



U.S. Securities and Exchange Commission
Office of Inspector General
Office of Audits

Audit of SEC's Controls over Support Service, Expert and Consulting Service Contracts



March 29, 2013
Report No. 513

REDACTED PUBLIC VERSION



OFFICE OF
INSPECTOR GENERAL

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

MEMORANDUM

March 29, 2013

To: Vance Cathell, Director, Office of Acquisitions

From: Carl W. Hoecker, Inspector General, Office of Inspector General

Subject: *Audit of SEC's Controls over Support Service, Expert and Consulting Service Contracts, Report No. 513*

This memorandum transmits the U.S. Securities and Exchange Commission Office (SEC) of Inspector General's (OIG) final report detailing the results on the *Audit of SEC's Controls over Support Service, Expert and Consulting Service Contracts*. This audit was conducted as part of our continuous effort to assess management of the Commission's programs and operations and as a part of our annual audit plan.

The final report contains seven recommendations which if fully implemented should strengthen the Office of Acquisition's (OA) controls over support service, expert and consulting service contracts. OA concurred with all the recommendations. Your written response to the draft report is included in Appendix V.

Within the next 45 days, please provide the OIG with a written corrective action plan that is designed to address the recommendations. The corrective action plan should include information such as the responsible official/point of contact, timeframes for completing required actions, and milestones identifying how you will address the recommendations.

REDACTED PUBLIC VERSION

Should you have any questions regarding this report, please do not hesitate to contact me. We appreciate the courtesy and cooperation you and your staff extended to our office.

Attachment

cc: Elisse B. Walter, Chairman
Erica Y. Williams, Deputy Chief of Staff, Office of the Chairman
Luis A. Aguilar, Commissioner
Troy A. Paredes, Commissioner
Daniel Gallagher, Commissioner
Jeff Heslop, Chief Operating Officer, Office of Chief of Operations
Judith Blake, Branch Chief, Business Management Office, Office of
Acquisitions

Audit of SEC's Controls over Support Service, Expert and Consulting Service Contracts

Executive Summary

The U.S. Securities and Exchange Commission (SEC or Commission) Office of Inspector General (OIG) contracted with Castro & Company, LLC (Castro & Co) to conduct an audit of the SEC's support services, expert and consulting service contracts and identify potential areas for improvement.

The SEC's mission is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. The SEC has approximately 3,500 employees and 1,540 contractors the SEC uses to aid in completing its mission. Over the years the Commission has issued a number of support services, expert and consulting service contracts. The SEC's use of contractors and the administration of contracts are governed by the Federal Acquisition Regulation (FAR). The 48 Code of Federal Regulation, Chapter 1, FAR provides uniform policies and procedures for acquisitions that executive agencies such as the SEC, are to follow.

The Office of Acquisitions (OA) executes contracts for SEC offices and divisions' procurement needs, maintains contract administration and oversees contracting officer's representative (COR) training and certification, the government purchase card program, and acquisition policy. OA performs best-value contracting to assist its customers in accomplishing the SEC's mission. SEC's acquisition workforce (contracting personnel) includes contracting officers (CO), contract specialists, CORs, and program managers.

At the SEC, CORs and program managers are responsible for ensuring sufficient direction is provided to contractor personnel, contract terms are met and the government's interests are protected, without assuming supervision and control over contractor personnel's day-to-day activities.

The audit focused on the provisions of FAR 37.104,¹ which pertains to Personal Services Contracts (PSC) and FAR 7.5,² which describes Inherently Governmental Functions (IGF). The government is normally required to obtain its employees by direct hire under competitive appointment or other procedures required by civil

¹ Federal Acquisition Regulation, Subpart 37.1 – *Services Contract-General*, Clause 37.104 – Personal Services Contracts.

² Federal Acquisition Regulation, Subpart 7.5 – *Inherently Governmental Functions*, Clause 7.503 – Policy.

service laws. Obtaining personal services by contract, rather than by direct hire circumvents those laws, unless Congress has specifically authorized acquisition of the services by contract. The FAR characterizes a PSC as a contract where an employer-employee relationship is created between the government and contractor personnel. The employer-employee relationship may be created by the contract terms or the manner in which the contract is administered (e.g., by subjecting contractor personnel to relatively continuous supervision and control of a government officer or employee).

The FAR 37.104(d) has identified six descriptive elements that, along with other definitional and descriptive sections of FAR part 37, should be considered when assessing whether a contract is personal in nature.³

Services that are inherently governmental in nature should not be acquired. For example, contracting for policy decisions is not allowable because it is an inherently governmental function. However, support services to analyze policy and provide recommendations are allowable. Also, contractors should not be used to prepare testimony to Congress or to lobby Congress. Further, caution should be exercised in allowing contractors to accept products or activities on behalf of the government because these actions are normally considered to be inherently governmental functions.⁴

Objectives. The overall objective of the audit was to determine whether OA, when awarding support services, expert and consulting service contracts, complied with governing laws and regulations regarding PSCs and IGFs. Specific audit objectives included:

- Determine if OA has developed appropriate controls and has written policy that prevents contractors from performing personal services and inherently governmental functions.
- Identify the procedures OA has established and uses to monitor and carryout the terms of these contracts in accordance with governing federal laws, regulations and its internal policy.
- Assess whether OA developed controls to ensure the SEC is properly charged for the services that are rendered under the terms of these contracts.
- Identify best practices and possible cost savings or funds put to better use, and provide recommendations to improve SEC's contracting practices.

³ See Appendix II.

⁴ See FAR Subpart 7.503.

Where appropriate, Castro & Co also identified areas for improvement.

Results. Prior to November 15, 2012, OA did not have any written policy related to the management and administration of service contracts. Further, OA had not adopted any controls at the time that would prevent contracting personnel or SEC staff from forming employer-employee relationships and entering into PSCs.⁵ We identified a number of control deficiencies concerning the SEC's controls over support service and consulting contracts. Specifically, through analysis and interviews we determined that three support service and consulting contracts/task orders may have resulted in possible employer-employee relationships due to SEC personnel's continuous supervision of the contractors. Also, we found three awarded service contracts included language that aligns with PSC characteristics.

In addition, we identified three service contracts/task orders that contained language that could indicate the performance of IGFs by contractors. This language should not have been included in the contracts. Because OA did not provide adequate oversight of these contracts it could have resulted in contractors performing IGFs. We also determined that OA did not take adequate measures in developing contract language for specific contracts to describe the contractors' job duties and responsibilities.

OA's newly issued guidance and operating procedures are comprehensive, but need to be further strengthened to better ensure SEC personnel are trained and are given current guidance regarding their responsibilities to administer and manage contractors and are cognizant of FAR violations pertaining to employer-employee relationships, PSCs and contractors conducting IGFs.

Also, we found OA has established controls to ensure that the SEC is appropriately charged for services received. Based on our discussions with OA personnel and analysis of invoices tested, the SEC controls over contractor invoicing appears reasonable.

Finally, we performed benchmarking with other federal agencies to identify best practices that could to improve SEC contracting practices. Recommendations on how to improve SEC contracting practices are included below.

Summary of Recommendations. Based on the results of our audit, we recommended OA request OGC review the contracts identified in this audit for compliance with the FAR provisions on PSCs and IGFs and take necessary corrective actions for the contracts that remain open. We also recommended OA review support services contracts to ensure the contracts are designed and written

⁵ See Appendix III for FAR 37.104(d) six elements.

to prevent PSCs and contractors from performing IGFs. Finally, we recommended OA implement its recently published administrative regulation and operating procedures on service contracts and provide training to contracting personnel and other program personnel who work with contractors on service contracts.

Management's Response to the Report's Recommendations. OIG provided OA with the formal draft report on March 21, 2013. OA concurred with all recommendations in this report. OIG considers the report recommendations resolved. However, the recommendations will remain open until documentation is provided to OIG that supports each recommendation has been fully implemented.

OA's response to each recommendation and OIG's analysis of their responses are presented after each recommendation in the body of this report.

The full version of this report includes information that the SEC considers to be sensitive and proprietary. To create this public version of the report, OIG redacted (blacked out) potentially sensitive, proprietary information from the report.

TABLE OF CONTENTS

Executive Summary.....	iii
Table of Contents	vii
Background and Objectives.....	1
Background	1
Objectives	4
Findings and Recommendations	5
Finding 1: OA’s Oversight of Service Contracts and Language in Service Contracts Needs Improvement	5
Recommendation 1	10
Recommendation 2	11
Recommendation 3	11
Finding 2: OA Awarded Service Contracts That Allowed Contractors to Perform Inherently Governmental Functions	12
Recommendation 4	15
Recommendation 5	16
Finding 3: OA’s New Guidance Pertaining to the Managing and Administering Service Contracts Should Be Improved in Some Areas	16
Recommendation 6	21
Recommendation 7	22
Appendices	
Appendix I: Abbreviations.	23
Appendix II: Scope and Methodology.....	24
Appendix III: Criteria.	28
Appendix IV: List of Recommendations.....	31
Appendix V: Management Comments.....	33
Tables	
Table 1: Support Services and Consulting Service Contracts that May Have Been Administered as Personal Service Contracts.....	6
Table 2: Contracts that Contained Language that Could Indicate the Performance of IGFs by Contractors.....	13

Background and Objectives

Background

The U.S. Securities and Exchange Commission (SEC or Commission) Office of Inspector General (OIG) contracted with Castro & Company, LLC (Castro & Co) to conduct an audit of the SEC's support services, expert and consulting service contracts and identify potential areas for improvement.

The SEC's mission is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. The SEC has approximately 3,500 employees and 1,540 contractors that are used to aid in completing its mission. Over the years the agency has issued a number of support services, expert and consulting service contracts. The SEC's use of contractors and the administration of contracts are governed by the Federal Acquisition Regulation (FAR). The 48 Code of Federal Regulation, Chapter 1, FAR provides uniform policies and procedures for acquisitions that executive agencies such as the SEC are to follow.

Office of Acquisitions

The Office of Acquisitions (OA) is led by a director and consists of five branches that are overseen by branch chiefs. Overall, OA executes contracts for SEC offices and divisions' procurement needs, maintains contract administration, and oversees contracting officer's representative (COR) training and certification, the government purchase card program, and acquisition policy. OA performs best-value contracting to assist its customers in accomplishing the SEC's mission. OA's acquisition workforce includes contracting personnel such as contracting officers (CO), contract specialists, CORs, and program managers.

The CO is the U.S. government's authorized agent for dealing with contractors and has sole authority to solicit proposals, negotiate, award, administer, modify, or terminate contracts and make related determinations and findings on behalf of the U.S. government. The CO has the overall and primary responsibility for the administration of contracts.

At the SEC, CORs, and program managers are responsible for ensuring that sufficient direction is provided to contractor personnel, the contract terms are met and the government's interests are protected, without assuming supervision and control over contractor personnel's day-to-day activities.

On November 15, 2012, OA issued SECR 10-24, *Management and Administration of Service Contracts* (SECR 10-24). The SECR 10-24 is comprehensive and provides direction to SEC staff regarding the avoidance of employee-employer relationships, personal services, and inherently governmental functions (IGF). Also, in November 2012, OA issued Operating Procedures (OP) 10-24 to accompany the SECR 10-24. OP 10-24 is comprised of in-depth guidance and procedures SEC contracting personnel and employees should follow regarding the administration and oversight of service contracts. OP 10-24 consists of the following distinct areas:

1. Service Contract Checklist.
2. Desk Reference: Management and Administration of Service Contracts.
3. Training SECR, OP 10-24 and Checklist.
4. Training slides, "SEC Employees: Rules for Working with Contractors."

Overview of Personal Services Contracts

The government is normally required to obtain its employees by direct hire under competitive appointment or other procedures required by civil service laws. Obtaining personal services by contract, rather than by direct hire circumvents those laws, unless Congress has specifically authorized acquisition of the services by contract. FAR 37.104 prohibit agencies from awarding personal services contracts (PSC) unless specifically authorized by statute. Hence, PSCs generally are not allowable.

The FAR characterizes a PSC as a contract where an employer-employee relationship is created between the government and contractor personnel. The employer-employee relationship may be created by the contract terms or the manner in which the contract is administered (e.g., by subjecting contractor personnel to relatively continuous supervision and control of a government officer or employee. An inappropriate employer-employee relationship may develop through the actions of government personnel such as COs, contract specialists, CORs, or program managers. In addition, government personnel in supervisory roles at the SEC, such as branch chiefs or team leads who are not officially appointed as the COR or program manager, may exert inappropriate control over contractor personnel through their day-to-day interactions with the contractors.

When contractor personnel are continuously supervised by a government employee, as though the contractor employee is a civil servant employee, the contract can have characteristics of a personal services contract. An example of how a non-personal services contract might improperly expand into a personal services area includes when contractor personnel fall under the direct supervision and control of agency management. Such control is evidenced by the government

employee performing tasks such as specifying the contractor personnel's duties, approving hours of work or leave, providing performance appraisals, and issuing disciplinary action against the contractor employee. Unless specifically authorized by legislation, agencies cannot enter into such contracts.

Hence, while the government is responsible for oversight of its contracts, government employees must avoid direct supervision of contractor employees to fill the government's contract requirements. The FAR 37.104(d) has identified six descriptive elements that, along with the other definitional and descriptive sections of FAR part 37, should be considered when assessing whether a contract is personal in nature.⁶

Overview of Inherently Governmental Functions

FAR Subpart 37.203 lists five prohibited uses for advisory and assistance services contracts—

- (1) to perform work of a policy, decision-making, or managerial nature which is the direct responsibility of agency officials [see discussion of inherently governmental functions below];
- (2) to bypass or undermine personnel ceilings, pay limitations, or competitive employment procedures;
- (3) to contract with former government employees on a preferential basis;
- (4) to aid in influencing or enacting legislation; or
- (5) to obtain professional or technical advice which is readily available within the agency or another Federal agency.

Services that are inherently governmental in nature should not be acquired. For example, contracting for policy decisions is not allowable because it is an inherently governmental function. However, support services to analyze policy and provide recommendations are allowable. Also, contractors should not be used to prepare testimony to Congress or to lobby Congress. Further, caution should be exercised in allowing contractors to accept products or activities on behalf of the government because these actions are normally considered to be inherently governmental functions.⁷

⁶ See Appendix II.

⁷ See FAR Subpart 7.503.

OA's Support Services, Expert Witness, and Consulting Service Contracts Invoicing

Time and materials contracts provide for acquiring supplies/services on the basis of direct labor hours at specified fixed hourly rates and materials at cost, including material handling costs if appropriate. Labor-hour contracts are a variation of time and materials contracts and they exclude materials that are supplied by the contractor. Time and materials and labor hour contracts are used when it is not possible to estimate accurately the extent or duration of the work or to anticipate costs with any degree of confidence. OA's support services, expert witness, and consulting service contracts were primarily awarded as time and material/labor hour contracts for which the government paid the contractor an hourly fee for the services provided.

OA has established controls to ensure the SEC is appropriately charged for the services it receives from support services, expert witness, and consulting service contracts. Before contractor invoices are paid CORs review the invoices and examine timesheets and supporting documentation to determine whether the contractor's charges are appropriate and pertinent information corresponds with the contract's terms.

Objectives

Objectives. The overall objective of the audit was to determine whether OA, when awarding support services, expert and consulting service contracts, complied with governing laws and regulations regarding PSCs and IGFs. Further audit objectives were to:

- Determine if OA has developed appropriate controls and has written policy that prevents contractors from performing personal services and inherently governmental functions.
- Identify the procedures OA has established and uses to monitor and carryout the terms of these contracts in accordance with governing federal laws, regulations and its internal policy.
- Assess whether OA developed proper controls to ensure the SEC is properly charged for the services that are rendered under the terms of these contracts.
- Identify best practices and possible cost savings or funds put to better use and provide recommendations to improve SEC contracting practices.

Where appropriate, Castro & Co also identified areas for improvement.

Findings and Recommendations

Finding 1: OA's Oversight of Service Contracts and Language in Service Contracts Needs Improvement

SEC's oversight of three support services and consulting service contracts/task orders may have resulted in possible employer-employee relationships, due to SEC personnel's continuous supervision of the contractors. Also, our review of three awarded service contracts found they included language that aligns with PSC characteristics.

Prior to November 15, 2012, OA did not have any written policy related to the management and administration of service contracts. Further, OA had not adopted any controls that would prevent contracting personnel or SEC staff from forming employer-employee relationships and entering into PSCs.⁸

We obtained a listing of support services, expert witness, and consulting service contracts from OA and tested a sample of 134 contracts by applying the six elements identified in FAR 37.104(d) to assess whether the contract was personal in nature. These contracts were primarily awarded as time and material/labor hour contracts and the government paid the contractor an hourly fee for the services provided.

Through analysis and interviews we determined that the service contracts identified in Table 1 may have been administered as PSCs. Specifically, we determined that the [REDACTED] and [REDACTED] contracts were positive for all six elements in FAR 37.104(d) and the [REDACTED] contract was positive to 5 of the 6 elements. We determined the second element, which asks "Are the principal tools and equipment furnished by the government?" was not a significant factor for the [REDACTED] and [REDACTED] contracts. For both contracts, the furnishing of such equipment as telephones and computers was also not a material factor. Also, our testing found no issues with expert witness contracts.

⁸ See Appendix III for FAR 37.104(d) six elements.

Table 1: Support Services and Consulting Service Contracts that May Have Been Administered as Personal Service Contracts

Vendor Name (Contract/Task Order Number)	Service Description	Contract Status	Contract Value
(SECHQ [REDACTED] - [REDACTED])	Professional Services	Task order has not been fully closed. Period of performance (POP) expired July 2012. Position was abolished in June 2012.	\$106,797
(SECHQ [REDACTED])	IT Forensic and Litigation Support	Contract is open. Contract POP is July 2012 - July 2017	\$3,745,140
(SECHQ [REDACTED])	HR Support	TO cancelled via mod dated 11/19/12. New TO 0100, POP expires August 30, 2014.	\$100,000

Source: Castro & Company Generated

[REDACTED] **Contract.** We interviewed the CO, COR, and sole contractor for this contract. The COR informed us she provided daily supervision to the sole contractor on this contract. This supervision included determining daily work assignments that were to be completed. The contractor confirmed this information and informed us that SEC staff had also interviewed her to determine her suitability for the position. The period of performance for this contract expired in July 2012. At that time, the contractor was hired as a SEC employee and currently performs many of the same job functions she did as a contractor.

Based on our analysis and interviews conducted, we determined this contract was positive for all six elements identified in FAR 37.104(d) that are used to assess if an employer-employee relationship has been created. Specifically, our assessment of the six elements found the following:

- The contractor primarily conducted its work on site at the SEC.
- Principal tools and equipment (such as computers and telephones) were furnished by the government, although this was not material.
- The contractor's services were applied directly as an integral effort of the Operations Center facilities branch, which served as the contractor's main point of contact.
- Comparable services and meeting comparable needs were performed using SEC personnel because the contractor later was hired as an SEC employee and now performs the same job duties she did as a contractor.
- The need for the service provided could reasonably have been expected to last beyond one year.
- Interviews with the contractor and COR indicated SEC personnel provided continuous supervision of the contractor.

We determined this contract/task order may have been administered as a PSC primarily due to the COR's relatively continuous supervision of the contractor.

██████████ **Contract.** For this contract we interviewed the CO, COR, the Division of Enforcement's (Enforcement) IT forensic branch chief, SEC team leads, ██████████ project managers and numerous ██████████ staff. The Enforcement IT forensic branch chief, who was not the COR, told us he interviewed contractor personnel prior to ██████████, Inc. hiring them. The branch chief asserted he made the final determination to hire contractor staff.

We also found an instance where a contractor staff with no previous relationship to ██████████, was referred to ██████████ to be hired based on an interview this person had with the branch chief. We were also told that SEC employees directly supervised contractor staff's daily work and contractors worked side-by-side with Enforcement's IT forensic specialists, who conducted the same job functions and were considered interchangeable with SEC employees by managers in the IT forensic branch. Thus, we determined that SEC staff provided relatively continuous supervision of contractors and an employee-employer relation was present.

Based on our analysis and interviews conducted, we determined this contract was positive for five of the six elements identified in FAR 37.104(d) that are used to assess if a contract is personal in nature. Specifically, our assessment of the six elements found the following:

- The contractor's principal tools and equipment (e.g., 90 work stations and a mix of Dell OptiPlex computer models) were furnished by the SEC.
- The services provided by the contractor were applied directly to the integral effort of the Enforcement IT forensics branch.
- Comparable services and meeting comparable needs were performed using civil services personnel because ██████████ contractors and SEC personnel worked side-by-side performing the same functions.
- The need for the service provided could reasonably have been expected to last beyond one year, because the contract's period of performance was from July 2012 to July 2017.
- Interviews conducted with SEC personnel and ██████████ contractors indicated the services the contractor provided were subject to continuous supervision of SEC personnel.

As a result of SEC staffs' direct supervision and contractors performing interchangeable job duties with federal employees, we determined this contract may have been administered as a PSC.

█████ **Contract.** For this contract we interviewed the CO, COR, the Office of Human Resources (OHR) assistant director, labor relations branch chief, SEC program leads and █████ contractor personnel. █████ contractors informed us they were supervised on a daily basis by SEC staff. In addition, we identified a contractor whose leave was approved by SEC staff.

Based on our analysis and interviews conducted we determined this contract was positive for all six elements identified in FAR 37.104(d) that are used to assess if an employer-employee relationship has been created. Specifically, our assessment of the six elements found the following:

- The contractor primarily conducted its work on site at the SEC.
- Principal tools and equipment (such as computers and telephones) were furnished by the government, although this was not material.
- Services were applied directly to the integral effort of OHR.
- Comparable services and meeting comparable needs were performed using civil services personnel. The contract stated that the purpose of the contract was to provide "...programmatic support to OHR in response to workload surges and staff shortages, to ensure consistent, quality deliver of Human Resources products and services to SEC customers and various stakeholders."
- The need for the service provided could reasonably have been expected to last beyond one year because a contract modification was issued in November 2012 and the period of performance expires in August 2014.
- Interviews with numerous SEC personnel and █████ contractors indicated the services the contractor provided were subject to continuous supervision of SEC personnel.

We determined this contract may have been administered as a PSC primarily due to SEC staff's continuous supervision of contractor personnel.

Language in Awarded Service Contracts

Our audit revealed seven contracts/task orders for service contracts that contained language we determined was indicative of a PSC. We did not find any corroborating evidence related to these contracts indicating noncompliance with FAR 37.104. Our review of service contracts found the following contract language we interpreted as indicating the contractors' work was to be assigned and monitored by SEC personnel.

Assignments – The individual will work closely with team leads and divisions to receive assignments.

Monitoring – Government personnel must be on-site to oversee contractor personnel.

Also, we found some service contracts did not have specific contractor deliverables. This gave the perception the contractors' work would be personal services in nature and would be under SEC staff's supervision. For example, certain contracts contained the following clause in the contract's deliverable section:

Onsite contractors shall complete work assignments and tasks on time; ensure work products are thorough and accurate; and work and interact professionally and effectively with all levels of management and staff in completing assignments...The contractor shall provide the contracting officer with a monthly status report summarizing the level of effort expended under the contract by task order...

Other contracts had the following language:

The SEC reserves the right to interview contractor personnel prior to placement of the individuals(s) under the contract.

Our interviews with contractor personnel, CORs, and program managers confirmed instances where contractors received daily work assignments from SEC personnel and contractors received continuous supervision from SEC personnel.

OA's Management and Contract Administration Controls

Prior to November, 2012, OA had not developed procedures to ensure contracting personnel reviewed service contracts prior to award and verified the contract did not contain language that could be constituted as employer-employee relationship or PSC.

Also, OA did not always ensure language was included in awarded service contracts requiring the contractor designate a point of contact or project manager to supervise contractor personnel. Additionally, some contracts also did not adequately address contractor personnel's work schedules, timesheet approval, and leave requests. We believe having these items explicitly discussed in the service contract safeguards the SEC against employer-employee relationships being created.

Conclusion

The SEC may have entered into employer-employee relationships and administered three PSCs. We determined that OA's oversight of service contracts and the language in the contracts need improvement.

Prior to November 15, 2012,⁹ OA did not have any written policy related to the COs, contract specialists, CORs, and program managers characterized specifically as "management and administration of service contracts." Further, OA did not have procedures in place to ensure contracting personnel overseeing service contracts reviewed the contracts on an ongoing basis. Additionally, OA did not require personnel such as CORs, and program managers to use measures such as post-award checklists that could have aided in preventing service contracts from being administered as PSCs. These deficiencies further happened because OA did not at the time have any controls in place to prevent employer-employee relationships from occurring, and they did not provide adequate training to contracting personnel regarding the SEC's relationships with contractors and other preventive measures that could have been taken. Having policy and procedures and providing staff with adequate training would have ensured that service contracts were not administered as PSCs and did not include language that could be constituted as a PSC.

Lastly, FAR 37.104 requires agencies to be authorized by statute to enter into a PSC. OA did not have this authorization for the [REDACTED] [REDACTED] contracts. OA not having policy and controls in place regarding service contracts, prior to November 2012, put the Commission at risk for SEC personnel to provide continuous supervision of its contractors and enter into PSCs.

Recommendation 1:

The Office of Acquisitions should coordinate with the Office of the General Counsel to determine if the [REDACTED], Contract No. SECHQ-[REDACTED]; [REDACTED], Contract, No. SECHQ-[REDACTED]; and [REDACTED], Contract No. SECHQ-[REDACTED] were personal services contracts prohibited by Federal Acquisition Regulation (FAR) 37.104 and take any action needed to ensure compliance with the FAR's provision for the contracts that remain open.

Management Comments. OA concurred with this recommendation. See Appendix V for management's full comments.

⁹ OA issued SECR 10-24, *Management and Administration of Service Contracts and Operating Procedures (OP) 10-24* in November 15, 2012. See Finding 3 for further detail on the new policy.

OIG Analysis. We are pleased OA concurred with this recommendation. OIG considers this recommendation resolved. However, the recommendation will remain open until documentation is provided to OIG that supports it has been fully implemented.

Recommendation 2:

The Office of Acquisitions should ensure contracting personnel such as contracting officers and contract specialists review service contracts prior to award and verify they do not contain language that could be construed as an employer-employee relationship or personal services contract.

Management Comments. OA concurred with this recommendation. See Appendix V for management's full comments.

OIG Analysis. We are pleased OA concurred with this recommendation. OIG considers this recommendation resolved. However, the recommendation will remain open until documentation is provided to OIG that supports it has been fully implemented.

Recommendation 3:

The Office of Acquisitions should ensure service contracts have a designated contractor point of contact or project manager to oversee its personnel's work assignments, work schedules, timecard approval, leave requests, and other administrative requirements.

Management Comments. OA concurred with this recommendation. See Appendix V for management's full comments.

OIG Analysis. We are pleased OA concurred with this recommendation. OIG considers this recommendation resolved. However, the recommendation will remain open until documentation is provided to OIG that supports it has been fully implemented.

Finding 2: Three Service Contracts/Task Orders Contained Language That Was Indicative of Inherently Governmental Functions

We identified three service contracts/task orders that contained language that could indicate the performance of IGFs by contractors. This language should not have been included in the contract.

Our review of 134 support services, expert and consulting service contracts found that three contained language that could be construed as allowing contractors to perform IGFs. Specifically, we determined that language in the [REDACTED], LLC contract for professional services, [REDACTED] contract for program management, and support services, and [REDACTED] contract for human resource support allowed for the contractor's performance of IGFs which is contrary to FAR 7.503(c)(12)(v) and the Office of Federal Procurement Policy (OFPP) Letter 11-01.¹⁰ OFPP provides executive departments and agencies guidance on managing the performance of inherently governmental and critical functions. It further provides examples and tests to help agencies identify inherently governmental functions, such as explaining what agencies must do when work is "closely associated" with inherently governmental functions.

In developing statements of work (SOW) we learned that COs and contract specialists often re-use old SOWs to draft new SOWs. As a result, language in many of the contracts we reviewed was exactly the same or were nearly the same. The [REDACTED] and [REDACTED] contracts had similar contract language we determined could be constituted as an IGF.

Table 2: Contracts that Contained Language that Could Indicate the Performance of IGFs by Contractors

Vendor Name	Contract/Task Order Number	Contract Status	Service Description
[REDACTED]	SECHQ [REDACTED]	Contract is open. POP expires August 31, 2014	Professional Services
[REDACTED]	SECHQ [REDACTED]	Contract is open. POP expires December 31, 2015. TO for contract a specialist was terminated December 2012.	Program Management/Support Services
[REDACTED]	SECHQ [REDACTED]	TO cancelled via mod dated 11/19/12. New TO 0100, POP expires August 30, 2014	HR Support

Source: Castro & Company Generated

[REDACTED] **Contract Language.** We interviewed the CO and COR for this contract, but were unable to conduct interviews with contractor personnel who performed contract specialist functions because they were replaced by another contractor. This service contract did not clearly define the transition point between contractor functions and the functions that were reserved for the

¹⁰ Office of Management and Budget (OMB) Publication of the Office of Federal Procurement Policy (OFPP) Letter 11-01, *Performance of Inherently Governmental and Critical Functions*.

government, and in some cases was poorly worded or unclear. This services contract included the following language:

Contract Specialist III: Individual shall have the ability to negotiate and serve as the point of contact on multiple requirements... Negotiates effective settlement solutions...administers complex, large dollar contracts and other types of contract documents as needed...Negotiating and managing complex sales, services, consulting, and licensing related contracts of significant importance and strategic value...Develop and issue complex solicitations, evaluate proposal, conduct negotiations, perform price/technical trade off analysis, award, and administer contracts through closeout.

We determined the contract language for the contract specialist III is specific to inherently governmental functions and thus is inconsistent with FAR 7.503(c)(12)(v), which identifies the administration of contracts as IGFs.

Contract Language. We interviewed the CO and COR for this contract, but were unable to conduct interviews with contractor personnel because OA terminated its Task Order (TO) with the vendor on December 7, 2012, prior to us arranging to meet with the contractors. This TO included the language below:

Contract Specialist I and II: Individual shall have the ability to negotiate and serve as the point of contact on multiple requirements...

Contract Specialist III: Individual shall have the ability to negotiate and serve as the point of contact on multiple requirements... Negotiates effective settlement solutions...administers complex, large dollar contracts and other types of contract documents as needed... Negotiating and managing complex sales, services, consulting, and licensing related contracts of significant importance and strategic value... develop and issue complex solicitations, evaluate proposal, conduct negotiations, perform price/technical trade off analysis, award, and administer contracts through closeout.

Our review of the contract specialists I, II, and III job descriptions found the duties and responsibilities included administering contracts and conducting negotiations to determine contract requirements. We determined the contract language is specific to inherently governmental functions and thus is not consistent with FAR 7.503(c)(12)(v) which identifies the administration of contracts as IGFs.

█████ **Contract Language.** The language in this contract included the following:

Employee and Labor Relation Specialist Support. Representing management and applies expert knowledge and skill in collective bargaining and/or negotiations...negotiating outside the collective bargaining process; overseeing arbitration and grievances...

We conducted interviews with the CO, COR, Office of Human Resources (OHR) assistant director, labor relations branch chief, SEC program leads and ██████ contractors. One contractor stated her responsibilities included drafting documentation for OHR actions such as disciplinary action, leave restriction, and the removal of SEC personnel. Another contractor, who was an industrial psychologist, indicated her responsibilities included implementing the SEC's performance management system.

The COR and team leads for the ██████ contract told us, as written, the job description would be considered an IGF. However, they asserted that contract personnel did not perform these duties, and they further believe the contract was poorly worded.

Based on our analysis, we determined contractor personnel did not always perform the specific work requirements detailed in the contract. Also, contractors should not represent management as part of its collective bargaining negotiation process. According to OFPP Letter 11-01 Section 5:

“A function requiring the exercise of discretion shall be deemed inherently governmental if the exercise of that discretion commits the government to a course of action where two or more alternative courses of action exist and decision making is not already limited or guided by existing policies, procedures, directions, orders and other guidance...”

Conclusion

We determined language in the ██████ and ██████ contracts, as well as the SEC's oversight of these contracts could indicate the performance of IGFs by contractors. We based our determination on the following:

- OA did not conduct a review to ensure language in awarded service contracts did not include duties or responsibilities that are consistent with IGFs. Not doing so resulted in several contracts having similar language that could indicate the performance of IGFs by contractors.

- OA did not perform reviews of service contract actions to assess whether the contracts included language that could be interpreted to allow for contractors to perform IGFs.
- OA did not ensure language in the contracts was defined in accordance with FAR requirements to avoid contracts allowing for contractor to perform IGFs.

Because OA did not provide adequate oversight of these contracts, it could have resulted in contractors performing IGFs. Further, we determined that OA did not take adequate measures in developing contract language for the [REDACTED] and [REDACTED] contracts to describe the contractors' job duties and responsibilities.

Recommendation 4:

The Office of Acquisitions should review all active service contracts and assess whether they include language that could reasonably be interpreted to allow for contractor performance of inherently governmental functions (IGF). Service contracts that are found to include IGF language should be modified to remove the language.

Management Comments. OA concurred with this recommendation. See Appendix V for management's full comments.

OIG Analysis. We are pleased OA concurred with this recommendation. OIG considers this recommendation resolved. However, the recommendation will remain open until documentation is provided to OIG that supports it has been fully implemented.

Recommendation 5:

The Office of Acquisitions should implement SECR 10-24 dated November 15, 2012, and its associated Operating Procedures to ensure language in service contracts conform to the Office of Management and Budget Publication, *Office of Federal Procurement Policy Letter 11-01, Performance of Inherently Governmental and Critical Functions* and the Federal Acquisition Regulation 7.503 requirements, to avoid contracts allowing for contractors performance of inherently governmental functions.

Management Comments. OA concurred with this recommendation. See Appendix V for management's full comments.

OIG Analysis. We are pleased OA concurred with this recommendation. OIG considers this recommendation resolved. However, the recommendation will remain open until documentation is provided to OIG that supports it has been fully implemented.

Finding 3: OA’s New Guidance Pertaining to Managing and Administering Service Contracts Should Be Improved in Some Areas

OA’s newly issued guidance and operating procedures should to be revised relating to clearly prohibiting interviews of contractors, providing contracting personnel with specialized training related to PSCs and IGFs, and strengthening pre-award and post-award monitoring procedures.

In November 2012, OA issued SECR 10-24 and OP10-24, which consists of comprehensive policy and guidance and includes detailed checklists and training slides that covers contracting official’s management and administration of service contracts. We found the policy contains gaps that should be addressed related to clearly prohibiting interview contractor personnel, providing contracting personnel with specialized training in relation to PSCs and IGFs, and strengthening its pre-award and post-award monitoring procedures.

Review of SECR 10-24 and OP 10-24

Our assessment of SECR 10-24 and OP 10-24 found the guidance to be very useful. It consists of specific guidance and requirements contracting personnel need in managing and overseeing service contracts in areas such as employee-employer relationships, PSCs, and IGFs. However, the guidance should be strengthened in relation to FAR 37.104 requirements. OA’s guidance includes pre-award procedures that are beneficial, such as the pre-award checklist SEC personnel must now use to ensure compliance with FAR requirements related to PSCs and IGFs. The OP 10-24, *Desk Reference: Management and Administration of Service Contracts*, “Dos and Don’ts List” states the following:

SEC employees shall not do the following:

Make hiring decisions for contractors. Meetings with individual contractor employees or potential employees to verify the person’s competence for the contract task should generally occur only when

the SEC staff considers such a verification meeting important to provide assurance that the individual meets contract requirements or for other appropriate reason. If a meeting with a proposed contractor employee to determine whether their qualifications and ability appear to meet the requirements of the contract statement of work occurs, participation of contractor management is advised.

We found this statement is vague and open to SEC staff's interpretation. Meeting with contractors to evaluate their qualifications is equivalent to conducting interviews in some circumstances such as post-contract award. SEC personnel frequently told us about "meet and greets," which appear to be interviews. OA's policy should be clearer regarding when "meet and greets" are appropriate.

Training Related to PSCs and IGFs. Since 2010, as part of the SEC's new employee orientation, OA has provided new employees with an overview of employees' responsibilities related to contracting. However, we determined that OA did not provide adequate training to contracting personnel related to PSCs and IGFs. For example, OA's *Acquisition and Competition* training at the SEC's San Francisco Regional Office in June 2012, only had 2 of 110 slides that covered personal services contracts and none that were related to IGF. Also, on June 12, 2012, OA provided a 25-minute training session to attendees related to contracting personnel regarding personal services, and in December 2012, OA provided a two-hour training session to contracting personnel on SECR 10-24 and OP 10-24 requirements. Consequently, this training was not offered to SEC staff such as project managers and branch chiefs who interact with and/or influence contractors and their work, but do not have actual contract oversight responsibilities. While the training OA has provided to SEC employees regarding their responsibilities related to contracting has improved, it should be revised to cover areas such as post-award monitoring procedures. Thus, we determined OA did not provide adequate training to SEC personnel regarding employee-employer relationships, PSCs and IGFs. Because OA did not develop policy and procedures or provide training to SEC contracting personnel prior to 2012, related to PSCs and IGFs, its internal controls over service contracts were lacking and need improvement.

Post-Award Monitoring. Our review of OP 10-24 found it also does not adequately address post-award monitoring procedures. OA has not utilized post-award monitoring controls which could be used to ensure contracts are not being administered in ways that could evolve into a PSC or engage contractors in IGFs. The OP indicates CORs and other government employees should "implement management control measures to administer the terms of the contract." However, the OP does not specify what control measures should be, or how they should be implemented. We believe the OP should clearly define post-award procedures, and a checklist similar to OA's pre-award checklist should be developed to use as a tool to monitor the administration of service contracts on an ongoing basis.

Benchmarks with Other Federal Agencies

To gain an understanding of best practices for administering and managing service contracts at other agencies, we reviewed the standard operating procedures (SOP) from four federal agencies regarding PSCs and IGFs. We found these agencies used both pre-award and post-award procedures to ensure contracts were not issued as PSCs or IGFs. Specifically, we found that the agencies have:

- SOPs for PSCs and IGFs that are based on the FAR requirements.
- A PSC/IGF checklist is used that must be reviewed and approved by the CO.
- Pre-award review procedures are used to provide guidelines to aid in ensuring service contracts are not issued as PSCs/IGFs.
- Finally, two agencies use post-award monitoring procedures that provide guidelines to ensure service contracts are not issued as PSCs/IGFs.

Pre-Award Procedures. Our review found that the four agencies use pre-award procedures to ensure contracts are not issued as PSCs/IGFs. In reviewing one of the agency's policies and procedures, we found that the CO is required to review all requirement packages for services from its program office. This is done to ensure that a PSC is not created. Our review of the agency's policies and procedures showed they included the same elements found in the FAR to assess whether a proposed service contract should be characterized as a PSC or IGF. We found one of four agency's policy determined that the "assessment should identify functions that are closely associated with inherently governmental functions." The policy further stated that "If contractors have experience performing such work then special monitoring should be implemented to guard against expansion into inherently governmental functions."

Additionally, two of the four agencies have pre-award procedures that must be done before a service contract is issued. A pre-award assessment is done by the program office to ensure the SOW does not include any PSC or IGF language before the contract is awarded. When implementing the policy the agency's managers consider the following factors:

- Nature of the work to be performed. IGFs may not be contracted.
- Availability of existing federal employees with the knowledge, skills and experience to understand the work, manage the contracts and assess results achieved.
- Whether the agency can obtain highly specialized skills or historical knowledge (e.g., of plan practices) through civil service recruitment.
- Relative cost of performance by contract or federal employees.

One agency stated “All new requirements for services including expiring contracts that will be re-competed must undergo an assessment to ensure that any proposed contract award for services does not include any inherently governmental functions or unauthorized personal services.”

Consequently, all four agencies use a checklist or similar-type document to evaluate whether a contemplated contract complies with the FAR and attempt to ensure that service contracts are not issued as PSCs/IGFs.

Post-Award Procedures. Further, we found that two agencies in our benchmark sample used post-award procedures to aid in ensuring an employer-employee relationship between the agency and contractor personnel did not exist. Also, to preclude the creation of a prohibited employer-employee relationship between the agency and contractor personnel and to preserve the independent status of contractor personnel, one agency exercised the following precautions:

- Agency employees cannot directly or indirectly supervise contractor personnel.
- Contractor personnel workstations must be separate from agency employee workstations, to the maximum extent practicable.
- Contractor personnel must wear badges when onsite at agency offices or facilities and display office signs that identify them as contractor personnel.
- Contractor personnel cannot attend regular agency staff meetings.
- Contractor personnel, in general, cannot participate in services that are provided for the benefit of agency employees (e.g., counseling and referral services, agency recreational activities, office picnics, and holiday parties).

Other post-award procedures employed by the four agencies in our benchmark included a continuous review of the functions contractors perform, in particular, the way contractors conduct work that is associated with IGFs, such as awarding and administering contracts and the direction and control of federal employees.

Survey for CORs and Program Managers

During September 2012, we surveyed SEC CORs and program managers regarding the SEC’s practices in providing oversight of contractor personnel and specialized training they have received to assist in performing their duties for support services and consulting contracts. Approximately 47 percent of the CORs and program managers, who received the survey, responded to it. The survey revealed that improvements were needed to ensure CORs and program managers have a better understanding of what constitutes a PSCs and IGFs. Overall, the survey found the following:

- Twenty of 51 (39 percent) respondents stated they performed daily supervision of contractors. This is a red-flag for a possible employer-employee relationship in violation of FAR 37.104.
- Two of 53 (4 percent) respondents interviewed contractors before they were hired to support contract work. This relates to an employer-employee relationship in violation of FAR 37.104. We believe this response is probably significantly understated because discussions we had with individual contractors and SEC personnel stated that “meet and greets” were conducted by SEC personnel to determine the suitability of contractors before they were hired. SEC personnel did not believe “meet and greets” were the same as interviews.
- Nineteen of 55 (35 percent) respondents indicated that comparable services were performed by former or SEC civil service staff. This indicates an area that should receive additional attention in contract creation and oversight to avoid a PSC.
- Four of 49 (8 percent) respondents indicated they did not receive any or timely training related to PSCs and IGFs.

We determined further training is needed for SEC personnel who administer and oversee service contracts.

Conclusion

OA’s newly issued guidance and operating procedures are comprehensive, but need to be further strengthened to better ensure SEC personnel and other program personnel who work with contractors, that are on a service contract, are trained and given current guidance regarding their responsibilities to administer and manage contractors and are cognizant of FAR as it pertains to employer-employee relationships, PSCs and contractors conducting IGFs. Not having solid pre-award and post-award monitoring procedures could result in FAR violations pertaining to PSCs and IGFs.

Recommendation 6:

The Office of Acquisitions should revise SECR 10-24, *Management and Administration of Service Contracts* and Operating Procedures 10-24 to clearly prohibit interviewing contractor employees and require post-award reviews be done on service contracts using a checklist that covers common areas that

should be avoided during contract administration and oversight of service contracts.

Management Comments. OA concurred with this recommendation. See Appendix V for management's full comments.

OIG Analysis. We are pleased OA concurred with this recommendation. OIG considers this recommendation resolved. However, the recommendation will remain open until documentation is provided to OIG that supports it has been fully implemented.

Recommendation 7:

The Office of Acquisitions should periodically provide training on avoiding actions that could be interpreted as supervision of contractor employees, on avoiding inappropriate employer-employee relationships between government employees and contractor personnel, and on preventing contractors from performing inherently governmental functions. This training should be provided to contracting personnel and other program personnel who work with contractors on service contracts.

Management Comments. OA concurred with this recommendation. See Appendix V for management's full comments.

OIG Analysis. We are pleased OA concurred with this recommendation. OIG considers this recommendation resolved. However, the recommendation will remain open until documentation is provided to OIG that supports it has been fully implemented.

Abbreviations

Castro & Co	Castro & Company, LLC
CNCS	Corporation for National and Community Service
CO	Contracting Officer
COR	Contracting Officer's Representative
COSO	Committee of Sponsoring Organizations of the Treadway Commission
Enforcement	Division of Enforcement
FAR	Federal Acquisition Regulation
FPDS	Federal Procurement Data System
IGF	Inherently Governmental Function
IT	Information Technology
OA	Office of Acquisitions
OHR	Office of Human Resources
OIT	Office of Information Technology
OFPP	Office of Federal Procurement Policy
OIG	Office of Inspector General
OMB	Office of Management and Budget
OP	Operating Procedure
POP	Period of Performance
PSC	Personal Services Contract
SEC or Commission	U.S. Securities and Exchange Commission
SECR	SEC Administrative Regulation
SOP	Standard Operating Procedure
SOW	Statement of Work
TO	Task Order

Scope and Methodology

The full version of this report includes information that the SEC considers to be sensitive and proprietary. To create this public version of the report, OIG redacted (blacked out) potentially sensitive, proprietary information from the report.

As part of the OIG's annual audit plan, Castro & Co conducted an audit of SEC's support service, expert and consulting service contracts.

Castro & Co conducted this performance audit in accordance with the generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Scope. Castro & Co conducted its fieldwork from July 2012 to January 2013 at the SEC's Headquarters site in Washington, D.C. The scope of our audit covered a select number of support services, expert and consulting service contracts that were executed by all SEC divisions/offices (e.g., headquarters, operations center and the regional offices) during calendar years 2008 to 2011, and from January 2012 to September 2012.

Methodology. To accomplish the overall objective to determine whether OA awarded support services, expert and consulting services contracts, and complied with governing laws and regulations regarding PSCs and IGFs, Castro & Co obtained, reviewed and analyzed support service, expert and consulting service contracts to determine if indicators of PSCs or IGFs were present. In addition, we conducted interviews with CO's, contract specialists, CORs, and other personnel to corroborate evidence we gathered during our contractor file review.

To accomplish the objective of determining whether OA developed appropriate controls and has written policy that prevent contractors from performing PSCs and IGFs, Castro & Co reviewed SEC's regulations and policies and procedures pertaining to contracting, relevant federal laws, regulations, and guidance. We also reviewed reports OIG's issued related to PSCs and IGFs. In addition, we reviewed OA's new Administration Regulation regarding service contracts to determine if the policy would provide improved guidance on how contracts should be administered to avoid PSCs or IGFs. In addition, we developed, administered, and analyzed the results of a survey that was directed to SEC's CORs, inspection and acceptance officials and program managers to determine whether SEC's practices in providing supervision, control, and training to SEC staff were appropriate for those performing oversight duties.

To accomplish the objective of identifying procedures OA has established and uses to monitor and carry out the terms of contracts to ensure compliance with governing laws

and regulations and its internal policy, Castro & Co conducted interviews with select OA personnel who were responsible for administering SEC's contracts. Such personnel included the COs/contract specialists and CORs. We also reviewed training provided to SEC personnel related to service contracts to determine if adequate coverage was provided related to PSCs and IGFs.

To accomplish the objective of assessing whether OA developed controls to ensure the SEC is charged appropriately for the services that are rendered under the terms of the contracts, Castro & Co conducted interviews with OA personnel regarding contract administration, including the review of invoices. Additionally, Castro & Co obtained, reviewed and analyzed invoices to ensure charges were appropriate when compared to contract terms and were supported by appropriate documentation.

To accomplish the objective of identifying best practices and possible cost savings or funds put to better use and provide recommendations to improve SEC contracting practices, Castro & Co reviewed policies and procedures from other federal agencies to benchmark best practices regarding contract administration, including the handling of PSCs and IGFs. We also reviewed reports issued by the Government Accountability Office, as well as other federal agencies related to PSCs and IGFs to determine whether any issues in the reports were applicable to the scope of our audit. Our review of contractor invoices found that OA has established controls to ensure that the SEC is appropriately charged for services received. Based on our discussions with OA personnel and analysis of invoices tested, the SEC controls over contractor invoicing appear reasonable. Our audit found that CORs reviewed the contractor's invoices when they were received. This review included examining supporting documentation, such as timesheets to determine whether charges were appropriate. The CORs asserted they ensured all pertinent information corresponded with the terms of the contracts. In addition, we tested 93 invoices and its supporting documentation and verified the SEC was appropriately charged for the contractor's services. We traced the fees that were paid to the amounts allowed per the terms of the contract, for the type of applicable work, and found no discrepancies.

In addition, our benchmark procedures included reviewing standard operating policies and procedures from other federal agencies related to PSCs and IGFs to gain an understanding of best practices utilized at those agencies. We did not determine any possible cost savings or funds that were put to better use.

Internal Controls. The Internal Control—Integrated Framework, published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), provides a framework for organizations to design, implement, and evaluate controls

that facilitate compliance with federal laws, regulations, and program compliance requirements. We based our assessment of OA's internal controls that were significant to the audit objectives on the COSO framework, including control environment, risk assessment, control activities, information and communication, and monitoring.

Use of Computer-Processed Data. We did not assess the reliability of this function because it did not pertain to our audit objectives. For our contract testing, we obtained a listing of support services, expert witness, and consulting contracts from FPDS. The original file contained all contract actions (initiations, modifications, deobligations, etc.) from January 1, 2008 to March 31, 2012. After talking to OIG we determined the file contained actions for contracts awarded prior to fiscal year 2008. OIG reviewed the original file and removed the actions for all contracts prior to 2008. The OIG determined the date awarded based on the assigned contract number. For those contracts that did not follow the standard naming convention, the date was verified in FPDS.

Random Sampling. Castro & Co employed a methodology of random sample selection for our sample universe. Sample sizes were determined by evaluating the population of contracts to test and by giving consideration to the significance of the control, inherent risk, and professional judgment.

We obtained a population of 1,442 individual contracts and excluded all contracts below the micro-purchase threshold of \$3,000, as well as those contracts which only included deobligations. This resulted in a final population of 1,288 contracts. We determined an appropriate sample size was 10 percent of the overall population, or 129 contracts. Between November 2012 and December 2012, OIG requested we review five additional contracts. Therefore, our total sample size amounted to 134 contracts.

For the original 129 contracts, we divided the contracts into two groups, based on the dollar value of each contract: Group 1 contained contracts valued from \$3,000 to \$25,000, and Group 2 contained contracts valued over \$25,000. We selected 10 items from Group 1 using random sample selection. For Group 2, we used the Stratified Random sample selection and grouped the contracts into strata based on dollar value. We weighted each stratum based on the "percent of records," or the number of contracts within each stratum as compared to the number of contracts within the overall population. We then multiplied the percentage of records to the target, total sample items and to determine the total number of contracts to be tested within the strata.

Appendix II

For invoices testing, we obtained a list of payment vouchers associated with each contract previously selected for testing. This resulted in 930 payment vouchers within the population. We determined 10 percent of the population was a reasonable sample size. We used the IDEA's random sample selector which identified 93 payment vouchers that should be tested.

Criteria

FAR 37.104(d). Consist of the following six questions that should be raised to determine whether an employer-employee relationship has been created, and therefore a personal services contract may exist.

- 1) Is the performance on site?
- 2) Are the principal tools and equipment furnished by the government?
- 3) Are the services being performed by the contractor directly applied to the integral effort of the agency or an organizational subpart in furtherance of an assigned function or mission?
- 4) Are comparable services being performed in the same or similar agencies by civil service personnel?
- 5) Will the need for this type of service be expected beyond one year?
- 6) Does the nature of the service being provided reasonably require government direction or supervision of contractor employee in order to protect the government's interest, retain control of the function involved, or retain personal responsibility for the function by a duly authorized Federal officer or employee?

FAR 7.503 (a). States that “contracts shall not be used for the performance of inherently governmental functions.” Although FAR 7.503 does not provide an exact definition of IGFs, it provides a list of duties which may be considered as such. The list, while not all inclusive, includes the following:

- The determination of agency policy, such as determining the content and application of regulations, among other things.
- The determination of Federal program priorities for budget requests.
- The direction and control of Federal employees.
- The selection or non-selection of individuals for Federal Government employment, including the interviewing of individuals for employment.
- The approval of position descriptions and performance standards for Federal employees.
- In Federal procurement activities with respect to prime contracts—
 - 1) Determining what supplies or services are to be acquired by the Government (although an agency may give

- contractors authority to acquire supplies at prices within specified ranges and subject to other reasonable conditions deemed appropriate by the agency);
- 2) Approving any contractual documents, to include documents defining requirements, incentive plans, and evaluation criteria;
- 3) Awarding contracts;
- 4) Administering contracts (including ordering changes in contract performance or contract quantities, taking action based on evaluations of contractor performance, and accepting or rejecting contractor products or services);
- 5) Terminating contracts;
- The determination of budget policy, guidance, and strategy.

31 U.S.C. 1342. States that, “An officer or employee of the United States Government or of the District of Columbia government may not accept voluntary services for either government or employ personal services exceeding that authorized by law except for emergencies involving the safety of human life or the protection of property.”

FAR Subpart 37.203. Consist of the five prohibited uses for advisory and assistance service contracts.

Comptroller General Decision Encore Management, Inc., B-278903.2 (Comp. Gen. Feb. 12, 1999). On February 12, 1999, the Comptroller General of the United States determined that the Corporation for National and Community Service (CNCS) administered a contract for clerical and administrative support as a personal services contract and CNCS’s cancellation of a request for proposals for a replacement contract was reasonable.

Comptroller General Decision Kelly Services, B-186700 (Comp. Gen. Jan. 19, 1977). The six elements relate principally to the third statutory criterion concerning supervision of the contractor’s employee by a federal officer or employee. That is, the proscribed supervision is frequently evidenced by these elements. The absence of any one or a number of them, however, would not mean that supervision is not permitted by the contract, or present in the actual work performance, but only that there is less likelihood of its existence.

Office of Federal Procurement Policy Letter 11-01, Performance of Inherently Governmental and Critical Functions, September 12, 2011. The purpose of the policy letter is to provide executive departments and agencies guidance on managing the performance of inherently governmental and critical functions.

SECR 10-24 and SEC OP 10-24, Management and Administration of Service Contracts, November 15, 2012. This SECR implements the guidance noted in the OFPP Letter 11-01, *Performance of Inherently Governmental and Critical Functions*. This SECR and the accompanying OP, provides procedures to avoid entering into contracts for IGFs and personal services. In addition, these documents present procedures to be utilized for acquiring and administering contracts for functions closely associated with IGFs and critical functions.

Committee of Sponsoring Organizations of the Treadway Commission – *Integrated Framework*, 1992. The framework provides a principles-based guidance for designing and implementing effective internal controls.

List of Recommendations

Recommendation 1:

The Office of Acquisitions should coordinate with the Office of the General Counsel to determine if the [REDACTED] Contract No. SECHQ-[REDACTED] Contract, No. SECHQ-[REDACTED]; and [REDACTED] Contract No. SECHQ-[REDACTED] were personal services contracts prohibited by Federal Acquisition Regulation (FAR) 37.104 and take any action needed to ensure compliance with the FAR's provision for the contracts that remain open.

Recommendation 2:

The Office of Acquisitions should ensure contracting personnel such as contracting officers and contract specialists review service contracts prior to award and verify they do not contain language that could be construed as an employer-employee relationship or personal services contract.

Recommendation 3:

The Office of Acquisitions should ensure service contracts have a designated contractor point of contact or project manager to oversee its personnel's work assignments, work schedules, timecard approval, leave requests, and other administrative requirements.

Recommendation 4:

The Office of Acquisitions should review all active service contracts and assess whether they include language that could reasonably be interpreted to allow for contractor performance of inherently governmental functions (IGF). Service contracts that are found to include IGF language should be modified to remove the language.

Recommendation 5:

The Office of Acquisitions should implement SECR 10-24 dated November 15, 2012, and its associated Operating Procedures to ensure language in service contracts conform to the Office of Management and Budget Publication, *Office of Federal Procurement Policy Letter 11-01, Performance of Inherently Governmental and Critical Functions* and the Federal Acquisition Regulation 7.503 requirements, to avoid contracts allowing for contractors performance of inherently governmental functions.

Recommendation 6:

The Office of Acquisitions should revise SECR 10-24, *Management and Administration of Service Contracts* and Operating Procedures 10-24 to clearly prohibit interviewing contractor employees and require post-award reviews be done on service contracts using a checklist that covers common areas that should be avoided during contract administration and oversight of service contracts.

Recommendation 7:

The Office of Acquisitions should periodically provide training on avoiding actions that could be interpreted as supervision of contractor employees, on avoiding inappropriate employer-employee relationships between government employees and contractor personnel, and on preventing contractors from performing inherently governmental functions. This training should be provided to contracting personnel and other program personnel who work with contractors on service contracts.

Management Comments

MEMORANDUM

March 26, 2013

To: Jacqueline Wilson, Assistant Inspector General for Audits

From: Vance Cathell, Director, Office of Acquisitions *V.Cathell*

Subject: Response to SEC IG's Draft Audit 513, *Audit of SEC's Controls Over Support Service, Expert and Consulting Service Contracts*

Thank you for the opportunity to review and comment on the recommendations in draft Audit Report, *Audit of SEC's Controls Over Support Service, Expert and Consulting Service Contracts* dated March 21, 2013. The Office of Acquisitions (OA) appreciates the recommendations designed to strengthen OA's controls over service contracts. We are pleased the OIG found that controls to ensure that the SEC is being properly charged for services appear to be reasonable.

OA is committed to assuring proper oversight and management of service contracts, and I welcome your suggestions on improvements in our policies and processes. SEC Regulation 10-24, *Management and Administration of Service Contract* was issued in November of 2012, after the period covered by this audit. OA will review the regulation and its associated operating procedures, training, and guides, and adjust them as appropriate to incorporate recommendations.

Recommendation 1:

The Office of Acquisitions should coordinate with the Office of the General Counsel to determine if the [REDACTED], Contract No. SECHQ-[REDACTED]; [REDACTED] Contract, No. SECHQ-[REDACTED]; and [REDACTED] Contract No. SECHQ-[REDACTED] were personal services contracts prohibited by Federal Acquisition Regulation (FAR) 37.104 and take any action needed to ensure compliance with the FAR's provision for the contracts that remain open.

Response:

OA concurs with this recommendation. OA will submit the referenced contracts to OGC for review, and will take appropriate action on the active contract to assure it complies with FAR 37.104 provisions.

Recommendation 2:

The Office of Acquisitions should ensure contracting personnel such as contracting officers and contract specialists review service contracts prior to award and verify they do not contain language that could be construed as an employer-employee relationship or personal services contracts.

Subject: Response to SEC IG's Draft Audit 513, *Audit of SEC's Controls Over Support Service, Expert and Consulting Service Contracts*

Response:

OA concurs with this recommendation. OA will amend SEC's Operating Procedure 10-24 (November 21, 2012) to require clearly that contracting personnel review service contracts to verify they do not contain language that could be construed as an employer-employee relationship or personal services contracts.

Recommendation 3:

The Office of Acquisitions should ensure service contracts have a designated contractor point of contact or project manager to oversee its personnel's work assignments, work schedules, timecard approval, leave requests, and other administrative requirements.

Response:

OA concurs with this recommendation. OA will institute controls to assure that Contract Specialists and Contracting Officers include a requirement in service contracts to have a designated contractor point of contact or project manager to ensure that contractor personnel are under their employer's administrative control and supervision.

Recommendation 4:

The Office of Acquisitions should review all active service contracts and assess whether they include language that could reasonably be interpreted to allow for contractor performance of inherently governmental functions (IGF). Service contracts that are found to include IGF language should be modified to remove the language.

Response:

OA concurs with this recommendation. OA will conduct a review and assess all active service contracts that have a statement of work to determine if the contract language could reasonably be interpreted to allow for contractor performance of inherently governmental functions. The Contracting Officer, who may also seek review by the Office of General Counsel, will modify any such language found.

Recommendation 5:

The Office of Acquisitions should implement SECR 10-24 dated November 15, 2012, and its associated Operating Procedures to ensure language in service contracts conform to the Office of Management and Budget Publication, Office of Federal Procurement Policy Letter 11-01, *Performance of Inherently Governmental and Critical Functions* and the Federal Acquisition Regulation 7.503 requirements, to avoid contracts allowing for contractors performance of inherently governmental functions.

Subject: Response to SEC IG's Draft Audit 513, *Audit of SEC's Controls Over Support Service, Expert and Consulting Service Contracts*

Response:

OA concurs with this recommendation. Since November 2012, OA has been implementing SECR 10-24 and the associated Operating Procedures for all new service contract awards to ensure language in service contracts conforms to OFPP Policy Letter 11-01. OA has provided a number of training sessions to procurement personnel and new supervisors, and recently made the training available online for all SEC personnel. Additional training and communications SEC wide will be conducted. OA will implement oversight controls to assure that SECR 10-24 is being followed. A *Reference Deskside Guide* has also been posted as a handy reference point for use by SEC personnel when dealing with service contractors.

Recommendation 6:

The Office of Acquisitions should revise SECR 10-24, *Management and Administration of Service Contracts* and Operating Procedures 10-24 to clearly prohibit interviewing contractor employees and require post-award reviews be done on service contracts using a checklist that covers common areas that should be avoided during contract administration and oversight of service contracts.

Response:

OA concurs with this recommendation. OA will revise SECR 10-24 and the associated Operating Procedures to clearly prohibit interviewing contractor employees. This prohibition will continue to be emphasized during training. OA will develop a checklist for post-award reviews for service contracts.

Recommendation 7:

The Office of Acquisitions should periodically provide training on avoiding actions that could be interpreted as supervision of contractor employees, on avoiding inappropriate employer-employee relationships between government employees and contractor personnel, and on preventing contractors from performing inherently governmental functions. This training should be provided to contracting personnel and other program personnel who work with contractors on service contracts.

Response:

OA concurs with this recommendation. OA has provided training and will continue to provide periodic training to SEC staff involved in service contracts on avoiding actions that could be interpreted as supervision of contractor employees, on avoiding inappropriate employer-employee relationships and on preventing contractors from performing inherently governmental functions. OA will continually review training and make noted improvements.

Cc: Darlene Pryor; Russ Moore

Audit Requests and Ideas

The Office of Inspector General welcomes your input. If you would like to request an audit in the future or have an audit idea, please contact us at:

U.S. Securities and Exchange Commission
Office of Inspector General
Attn: Assistant Inspector General for Audits (Audit Request/Idea)
100 F Street, N.E.
Washington D.C. 20549-2736

Tel. #: 202-551-6061
Fax #: 202-772-9265
Email: oig@sec.gov

SEC OIG Hotline

To report fraud, waste, abuse, and mismanagement at SEC,
contact the Office of Inspector General at:
Phone: 877.442.0854

Web-Based Hotline Complaint Form:
www.reportlineweb.com/sec_oig