
**AUDIT OF SHELTER COVE PROPERTY MANAGEMENT
CONTRACTS**

Audit Report No. A99-003
January 11, 1999



OFFICE OF AUDITS

OFFICE OF INSPECTOR GENERAL

DATE: January 11, 1999

TO: A. J. Felton, Deputy Director
Dallas Field Operations Branch
Division of Resolutions and Receiverships

Kenneth Gorham, Regional Manager
Division of Administration
Dallas Regional Office



FROM: Carl S. Mays
Regional Director

SUBJECT: *Audit of Shelter Cove Property Management Contracts* (Audit Report No. A99-003)

This report presents the results of an audit of the Federal Deposit Insurance Corporation's (FDIC) property management contracts awarded for Shelter Cove, a recreational vehicle condominium park located in Osceola County, Florida. The FDIC contracted with The Hilton Group Company (Hilton) to manage Shelter Cove under contract 97-00142N-C2. The Office of Inspector General (OIG) conducted this audit at the request of the Division of Administration (DOA), Atlanta Regional Office.¹

BACKGROUND

The FDIC's Orlando Consolidated Office acquired Shelter Cove in July 1993 by foreclosing on three loans to Shelter Cove's developer from the Park Bank of Florida, St. Petersburg, Florida. Park Bank failed in 1986 and the FDIC, in its corporate capacity, purchased the Park Bank assets—including the Shelter Cove loans—that Park Bank's acquiring institution did not buy. Shelter Cove consisted of 1,244 recreational vehicle lots (most of which were undeveloped), common areas, and other amenities located on approximately 154 acres plus an undeveloped 38-acre tract. Upon foreclosure of the Shelter Cove loans, the FDIC acquired the title to 1,082 of the recreational vehicle lots of which only 118 were developed. The FDIC also acquired the

¹Effective June 30, 1997, the FDIC transferred the management of Shelter Cove to the Division of Resolutions and Receiverships in Dallas, Texas, and the administration of Shelter Cove's property management contracts to DOA in Dallas, Texas.

responsibility for Shelter Cove's (1) water-treatment plant and distribution system; (2) sanitary and sewer system, including the waste-treatment plant and collection system; and (3) electric-distribution system as well as a portion of its common areas.

Because of problems with Shelter Cove's water and sewer systems, the magnitude of required repairs and maintenance, and concerns expressed by Shelter Cove's site owners, the Circuit Court of Osceola County, Florida, appointed a receiver on January 5, 1990. The court-appointed receiver's role was to monitor activities at Shelter Cove and protect the site-owners' interests. After Shelter Cove's lot owners notified the court that they believed the receiver had not protected their interests, the court replaced the receiver on February 22, 1994, with a new receiver. The new receiver served as chairman of the homeowners' association, billed and collected homeowners' association fees and electrical fees, and maintained parts of the common areas. Accordingly, the FDIC shared the management of Shelter Cove with the court-appointed receiver for the entire period that it owned Shelter Cove.

The decision to foreclose on the loans and acquire Shelter Cove in its corporate capacity created additional responsibilities for the FDIC. Specifically, in addition to acquiring Shelter Cove's unsold lots, the FDIC also acquired the responsibility to

- repair and maintain substandard water, sewer-treatment, and electric-distribution systems;
- resolve environmental concerns related to wetlands, underground petroleum storage tanks, and 55-gallon drums located on the property;
- pay delinquent and future real estate taxes; and
- maintain parts of the common areas.

To satisfy those responsibilities, the FDIC executed a contract with Hilton on July 22, 1993, to manage the property. Hilton's contract authorized payment for property management services based on an hourly rate and reimbursement of expenses. The FDIC awarded Hilton a new contract for 1 year on November 29, 1993. Additional contract extensions continued the contractual relationship with Hilton through March 31, 1998. Beginning with the November 29, 1993, contract, the FDIC paid Hilton a fixed property management fee of \$5,000 per month. Hilton used various subcontractors to maintain and repair Shelter Cove's common areas and water, sewer, and electrical facilities. The FDIC paid Hilton and its subcontractors for property management fees and repair and maintenance expenses either directly or through an operating account established in Hilton's and the FDIC's names with Hilton controlling the account.

On October 16, 1997, the FDIC began negotiations with the court-appointed receiver to terminate the FDIC's ownership and involvement in Shelter Cove. Specifically, the FDIC proposed that it

- transfer ownership of 1,082 lots and its interest in Shelter Cove's water, sewer, and electrical systems and common areas to the homeowners' association;

- forfeit any claim against the \$250,000 held in the homeowners' association treasury;
- pay \$40,000 to the homeowners' association; and
- keep the 38-acre undeveloped section of Shelter Cove.

The Circuit Court of Osceola County, Florida, approved the FDIC's settlement agreement, which was effective on July 29, 1998.

OBJECTIVES, SCOPE, AND METHODOLOGY

The audit objective was to determine whether Hilton's billings were adequately supported and in accordance with the contract terms. During the audit, we expanded the scope to determine whether (1) Hilton's subcontractors billed within the terms of the contract and maintained adequate support and (2) the FDIC's corporate purchase of Shelter Cove complied with FDIC policy.

To accomplish the objectives, we interviewed FDIC officials in the Division of Resolutions and Receiverships (DRR) in Dallas, Texas; DOA in Atlanta, Georgia, and Dallas, Texas; and Legal Division in Washington, D.C. Specifically, we obtained information regarding the FDIC's (1) on-going discussions with Hilton to resolve differences regarding miscellaneous expense billings, (2) acquisition of Shelter Cove, and (3) efforts to relinquish its interest in Shelter Cove to its homeowners' association. In addition, we reviewed DOA contract files, DRR property management files, and Legal Division correspondence.

To assess the FDIC's corporate purchase of Shelter Cove, we reviewed the foreclosure case and other documentation regarding the Corporation's decision to foreclose on the Shelter Cove loans. We also reviewed the FDIC's policy as of the foreclosure date regarding acquiring properties with environmental issues as well as current policies addressed in the FDIC's *Termination Manual*, *Asset Disposition Manual*, and applicable memoranda.

We reviewed the FDIC's property management contracts with Hilton to determine whether the services billed were allowable and properly documented. We also reviewed Hilton's contract files to obtain information on the proposals, agreements, and contracts between Hilton and its subcontractors to determine whether their billings were allowable and properly documented. To evaluate Hilton's and its subcontractor's billings, we reviewed information obtained from the FDIC's Division of Finance (DOF) and Hilton's contract files and developed a database consisting of invoice numbers and dates, services performed, and amounts billed. We selected a judgmental sample of 79 invoices representing \$595,074 (about 48 percent) of the \$1,238,527 billed by subcontractors. We based our selection on the amounts billed and the types of services performed.

Our review of Hilton's property management fee billings was limited to comparing the monthly billings to the fixed monthly fee allowed by contract terms. We also reviewed miscellaneous

expenses totaling \$15,913 that Hilton billed to determine whether they were allowable and adequately supported. In addition, we interviewed Hilton and nine subcontractors who provided services at Shelter Cove to obtain documentation supporting their billings.

Finally, we obtained information on the amount that the FDIC paid for homeowners' association fees, property taxes, and legal fees to outside counsel to determine the Corporation's total expenditures related to its ownership of Shelter Cove. However, they were mostly fixed expenses and we did not review them in detail. For example, homeowners' association fees were a fixed monthly amount per lot times the number of lots that the FDIC owned. Table 1 shows the total amounts paid by the FDIC and the amounts that we reviewed.

Table 1: Analysis of the Total Amounts Paid and Reviewed

Category	Amount Paid by FDIC	Amount Reviewed by OIG
Management fees ^a	\$ 276,825	\$276,825
Miscellaneous expenses	15,913	15,913
Subcontractor fees	1,238,527	595,074
Other expenses ^b	1,562,997	0
Total	\$3,094,262	\$887,812

^aOur review of Hilton's property management fees was limited to determining whether they agreed with the fixed monthly amount allowed by the contracts.

^bOther expenses consisted of FDIC's bid at foreclosure, homeowners' association fees, legal fees, property taxes, the FDIC's disposition fee, and other miscellaneous expenses such as one-time payments to Shelter Cove residents.

Source: OIG analysis of Hilton's contract files and the FDIC's DRR contract files, DOF accounting records, and Legal Division correspondence.

We did not evaluate Hilton's system of internal controls because we concluded that the audit objectives could be met more efficiently by conducting substantive tests rather than placing reliance on the internal control system. The OIG conducted the audit from December 1997 through August 1998 in accordance with generally accepted government auditing standards.

RESULTS OF AUDIT

We questioned \$68,633 of billings that we reviewed because they were not in accordance with the terms of the contract or not adequately supported. Specifically, we questioned \$12,201 that Hilton billed for miscellaneous expenses and \$56,432 that Hilton's subcontractors billed for repair and maintenance services. We also questioned Hilton's retention of \$6,000 in funds that remained in the operating account established by the FDIC. We did not question any of Hilton's property management fees because they were based on fixed monthly amounts and complied with contract terms.

Although it complied with applicable FDIC policy, the FDIC's acquisition of Shelter Cove was costly to the Corporation. The FDIC, in its corporate capacity, paid a total of \$3,094,262 to acquire, maintain, and dispose of Shelter Cove and ultimately deeded the majority of the

property to the Shelter Cove homeowners' association at no cost to the association. The Corporation retained a 38-acre undeveloped tract of the property for which it received \$125,000 upon disposition.

Based on our audit, we recommend that the Deputy Director, Dallas Field Operations Branch, DRR, and the Regional Manager, Dallas Regional Office, DOA, disallow questioned costs totaling \$74,633.

UNALLOWABLE MISCELLANEOUS EXPENSES BILLED BY HILTON

Hilton billed the FDIC and received payment for \$15,913 of miscellaneous expenses from July 1993 through December 1997, of which \$15,346 was unallowable. Of the \$15,346 in unallowable expenses, the FDIC had questioned \$3,145 billed during 1997 and Hilton had reimbursed that amount. Accordingly, we questioned the remaining \$12,201. Except for the initial agreement from July 22, 1993, to November 28, 1993, Hilton's contract specifically prohibited the billing of miscellaneous expenses. For that initial period, the contract stated that the FDIC would reimburse all out-of-pocket expenses, and Hilton billed the FDIC \$567 in miscellaneous expenses for that period.

For the period November 29, 1993, through December 31, 1995, Hilton's contract prohibited the following expenses:

- office equipment and supplies other than those located at the property and used exclusively for the property;
- overhead incurred in the property manager's general offices;
- accounting, bookkeeping, legal reporting, copying, electronic data processing, and legal;
- executive and supervisory personnel compensation;
- matters unrelated to the property; and
- leasing of space or sale of the property.

Hilton's contracts with the FDIC for February 1, 1996, through March 31, 1998, stated:

“The Monthly Management Fee shall include all costs of doing business. No other costs will be reimbursed by the FDIC to the Property Manager, except for Property related operational expenses as provided in the approved operating budget for the Property.”

In addition, Article IV of the 1997 contract stated:

“This fixed price includes any and all of Contractor’s costs and expenses, direct and indirect, as well as any profit, fee or any markups of any nature.”

Miscellaneous expenses that Hilton billed to the FDIC included charges for telephone calls, copying, postage, and office supplies. Although the property management contract prohibited the billing of those expenses, the FDIC reimbursed Hilton for those charges from December 1993 through September 1997. The FDIC later questioned \$3,145 of miscellaneous expenses that it paid for 1997 and successfully recovered those funds from Hilton. However, the FDIC had not requested Hilton to reimburse the Corporation for the miscellaneous expenses billed and paid for December 1993 through December 1996. In addition, the FDIC officials could not explain why the Corporation had not requested reimbursement for those expenses. Accordingly, we questioned \$12,201 in unallowable miscellaneous expenses.

In addition, an outside audit performed at the FDIC’s request for the period August 1, 1995, through December 31, 1996, determined that Hilton never incurred over \$4,000 of the miscellaneous expenses billed. Specifically, Hilton billed the FDIC in November 1995, December 1995, November 1996, and December 1996 for expenses identified as “excess billing for year end reconciliation of purchase order.” Hilton billed those amounts to show the expenditure of the total amounts in Shelter Cove’s annual budgets for those years. However, the FDIC did not follow up on the audit finding and those amounts are included in the \$12,201 of miscellaneous expenses that we questioned.

Hilton’s president stated that he billed miscellaneous expenses based on his interpretation of the contract, the FDIC’s practice of paying miscellaneous expenses that he billed from 1993 through 1996, and FDIC purchase orders that included miscellaneous operating expenses. He stated that he considered the FDIC’s payment of miscellaneous expenses billed through 1996 to be authorization to bill miscellaneous expenses in 1997. He also said that because FDIC purchase orders included line items for miscellaneous expenses, they were allowable up to the specified ceiling amounts. However, DOA officials stated that the miscellaneous expenses included in Shelter Cove’s budgets related to costs directly attributable to the operation of Shelter Cove rather than to operating expenses of Hilton’s office. Although DOF officials informed Hilton that miscellaneous expenses were not allowable, Hilton continued to bill for them.

UNALLOWABLE AND UNSUPPORTED BILLINGS BY HILTON’S SUBCONTRACTORS

Of the \$595,074 in Hilton’s subcontractor billings that we reviewed, we questioned \$56,432 because the subcontractors billed unallowable amounts or did not maintain documentation to support their billings. In addition, the subcontractors did not maintain documentation to support an additional \$71,787 of those billings for the period July 1993 through January 1996. However, we did not question those billings because neither the FDIC nor Hilton required that subcontractors retain support for services performed during that period. Of the \$56,432 that we

questioned, \$53,510 was unsupported. The remaining \$2,922 was unallowable and included \$2,072 for markups, \$425 for duplicate charges, and \$425 for mathematical errors.

On February 1, 1996, the FDIC included controls in Hilton's contract that required the submission and verification of subcontractor invoices. Specifically, the controls required Hilton to discuss reimbursement requirements with its subcontractors, ensure that each subcontractor complied with applicable FDIC contract requirements, and make adjustments to subcontractor invoices to comply with the FDIC requirements. However, the subcontractors continued to submit invoices without supporting documentation, and Hilton continued to pay the invoices.

Hilton's president stated that his priority was to ensure that emergencies occurring at the property were resolved in a timely manner. He stated that promptly paying the subcontractors ensured their willingness to continue providing services at Shelter Cove. He added that he verified many of the subcontractor services through on-site visits to Shelter Cove.

DRR officials stated that the FDIC relied on Hilton, as it does with all contractors, to ensure that subcontractors actually performed the services and billed in accordance with contract terms and conditions. They added that many of the subcontractors' services performed at Shelter Cove, such as mowing grass and removing debris, did not lend themselves to the maintenance of detailed documentation to support the billings.

OPERATING ACCOUNT FUNDS NOT RETURNED TO THE FDIC

Hilton refused to return \$6,000 remaining in the operating account established for Shelter Cove by the FDIC when its property management contract expired on March 31, 1998. Hilton's president believed that the FDIC owed that amount for 1997 miscellaneous expenses. Although Hilton and FDIC officials held numerous discussions regarding whether those expenses were allowable and the FDIC directed Hilton to return the operating account funds to the FDIC, Hilton refused. In fact, Hilton's president stated to the OIG that he did not intend to return the operating account funds to the FDIC. We believe that Hilton is not entitled to miscellaneous expenses and, therefore, question the \$6,000 in funds retained by Hilton.

Although DOA issued demand letters requesting Hilton to return the \$6,000, Hilton refused to return the operating account funds. Accordingly, during our exit conference with DRR officials on July 15, 1998, we suggested that DRR should coordinate with DOF to obtain the \$6,000 directly from the financial institution where the operating account was established. On July 30, 1998, the FDIC received the \$6,000 from the financial institution.

THE FDIC'S PURCHASE OF SHELTER COVE COMPLIED WITH POLICY BUT WAS COSTLY

Although the FDIC complied with its policy governing the assessment of real estate assets for foreclosure, the FDIC's acquisition of Shelter Cove was costly to the Corporation. The FDIC

paid a total of \$3,094,262 over a 5-year period to acquire, maintain, and dispose of Shelter Cove but received only \$125,000 in return.

The FDIC's Division of Liquidation² *Credit Manual* contained the FDIC policy for the purchase of real estate assets at the time that the FDIC foreclosed on the Shelter Cove loans and assumed ownership of Shelter Cove. The manual required the FDIC to

- conduct a complete environmental evaluation prior to foreclosure should evidence of potential environmental hazards become known and
- limit foreclosure bids to 85 percent or less of the appraised property value making allowances for taxes, insurance, legal fees, maintenance, and other expenses associated with ownership of the property.

Before foreclosing on the Shelter Cove loans, the FDIC contracted with an environmental and engineering services firm to evaluate Shelter Cove. The firm identified several environmental problems and made recommendations to bring Shelter Cove's sewage and water treatment facilities into compliance with Florida Department of Environmental Protection (FDEP) regulations. Based on those recommendations, the FDIC limited its foreclosure bid to no more than 70 percent of the appraised value after deducting real estate taxes, the environmental study cost, and estimated environmental cleanup costs.

Since 1993 when the FDIC foreclosed on Shelter Cove, the Corporation has strengthened its policies regarding the assessment and acquisition of properties involving environmental issues. For instance, the FDIC's *DRR Asset Disposition Manual* requires account officers to (1) perform thorough analyses of legal, financial, and physical aspects of properties and (2) determine whether to hold, abandon, or market such assets. It further specifies that environmentally distressed properties are examples of assets subject to abandonment, depending on potential liabilities, cleanup costs, and estimated market values. In addition, other asset disposition memoranda provide guidance in managing and disposing of environmental properties, specifically requiring the Corporation to

- maintain and develop management systems to identify and assess environmental issues;
- address impediments to disposition efforts for environmental properties;
- implement aggressive marketing strategies;
- identify the cost and status of completed environmental investigations as well as cleanup costs; and
- assess environmental litigation, liens, and other actions that could affect the sale of assets.

²The FDIC reorganized the Division of Liquidation as the Division of Depositor and Asset Services in September 1993 and then merged it with the Division of Resolutions in December 1996 to form the Division of Resolutions and Receiverships.

The FDIC complied with its policies for assessing environmentally distressed properties before it foreclosed on the Shelter Cove loans and took title to the property. It also complied with foreclosure bid limits based on the appraised value of the property less the estimated ownership costs at the time of foreclosure. However, the total amount that the FDIC ultimately paid for Shelter Cove, from its acquisition in July 1993 through its disposition in July 1998, greatly exceeded Shelter Cove's appraised value at the time of foreclosure.

When the FDIC foreclosed on the loans, Shelter Cove had an appraised value of \$835,700, and the FDIC bid \$425,000 at the foreclosure sale on July 23, 1993. While holding title to Shelter Cove, the FDIC paid an additional \$2,629,262 in property management fees, repair and maintenance expenses, homeowners' association fees, legal fees, property taxes, and other miscellaneous expenses. When it disposed of Shelter Cove on July 29, 1998, the FDIC transferred its ownership interest in Shelter Cove and paid an additional \$40,000 to the homeowners' association and forfeited any rights to claims against the association. Table 2 shows the total costs that the FDIC incurred to acquire, maintain, and dispose of Shelter Cove.

Table 2: The FDIC's Acquisition, Maintenance, and Disposition Costs for Shelter Cove

Category	Amount
Bid at loan foreclosure ^a	\$ 425,000
Homeowners' association fees	880,523
Water and sewer systems repairs and maintenance	458,391
Environmental cleanup, debris removal, and mowing	395,050
Electrical system repairs and maintenance	295,092
Property management fees and expenses	292,738
Legal fees and taxes	206,907
Engineering and consulting fees	89,994
Disposition fee	40,000
Other fees ^b	10,567
Total	\$3,094,262

^aThe FDIC and Park Bank receivership also incurred substantial losses on the Shelter Cove loans originated by Park Bank. The original loans plus accrued interest totaled over \$7 million at the time the FDIC foreclosed on the loans. The \$425,000 that the FDIC bid at loan foreclosure to acquire Shelter Cove would reduce the losses on the loans by the same amount.

^bOther fees consisted of miscellaneous expenses such as consulting fees and other one-time payments to Shelter Cove residents.

Source: OIG analysis of Hilton's contract files and the FDIC's DRR contract files, DOF accounting records, and Legal Division correspondence.

Although the FDIC attempted to dispose of Shelter Cove during 1994, 1995, and 1996, several factors contributed to its inability to sell or otherwise dispose of Shelter Cove. Specifically, disposition efforts were hampered by (1) court and FDEP orders related to environmental problems, (2) inconsistent legal opinions by FDIC legal representatives, and (3) the lack of interest by prospective buyers. For example, an FDEP order issued on February 15, 1989,

requiring Shelter Cove residents to boil all water before consumption was still in effect until repairs to the water and sewage systems complied with regulations. In addition, FDIC repaired Shelter Cove's electrical system over concerns of the safety of its residents. Accordingly, upon acquisition of Shelter Cove, the FDIC became responsible for ensuring that Shelter Cove's water, sewer, and electrical systems complied with the FDEP and court orders.

Further, the FDIC's Legal Division issued inconsistent opinions on whether the Corporation could or should dispose of Shelter Cove. Specifically, in a September 30, 1994, memorandum, the Legal Division discouraged the FDIC from disposing of Shelter Cove by deeding its lots to the homeowners' association. Other legal opinions conflicted regarding the FDIC's options to abandon Shelter Cove. Specifically, one opinion stated that the FDIC could abandon the property, a second opinion stated the FDIC could not abandon the property, and a third opinion was inconclusive regarding the FDIC's options.

The FDIC's Dallas Office assumed oversight for Shelter Cove in June 1997 and DRR officials in that office initiated steps to dispose of the FDIC's ownership interest. Specifically, the DRR officials initiated a plan to (1) discontinue payment of homeowners' association fees, (2) end the contractual relationship with Hilton, and (3) increase the responsibility of the homeowners' association for Shelter Cove's costs.

In December 1997, the FDIC discontinued payments for homeowners' association fees. Before that time, the FDIC had subsidized the homeowners' association by paying monthly fees totaling \$880,523 for 1,082 (about 87 percent) of the 1,244 Shelter Cove lots. Many of those lots were either undeveloped or unusable due to the state of Florida wetland restrictions. To facilitate efforts to end the Corporation's involvement with Shelter Cove and allow time to complete negotiations with the court-appointed receiver that it began in October 1997, the FDIC extended Hilton's contract for 3 months through March 31, 1998.

Although the negotiations required almost 7 months of discussions between the FDIC's Legal Division and DRR representatives and the court-appointed receiver, the FDIC signed an agreement on May 28, 1998, to end its involvement in Shelter Cove. The FDIC agreed to (1) not make any claim for homeowners' association fees; (2) transfer title to its interest in lots, common areas, and utility systems to the homeowners' association; and (3) pay \$40,000 to the homeowners' association. However, the FDIC retained ownership of a 38-acre undeveloped tract of Shelter Cove, which it sold on June 5, 1998, for \$125,000. The Circuit Court of Osceola County, Florida, approved the agreement, and it became final on July 29, 1998.

CONCLUSIONS AND RECOMMENDATIONS

Of the \$887,812 in expenses that we reviewed, we questioned Hilton's unallowable billings for miscellaneous expenses totaling \$12,201 and its refusal to return \$6,000 remaining in the operating account established by the FDIC for Shelter Cove. In addition, we questioned \$56,432 of subcontractor billings as unallowable or unsupported. The FDIC's purchase of Shelter Cove proved costly because the Corporation expended about \$3.1 million to acquire, maintain, and dispose of the property but received only \$125,000 in return. However, because the FDIC's

current policies governing the acquisition of environmental properties require the Corporation to take additional detailed steps before acquiring distressed properties, we are not making a recommendation related to this issue. Accordingly, we recommend that the FDIC's Deputy Director, Dallas Field Operations Branch, DRR, and Regional Manager, Dallas Regional Office, DOA, take the following actions:

- (1) Disallow \$12,201 (questioned cost) that Hilton billed for miscellaneous expenses.
- (2) Disallow \$56,432 (questioned cost, of which \$53,510 is unsupported) that Hilton billed for subcontractors.
- (3) Disallow Hilton's retention of \$6,000 (questioned cost) remaining in the Shelter Cove operating account established by the FDIC and obtain the funds directly from the financial institution. On July 30, 1998, the FDIC received the \$6,000 remaining in the Shelter Cove operating account from the financial institution. Accordingly, no additional action is required on this recommendation.

CORPORATION COMMENTS AND OIG EVALUATION

The Deputy Director, Dallas Field Operations Branch, DRR, and Regional Manager, Dallas Regional Office, DOA, provided written responses to a draft of this report on December 4, 1998, and December 16, 1998, respectively. The Deputy Director and Regional Manager's responses agreed with the recommendations and provided the requisites for a management decision on each of the three recommendations. The responses are not summarized because the actions planned or completed are identical to those recommended. The Deputy Director and Regional Manager's responses are presented as appendix I to this report. Appendix II presents management's proposed actions on our recommendations and shows that there is a management decision for each recommendation in this report.

Based on the audit work, the OIG will report questioned costs of \$74,633 (of which \$53,510 is unsupported) in its *Semiannual Report to the Congress*.

December 4, 1998

TO: Carl S. Mays Regional Director
Office of Inspector General/Atlanta

FROM: A. J. Felton, Deputy Director
Dallas Field Operations Branch
Division of Resolutions and Receiverships



SUBJECT: OIG AUDIT OF SHELTER COVE PROPERTY MANAGEMENT CONTRACTS

The following response is to the subject OIG Audit Draft Report dated November 6, 1998. DOA and DRR of the Dallas Field Operations Branch were asked to respond with comments and time frames relating to the recommendations in this report.

The OIG Report recommends that the EDIC disallow questioned cost of \$12,201 in miscellaneous expenses and \$56,432 in what is felt to be questionable and unsupported subcontractor bills. The documentation to support these recommendations was received by the FDIC on December 3, 1998. Both DOA/ASB and DRR are reviewing this documentation and preparing request to the legal department for assistance which is further explained in the responses to the recommendations of this report.

The audit which is the subject of this report was requested by DOA/ASB and DRR because it was felt that Hilton was billing for expenses that were not in compliance with the contract. As such OIG agreed to conduct this audit on the FDIC's behalf and we are appreciative of the OIG's efforts in assisting the FDIC in resolving these issues.

The OIG Recommendations and DRR's response to them is as follows:

Recommendation:

DRR and DOA should disallow \$12,201 in (questioned cost) that Hilton billed for miscellaneous expenses.

Agree/Disagree:

This office agrees with this recommendation to disallow these questioned cost.

December 4, 1998

Corrective Action Taken to Date:

To date no action has been taken to recover these miscellaneous expenses pending on the results of this audit. DOA and DRR had requested this audit because it was felt that this was a violation of the contract. The result is the subject of this audit.

Corrective Action to be Taken:

The following actions will be taken with regard to this specific recommendation once the supporting documentation is received and reviewed from the offsite storage files:

- 1) Make demand on Hilton for a refund of the \$12,201 in miscellaneous expenses
- 2) Request DOA Legal Department to determine if there is a statute of limitation issue that would bar the FDIC from pursuing this matter through the courts if it becomes necessary.
- 3) Request DOA Legal Department to determine if the FDIC has a legal right to pursue Hilton under the terms of the contract since the expenses were paid and approved by authorized EDIC personnel.
- 4) Request a legal opinion as to the cost effectiveness to attempt to collect these funds through the courts if it becomes necessary.

Once these legal issues have been properly addressed DOA and DRR will collectively make a business determination if it is cost effective to initiate litigation against Hilton to recover these proceeds.

Timeframe for Corrective Actions:

Once the legal issues are resolved and received by not later than March 30, 1999, it should be another 90 days or say June 30, 1999 to initiate litigation if deemed appropriate and cost effective.

Documentation to Support Actions:

The EDIC will provide OIG copies of all legal opinions, demand letters and any other correspondence relating to attempts to recover these funds. If it is felt not to be cost effective to pursue this matter through litigation the FDIC will provide OIG with a memorandum of such a decision and justification for that decision.

Recommendation:

DOA and DRR should disallow \$56,432 (questioned cost, \$53,501 of which is unsupported) that Hilton billed for subcontractors.

Corrective Action Taken to Date:

December 4, 1998

Based upon the information provided on December 3, 1998 by the OIG a letter is being sent to Hilton to either provide the supporting documentation on these invoices or submit the total amount recommended to be disallowed.

Corrective Action to be Taken:

Upon receipt of any supporting documentation from Hilton DOA/ASB and DRR will take the same action described in the first recommendation.

Timeframe for Corrective Actions:

Once the information is received and reviewed, DOA and DRR will inform OIG of its decision to either to pursue or not to pursue this issue. This will be provided to OIG not later than March 30, 1999.

Documentation to Support Actions:

The FDIC will provide a written memo to the OIG regarding a decision to pursue or not to pursue litigation along with justification of this decision. Additionally copies of any and all legal opinions, demand letters and any other correspondence with Hilton in an attempt to recover these funds will be furnished.

The final recommendation does not require a response from DOA or DRR as the \$6,000 dollars was recovered by the FDIC on July 30,1998.

FDIC

Federal Deposit Insurance Corporation

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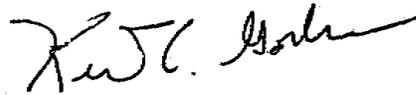
Dallas Regional Office
Division of Administration
Acquisition Services Branch

MEMORANDUM

DATE: December 4, 1998

TO: Carl S. Mays
Regional Director
Office of Inspector General/Atlanta

FROM: Kenneth Gorham, Regional Manager
Dallas Regional Office
Division of Administration



SUBJECT: DOA/ASB Response - *Audit of Shelter Cove Management Contracts*

This response addresses the three recommendations raised in the subject report. The first two recommendations are subject to action by the FDIC. The OIG is requiring no further action on the third recommendation; however, due to pending actions in ASB Washington a response has been provided in this document.

The Atlanta Regional Office discovered the \$12,201.00 billed by The Hilton Group Company and as a result of the (questioned cost) an audit was ordered and conducted by Lanier & Company. The Lanier & Company audit was received in Atlanta on or about April 25, 1997. The asset was transferred to Dallas on June 30, 1997. It is the understanding of Dallas ASB that as a result of the Lanier & Company audit, the contract (question cost) was referred to the OIG for further investigation.

(1) **Disallow \$12,201 (questioned cost) that Hilton billed for miscellaneous expenses.**

Recommendation:

DOA/ASB in cooperation with DRR and Legal should seek reimbursement of subject expense.

Agree/Disagree:

DOA/ASB agrees with the OIG recommendation concerning all questioned cost.

Corrective Action Taken to Date:

The Dallas Office has taken no corrective action pending the completion of the full OIG report.

Corrective Action to be Taken:

DOA/ASB will coordinate claim procedures in cooperation with DRR and Legal. If the formal claim process is not successful, a joint determination involving DOA, DRR, and Legal will be made as to the cost effectiveness of pursuing further legal remedies.

Timeframe for Corrective Actions:

The formal claim process and legal review will be accomplished by March 30, 1999. If the formal claim process is not successful, and legal action is recommended, then litigation efforts should be accomplished no later than June 30, 1999.

- (2) **Disallow \$56,432 (questioned cost, \$53,510 of which is unsupported) that Hilton billed for subcontractors.**

Recommendation:

Disallow the \$56,432 billed by Hilton for subcontractor cost.

Corrective Action to be Taken:

Based upon information provided to DRR on December 3, 1998, Hilton is being requested to provide supporting documentation on the questioned invoices or submit the total amount noted as deficient to the FDIC.

Timeframe for Corrective Actions:

DOA/ASB agrees with the time frames outlined in the DRR response. All formal claim procedures and legal reviews will be accomplished by March 30, 1999. If legal action is deemed appropriate, it should commence no later than June 30, 1999.

- (3) **Disallow Hilton's retention of \$6,000.00 (questioned cost) remaining in the Shelter Cove Operating account established by the FDIC and obtain the funds directly from the financial institution. On July 30, 1998, the FDIC received the \$6,000.00 remaining in the Shelter Cove operating account from the financial institution. Accordingly, no additional action is required on this recommendation.**

Response: Note: On August 13, 1998, DOA/ASB Dallas received a formal claim from The Hilton Group Company for return of the \$6,000.00 in dispute which was obtained by the FDIC directly from the financial institution where the operating account was established. A denial of the claim by the contracting officer was sent to Mr. Hilton on October 5, 1998. The Hilton Group Company has filed an appeal to the denial of the claim with the DOA/ASB Associate Director in Washington, DC. The decision on this appeal is unknown at this time; however; the final decision of this appeal along with all correspondence with Mr. Hilton involving this audit through resolution will be disclosed to the OIG.

Documentation to Support Actions:

The FDIC will make full disclosure to the OIG on all actions and decisions relative to Hilton. The OIG will be provided with copies of all documents relating to Hilton as well.

MANAGEMENT RESPONSES TO RECOMMENDATIONS

The Inspector General Act of 1978, as amended, requires the OIG to report on the status of management decisions on its recommendations in its semiannual reports to the Congress. To consider the 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 that the 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.

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	The Deputy Director, Dallas Field Operations Branch, DRR, and Regional Manager, Dallas Regional Office, DOA, agreed with the recommendation and stated that DRR and DOA in conjunction with the Legal Division would pursue recovery of the questioned cost.	06/30/99	Copies of demand letters, settlement agreements, and legal opinions.	\$12,201 disallowed cost	Yes
2	The Deputy Director, Dallas Field Operations Branch, DRR, and Regional Manager, Dallas Regional Office, DOA, agreed with the recommendation and stated that DRR and DOA in conjunction with the Legal Division would pursue recovery of the questioned cost.	06/30/99	Copies of demand letters, settlement agreements, and legal opinions.	\$56,432 disallowed cost	Yes
3	On July 30, 1998, the Corporation recovered \$6,000 remaining in the Shelter Cove operating account directly from the financial institution.	Completed	Copy of wire transfer.	\$6,000 disallowed cost	Yes