MORTGAGE PROJECT GROUP'S BILLINGS

Audit Report No. 00-010
March 28, 2000

OFFICE OF AUDITS

OFFICE OF INSPECTOR GENERAL

DATE: March 28, 2000

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SUBJECT: Audit of Mortgage Project Group's Billings (Audit Report No. 00-010)

This report presents the results of the Office of Inspector General's (OIG) audit of Mortgage Project Group, Inc.'s (MPG) billings of special servicer fees for contract 97-00321-CEB. Generally, we found that MPG billed its special servicer fees in accordance with the terms and conditions of the contract. However, we identified two instances where MPG inappropriately billed the Federal Deposit Insurance Corporation (FDIC), resulting in almost $58,300 in questioned costs. Further, in performing our audit of MPG's billings, we identified areas where we believe the FDIC could have better planned and administered the MPG contract. The discussion of these areas provides an opportunity for FDIC management to consider changes to the FDIC's solicitation, award, and contract administration activities, which could provide for better future contract execution.

BACKGROUND

The FDIC owns the servicing rights to Real Estate Mortgage Investment Conduit (REMIC) and REMIC-like asset pools of loans.[1] These loans are primarily secured by 1-4 family residential

[1] The REMIC is a multiple-class mortgage cash flow security, backed by residential mortgage loans, which generally have been pooled together in mortgage backed security (MBS) trusts. REMIC securities restructure principal and interest payments into separately traded securities. By redirecting the cash flow from the underlying standard MBS, the issuer can create a security having several classes, also called tranches, which may carry different coupon rates, average lives, prepayment sensitivities, and final maturities. These complex REMIC transactions distribute mortgage cash flows in an almost unlimited variety of ways.

properties located in California. The FDIC also has management, liquidation, and accounting responsibilities for any owned real estate (ORE) resulting from defaulted loans within these loan pools. Additionally, the FDIC has responsibility to ensure that principal and interest advances on another group of REMIC loans serviced for others are collected.

To assist with the servicing of these various assets, on April 1, 1997 the FDIC awarded a special servicing contract to MPG. MPG's contract was for 1 year, with two 6-month option periods. The FDIC exercised the options, extending the contract performance period to March 31, 1999. Subsequently, the FDIC approved a Justification for Non-Competitive Procurement (JNCP) to restructure and extend the MPG contract period to December 31, 1999.

MPG's responsibilities under its special servicing contract include the following:

- Managing and disposing of foreclosed properties on behalf of the investors.
- Funding recoverable expenses to maintain, repair, and sell the investor-owned properties.
- Collecting sales proceeds of disposed properties and passing through proceeds to the sub-servicer for distribution to the trustee and investors.
- Processing pool insurance claims, mortgage insurance claims, and trustee claims for reimbursement of advances and expenses.
- Monitoring and reconciling cash flow activity and the work product of the trustee and the mortgage loan sub-servicer.
- Accounting for various REMIC receivables, payables, expenses, and cash receipts.
- Reporting activity to the trustee and investors related to the pools, cash flows, and asset-specific activity.

On September 10, 1997, the FDIC modified the MPG contract to require MPG to reconcile the accounting records and to review Loss Letters[2] of a previous FDIC servicer. Under this modification, MPG was tasked with reconciling the prior accounting of advances, including: ORE expense advances, principal and interest advances, advance-related suspense funds held by the previous servicer, and various custodial accounts. To perform this reconciliation of prior advances, MPG had to review all Loss Letters prepared by the prior servicer from October 1994 through March 1997 and prepare supplemental Loss Letters, as necessary, for this period.

MPG's contract, as modified, provided for MPG to be paid monthly fixed dollar amounts for services provided. Table 1 shows the total amounts that the FDIC paid for various categories of services through January 31, 1999.

[2] A Loss Letter is a document containing loan level information, in letter format, prepared by the contractor and delivered to the trustee or investor. The Loss Letter describes the liquidation event, e.g. the receipt of all funds in final payment of a mortgage loan; all expenses associated with the liquidation event including principal and interest advances and unrecovered servicing fees, if any; the final liquidation proceeds; and the loss associated with the liquidation event.

Table 1: Analysis of Special Servicing Fees Paid by FDIC

Fee Category	Fee Unit	Monthly Amount	Total Amount Paid
Flat Fixed Fee	N/A	$ 16,784.00	$ 402,816
Category 1	Per Pool	796.58	1,408,177
Category 2	Per Asset (varies as foreclosures occur)	122.01	402,145
Category 3	Per Pool	968.11	702,848
Category 4	Per Asset	579.00	24,318
Loss Letters	Per Review	457.00[a]	202,908
Travel			1,474
Special Hazard Losses	Per Task	N/A	9,750
Total Payments			**$3,154,436**

Source: MPG contract

[a]Loss Letters were paid on a per task basis, not a monthly basis.

Due to the complexity of the MPG contract, the FDIC assigned Irvine and Dallas staff to a contract administration team in April 1997. The original team consisted of a Division of Administration (DOA) contracting officer and contract specialist in Irvine, a Division of Resolutions and Receiverships (DRR) Irvine oversight manager, and three Division of Finance (DOF) technical monitors—one in Irvine and two in Dallas. When the Irvine office closed in September 1998, the DOA and DRR Irvine contracting and oversight responsibilities transferred to Dallas.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of our audit was to determine whether MPG's billings were reasonable, adequately supported, and in compliance with the terms and conditions of the contract and the subsequent modifications. Our audit scope included MPG's billings for the period April 1, 1997 through January 31, 1999.

To gain an understanding of the history of the MPG contract award process, including the establishment of the contract's Statement of Work (SOW) and the billing fee structure in the FDIC's Request for Proposal (RFP), we interviewed officials from MPG and cognizant FDIC personnel from DOA, DRR, and DOF. We also reviewed the FDIC's MPG contract files, MPG's proposal submissions, and DOA's cost analysis of the proposals. Further, we reviewed the FDIC Technical Evaluation Panel's (TEP) analysis of offerors' bids and its recommendation for contract award. Finally, to gain an understanding of the contract administration process that led to the final approved changes to the contract, we reviewed the contract and oversight files relating to the contract modifications.

To determine the mathematical accuracy and correctness of the fees billed by category, we recalculated all of MPG's fee billings during the audit period and verified the billing rates to the terms and conditions of the contract. We then traced MPG's invoice quantities to MPG's records. These records consisted of asset inventory reports compiled by MPG from sub-servicer reports. We randomly selected 2 months and verified 284 of the 2,808 Category 2 asset

quantities invoiced to MPG's records, or $34,651 of the $402,145 invoiced. Because of errors noted in the 2 months tested, we expanded our review to cover all Category 2 asset quantities invoiced for the period April 1, 1997 through December 31, 1998. Finally, we reviewed the contractually required deliverable schedule for Loss Letters and compared the schedule to MPG's actual delivery of Loss Letters and actual dates that the Loss Letters were billed. We did not review Category 4 asset activities because the $24,318 that the FDIC paid MPG for these activities was not material.

We reviewed DRR's and DOF's site visitation programs, looking for the frequency and scope of DRR and DOF visits to MPG, and noting who participated in the visits. We reviewed DRR oversight management and DOF correspondence files, looking for any significant problems relating to MPG's performance, billings, and any internal and external audits performed. We also reviewed these files to determine DRR's and DOF's roles and responsibilities and actions taken by each during the award and administration process of the MPG contract.

Finally, we reviewed MPG's correspondence files, invoice files, work products, and organizational charts to gain an understanding of how MPG performed its contracted work requirements and monitored its performance against established contract goals and scheduled timelines. We reviewed MPG's analysis of the Pooling and Servicing Agreements (PSA) and its assessment of the FDIC's responsibilities and obligations to the trustee and investors.
We did not perform a comprehensive review of MPG's internal controls. Instead we relied on substantive testing to meet our audit objective. The OIG performed work primarily at the FDIC's offices in Dallas, Texas, and at MPG's office in Irvine, California. The audit was conducted from January 1999 through April 1999 in accordance with generally accepted government auditing standards.

RESULTS OF AUDIT

Generally, MPG billed its special servicing fees in accordance with the terms and conditions of the contract. The two exceptions we noted were related to MPG billings for Category 2 assets (servicing work related to ORE) and for the preparation of certain Loss Letters. For these two fee categories, we identified almost $58,300 in questioned costs. Specifically, MPG inappropriately billed $51,854 for Category 2 account reconciliation and post liquidation work before the effective date of the contract modification that authorized such work. In addition, MPG inappropriately billed $6,400 for Loss Letter work that was covered under the fixed monthly fee portion of the contract.

Additionally, in performing our review of MPG's billings, we identified other matters that we want to bring to FDIC management's attention. Generally, we believe the FDIC could have better planned and administered the MPG contract. Specifically, the FDIC could have:

- better identified its work requirements in the SOW for Category 3 assets,
- reduced contract cost by withdrawing Category 3 asset pools from the contract after award, and
- restructured and extended MPG's contract in a more economical manner.

We believe that had the FDIC more effectively managed and administered the MPG contract, cost savings may have been realized. We recognize that contract changes and savings cannot be made to the MPG contract at this time. However, we believe lessons can be learned from the MPG contract, which will improve the FDIC's management and administration of future contracts.

MPG GENERALLY BILLED THE FDIC ACCORDING TO CONTRACT TERMS

Generally, MPG billed the FDIC in accordance with the provisions of the contract. The contract's terms and conditions required MPG to perform specific tasks for fixed monthly or per task fees. MPG adequately performed these tasks and was responsive to the FDIC's varying needs. Specifically, fixed fee, Category 1, and Category 3 billings submitted by MPG from April 1, 1997 through January 31, 1999 were adequately supported and were consistent with the terms and conditions of the contract.

However, MPG did not always appropriately bill the FDIC for Category 2 asset work or for preparing basic contract Loss Letters. Specifically, MPG billed $51,854 for Category 2 account reconciliation and post asset liquidation work performed before the effective date of the contract modification authorizing such work. Additionally, MPG did not appropriately bill $6,400 for basic contract Loss Letters. These letters should have been prepared at "no cost" because they were covered under the basic contract's fixed monthly fee. Instead, MPG billed these basic contract loss letters using Amendment One contract provisions. In total, we question $58,300 in MPG billings.

MPG IMPROPERLY BILLED FOR CATEGORY 2 ASSET WORK

During the period May 1, 1997 through August 31, 1997, MPG billed Category 2 monthly asset quantities that exceeded the approved asset inventory for two reasons. First, MPG billed account reconciliation work for assets outside the contracted asset inventory. Second, MPG billed the FDIC for work related to assets that had been sold and removed from inventory. Table 2 shows the actual monthly Category 2 asset inventory quantities compared to the asset quantities invoiced by MPG.

Table 2: Category 2 Asset Inventory and Invoiced Quantities Prior to Amendment One

Month	Beginning Inventory	REO Acquisitions	Total Assets	Asset Quantities Invoiced	Difference
May 1997	93	10	103	175	72
June 1997	82	10	92	221	129
July 1997	64	10	74	173	99
August 1997	63	8	71	196	125
Total	**302**	**38**	**340**	**765**	**425**

Source: MPG's Monthly Inventory Reports and Invoices

As show in Table 2, for the period May 1997 through August 1997, MPG billed the FDIC for a total of 425 assets that were not covered under the terms of the contract.

The MPG contract stated that the FDIC would pay MPG a monthly fee of $122.01 per asset for Category 2 assets. The contract defined Category 2 asset as owned real estate generated as a result of the default of an underlying loan. Attachment 6 to the contract identified the initial Category 2 asset inventory. In addition to the initial inventory of Category 2 assets, the contract allowed MPG to bill a monthly fee for each owned real estate asset subsequently added to the MPG contract. The contract allowed MPG to bill the FDIC for assets added to the initial inventory, commencing with the month a particular asset was added.

In April 1997, MPG began receiving receipt and disbursement information from the sub-servicer related to assets that were not included in MPG's initial inventory of Category 2 assets. The subservicer transferred the receipts and disbursements to MPG for account reconciliation work to be performed. However, because these assets were not in MPG's contracted inventory, MPG properly refused to perform account reconciliation tasks for these assets unless the FDIC specifically allowed MPG to include these assets in its monthly Category 2 billings.

In an undated letter submitted with MPG's May 1997 invoice, MPG proposed that it be allowed to bill, as a Category 2 asset, all unsold and sold real estate assets that had FDIC and sub-servicer account balances needing to be researched and cleared. MPG also proposed that for all sold assets it be allowed to bill monthly for up to 60 days after completion of the cash/loss letter. This undated MPG letter included written comments by the DRR oversight manager instructing the DOF technical monitor to confirm whether MPG's proposed letter was ". . . okay with contract language." The DOF technical monitor advised the oversight manager that these accounting tasks were outside the contract terms but it was in the FDIC's best interest to have MPG perform these tasks.

MPG's June 1997 invoice submission included a letter dated July 16, 1997, once again attempting to clarify the Category 2 billing process. In this letter, MPG proposed a second billing method that would allow MPG to bill all active owned real estate and any sold owned real estate for which they received or disbursed funds subsequent to sale. On this letter was a hand written comment by the DRR oversight manager, apparently directed to the DOA contract specialist, indicating that they had discussed this issue. However, there was no mention of exactly how MPG was to bill for tasks that were outside the contract terms.

Ultimately, on September 10, 1997, the contracting officer and MPG signed Amendment One, which specifically added account reconciliation and post liquidation work to the contract. The language in the amendment differed from either of MPG's proposals. The amendment limited the billing period to 60 days for each asset or fund amount. Although the contract amendment apparently resolved the ongoing issue regarding paying MPG for work that was outside the scope of the original contract, a significant problem remained related to the effective date of the amendment. That is, the amendment was made effective on September 10, 1997. However, that was not when MPG began billing for this "out of scope" work.

According to MPG's president, in May 1997 MPG started billing for account reconciliation work related to pre-contract and sold assets. That MPG began billing for these non-contract assets is supported by MPG's legal counsel who told us that in May 1997, while he was the DRR oversight manager for the MPG contract, he verbally instructed MPG to begin billing for these

assets.[3] As we previously stated, we performed a detailed review of Category 2 assets billed for the months of June 1997 and December 1998. The June billing clearly shows that MPG's excessive billings over the approved inventory were due to the account reconciliation work and the post liquidation work. We discussed the billings with a MPG official, who confirmed that what happened in June 1997 started with the May billing.

In explaining why the FDIC paid MPG for work that was not covered by the contract, DOF and DOA personnel told us that the FDIC and MPG understood from the inception of the contract that MPG would perform the reconciliation and post liquidation work and would be compensated per a future amendment to the contract. DOF and DOA personnel also stated that the May 1997 and June 1997 invoice submissions were signed and approved by the contracting officer, thereby implying acceptance by all parties. A DOA official in Dallas further stated that no amendment to the contract was required for the May and June billings because the contracting officer was within his authority to make prompt decisions on contractual questions and problems.

We disagree with the position taken by the Dallas DOA official that the contacting officer's signature on the invoices constituted proper approving for billings outside the scope of the contract. We fully recognize that the FDIC's *Acquisition Policy Manual* (APM) allows, on an as needed basis and with proper authorization, an effective date of a contract (or amendment) prior to the execution date. This provision is appropriate when an approved contracting officer provides a contractor the verbal authorization to begin work before having a fully executed contract in place. However, the APM requires such verbal authorization to be followed up in writing. However, in this case, the verbal authorization was not made by the contracting officer and was not properly followed up with a contract amendment indicating an earlier effective date covering MPG billings. Amendment One provisions authorized MPG to commence account reconciliation and post liquidation work and bill for these tasks starting in September 1997. The FDIC could have made April 1, 1997 the effective date of Amendment One. However, the amendment specifically provided September 10, 1997 as the effective date.

Conclusion and Recommendation

The FDIC should have complied with contracting policy when task changes were provided to MPG. Any verbal authorization to MPG advising it to perform work outside the scope of the contract should have been made by the contracting officer and should have been followed up in writing. However, we found no documentation confirming that the contracting officer authorized MPG to begin working the account reconciliation and post liquidation tasks in May 1997. Further, we do not believe that the contracting officer's signature approving the May and June invoices was sufficient action to support authorization for the Category 2 account reconciliation and post liquidation tasks billed for the period May through August 1997. The contracting officer should have provided a written document delineating acceptance of either MPG's May proposed billing method; MPG's June proposed billing method, or a FDIC alternative billing method. We have no documentation to support the billing method or methods used by MPG or approved by the FDIC for the months of May through August 1997.

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[3] Before being hired as MPG's Legal Counsel, this individual was DRR's oversight manager for the MPG contract from April 1, 1997 through December 4, 1997. The FDIC's Office of Ethics investigated this matter and determined that the former DRR employee could not represent MPG on issues related to the FDIC.

Although we acknowledge that it may have been necessary for the FDIC to have the additional account reconciliation and post liquidation tasks performed, a technical contract violation occurred because tasks performed were not covered by a written contract or amendment. Without specific contract language authorizing the additional Category 2 account reconciliation and post liquidation work prior to September 1997, we have questioned all quantities invoiced over the monthly Category 2 ORE asset inventory quantities for the period of May 1997 through August 1997. We allowed fees for the cumulative Category 2 beginning monthly inventory and acquisition quantities of 340, and questioned the remaining 425 quantities billed. For the 425 assets billed at the $122.01 contract fee, we questioned costs totaling $51,854.

Accordingly, the OIG recommends that the Associate Director, Acquisition and Corporate Services Branch, DOA,

(1) Analyze the fees paid to MPG for account reconciliation and post liquidation work performed without a contract, determine whether these services should be ratified, and determine how much of the $51,854 should be disallowed.

MPG IMPROPERLY BILLED FOR REVISED LOSS LETTERS

In March 1998, MPG improperly billed the FDIC for preparing 14 revised Loss Letters. Specifically, soon after the inception of its contract in April 1997, MPG began preparing contract-required Loss Letters. MPG's reimbursement for these Loss Letters was covered as part of its fixed monthly fee. MPG realized that it had incorrectly prepared 14 Loss Letters in June 1997 and began revising them. Then, in March 1998, MPG billed the FDIC for revising the same 14 Loss Letters that MPG, itself, had prepared incorrectly, almost 1 year earlier. As a result, the FDIC paid MPG almost $6,400 for MPG to correct its own errors.

Shortly after contract award, MPG realized that the FDIC's previous special servicing contractor had incorrectly prepared Loss Letters (at the same time, MPG realized that 14 of its own Loss Letters were prepared in error). Specifically, the previous contractor and MPG mistakenly recognized property tax penalties and related interest and fees as expenses, contrary to provisions in the PSA. To address the problems associated with these incorrect Loss Letters, the FDIC and MPG agreed to allow MPG to revise "historical" Loss Letters that were incorrectly prepared. A contract amendment was agreed to that permitted MPG to bill the FDIC for these revisions. Such an agreement was documented as part of Amendment One to the basic contract. In part, the amendment states, "MPG will identify the inventory of Loss or Cash Letters that were completed after October 1994; review them; and prepare supplementals, as necessary." Although MPG was clearly allowed to bill the FDIC for revising the Loss Letters that were incorrectly prepared by the previous special servicing contractor, we do not believe that MPG should receive additional reimbursement for revising Loss Letters that MPG, itself, incorrectly prepared.

According to MPG's Legal Counsel, when he was the oversight manager for this contract, he instructed MPG to prepare the Loss Letters in the same manner as the previous special servicing contractor. It may be argued, therefore, that MPG is entitled to the additional compensation because the FDIC contributed to MPG's error. We disagree with this potential argument for two

reasons. First, section 5.7.1 of the basic contract required MPG to prepare Loss Letters in accordance with the PSA. Any failure on the part of MPG to prepare the Loss Letters in compliance with the PSA is MPG's responsibility, and MPG should bear the cost. Second, neither MPG's Legal Counsel nor any FDIC officials have yet to provide us any evidence, other than the Legal Counsel's oral statement, that the FDIC provided MPG incorrect guidance.

In addition, although MPG's Legal Counsel said that while he served as MPG's oversight manager he verbally instructed MPG to bill these 14 Loss Letters, the contracting officer never confirmed these instructions by following up with a written authorization, as required by FDIC policy. Finally, we find the timing of MPG's billing interesting. MPG did not actually bill the FDIC for these revisions until almost 1 year after the original work was performed. In fact, the billings did not take place until after the former oversight manager was employed by MPG.

In addressing the issue of MPG's billings of the revised Loss Letters, DRR personnel pointed out that the amendment did not explicitly exclude from reimbursement Loss Letters prepared by MPG. A DRR official stated that these 14 Loss Letters had to be completed a second time because MPG was not instructed by the FDIC to include hazard insurance. Again, we disagree with DRR's position on this matter. First, although we acknowledge that Amendment One did not specifically exclude from reimbursement Loss Letters prepared by MPG, the amendment section addressing Loss Letter reviews is titled "Historical Reconciliations and Reviews." Second, as we previously stated, MPG was required to prepare loss letters in accordance with the PSA and to include sufficient information to easily identify liquidation amounts received and disbursed. Section 2.13 of the MPG contract defined liquidation amounts to include special hazard insurance proceeds. Therefore, the PSA and the contract provided MPG the information necessary for it to correctly prepare the Loss Letters.

Conclusion and Recommendation

The preparation of Loss Letters was covered in the basic contract as part of MPG's fixed monthly fee. Although MPG was clearly entitled to be reimbursed for revising the incorrect Loss Letters prepared by the previous servicer, it is not reasonable for the FDIC to reimburse MPG for correcting its own mistakes.

Accordingly, the OIG recommends that the Associate Director, Acquisition and Corporate Services Branch, DOA,

(2) Disallow $6,400 in questioned costs related to MPG's billing the FDIC for revising Loss Letters that MPG initially prepared in error.

FDIC COULD HAVE BETTER PLANNED AND ADMINISTERED THE CONTRACT

We believe that the FDIC could have better planned and administered the MPG contract. The FDIC program offices involved with this contract should have ensured that the RFP contained sufficient information necessary to meet procurement needs and the FDIC could have more effectively managed contract changes. Specifically, the FDIC could have:

- more clearly identified and delineated the Category 3 work requirements in the SOW during the contract planning process,
- reduced contract cost by withdrawing the Category 3 asset pools from the contract, and
- restructured and extended the MPG contract in a more economical manner.

The FDIC Could Have Better Identified Work Requirements

Prior to awarding the contract to MPG, the FDIC could have better identified contract work requirements within its SOW. In particular, the FDIC could have more clearly delineated to the potential bidders the Category 3 services that were required under the contract. Evidence suggests that MPG did not fully understand the nature of the work required for the Category 3 assets. As a result, MPG bid a fee that appears excessive for the work actually required.

Language in the SOW regarding Category 3 work requirements was vague. Specifically, Section 1.1 of the SOW contained only the following description relating to the Category 3 work requirements: "In addition, there are approximately 32 other REMIC Pools, consisting of approximately 5,400 loans, the loan level servicing of which has been returned to the Trustee under a settlement agreement. These Pools require monitoring of FDIC's interest through review of Trustee reports for compliance with the settlement agreement and reports of review findings to FDIC." We found no other language in the SOW that specifically addressed the Category 3 work requirements. Most importantly, the FDIC did not clearly specify what the phrase "required monitoring" entailed.

We do not believe that the SOW adequately described the monitoring tasks to be performed, the Trustee reports to be reviewed, and the extent of the FDIC's compliance testing and reporting requirements. As we previously stated, the language in the SOW regarding Category 3 work was brief and lacked specificity. We also base our belief that the SOW was not adequate on our analysis of the offerors' bids. The four bids for Category 3 tasks ranged from a low of $5 per month to a high of $1,061 a month. Further, MPG's Category 3 bid of $1,061 was over 300 percent higher than FDIC's own cost estimate of $260 a month for Category 3 work. Table 3 shows the FDIC's procurement case cost estimate and the offerors' bids received by the FDIC in response to the SOW.

Table 3: Comparison of FDIC's Cost Estimate and Offerors' Bids for the RFP

Monthly Fees	FDIC Case Cost Estimate	Offeror #1	Offeror #2	MPG	Offeror #4
Fixed Fee	$41,000	$305,000.00	$40,000	$16,784	$52,000
Category 1	770	2.50	914	878	400
Category 2	820	780.00	648	129	300
Category 3	260	5.00	198	1,061[a]	250
Total	**$2,453,640**	**$4,591,410.00**	**$2,367,816**	**$1,763,004**	**$1,532,400**

Source: TEP analysis contained in DOA contract files.

[a]MPG revised its bid to $968.11 in its Best and Final Offer proposal

Additional evidence that the SOW may not have been adequate was the FDIC's own recognition prior to contract award that MPG had priced the Category 3 fee too high for the work required. In a memorandum, *Addendum to TEP Recommendation,* dated February 19, 1997, the DRR TEP Chairman advised the contract specialist that although Category 3 assets required very little activity except for monitoring, MPG priced its Category 3 work higher than its work on Category 1 assets, where the bulk of the work would be done. The TEP Chairman's memorandum further stated that MPG's proposed Category 3 fees were totally unjustified based on the amount of work required.

MPG's president told us that MPG could not determine the work requirements for Category 3 assets based on the SOW alone. Therefore, MPG called the FDIC and obtained "over the telephone" clarification of the required Category 3 special services. Based on the verbal information received, MPG bid a Category 3 fee based on a staff of five performing a "full loss letter audit" for each pool asset. This loss letter audit was to include a detailed audit of the loan servicer's loan servicing and advance recovery systems.

However, according to MPG's president, immediately after the award of the contract, the FDIC told MPG that the loss letter audits for Category 3 assets would not be performed. Because of an on-going lawsuit filed March 1996 against the FDIC by the loan servicer, neither the FDIC nor MPG had access to the servicer's accounting records needed to perform the loss letter audit. Moreover, an August 1994 settlement agreement between the FDIC and the loan servicer limited the FDIC's audit rights to a review of the servicer's monthly reports. The FDIC had no rights to audit the loan servicing and advance recovery systems as was proposed.

After the award of the contract, MPG immediately recognized the reduced level of effort required for monitoring and reporting on the servicer's activities and canceled the hiring of two persons. MPG reassigned two employees targeted for Category 3 work, to the new Category 1 and 2 Loss Letter work requirements being added to the contract through Amendment One. Ultimately, MPG assigned only one employee to perform the limited work of monitoring and reporting on the servicer's activities relating to Category 3 pools. Thus, in lieu of the five employees that MPG originally envisioned in establishing its Category 3 fee, MPG used only one employee. This MPG employee told us he spent from 2 days to 2 weeks each month performing the Category 3 contracted tasks.

DOF and DOA personnel told us that the variance in bids was not due to a vague SOW, but rather the lack of experience of two of the bidders. The TEP established the competitive range to include only those firms, MPG and Offeror #4, which the panel believed had the necessary experience. They also said that in addition to the original SOW provided as part of the Request for Proposal, the two firms deemed to be in the competitive range were provided Amendment 1 to the SOW, a more detailed SOW covering the Category 3 Assets.

We believe that the bidding differential was attributed to a vague SOW. Although the TEP may have eliminated two bidders from the competitive range because of lack of experience, the Category 3 bids of the two remaining bidders (MPG and Offeror #4) were still far apart. Further, MPG told us that Amendment 1 to the SOW, the more detailed SOW provided to MPG and Offeror #4 during the Best and Final Offer phase, did not address the scope of work for Category 3 assets, but only clarified the definition of Category 3 assets. Our review of the amendment confirmed this statement.

We believe that the difference in bids is attributable to the fact that Offeror #4 was the incumbent contractor performing the Category 3 work at the time the bids were submitted. Therefore, Offeror #4 had a detailed knowledge of the Category 3 work requirements. We believe had the FDIC clearly identified the Category 3 work requirements in the original Request for Proposal or during the Best and Final Offer phase, MPG would have clearly understood that a full loss audit was not required. It is, therefore, likely that MPG would have accordingly reduced its final Category 3 bid to reflect a similar price as Offeror #4's $250 per asset bid and the FDIC's cost estimate of $260 for Category 3 assets, which did not include the full loss letter audit.

As a result of the unclear requirements in the statement of work, we estimate that MPG overpriced the monthly Category 3 fee by 90 percent. MPG based its fixed monthly bid for the Category 3 work on needing five fulltime employees. However, MPG actually only needed the efforts of one employee for approximately 2 weeks out of each month. Based on this 90 percent overpricing, we believe that the FDIC made a total of about $613,400 in unnecessary payments during the period of April 1, 1997 through January 31, 1999.

The FDIC Had Opportunities To Reduce Contract Costs

Even after the FDIC had awarded the contract to MPG, the FDIC had opportunities to reduce the fees paid to MPG for Category 3 work. Immediately after award of the MPG contract on April 1, 1997, the DOA Irvine contracting officer could have coordinated with DRR and DOF to withdraw the Category 3 asset pools from the contract as suggested in the February 19, 1997 TEP memorandum.

When asked about the withdrawal of Category 3 assets, the Irvine DRR oversight manager said the reason immediate attention was not focused on Category 3 tasks after contract award was that the FDIC and MPG placed priority on the Category 1 tasks in order to facilitate the FDIC's efforts to sell the asset portfolio. DOF and DOA personnel stated that the procurement case cited the importance of having all REMIC functions retained in a single, cohesive location and that the FDIC did not have the level and breadth of experience necessary to maintain the varied requirements of the REMIC portfolio.

We disagree with the FDIC's position on these matters. The Category 3 work requirements were vastly different and separate from the Category 1 and 2 work requirements. Category 3 assets also were not part of the portfolio sale initiative. For the Category 3 assets, the FDIC simply needed to monitor and collect outstanding cash advances reported on the general ledger. In February 1997, prior to the MPG contract award, the FDIC had reconciled the cash advance account, had identified applicable variances, and had created spreadsheets to enter the necessary monthly data reported and received from the servicer to monitor the reimbursement of the cash advances.

DOF and DOA acknowledged that from its inception the MPG contract contained a 30-day notice for withdrawal of any or all assets. DOF and DOA also provided us with a copy of the bidders Questions and Answers where the FDIC told the bidders that the FDIC would not pay a termination fee for the premature withdrawal of any category of loans. The FDIC informed the bidders that they were to bid based on the possibility that a specific asset category could be withdrawn at any time.

On February 16, 1999, the FDIC took what we believe was appropriate action and withdrew Category 3 asset pools from the MPG contract effective February 1, 1999. DOF is currently performing the Category 3 work in-house. DOF's financial manager told us that DOF is still assessing its staffing needs for the work but the requirement would be less than 2 weeks each month for one employee.

The FDIC Could Have Restructured The MPG Contract In A Manner That Was More Economical

The FDIC could have changed the Category 1 work requirements and extended the MPG contract in a more economical manner. Specifically, we believe the FDIC should have followed its approved JNCP, which authorized moving the asset pools related to Loans Serviced for Others (LSFO) to the new Dallas DOF 5-year joint venture contract. Instead, FDIC management moved the REMIC pools (rather than the LSFO pools) to the new Dallas DOF contract and MPG began billing the complex REMIC pools on an hourly-rate basis instead of the MPG contracted fixed monthly fee basis. Accordingly, we believe the FDIC will pay MPG more in fees than it would have paid had the approved JNCP been followed.

The JNCP that Dallas DRR and DOF management approved on February 16, 1999, authorized the removal of 42 Category 1 LSFO pools from the MPG contract, and extended the period of performance to December 31, 1999. However, instead of following the JNCP, the contract administration team removed 8 LSFO pools and 34 Category 1 REMIC pools from the MPG contract. All 42 of these pools were transferred to the new Dallas 5-year joint venture contract managed in part by MPG.

As is supported by language in the JNCP, it is generally accepted that the LSFO pools are easier to work than the more complex REMIC pools. In fact, MPG's records show that during the course of its contract it had two people directly working on the 42 LSFO pools and five people directly working on the 34 REMIC pools. However, under the MPG contract, the FDIC pays the same monthly fixed fee for the LSFO pools as for the REMIC pools. Therefore, because the REMIC pools required three more employees than the LSFO pools for a similar workload, we estimate that the FDIC will pay MPG approximately $214,000 more by shifting the more complex REMIC pools to the new Dallas joint-venture contract. We based our estimate on the monthly cost per employee of approximately $6,512 included in the JNCP cost estimate. Because the 34 LSFO pools required only two-MPG employees, we believe that three of the five MPG employees would not have been necessary for the 11-month period February 1, 1999 thorough December 31, 1999.

In explaining why they did not follow the JNCP, the FDIC's contract administration team stated that there was concern that the FDIC would not sell the portfolio in October 1999. The DRR oversight manager stated that if the sale was unsuccessful in October 1999, the FDIC would continue to need MPG's experienced staff to work the REMIC pools after December 31, 1999. In order to provide the experienced employees with a more secure work environment, the FDIC placed the REMIC work under the new 5-year joint venture contract. The OIG believes that it is likely that the FDIC has qualified staff, currently managing and overseeing the MPG contract, that could complete the REMIC work when MPG's contract expires.

CONCLUSION

We believe that in addition to specific questioned costs identified in this report that need to be addressed by FDIC management, there are lessons that can be learned from this procurement. It is important to note that the FDIC has policies and procedures in place to guide and direct its staff in effectively establishing, administering, and overseeing contracts. For example. the FDIC's *Acquisition Policy Manual* points out the importance of developing a clear, concise, well thought out SOW and a complete and adequate requirements package. Moreover, the manual also provides sufficient guidelines for processing contract changes. Nevertheless, we believe that there were problems with this procurement from the outset. Such problems occurring, in an environment of adequate policies and procedures, illustrate the need for FDIC management to carefully monitor all procurements.

CORPORATION COMMENTS AND OIG EVALUATION

On March 13, 2000, the Associate Director of DOA's Acquisition and Corporate Services Branch provided a written response to recommendations addressed to him in a draft of this report. In addition, the Deputy Director of the Dallas Field Operations Branch, DRR, and Deputy Director of the Field Finance Center, DOF, provided written responses on February 23, 2000 and February 28, 2000, respectively. All three responses are presented in appendix I of this report. A summary of the responses to the draft and our analysis follows.

Analyze the fees paid to MPG for account reconciliation and post liquidation work performed without a contract, determine whether these services should be ratified, and determine how much of the $51,854 should be disallowed (recommendation 1): Both the Associate Director, DOA, and the Deputy Director, DRR, disagreed with the recommendation. The Associate Director, DOA, stated that "DOA staff believes that the work billed between April 1997 and September 1997 was within the scope of the original agreement and our documentation supports this mutual understanding of the definition of Category 2 assets." We have discussed this matter, at length, with DOA personnel throughout the audit, and we continue to disagree with the Associate Director's position on this matter. Although the nature of the work billed during the period in question was covered by the contract, the asset quantities billed were not. As we previously stated, attachment 6 to the contract identified the initial Category 2 asset inventory and the contract allowed MPG to bill a monthly fee for each owned real estate asset subsequently added to the contract. However, the 425 asset quantities that we questioned were not in the contracted inventory and, therefore, were not covered by the contract until the signing of Amendment One, in September 1997.

The DRR Deputy Director's argument follows a line of reasoning similar to that of the Associate Director but he adds that "Both the oversight manager and technical monitor signed off on the monthly invoices which included the expenses for the months prior to the amendment which verifies that they were in agreement to pay MPG for this work." Our position on this matter remains the same. We do not believe that the contracting officer's signature on an invoice constituted the proper approving of work outside the scope of the contract.

We recognized in our conclusion to this finding that the additional work billed by MPG may have been necessary. That is why we treated this matter as a technical contract violation and recommended that the FDIC ratify the fees paid that it believes were appropriate. We continue to believe that our recommendation has merit.

The Corporation's response provided us with the requisite elements of a management decision for the recommendation. Although we do not agree with management's decision, we do not believe the disagreement is significant.

Disallow $6,400 in questioned costs related to MPG's billing the FDIC for revising Loss Letters that MPG initially prepared in error (recommendation 2): Both the Associate Director, DOA, and the Deputy Director, DRR, disagreed with the recommendation. The Associate Director's position is that MPG prepared the 14 Loss Letters incorrectly based on the data available and at the direction of the Oversight Manager. He also said that "The Oversight Manager was aware the loss letters were not as complete as they could be, but wanted to complete the loss letters with what information was available and re-do them later, if necessary." Again, the DRR Deputy Director's argument is similar.

We reviewed the oversight files and interviewed the cognizant Oversight Manager at length, but found no evidence to support the statement that Oversight Manager knowingly instructed MPG to prepare the Loss Letters incorrectly. Further, the Associate Director's statement that MPG did not have access to the third-party servicer's monthly reports is not relevant to our finding. MPG's error involved improperly recognizing in the Loss Letters property tax penalties and related interest and fees as expenses, contrary to the PSA. Upon a closer reading of the PSA, MPG realized that both MPG and the previous special servicing contractor had incorrectly prepared the letters. As a result, Amendment One was added to the contract, which allowed MPG to correct "Historical Loss Letters." Having represented themselves as experts in the field of special servicing, we believe that MPG should have borne the cost of incorrectly preparing their Loss Letters.

We acknowledged in the report that the contract amendment referring to the revision of Loss Letters did not specifically exclude letters prepared by MPG. Our position is simply that the FDIC should not pay MPG for correcting its own mistakes.

The Corporation's response provided us with the requisite elements of a management decision for the recommendation. Although we do not agree with management's decision, we do not believe the disagreement is significant.

Appendix II presents management's proposed actions on OIG recommendations and shows that we have management decisions for the two recommendations in this report.

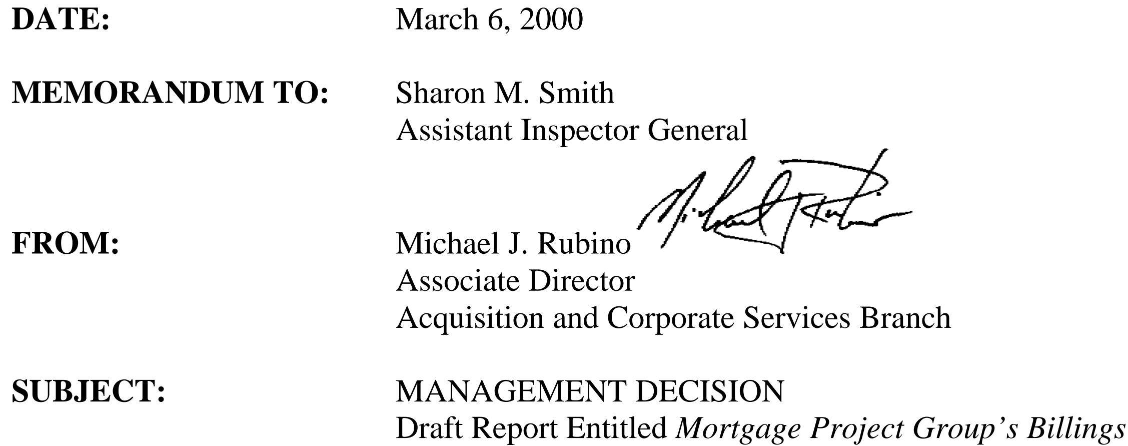
Based on our work, the OIG will report questioned costs of $58,254 in its *Semiannual Report to the Congress.*

APPENDIX I

CORPORATION COMMENTS

FDIC

Federal Deposit Insurance Corporation
Washington, D.C. 20429 Division of Administration



DATE: March 6, 2000

MEMORANDUM TO: Sharon M. Smith
Assistant Inspector General

FROM: Michael J. Rubino
Associate Director
Acquisition and Corporate Services Branch

SUBJECT: MANAGEMENT DECISION
Draft Report Entitled *Mortgage Project Group's Billings*

The Acquisition and Corporate Services Branch (ACSB) has completed its initial review of the subject Office of Inspector General (OIG) draft report. Our review focused on the recommendations in the report that would be entered into the Internal Review Information System (IRIS). The management decision is presented in three parts: (1) the Executive Summary; (2) Management Decision detail; and (3) a Summary of the Management Decisions Table.

EXECUTIVE SUMMARY

The following table represents an overview of the management decision. A more comprehensive summary of the decision that details specific areas of agreement or disagreement with the findings and describes necessary corrective actions, including milestone dates follows.

Finding #	Finding Description	Questioned Costs	Management Response	Recovery Amount	Difference
1	MPG improperly billed for Category 2 asset work	$ 51,854	Disagree	$ 0	$51,854
2	MPG improperly billed for revised loss letters	$ 6,400	Disagree	$0	$6,400

MANAGEMENT DECISION

FINDING # 1: MPG improperly billed for Category 2 asset work

CONDITION: OIG concluded that MPG billed $51,854 for Category 2 account reconciliation and post asset liquidation work performed before the effective date of the contract modification authorizing such work.

RECOMMENDATION: The Associate Director, DOA, should analyze the fees paid to MPG for account reconciliation and post liquidation work performed without a contract, determine whether these services should be ratified, and determine how much of the $51,854 should be disallowed.

MANAGEMENT DECISION: We disagree with the recommendation. DOA staff believes that the work billed between April 1997 and September 1997 was within the scope of the original agreement and our documentation supports this mutual understanding of the definition of Category 2 assets. The work subsequent to that period was a significant departure and enlargement of the original statement of work, which required new pricing. The change also instituted a limitation on how long MPG could bill accounting work on sold REO and created an automatic Category 2 Asset withdrawal mechanism.

CORRECTIVE ACTION: It is our position that the Category 2 account reconciliation and post asset liquidation work performed between April 1997 and September 1997 were within the scope of the original contract. Therefore, no ratification and/or disallowance should be necessary.

FINDING # 2: MPG improperly billed for revised loss letters

CONDITION: OIG concluded that MPG did not appropriately bill $6,400 for basic contract loss letters. The OIG believes the letters should have been prepared at "no cost" because they were covered under the basic contract's fixed monthly fee.

RECOMMENDATION: The DOA Regional Manager should disallow $6,400 in questioned costs related to MPG's billing the FDIC for revising Loss Letters that MPG initially prepared in error.

MANAGEMENT DECISION: We disagree with the recommendation. MPG did not inappropriately bill FDIC $6,400 for duplicate Loss Letters. Therefore, no further action is required and recovery is not warranted.

The Contractor prepared the 14 Loss Letters with the data available at the time at the direction of the Oversight Manager. The Oversight Manager was aware the loss letters were not as complete as they could be, but wanted to complete the loss letters with what information was available and re-do them later, if necessary. The Contractor documented the unavailable data in its Project Plan, attached as Attachment 1 to Amendment #1 of the Agreement. MPG proposed corrective action, which the FDIC acknowledged and accepted. This Plan acknowledged that MPG did not have access to the third-party Servicer's (Wendover) monthly open and expired item report that detailed exceptions on a asset level. A contractor cannot be held responsible for circumstances beyond its control. FDIC acknowledged the Contractor's inability to access data, accepted the corrective action, and acted accordingly to obtain the data and compensated the Contractor for the work performed.

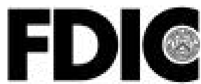
CORRECTIVE ACTION: FDIC staff required that the Loss Letters be redone later when adequate information was available to the Contractor. Therefore, no corrective action is necessary.

cc: David McDermott
Howard Furner
Andrew Nickle
Mary Rann
Freddie Cook
Sandra West, Dallas

EXHIBIT A

SUMMARY OF ACQUISITION SERVICES BRANCH MANAGEMENT DECISIONS

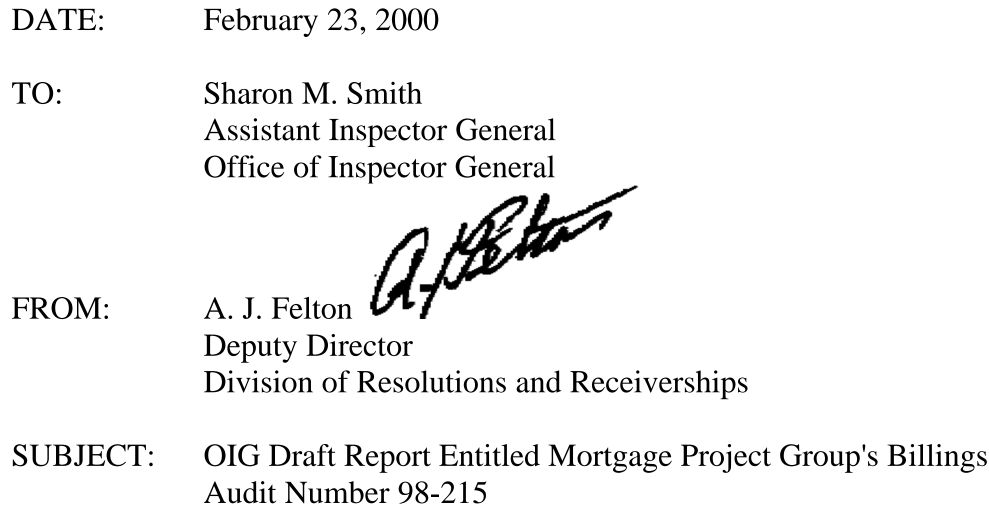
NO.	FINDING DESCRIPTION	QUESTIONED COST/OTHER FINANCIAL ADUSTMENT	MANAGE-MENT RESPONSE	DESCRIPTION OF CORRECTIVE ACTION	EXPECTED COMPLETION DATE	DOCUMENT VERIFYING COMPLETION
1	MPG improperly billed for Category 2 asset work	$ 51,864	Disagree	CORRECTIVE ACTION: We believe that OIG incorrectly interpreted this provision of the contract. Therefore, no corrective action is necessary. .	N/A	N/A
2	MPG improperly billed for revised loss letters	$6,400	Disagree	CORRECTIVE ACTION: We believe that OIG incorrectly interpreted this provision of the contract. Therefore, no corrective action is necessary	N/A	N/A



Federal Deposit Insurance Corporation
1910 Pacific Avenue, 2nd floor, Dallas, TX 75201

DATE: February 23, 2000

TO: Sharon M. Smith
Assistant Inspector General
Office of Inspector General



FROM: A. J. Felton
Deputy Director
Division of Resolutions and Receiverships

SUBJECT: OIG Draft Report Entitled Mortgage Project Group's Billings
Audit Number 98-215

We have reviewed the final draft of the subject audit dated January 14, 2000. I have restated the recommendations followed by our responses. Your report includes:

Recommendation 1.) Analyze the fees paid to MPG for account reconciliation and post liquidation work performed without a contract, determine whether these services should be ratified, and determine how much of the $51,854 should be disallowed.

The OIG is questioning $51,854, which was paid to MPG for account reconciliation and post liquidation tasks performed on assets between May 1997, and September 1, 1997 when both parties allowing reimbursement for this work signed an amendment. The OIG acknowledges that this work was necessary but that a technical contract violation occurred because the tasks were not covered in the contract or an amendment. MPG sent a letter to FDIC with the May billing asking for approval to reimburse the contractor for this work and this letter was discussed by the DRR oversight manager and DOF technical monitor Both the oversight manager and technical monitor signed off on the monthly invoices which included the expenses for the months prior to the amendment which verifies that they were in agreement to pay MPG for this work These actions were essential to the continuous operation. It is FDIC's position that the work performed was covered by the contract and that approval of the invoices by the Oversight Manager and the Contracting Officer was proof of that understanding Therefore there is not a valid reason to request reimbursement from the contractor for work performed for, and approved by, the oversight manager. DRR Management feels no further action is warranted

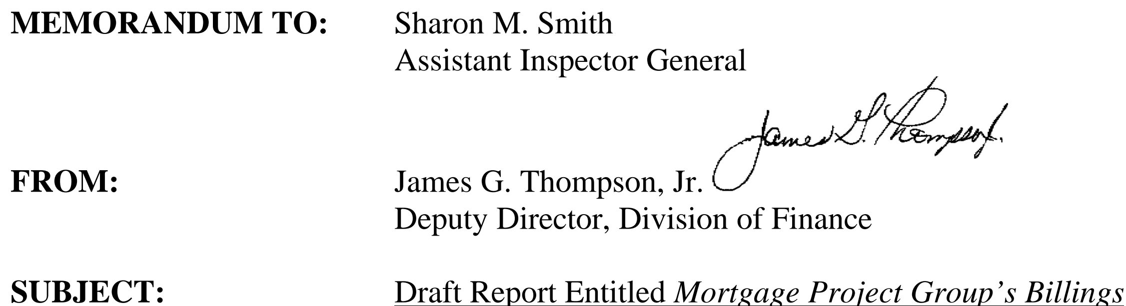
Recommendation 2.) Disallow $6,400 in questioned costs related to MPG's billing the FDIC for revising Loss Letters that MPG initially prepared in error.

The OIG is questioning $6,400 that was paid to MPG for loss letters that had to be completed a second time. MPG was verbally instructed by the FDIC oversight manager to complete the loss letters the same way as the previous contractor. Unfortunately, the previous contractor and the oversight manager were not aware of some of the provisions of the PSA and as a result, MPG

had to complete some of the loss letters a second time. The amendment to the contract indicates that MPG will be paid $457 for revising the incorrect loss letters and there is no mention that the incorrect loss letters had to be completed by the former contractor. It is clear that MPG completed the loss letters in question and the actions were requested and approved by the oversight manager, therefore, the contractor was entitled to be paid. DRR Management feels no further action is warranted.

James G. Thompson, Jr.
Deputy Director
350 N. St. Paul, Suite 18110
Dallas, Texas 75201

February 28, 2000



MEMORANDUM TO: Sharon M. Smith
Assistant Inspector General

FROM: James G. Thompson, Jr.
Deputy Director, Division of Finance

SUBJECT: Draft Report Entitled *Mortgage Project Group's Billings*

In response to the draft report referenced above, I have reviewed the recommendations and the draft responses provided to you by DRR and DOA. The responses indicate that no further corrective actions will be taken on these items. I concur and I have no further comments at this time.

If you have any questions concerning DOF, please advise.

Cc: Michael J. Rubino
A. J. Felton

APPENDIX II

MANAGEMENT RESPONSES TO RECOMMENDATIONS

The Inspector General Act of 1978, as amended, requires the OIG to report the status of management decisions on its recommendations in its semiannual reports to the Congress. To consider FDIC's responses as management decisions in accordance with the act and related guidance, several conditions are necessary. First, the response must describe for each recommendation

- the specific corrective actions already taken, if applicable;
- corrective actions to be taken together with the expected completion dates for their implementation; and
- documentation that will confirm completion of corrective actions.

If any recommendation identifies specific monetary benefits, FDIC management must state the amount agreed or disagreed with and the reasons for any disagreement. In the case of questioned costs, the amount FDIC plans to disallow must be included in management's response.

If management does not agree that a recommendation should be implemented, it must describe why the recommendation is not considered valid. Second, the OIG must determine that management's descriptions of (1) the course of action already taken or proposed and (2) the documentation confirming completion of corrective actions are responsive to its recommendations.

This table presents the management responses that have been made on recommendations in our report and the status of management decisions. The information for management decisions is based on management's written response to our report and subsequent discussions with management representatives.

Rec. Number	Corrective Action: Taken or Planned/Status	Expected Completion Date	Documentation That Will Confirm Final Action	Monetary Benefits	Management Decision: Yes or No
1	FDIC management did not agree with the recommendation stating that the billings questioned were within the scope of the original contract.	Not Applicable	Management Responses	None	Yes
2	FDIC management did not agree with the recommendation stating that the contractor prepared the 14 Loss Letters in question with data available at the time at the direction of the Oversight Manager.	Not Applicable	Management Responses	None	Yes