract, the contractor was to broadcast the radio

Additional Contract Information

advertisements nationwide for nine months beginning in October 2005. The contractor was to be paid \$120,000 for creating the advertisements and \$629,000 for broadcasting them during the first year of the contract.

In September 2005, HUD made significant modifications to the contract statement of work due to changes in its marketing strategy. The modifications included

- Primarily providing short radio spots and only limited nationally syndicated advertisements.
- Allocating more time and money (\$399,000) to developing the spots and much less (\$350,000) to the actual broadcasts.
- Airing the spots only for eight weeks beginning in March 2006.
- Airing the spots only in selected markets rather than nationally.

HUD modified the contract again on June 8, 2006. This modification revised the deliverable due dates and timelines for the remainder of the base contract period. The modification was done because the contractor was not on target with the deliverable schedule and timeline due to several new developments and needs of the HUD program office. These developments and needs were unanticipated and were not discussed during the contract award or kickoff or after the contract was executed. Documentation in the contract file states that several issues necessitated the changes. The issues included

- A new slogan was selected and needed to be incorporated.
- A new Web site was developed and needed to be included.
- HUD's internal approval process for the advertisements was more complex than originally conceived.
- There was extensive new or revised HUD oversight over all products throughout the development process.

Ultimately, HUD only spent \$290,000 on the airing of the advertisements during the first year.

In July 2006, HUD exercised the option year. Upon exercising the option, HUD again revised the statement of work, allocating more than \$400,000 in additional funds for development of the spots and less than \$180,000 for the actual

Additional Contract Information

broadcasts. The spots were to be broadcast in targeted markets for eight weeks beginning in March 2007. However, less than two weeks after exercising the option, HUD again modified the contract and allocated additional funds for development costs while reducing funds for the broadcasts to \$110,000.

HUD exercised the option year without performing required analysis to support its decision. Staff told us that the contractor's performance was mediocre. Once the contractor began providing deliverables that were "not good," HUD increased its review of the contractor. Staff indicated that HUD had previously used a large contractor to provide marketing regarding FHA. HUD split up the marketing services among three Section 8(a) contractors, including this contractor. Staff indicated that all three contractors had quality control problems.

HUD does not plan to renew any of the three contracts. Rather, it will integrate the advertising campaigns from each of the contracts and do the planning and development of the advertisements in house. HUD will then contract out the airing of the advertisements and additional development if needed.

As a result of the poorly written statement of work, coupled with other issues such as mediocre contractor performance, HUD did not obtain its intended benefit of warning persons nationwide regarding predatory lending. Although HUD aired the advertisements in 15 markets, given recent events regarding subprime lending and the high rate of foreclosures, HUD may have missed a prime opportunity to provide a meaningful service to the public nationwide.

Contract C-FTW-00398

HUD's Office of Lender Activities and Program Compliance had a need to obtain credit report and/or background check information on key members of mortgage lenders and loan correspondents who applied to become approved lenders or for existing approved lenders who were required to recertify annually. Previously, lenders paid for and submitted credit report information directly to HUD. The request was initiated by a former program director who was concerned that advances in computer technology made it easier to create counterfeit credit reports.

To accomplish its objectives, on September 30, 2004, HUD executed a one-year, firm-fixed price, Section 8(a), sole-source contract. The contract was originally

Additional Contract Information

valued at about \$1.4 million including the base year and three option years. The contractor was to provide a secure Internet interface, credit report access/background checks, Dun & Bradstreet monitoring service, and administrative/technical support. HUD already had a contract with Dun & Bradstreet. Staff and management advised us that, to their knowledge, there had never been a false report submitted so they did not believe that the contract was needed.

The statement of work did not appear to be based on a valid need and did not accurately describe the workload. The statement of work provides for an estimated 9,000 reports annually. Actual use under the contract averaged 86 reports per month or 1,032 reports annually. HUD could have obtained the credit reports directly from the credit reporting agencies for about \$30 each or less than \$31,000 annually. HUD would have been better served to have used an indefinite-delivery/indefinite-quantity type contract that was based on actual use.

Although HUD did not perform required analyses to determine whether it should execute the options, it exercised the first two of the one-year option periods. These were also based on an estimated need of 9,000 reports annually. If HUD had performed the required analysis, it should have, at a minimum, found that the use was far less than expected; thus, the costs were excessive. HUD could have either renegotiated the terms or concluded that it should not exercise the options. upon expiration of the current option year (the second of the three option years) on September 30, 2007, we estimate that HUD will have unnecessarily paid more than \$900,000 (\$1,020,743[contract costs for base and first two option years of \$323,495 + \$332,939 + \$364,309] minus \$92,880 [1,032 reports per year x \$30 each x 3 years] = \$927,863). We estimate that HUD can save \$368,283 (\$399,243 final contract option year – \$30,960 [\$30 x 1,032 reports]) in fiscal 2008 if it does not exercise the final contract option year.

Contract C-OPC-22899

HUD's Office of Lender Activities and Program Compliance had a need to obtain assistance in reviewing audit reports and related information that was submitted by mortgage lenders. HUD estimated that financial statements from 7,500 lenders were submitted annually. HUD's Lender Assessment Subsystem receives, collects, assesses, and scores financial, compliance, and performance-related information submitted by the lenders. HUD needed a contractor to review the

Additional Contract Information

financial statements and supplemental reports for audits that were flagged by the system.

To accomplish its objective, in July 2005, HUD executed a one-year, firm-fixed price, Section 8(a), sole-source contract with a one-year option period. The first year of the contract was valued at \$699,000 based on an estimated need of 2,000 audit reports annually plus other related deliverables. The contractor was to perform comprehensive reviews of each flagged audit to include reviewing and analyzing the audit reports to determine that mortgage lenders met HUD's financial requirements and identifying any noncompliance or internal control issues raised in the audit reports. The contractor was also to provide other related services.

During the first year, only 423 audit reports were assigned to the contractor for review. At an estimated cost of \$125 to review each audit report, HUD unnecessarily spent an estimated \$197,000 $([2,000 \text{ estimated reports} - 423 \text{ actual reports}] \times \$125)$ for the base year of the contract.

Although HUD did not perform the required analysis and despite the lack of use during the base year, HUD exercised the one-year option period for another 2,000 audit reports at a price of \$250,000 or \$125 per report. For the option period, HUD only required the contractor to review the audit reports. The other deliverables were removed from the statement of work. If HUD had performed the required analysis, it should have found that the estimated use was overstated and renegotiated the contract or taken other measures to avoid wasting additional funds. Five months into the current option period, the contractor had reviewed only 57 audit reports. HUD has determined that it will not renew the contract.

HUD would have been better served to have used an indefinite-delivery/indefinite-quantity type contract that was based on actual use.

Additional Contract Information

Contracts Reviewed and Deficiencies Found

Contract	Contract date	Maximum contract value	(1)	(2)	(3)	(4)
C-OPC-22682	November 5, 2005	\$ 536,281			X	X
C-OPC-22840	April 1, 2005	715,052			X	X
C-OPC-22907	September 29, 2005	754,487			X	X
C-OPC-22918	September 26, 2005	1,005,000			X	X
C-OPC-22898	July 13, 2005	1,344,975	X		X	X
C-OPC-22899	July 7, 2005	1,399,998	X		X	X
C-FTW-00398	September 30, 2004	1,419,986	X		X	
C-OPC-22888	February 10, 2005	1,726,712			X	X
C-OPC-22564	February 2, 2004	1,999,119	X			X
C-OPC-22947	September 29, 2005	2,170,148		X	X	X
C-DEN-01959	October 1, 2004	2,579,292	X			X
C-OPC-22822	April 1, 2005	2,900,000			X	X
C-DEN-02045	September 30, 2005	2,926,032	X			
C-OPC-22172	April 15, 2002	2,999,407			X	X

Additional Contract Information

Contracts Reviewed and Deficiencies Found (Continued)

Contract	Contract date	Maximum contract value	(1)	(2)	(3)	(4)
C-OPC-22812	February 9, 2005	3,000,000		X		X
C-OPC-22660	September 30, 2004	3,681,100		X		X
C-OPC-22303	February 10, 2003	9,009,676			X	X

- (1) Contract statement of work deficiencies
- (2) Inadequate review of contractor invoices
- (3) Need not established before exercising option period
- (4) Contractor performance reviews not completed as required