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RESOLUTION TRUST
CORPORATION

Western Storm Investigation
and Related Contracting
Deficiencies

Statement of
Gaston L. Gianni, Jr.
Associate Director
Federal Management Issues
General Government Division



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Resolution Trust Corporation
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Related Contracting Deficiencies

Summary of Statement by
Gaston L. Gianni, Jr.
Associate Director, Federal Management Issues
General Government Division

The Resolution Trust Corporation (RTC) needs a good, sound contracting process because of its legislative mandate to work through the private sector. Nevertheless, at the outset, RTC developed a loosely defined system to acquire needed services. Last year, in testimony before the House Banking Committee, GAO said that RTC seemed to have a mindset that essentially undervalued contracting.

RTC's mindset on contracting contributed to an environment which permitted Western Storm to occur. Lack of early planning and inappropriate contracting techniques hampered RTC's ability to monitor contractor performance and control costs for project Western Storm. The following points illustrate that the project had many serious problems and did not adequately protect the government's interests.

- RTC will have paid about \$24 million under a contract improperly issued on a sole source basis.
- A contractor representative was involved in three days of preaward discussions with RTC officials, concerning the upcoming project's scope and duration.
- Senior officials in RTC headquarters were aware of the contracting practices used but did not request advice on the appropriateness of the procurement procedure, or require appropriate written justification and approval.

In March 1992, RTC officials agreed to take certain actions to correct the contracting and internal control deficiencies which allowed Western Storm to occur. These management improvements have been partially implemented. However, these changes to the contracting system which allow wide discretion for RTC staff have not been accompanied by appropriate increases in internal controls.

Compounding its contractor oversight problems is the fact that RTC's Contracting Activity Reporting System (CARS) does not provide the performance information needed to adequately manage the overall contracting area. For example, when RTC top management requested information from CARS to prepare for a discussion with Western Region officials, CARS listed less than half of the task orders with estimated fees of less than 2 percent of actual fees.

Mr. Chairman and Members of the Committee:

We are pleased to be here to discuss the contracting activities of the Resolution Trust Corporation. Our testimony today will provide an overview of GAO's investigation of RTC's Western Storm Project, describe the management environment that allowed the project to occur, and analyze recent RTC management changes designed to correct contracting and internal control weaknesses. Detailed information regarding Western Storm is attached to my written statement.

RTC MISMANAGEMENT OF
PROJECT WESTERN STORM

RTC paid about \$24 million under an improperly issued, sole source contract for its Western Regional Office's Asset Stratification and Reconciliation Project, or Western Storm. The project, initiated in April 1991, was one of the largest individual contracts in RTC history. An investigation of the project by our Office of Special Investigations, completed in July 1992, disclosed that a lack of early planning and inappropriate contracting techniques hampered RTC's ability to monitor contractor performance and control costs.

Western Storm's principal purpose was to reconcile assets of 92 failed thrift institutions to financial management records in RTC's Western Region. RTC officials believed that the records contained about \$6.8 billion in erroneous transactions and almost \$1.1 billion in unprocessed transactions in suspense accounts. RTC decided to use an existing contract with Financial Management Task Force, Inc. (FMTF), whose primary subcontractor for the contract was Yale & Seffinger, P.C. (Y&S), a Denver certified public accounting firm.

On March 15 to 17, 1991, Western Region representatives and a Y&S partner held preaward discussions about Western Storm during which they estimated the project's cost at \$20 million and completion by June 30, 1991. On March 15, the Western Regional Director requested--but did not receive--approval from RTC's Deputy Executive Director for Asset Operations to engage contractors on a direct award basis. Because the request was denied, the Western Region split the contract into 92 separate task orders to FMTF, under an existing contracting mechanism called a Basic Ordering Agreement (BOA).

Contrary to RTC contracting procedures, RTC prepared no justification for Western Storm before it began. Instead, based on headquarters orders to reconcile the assets, the region's Senior Contract Specialist deemed the project to be urgent; and the Deputy Executive Director, after disapproving what he believed was a \$20 million sole source contract, allowed Western Region officials to proceed using separate task orders. When RTC's Director of Contracting learned of the 92 task orders, he stated that he believed (1) the action was "order splitting" to

avoid having to get higher level approval and (2) the region's contract office had been improperly excluded.

RTC'S EARLY ATTITUDE UNDERVALUED
SIGNIFICANCE OF CONTRACTING

I would like to provide a context for the chronology of events just provided by summarizing the development of the RTC contracting system, specific deficiencies surrounding the Western Storm contracting process, some of the steps that RTC agreed to take to correct those deficiencies, and our analysis of RTC's actions.

Contracting is an important management process to RTC because of its legislative mandate to work through the private sector. RTC estimates it will spend between \$15 billion and \$20 billion for contract services over the next several years. Various statutes and regulations govern procurement by federal agencies. RTC is exempt from those but still needs a good, sound contracting process.

At the outset, RTC developed a loosely defined system to acquire needed services. Essentially, it adopted Federal Deposit Insurance Corporation contracting procedures as an interim measure, even though those procedures were not designed to handle the volume or the broad spectrum of professional services RTC would have to acquire.

In February 1991 testimony before this Committee,¹ we summed up our views on RTC contracting by stating that RTC seemed to have a mindset that essentially undervalued contracting even though the law mandated that much of RTC's business be done through contractors. Work completed at that time showed the following:

- Unclear contract guidance was being given. Directives were sent unsigned and unnumbered, making it difficult for field staff to determine whether the document was agency policy.
- Contracts were poorly designed. They lacked clear requirements and often did not have provisions setting forth remedies for incomplete work.
- RTC had no standards for evaluating whether a contractor's proposal was within accepted norms regarding the types of services to be provided and the number of people to be used. Without those standards, RTC was vulnerable to certain risks because it was using inexperienced contractors who did not understand the full scope of effort required.

¹Resolution Trust Corporation: Performance Assessment to Date
(GAO/T-GGD-91-7, Feb. 20, 1991).

- RTC did not have a comprehensive system to monitor the performance of its contractors. We provided an example in which RTC had hired a contractor to review the quality of loan files being prepared for sale. The contractor was paid about \$286,000, even though its work was substantially incorrect. After the large investment firm that had purchased the loans reviewed the files, it required RTC to buy back \$2.3 million of them because of errors.

POOR PLANNING AND INAPPROPRIATE CONTRACTING CREATED AN UNMANAGEABLE PROJECT

RTC's overall mindset on contracting created an environment that permitted Western Storm to occur. Lack of early planning and inappropriate contracting hampered RTC's ability to monitor contractor performance and control project costs. The following points show that the project had serious problems and did not adequately protect the government's interests.

Poor Project Planning

Western Region staff did not do any pilot studies to help RTC define the project and develop a written plan or an adequate methodology to carry it out. Had RTC contracting procedures been followed, it would have been able to define specific contract requirements. According to RTC officials, excessive costs incurred early in the project could have been avoided if the project had been planned better.

As part of project planning, RTC should have considered options for completing the work. Many were possible. For example, RTC could have started by performing work on only a portion of the thrifts. This would have made the project's scope more reasonable and controllable. Instead, RTC started the project by committing at least 400 contractor staff to examine the records of over 90 institutions at 70 worksites simultaneously.

Another important element of project planning, namely staff training, was largely bypassed. Most contractor personnel had no previous experience working with RTC and had no knowledge of the RTC accounting and computer systems. Accordingly, they needed training, but RTC provided only a minimal amount. Also, to assist the contractor field staff, RTC set up a help desk in Denver with several RTC and contractor staff to answer questions for subcontractors. However, staff were not able to respond promptly and were inadequately trained to answer technical questions.

Improper Contracting Techniques Used

None of the written justifications or approvals required by RTC contracting procedures for a sole source award were obtained

before the task orders were issued to FMTF. Furthermore, the agreement under which the orders were issued was not a proper contracting vehicle and did not excuse RTC from obtaining competition for the project.

A fundamental internal control was bypassed. Under RTC directives in effect at the time the task orders were signed, the maximum dollar amount that could be spent by a regional official without higher level approval was \$500,000. The delegated authority was a much lower amount in the case of noncompetitive procurements such as were involved in this project. Expenditures exceeding these limits had to be approved by progressively higher levels at RTC headquarters, depending on the dollar amount involved. The Western Storm contract could have been approved only by RTC's Board of Directors. The region circumvented this requirement by breaking the project into separately priced task orders.

The region also failed to use the expertise of RTC's legal and contracting staffs in contracting for the work. Bypassing them led to inadequate contract documents that did not contain commonly used provisions that (1) clearly defined work to be performed, (2) set time frames for performance, (3) defined contractor qualifications and duties, and (4) set a ceiling on authorized hours and travel costs. Essentially, this led to a lack of cost control over the project.

Weak Project Management and Oversight

Further, RTC did not prepare a budget for the work at each thrift. Accordingly, it was unable to question the total hours charged to the project. An RTC official said that RTC could not estimate the project's costs because it did not know the extent of the work that was needed to reconcile the thrifts' records. While this may be true, RTC could have set some limit on total hours per thrift that could have been expended without prior approval. Without limits on travel costs, we believe that RTC contractors had no incentive to minimize those costs. As of October 1991, about \$3.8 million in travel costs had been paid.

In spite of the project's large scope, the region used only 3 employees to manage and oversee a total of about 800 contractor staff located throughout the region. Thus, contractor staff actually supervised much of the project. Without budgets and cost limits, there was no incentive for the contractor to control the hours charged. Costs grew from about \$20 million to about \$24 million.

Lastly, this project had no headquarters oversight. Senior RTC managers told us that their primary role was to set policy and that limited effort was devoted to monitoring contracting operations. When concerns regarding the project were brought to

the attention of headquarters officials, they were handled with a phone call to Western Region management. No follow-up monitoring or reporting was scheduled.

Compounding its contractor oversight problems is that RTC's Contracting Activity Reporting System (CARS) does not provide the performance information needed to adequately manage the overall contracting area. Essentially, CARS is limited to providing an inventory of contract solicitations and issued contracts. It does not provide information showing whether contractors have been providing the required services on schedule and within budget.

Perhaps the best example of these information shortcomings is project Western Storm itself. To prepare for a discussion with Western Region officials, RTC top management requested information on task orders issued to FMTF by the Denver Regional Office. The information on CARS listed only 49 task orders, with estimated fees of \$271,943, when in reality there were over 90 task orders, with estimated fees of over \$20 million.

PLANNED MANAGEMENT IMPROVEMENTS

In March 1992, RTC officials agreed to take certain actions designed to improve RTC's contracting and internal control system and to correct the deficiencies that allowed Western Storm to occur. These included:

- reviewing its Contracting Policies and Procedures Manual (CPPM), issued in August 1991, to assure that it was as effective and responsive to RTC's mission as possible;
- developing desk manuals to supplement the CPPM and provide specific guidance on the RTC contracting process;
- developing and providing additional contracting training courses for RTC staff;
- emphasizing the requirement that all contracting actions are to be entered into RTC's CARS; and
- clarifying when task orders can be used and when obtaining proper delegations of authority is needed.

Improvements Made

Some changes have been made and have improved the internal controls over RTC's contracting system. In May 1992, RTC revised and reissued its entire CPPM. As part of that revision, RTC clarified the responsibilities of various RTC offices and expanded the description of specific aspects of the RTC system. RTC expanded the section on the use of task order agreements and

clarified RTC's delegations of authority to issue contracts. Also, as agreed in March 1992, RTC has emphasized that all contracting actions need to be entered into CARS.

However, progress on developing desk manuals and providing additional contracting training was delayed pending completion of the revised CPPM. RTC needs to take action to ensure that the manuals and training are completed promptly.

Additional Improvements Needed

While the revised CPPM corrected some of the weaknesses that allowed the Western Storm Project to occur, other sections of the revised manual have not lessened RTC's vulnerability to fraud, waste, and mismanagement. In essence, RTC modified the contracting process in response to staff criticisms about the prior system's inability to meet their needs for the timely issuance of contracts. The revised manual provides wide discretion for RTC staff in several critical and sensitive points in its system. For example, rather than use competitive bidding to renew contracts that have expired, RTC's revised CPPM gives its staff the discretion to noncompetitively renew the existing contracts. Other sections give RTC staff discretion in choosing who may bid for a contract and in determining the extent and manner in which negotiations will be conducted.

In short, the changes seem to simply sanction some of the undesirable practices we observed in Western Storm. We are concerned that this added discretion in the revised contracting system is not accompanied by appropriate increases in internal controls. Currently, RTC management does not have an information system to monitor its contracting staff's compliance with contracting policies and procedures. For example, RTC management can not identify the extent and circumstances under which field contracting staff used noncompetitive contracting procedures.

In June 1992, RTC took preliminary steps to improve its monitoring of field operations. RTC has created three headquarters positions to monitor field contracting operations and, among other responsibilities, evaluate compliance with RTC contracting policies and procedures. Since this is a recent effort, we can not determine at this time if this will be an effective approach.

CONCLUSIONS

With the large number and dollar value of active contracts, RTC needs to take strong steps to ensure that its contracting employees are complying with established policies and that contractors are providing the best possible services. Unfortunately, the pace of RTC actions to improve internal control over contracts has not kept pace with RTC's rapidly

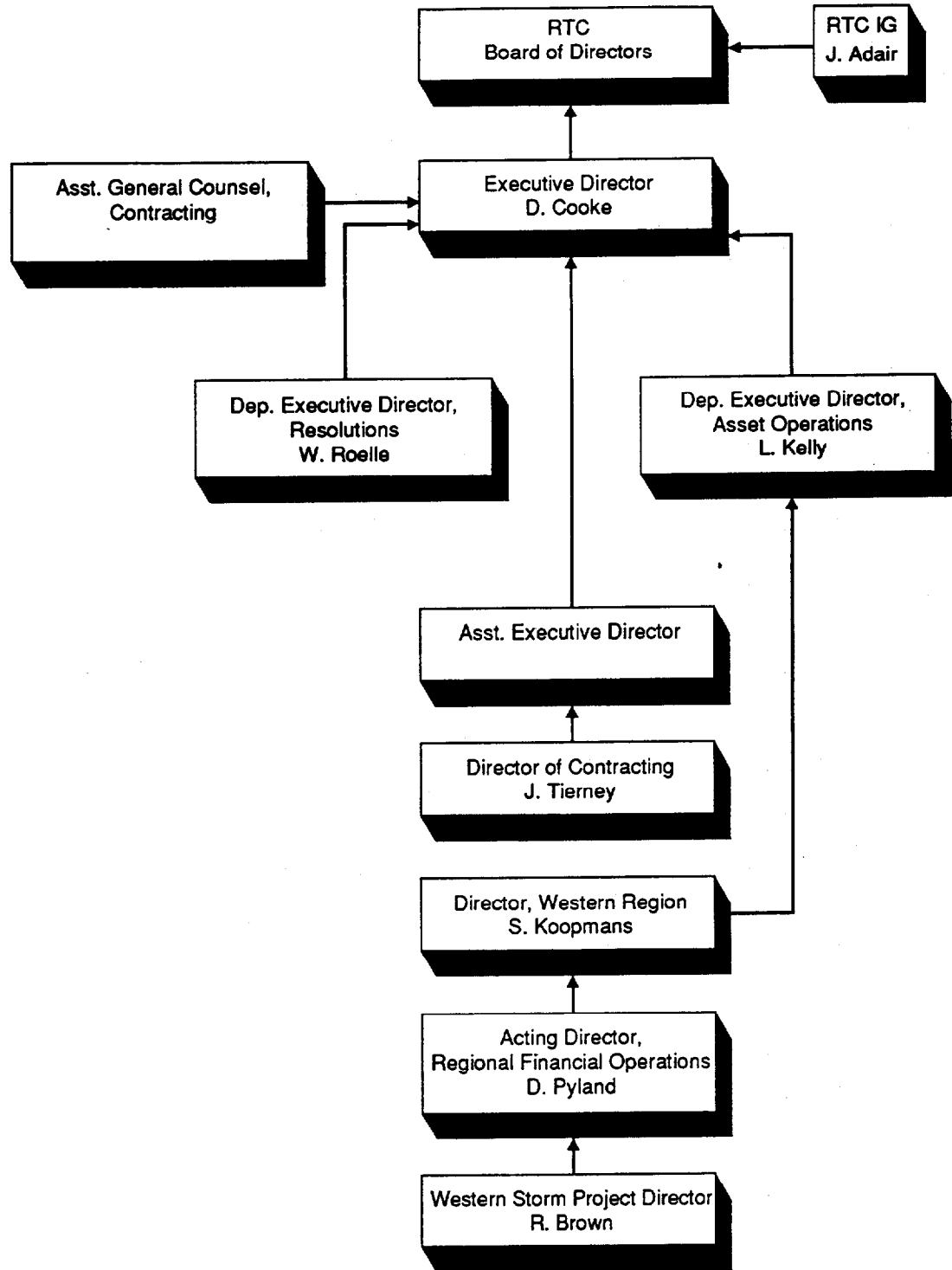
growing responsibilities. If RTC is to assure Congress and the public that it is taking reasonable actions to minimize the cost of the bailout, it should act promptly to assure that its contracting program has appropriate controls.

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Mr. Chairman, this concludes my prepared remarks. We would be pleased to answer any questions you may have.

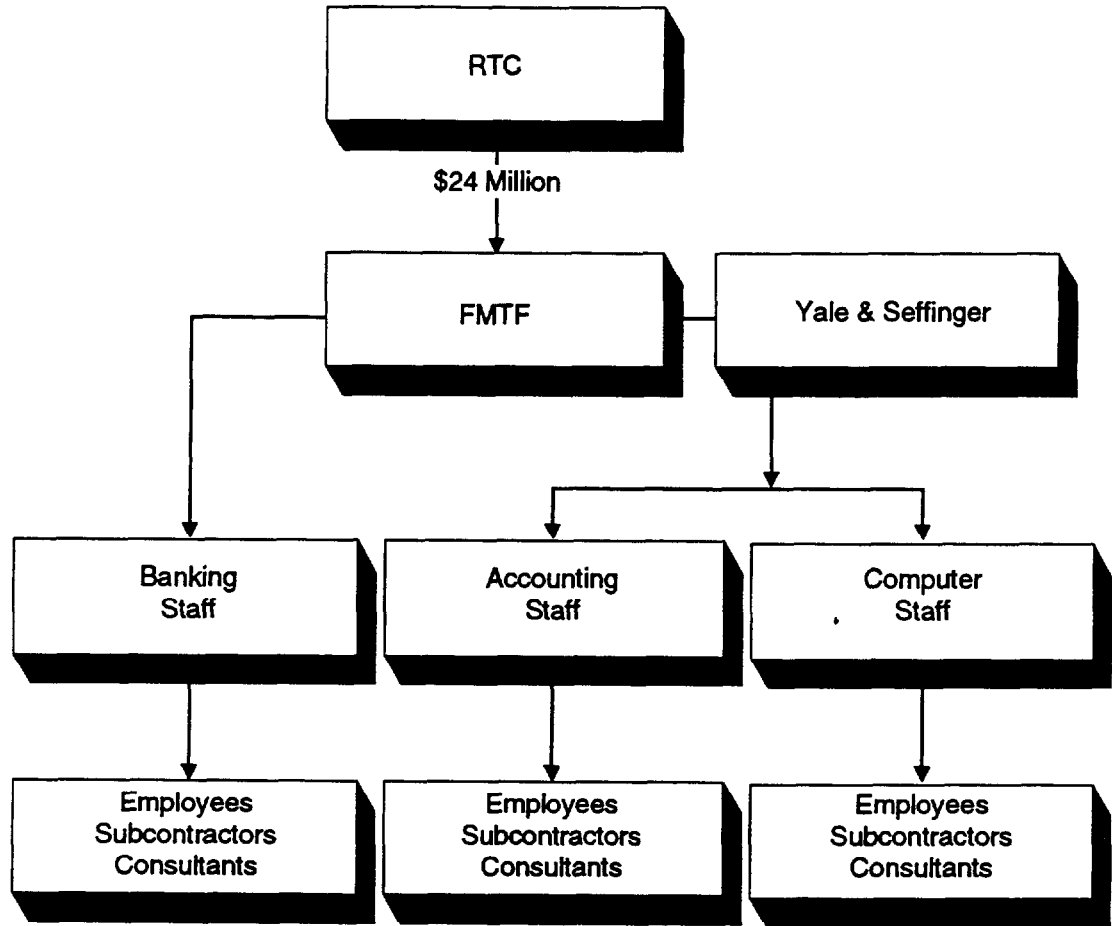
GAO Relationship of RTC and Key Western Storm Players

Chart 1:



GAO Distribution of Western Storm Funds

Chart 2:



Key Events Leading To Western Storm Award

Chart 3:**Friday, March 15, 1991**

- Pyland, Brown, and Lubbers meet and decide that 50-200 staff are needed to complete project in 6 weeks.
- Koopmans' memo to Kelly requests use of contractor on "direct award basis."

Saturday, March 16, 1991

- Pyland, Brown, and Lubbers meet and conclude that 500 staff are needed.

Sunday, March 17, 1991

- Pyland, Brown, and Lubbers meet and conclude that 800 staff are needed - \$20 million cost and June 30, 1991, completion.

Monday, March 18, 1991

- Lubbers contacts Y&S affiliates, advising that FMTF was awarded a contract.

Tuesday, April 2, 1991

- Pyland splits project into 92 task orders.
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