

**REPORT ON
INDEPENDENT EVALUATION AND ASSESSMENT OF
INTERNAL CONTROL FOR CONTRACT OVERSIGHT**

**SUBMITTED TO THE
U.S. SECURITIES AND EXCHANGE COMMISSION
OFFICE OF INSPECTOR GENERAL**

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June 25, 2004

Mr. Walter Stachnik
Inspector General
U.S. Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549

Subject: Independent Evaluation and Assessment of Internal Control for Contract Oversight
Task Order No. SECJQ1-03-D-0175 (September 24, 2003)

Dear Mr. Stachnik:

In accordance with terms of the subject task order, Cotton & Company LLP performed an independent evaluation of the U.S. Securities and Exchange Commission's internal control over contract management oversight of its customer service agreements with the Millennium Services Center (MSC) at the U.S. Department of Transportation (DOT) for services provided by Science Applications International Corporation (SAIC). The evaluation included review of management procedures and practices established to implement federal procurement, acquisition, and contract laws and regulations and the Commission's own procurement regulations and policies.

This evaluation focused on 1) the Commission's management controls used to obtain information technology (IT) support services through customer service agreements with MSC from November 2001 through April 2003 under Commission Contract No. SECHQ1-00-H-0239, and 2) a review and assessment of all task orders issued from February 2000 through December 2003 and MSC invoices submitted through the U.S. Treasury's Interagency Payment and Collection (IPAC) system.

We identified specific control weaknesses and deficiencies and developed recommendations designed to improve contract management oversight functions and procedures. We conducted the evaluation in accordance with *Government Auditing Standards*, as revised. We were not engaged to, and did not perform a financial statement audit, the purpose of which would be to express an opinion on specified elements, accounts, or items. This report is intended to meet the objectives described above and should not be used for other purposes.

Please call me at (703) 836-6701 if you have questions.

Very truly yours,

COTTON & COMPANY LLP



Michael W. Gillespie, CPA, CFE
Partner

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EXECUTIVE SUMMARY

The Office of Inspector General (OIG), U.S. Securities and Exchange Commission, contracted with Cotton & Company LLP to perform an independent evaluation of internal control over contract management oversight of the Commission's customer service agreements (task orders) with the Millennium Services Center (MSC) located at the U.S. Department of Transportation (DOT) for services provided by Science Applications International Corporation (SAIC). The evaluation included a review of management procedures and practices established to implement federal procurement, acquisition, and contract laws and regulations and the Commission's own procurement regulations and policies.

We conducted this evaluation from September 2003 to March 2004 in accordance with *Government Auditing Standards*, as promulgated by the Comptroller General in the "yellow book" for performance audits, and AICPA standards for consulting services. We also adhered to all relevant federal and Commission guidelines.

For the time period covered by our review, the Commission did not establish adequate controls for obtaining information technology (IT) support services using a customer service agreement with MSC. Commission officials indicated that the controls were improved during the course of the contract, including improvements made subsequent to our review period.

The Commission elected the option to have MSC maintain direct contract authority, administrative responsibilities, and contract management control over SAIC's performance. However, this arrangement did not meet the oversight needs of the Office of Information Technology (OIT), the office using SAIC's (and its subcontractors') services.

We noted specific control weaknesses over contract management oversight functions and procedures with respect to the MSC customer service agreements, including:

1. Commission task orders were not sufficiently detailed to fully describe the Commission's expectations and the oversight responsibilities of the MSC and the Commission.
2. MSC applied a management fee on SAIC invoices before sending them to the Commission. The Commission's Contracting Officer's Technical Representative (COTR) stated that the COTR was unaware of the amount or basis for the fees.
3. The Commission's COTR certified invoices without sufficient supporting documentation. The Commission may have been billed labor costs for employees who did not work on Commission tasks. This weakness relates to the decision to have MSC be responsible for contract administration. OIT technical staff did not clearly understand the limitations on their administrative duties under the contract.

We are recommending enhancing the Commission's existing policies and procedures and COTR training to improve the controls over task orders under customer service agreements with other federal agencies.

SCOPE, OBJECTIVES, AND METHODOLOGY

Scope and Objectives

The Commission's OIG contracted with Cotton & Company LLP to perform an independent evaluation of its internal control over contract management oversight of the customer service agreements with MSC. The evaluation included review of management procedures and practices established to implement federal procurement, acquisition, and contract laws and regulations and the Commission's own procurement regulations and policies.

This evaluation focused on 1) the Commission's management controls used to obtain IT support services through customer service agreements with MSC from November 2001 through April 2003 under Commission Contract No. SECHQ1-00-H-0239, and 2) a review and assessment of all task orders issued from February 2000 through December 2003 and MSC invoices submitted through the U.S. Treasury's Interagency Payment and Collection (IPAC) system.

The evaluation covered key phases of contract oversight processes for initiating and issuing task orders; modifying task orders; obligating and controlling funds; monitoring contractor activities; and assessing contractor performance. The evaluation also included review of controls established to protect the Commission from waste, fraud, and abuse by ensuring that only authorized work is performed, work performed is within the scope of the contract, and task-order deliverables are met. The evaluation also covered the Commission controls used to certify vendor payments processed through IPAC. This includes activities of the COTR and Contracting Officer (CO) from the time a task order was issued and executed. The evaluation did not include pre-award functions and activities.

The evaluation objective was to determine the adequacy, effectiveness, and sufficiency of controls to validate and verify that:

- All work performed by SAIC was authorized.
- Work performed by SAIC was within contract and task-order scope.
- Task orders were within the scope of the contract.
- SAIC and MSC invoices submitted to the Commission through IPAC were accurate, complete, and allowable.

Methodology

To achieve the evaluation objectives, we obtained, compared, and assessed applicable federal laws, regulations, and guidance governing federal agency acquisition of information technology and services to the Commission's contract oversight policies, procedures, and practices. We also reviewed relevant Commission, DOT, and SAIC financial records and documents supporting invoices to the Commission. This included tracing the Commission's task-order requests to MSC to support its work authorizations issued by MSC to SAIC. Further, we traced SAIC invoices

submitted to MSC to documents supporting the transfer of funds from the Commission to MSC in the IPAC system.

We also performed the following:

- Interviewed relevant Procurement and Contracting Branch (PCB) and Office of Information Technology (OIT) officials and staff and Department of Transportation (DOT) and MSC officials.
- Gained an understanding of the Commission's contract oversight processes and procedures and relevant Securities and Exchange Commissions Reviews (SECR) in place during the evaluation period and changes occurring within the past two years.
- Gained an understanding of the PCB and OIT organizational structures and operations.
- Conducted tests of customer service agreements (task orders), management oversight controls for issuing tasks, oversight and monitoring of contractor work, work assignment, and invoice certification.
- Compared the Commission's controls to those it used under similar agreements with other federal agencies.
- Assessed PCB and OIT processes and procedures used to modify task order requests issued through customer service agreements.

We conducted this evaluation from September 2003 to March 2004 in accordance with *Government Auditing Standards*, as promulgated by the Comptroller General in the "yellow book" for performance audits, and AICPA standards for consulting services. We used the following federal and Commission established guidelines as criteria for this evaluation:

- *Federal Acquisition Regulation (FAR)*.
- *A Guide to Best Practices for Contract Administration*, October 1994, issued by the Office of Federal Procurement Policy (OFPP).
- *Federal Acquisition Streamlining Act of 1994* and other relevant legislation and promulgated guidance.
- Office of Management and Budget (OMB) Circulars A-127, *Financial Management Systems*, and A-123, *Management Accountability and Control*.
- Applicable Commission procurement and contracting regulations, policies, guidance.

BACKGROUND

Since February 2000, the Commission has issued a series of task orders under the customer service agreements with MSC (issued under Commission No. SECHQ1-00-H-0239 and modifications). The purpose of these task orders was to obtain IT services from SAIC through MSC.

The MSC is a component of the DOT, and the customer service agreement was issued under MSC's Government-Wide Acquisition Vehicle (GWAC) known as Information Technology Omnibus Project (ITOP). ITOP is a multiple-award, indefinite delivery, indefinite quantity, contract vehicle designed to provide federal agencies with a fast and efficient way to obtain IT technical services, hardware and software.

Customer service agreements and the related agency task orders are similar to contracts in that they specify an agency's expectations, responsibilities, duties, and authorities, as well as provide a statement of work, list of deliverables, invoicing procedures, supporting documentation, and reporting procedures. Depending on the complexity and nature of work covered, the agreements may be large, formal documents describing all requirements or less formal reimbursable agreements.

PCB (within the Office of Human Resources and Administrative Services (OHRAS), formerly the Office of Administrative and Personnel Management), and OIT are responsible for issuing task orders and performing contract oversight activities. Specifically:

- PCB is responsible for purchasing and contracting for goods, services, supplies, and equipment. It also is responsible for performing a variety of contract and procurement activities including determining the appropriate type of contract for services needed, and reviewing statements of work and justifications for other than full and open competition.
- OIT is responsible for developing and maintaining the Commission's IT infrastructure and developing the IT security program, policies, and procedures. OIT responsibilities include daily management of support functions for systems and IT services, software development and maintenance, network and data communication design and maintenance, design engineering and oversight of the IT architecture, and configuration management and quality assurance group management. OIT is responsible for writing statements of work and initiating (when applicable) justifications for other than full and open competition.

From February 2000 through December 2003, the Commission awarded 95 tasks with a total obligation of \$29,255,686. From November 2001 through April 2003, the Commission awarded 43 task orders with a total obligation of \$10,918,699. During this period MSC's fee structure was based on a percentage of costs (e.g., 10 to 15%) as well as direct charge amounts.

EVALUATION RESULTS

The following is a discussion of the findings that we noted during our evaluation and recommendations designed to improve contract management oversight procedures.

1. Task Orders

Commission task orders to the MSC provided some information, but were not sufficiently detailed. Additional information would have better:

- Defined the Commission's expectations.
- Clarified and specified Commission and MSC contract oversight duties and responsibilities for SAIC.
- Identified deliverables.
- Defined reporting requirements.
- Specified invoicing procedures.
- Clarified the agreed-upon MSC management fees and fee basis.
- Specified the types of contracts available to the Commission through the ITOP contract with SAIC.

The importance of clarifying respective roles (especially in a complex arrangement involving two federal agencies and a contractor) was shown by an issue arising repeatedly during the contract. OIT technical staff questioned numerous invoices submitted by SAIC through the MSC. The technical staff felt the invoices were not sufficiently detailed and did not adequately support the costs claimed (see the finding on certification of invoices, below). OIT technical staff did not clearly understand the limitations on their administrative duties under the contract, since the Commission was paying MSC to be responsible for contract administration.

In June 2004, the General Services Administration (GSA) and DOT entered into an agreement that moved ITOP to GSA. Additionally, DOT announced that no new task orders or modifications to existing tasks would be accepted by DOT for ITOP and that all existing work would cease on September 30, 2004 (later extended to December 31, 2004). As a result of these actions, we are not making recommendations relating to modifications of existing task orders to MSC. Our recommendation relates to better defining future task orders.

Recommendation A:

The Office of Human Resources and Administrative Services should revise its existing policies and procedures to help ensure that task orders under GWAC-type vehicles clearly describe the services being requested, management fees, deliverables, performance period, invoicing procedures, and other required information.

2. Management Fees

During the period of our evaluation, MSC invoiced the Commission for \$11,566,646; of this amount, \$10,428,199 was for SAIC's services, and \$1,138,447 was for management fees. MSC management fees were a combination of percentage of costs (ranging from 10 to 15 percent) and direct charges.

Although the Commission's task orders contained a line item for an MSC fee, none of the task orders disclosed either the fee amount or percentage. We identified the management fee only by reviewing documentation maintained by MSC in its contract files. The Commission COTR was unaware of the amount of the fees or how they were derived.

Recommendation B

The Office of Human Resources and Administrative Services, in consultation with the Office of General Counsel and the Office of Financial Management, should submit a written request to MSC asking it to review whether the fees billed to the Commission were consistent with the fee structure in the ITOP contract.

3. Invoice Certification

MSC submitted SF 1081s and billing statements as support for reimbursement against Commission funds held at Treasury. The Commission received SF 1081s showing dollar amounts transferred by Treasury from the Commission fund account to MSC.

For instance, in January 2003, Treasury transferred \$438,429 from the Commission to MSC under the contract; accompanying this document was MSC's Invoice No. 40. The MSC invoice included the primary account number, secondary account code, description of service, current hours by account code, and monthly charges incurred during the period November 9 through December 6, 2002. The invoice did not include timesheets or other information to confirm that hours billed were actually worked by SAIC personnel.

The COTR (assisted by the OIT technical staff) was required to certify the charges or take exception to the billing. The OIT technical staff repeatedly raised questions about the amount of the invoices and how they were derived. OIT verbally requested that MSC provide a detailed breakdown of the labor hours for each task order. MSC was unable to accommodate this request because it did not have this information, but the COTR certified the invoices anyway (so that SAIC would continue to provide services under the contract).

Under the MSC contract, the DOT COTR was responsible for the accuracy of SAIC billings, as part of DOT's contract administration duties (which the Commission paid for in its fee). However, OIT staff did not clearly understand this contract provision (in part because of staff turnover in OIT, according to PCB).

During our review of SAIC invoices at MSC, we inquired of MSC and DOT personnel about whether any detailed supporting documentation, such as timesheets or a listing of names of SAIC personnel and subcontractors that worked on Commission tasks, accompanied the invoices. We were informed that they did not have this documentation, and that it would have to be obtained directly from SAIC.

During the evaluation, we obtained a list of personnel from SAIC who charged hours against the various MSC task orders for work performed at the Commission. We submitted the list to individual OIT task managers for confirmation and verification. We specifically asked the task managers if they knew the individuals and if they knew the individuals had worked on the specific tasks for which the hours were billed. From this test, we determined that the task managers could not verify 25,021.75 hours worked by 41 SAIC personnel invoiced at \$961,081.

Given the circumstances described above, an audit of the timesheets and other documentation supporting the invoices appears appropriate.

Recommendation C

The Office of Human Resources and Administrative Services should require COTRs and related technical staff to attend refresher training once every three years on contract administration (including certifying invoices).

Recommendation D

The Office of Human Resources and Administrative Services, in consultation with the Offices of Information Technology, General Counsel and Financial Management should request that the Defense Contract Audit Agency (the cognizant audit agency for SAIC) perform an audit of specified task orders under the MSC customer agreement.

Recommendation E

The Office of Information Technology should develop appropriate procedures for its COTRs to follow in certifying contractor invoices.

OIT indicated that it will develop procedures that OIT COTRs are to follow when certifying contractor invoices. These procedures will be based on SECR 10-15: Contracting Officer's Technical Representative (COTR) and Inspection and Acceptance Official (IOA), dated November 4, 2004.