



*The Modernized e-File Project Can Improve  
the Management of Expected Capabilities  
and Associated Costs*

**December 27, 2006**

**Reference Number: 2007-20-005**

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

**Redaction Legend:**

1 = Tax Return/Return Information

3(d) = Identifying Information - Other Identifying Information of an Individual or Individuals

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DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

December 27, 2006

**MEMORANDUM FOR CHIEF INFORMATION OFFICER**

**FROM:** *Michael R. Phillips*  
Michael R. Phillips  
Deputy Inspector General for Audit

**SUBJECT:** Final Audit Report – The Modernized e-File Project Can Improve the Management of Expected Capabilities and Associated Costs (Audit # 200620013)

This report presents the results of our review of the Modernized e-File (MeF) Project's<sup>1</sup> development and deployment activities. The overall objective of this review was to determine whether the MeF Project's release activities are ensuring its electronic filing capabilities are efficiently providing the intended benefits to the Internal Revenue Service (IRS) and taxpayers. This review was part of the Treasury Inspector General for Tax Administration's Fiscal Year 2006 Information Systems Programs audit plan for reviews of the IRS' modernization efforts.

*Impact on the Taxpayer*

The MeF system provides electronic filing capability to businesses and tax exempt organizations that previously had to file paper returns. Improvements in the management of the MeF Project's capabilities and associated costs can help meet the goal to replace the IRS' current tax return filing technology with a modernized, Internet-based electronic filing platform. This will serve to streamline filing processes and reduce the costs associated with the paper-based IRS.

*Synopsis*

MeF Release 3.2 went into production in January 2006. However, 53 of the Project's requirements were deferred to later releases. The MeF system also experienced problems in its

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<sup>1</sup> Appendix V presents a Glossary of Terms.



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ability to handle the number of returns filed during the March 2006 peak tax return filing period. The MeF Project team reported that tests performed in June 2006 demonstrated the MeF system would be ready to process the projected September 2006 peak tax return volume. On October 5, 2006, IRS management advised us that the MeF system successfully processed the September 2006 anticipated volumes without any issues.

The MeF Project's plans for processing additional tax forms are uncertain, including plans to schedule development of the U.S. Individual Income Tax Return (Form 1040) family, which are pending approval from the Office of Management and Budget. As a result of the uncertainties, the MeF Project has experienced:

- The inability to use fixed-price contracts. When release requirements are not defined and releases are not associated with available funding, project management's ability to use fixed-price contracts is limited and the successful completion of project development may be delayed.
- Difficulty in managing the Project's funding and contract accounting. Additional funding was needed to add controls to reduce potential system security threats and to implement unplanned system changes. Funds designated for future release development were used to develop these controls and system changes, although Congress specifically directed the IRS to stop shifting funds between releases and to notify the Congressional committees of any proposed changes to the Modernization program expenditure plans. Further, the MeF Project team has not performed an analysis to assess the cost effect on the current release and the requirements planned for deployment, as well as the effect on funding availability to develop the deferred requirements in future releases.
- Delays in negotiations and approvals of the Project's contracting actions. Without achieving timely agreement on contract costs, completion of project development and deployment activities are at risk. Also, without adequate coordination between the Project team and the Procurement Office in all contract changes, the IRS could be paying the contractor for work that has not been authorized. In addition, protracted claim settlement activities with the contractor could occur if the IRS decides to not pay for unauthorized work.

### *Recommendations*

The Chief Information Officer (CIO) should ensure the MeF Project office involves the Enterprise Service organization's Business Rules and Requirements Management office in its efforts to define release requirements. The definition of requirements should incorporate the concepts and plans for the Modernization and Information Technology Services organization's Information Technology Modernization Vision and Strategy and should include the content of each release, the expected deployment dates, and the anticipated funding for the release work.



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Upon plan approval, the MeF Project team should attempt to use fixed-price contracts based on anticipated funding and the approved release scope in accordance with existing contract guidance.

To appropriately manage MeF Project funding, the CIO should ensure prompt notification to the Congressional committees of any proposed changes to future Modernization program expenditure plans. The CIO also needs to identify the cost effect of deferring significant and material project release requirements or work segments to future releases. This process should help prevent payment for the same work more than once in the event significant and material requirements are deferred to another release.

The CIO should direct the MeF Project team to work with the Procurement Office to complete the negotiations of work previously completed and clarify the policy for escalating failed negotiation attempts. The CIO should ensure the IRS Procurement Office develops additional guidance to work with project development teams to timely monitor contractor progress and ensure work is properly authorized.

### Response

IRS management agreed with five of our six recommendations. The CIO plans to involve the Business Rules and Requirements Management office in its efforts to define requirements and incorporate concepts and plans for the Modernization and Information Technology Services organization's Information Technology Modernization Vision and Strategy into the MeF Project. To address the need to complete plans for future releases, the MeF Project has a defined sequencing plan, which includes implementing Release 5 in January 2008. The IRS believes that the attempt to use fixed-price task orders should occur after the stabilization of each release's Logical Design and Physical Design and will evaluate the appropriateness of using fixed-price contracts for Release 6. The CIO has developed policies and procedures to ensure prompt notification to the Congressional committees of any proposed changes to future expenditure plans. However, the CIO disagreed to implement a process to identify cost effects of deferring significant and material project release requirements or work segments to future releases.

The CIO agreed with the recommendation to direct the MeF Project team to work with the Procurement Office to complete negotiations of work previously completed and to clarify the policy for escalating failed negotiation attempts. Additionally, the IRS Procurement Office developed additional guidance to timely monitor contractor progress and ensure work is properly authorized. Management's complete response to the draft report is included as Appendix VI.



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*Office of Audit Comment*

We appreciate the CIO's plans to involve the Business Rules and Requirements Management office in its efforts to define requirements and incorporate concepts and plans for the Modernization and Information Technology Services organization's Information Technology Modernization Vision and Strategy into the MeF Project. However, we are concerned about the rationale provided for not using fixed-priced contracts and the absence of controls to assess the cost effect of deferring requirements to future releases.

The CIO's response states the MeF Project has been unable to use fixed-priced contracts due to project funding uncertainties, delays in receiving required funding, and that the IRS must enter into fixed-price contracts with appropriated, rather than anticipated funding. During our August 24, 2006, meeting to present our report findings, the MeF Project managers were in attendance when the IRS Director of Procurement stated incremental funding of Business Systems Modernization Projects was not a problem since it had been agreed to by the Office of Management and Budget. This funding agreement should alleviate the concern about the availability of funds to enter into fixed-price contracts.

We also have significant concerns about the absence of controls to assign and track project requirement costs. The CIO responded that it is not an appropriate or productive use of resources to cost deferred requirements and that an impact assessment is performed to determine the best way to leverage deferred requirement efforts in the future. The process of costing deferred requirements is actively performed in the management of other projects such as the Customer Account Data Engine project, the foundation for the IRS' Business System Modernization. Recent Customer Account Data Engine task order modifications included the associated costs assigned to eight requirements deferred to subsequent releases. We continue to believe the practice used by the Customer Account Data Engine project should be implemented by other projects to help control costs. In addition, we requested but were never provided evidence of any requirement deferral impact assessments on current or future releases.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Margaret E. Begg, Assistant Inspector General for Audit (Information Systems Programs), at (202) 622-8510.



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*Abbreviations*

CIO	Chief Information Officer
ELC	Enterprise Life Cycle
FTE	Full-Time Equivalent
IRS	Internal Revenue Service
MeF	Modernized e-File



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## *Background*

The Modernized e-File (MeF) Project's<sup>1</sup> goal is to replace the Internal Revenue Service's (IRS) current tax return filing technology with a modernized, Internet-based electronic filing platform. Providing this capability for filing 330 forms through the MeF system supports and facilitates the IRS' commitment to achieve the IRS Restructuring and Reform Act of 1998<sup>2</sup> goal of receiving "at least 80 percent of all tax returns in electronic form by the year of 2007." This Project also serves to streamline filing processes and reduce the costs associated with the paper-based IRS.

***The MeF Project aims to increase electronic tax return filing through a system that is efficient and easy to access, use, and maintain.***

The MeF system will be able to accept multiple tax return types and multiple tax returns submitted in the same transmission. Additionally, the MeF system will allow:

- The IRS to reduce costs associated with receiving, processing, manually entering data, and resolving data entry errors from paper returns.
- The IRS to reduce system maintenance costs by using the Internet as the electronic means for filing.
- Taxpayers, tax practitioners, and the IRS to reduce the amount of storage space needed for paper returns.
- Taxpayers and tax practitioners to save time and money associated with copying, assembling, and mailing a return.
- State agencies to electronically receive tax and information return data.
- Taxpayers, tax practitioners, and IRS employees to benefit from the increased amount of data available to customer support personnel.

In January 2005, the Department of the Treasury issued Treasury Decision 9175 requiring electronic tax return filing for certain corporations and exempt organizations. The Decision requires the following taxpayers filing at least 250 returns during the calendar year to file tax returns electronically for the taxable years ending on or after December 31, 2005:

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<sup>1</sup> Appendix V presents a Glossary of Terms.

<sup>2</sup> Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).





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- Corporations with assets of \$50 million or more that file a U.S. Corporation Income Tax Return (Form 1120) or U.S. Income Tax Return for an S Corporation (Form 1120S).
- Exempt organizations with assets of \$100 million or more that file a Return of Organization Exempt From Income Tax (Form 990).

This Decision lowers the asset amount to \$10 million or more for the above returns and adds returns for private foundations with taxable years ending on or after December 31, 2006.

The MeF Project has completed the following releases:

- Release 1 developed the infrastructure, application base, and support for 53 forms filed by corporations and 6 forms filed by exempt organizations. This Release's end product provided an option for Internet-based filing of Form 1120, Form 1120S, and Form 990 returns. The IRS deployed this Release in February 2004.
- Release 2 added the remaining 44 forms associated with corporations and the public disclosure capabilities required by the Tax Exempt and Government Entities Division. The IRS deployed this Release in August 2004.
- Release 3.1 incorporated the Return for Private Foundation (Form 990-PF) and the ability to file extensions for Form 1120 and Form 1120S. The IRS deployed this Release in January 2005.
- Release 3.2 added the Federal/State Single Point Filing System platform and the Federal/State components for Form 1120 and Form 990. This Release also provided operational functionality and interfaces to enhance the MeF system internally. The IRS deployed this Release in January 2006.

In addition, the MeF platform will be used by the Excise Tax e-File and Compliance Project. The Excise Tax e-File and Compliance Project will assist IRS employees who are auditing the tax paid on diesel fuel.

This review was performed at the Modernization and Information Technology Services organization's facilities in New Carrollton, Maryland, during the period February through August 2006. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.



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## *Results of Review*

### ***The Modernized e-File Project Has Provided Electronic Filing Capability to Corporations and Tax Exempt Organizations and Is Continuing Application Development***

The MeF system provides electronic filing capability to businesses and tax exempt organizations that previously had to file paper returns. The number of returns filed through the MeF system has continued to increase.

***Along with its success, the MeF Project has continued to experience challenges in providing all planned capabilities.***

For example, in 2005, an estimated 3 percent of the corporate and tax exempt organizations tax returns and related applications for extensions were electronically filed (212,900 corporate tax returns and 47,900 related applications for extensions; 4,800 tax exempt organizations returns and 1,900 related applications for extensions), while approximately 6 percent of the corporate and tax exempt organizations tax returns and related applications for extensions were projected to be electronically filed in 2006. As of August 6, 2006, the MeF system had processed 405,151 corporate returns and 381,511 related applications for extensions, and 7,396 tax exempt organizations tax returns and 8,629 related applications for extensions. Corporate and tax exempt organizations tax returns and applications for extensions filings between January 1 and August 6, 2006, showed a 279 percent increase in filings over all of Calendar Year 2005.

The MeF Project will also benefit the IRS and taxpayers by reducing manual processing and storage costs for paper returns. The MeF Project's Exhibit 300 goals for Fiscal Year 2005 included:

- Decreasing the number of Full-Time Equivalents (FTE) needed to conduct return processing of paper Forms 1120 and 990 returns from 1,044 FTEs to 1,014 FTEs.
- Decreasing the total IRS annual storage costs for Forms 1120 and 990 returns from \$5,392,000 to \$5,317,000.

While the MeF Project implemented software enabling additional electronic filing capability, the FTE and storage cost savings have not been realized yet by the IRS. Labor redeployments to reduce FTE processing needs may begin to be realized in Fiscal Year 2007. Although significant reductions in paper return storage are resulting from filings through the MeF system, no estimates are available for when related storage cost reductions will occur.

The MeF system experienced problems in its ability to handle the number of returns filed during the March 2006 peak tax return filing period, and the MeF Project team developed lessons



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learned to address these problems and to prevent similar occurrences in the September 2006 peak period and future periods. Subsequently, [REDACTED]

[REDACTED] In June 2006, a stress test was conducted to determine the extent of the MeF system's ability to accept and process tax returns and provide concurrent access to users. The MeF Project team reported the June 2006 stress test demonstrated the MeF system would be ready to accept and process the projected September 2006 peak tax return volume. On October 5, 2006, IRS management advised us that the MeF system successfully processed the September 2006 anticipated volumes without any issues.

***MeF Project release capabilities have been postponed, and the MeF Project release schedule for processing tax forms is uncertain***

Although MeF Release 3.2 went into production in January 2006, 53 project requirements were deferred to later releases. The deferred requirements include capabilities to create and store system error messages and capture audit trails, provide additional system performance measures, monitor infrastructure transactions and processes, and implement all necessary system security controls.

One particularly important requirement that was deferred involves the ability of the MeF system to display return information within stipulated time periods. This requirement was also discussed in a prior Treasury Inspector General for Tax Administration report<sup>3</sup> and has been a deferred requirement for the MeF system since Release 1. Although tests performed during this audit showed the largest tax return files could be displayed for viewing by the IRS, the MeF Project team has deferred completion of this requirement until deployment of Release 4 because all requirement criteria could not be met. The ability to display returns will help ensure the efficiency of IRS personnel who access returns through the MeF system.

The MeF Project's plans for processing additional tax forms (e.g., U.S. Individual Income Tax Return (Form 1040)) are uncertain. The most recent plans show Release 5 will be completed in January 2008 and will enhance the processing efficiency of forms currently filed through the MeF system and add the U.S. Income Tax Return of a Foreign Corporation (Form 1120-F). The IRS has publicly communicated that the Form 1040 will be available in January 2009 as part of Release 6; however, the IRS has not decided how the Form 1040 family of returns and related schedules will be made available for use (in phases or all at once). Also, plans to schedule MeF

***The MeF release structure still is not definite as to which forms and schedules will be provided after Release 4.***

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<sup>3</sup> *Controls Need to Be Strengthened to Ensure the Modernized e-File Project Meets Its Expectations* (Reference Number 2005-20-103, dated September 2005).



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Project development of the Form 1040 family are pending approval from the Office of Management and Budget.

In addition, development plans are not final for the U.S. Income Tax Return for Estates and Trusts (Form 1041) and the Exempt Organization Business Income Tax Return (Form 990-T). The MeF Project release schedule previously planned to include these forms in Release 4, but these plans were canceled. These forms are not specifically included in the current plans for the future releases.

As a result of the changes to project requirements and the tax forms to be included in future releases, the MeF Project has experienced:

- The inability to use fixed-price contracts.
- Difficulty in managing MeF Project funding and contract accounting.
- Delays in negotiations and approvals of MeF Project contracting actions.

***The Modernized e-File Project Has Not Completely Defined Its Release Requirements and Release Schedule to Allow Use of Fixed-Price Contracts***

The IRS issued contracting guidance on April 30, 2004, entitled *Enabling Fixed-Price Contracting for Business Systems Modernization Task Orders*, requiring fixed-price contracts and task orders for Business Systems Modernization acquisition projects at the appropriate life cycle development phase, unless the Federal Government's interest is best served by other contract types. A fixed-price contract is suitable for acquiring supplies or services on the basis of reasonably definite functional or detailed specifications. This contract type can be used when the Contracting Officer can establish fair and reasonable prices at the outset, performance uncertainties can be identified, and reasonable estimates of their cost effect can be made. The contractor has to be willing to accept a fixed price representing assumption of the risks involved. In addition, the Federal Acquisition Regulation<sup>4</sup> specifically states that the extended use of cost-reimbursement or time and materials contracts should be avoided after experience provides a basis for firmer pricing.

***The use of fixed-price contracts should lead to more cost-effective acquisitions, better value, and greater competition.***

The Enterprise Life Cycle (ELC)<sup>5</sup> established Milestone 4 as the business systems development and enterprise deployment decision point. The Milestone 4 activities are separated by two

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<sup>4</sup> 48 C.F.R. pt 1-53 (2002).

<sup>5</sup> Appendix IV presents an overview of the ELC.



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checkpoints. Milestone 4A activities involve further requirements definitions, development of the system's physical design, and determination of the applicability of fixed-price contracting to complete system development and deployment. Once the requirements are finalized and agreed to by the IRS and the contractor, a fixed-price contract can be used to achieve Milestone 4B.

We have previously reported the IRS is not using fixed-price contracts for modernization contracts despite guidance requiring the use of this contract type when possible.<sup>6</sup> The MeF Project is not using fixed-price contracting agreements and the MeF Release 3.2 and 4 development activities are included in four separate contracts. The following contract types are being used:

- The PRIME contract for developing the technological infrastructure supporting the MeF system is a hybrid cost-plus-fixed-fee term (level of effort) and cost-plus-fixed-fee completion contract.
- The MeF Project used cost-plus-fixed-fee term (level of effort) and cost-plus-incentive-fee contracts for system development.
- The work related to adding new MeF forms and schedules to the Modernized Tax Return Database is being completed under a General Services Administration contract.
- The contract providing engineering and technical support to the MeF Project is a level of effort contract.

Since the MeF Project has already had several releases developed and the foundation of the application is complete, the IRS should have the experience to provide the basis for negotiating fixed-price contracts for future development activities. However, MeF Project management stated funding to support the Project was received incrementally, thereby preventing the use of fixed-priced contracting. Further, management stated the decisions about which tax forms to include in each release have not been finalized and the original release schedule has been revised several times. Therefore, the uncertainty of the release content and schedule has prevented the use of fixed-price contracts.

The Modernization and Information Technology Services organization is trying to better focus the management of the development of modernized systems, such as the MeF system, through its Information Technology Modernization and Vision Strategy. A significant aspect of this 5-year plan is to address the priorities around modernizing tax administration. The MeF system is included in the Information Technology Modernization and Vision Strategy; however, the contents of the MeF releases are not specified.

The Modernization and Information Technology Services organization has also established a Business Rules and Requirements Management office in the Enterprise Services organization.

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<sup>6</sup> *Focusing Management Efforts on Long-Term Project Needs Will Help Development of the Customer Account Data Engine Project* (Reference Number 2006-20-076, dated June 2006).



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This office's mission is to provide practices, methodologies, and services supporting IRS projects to achieve desired business goals. Although this office is available to provide services to help in the development and management of project requirements, it has not been asked to participate in the formulation and definition of the MeF Project requirements.

The former Associate Chief Information Officer (CIO), Applications Development, has suggested the IRS narrow the scope of project development activities to allow for better management of requirements and system development. This suggestion includes dividing releases into smaller segments (e.g., semi-annual deployments instead of annual). The MeF Project's release deployments have generally been scheduled on an annual basis.

The benefits of fixed-price contracting for the management of the MeF Project will be realized only after the project requirements and the release content and schedule are fully developed and agreed to. The absence of the participation and expertise of the Business Rules and Requirements Management office in defining requirements may have contributed to the uncertainty of MeF system tax form deployment plans. When release requirements are not defined and releases are not associated with available funding, project management's ability to use fixed-price contracts is limited and the successful completion of the project development may be delayed.

### ***Recommendations***

***Recommendation 1:*** The CIO should ensure the MeF Project office involves the Enterprise Service organization's Business Rules and Requirements Management office in its efforts to define requirements. The definition of requirements should incorporate the concepts and plans for the Modernization and Information Technology Services organization's Information Technology Modernization Vision and Strategy. Incorporating this 5-year plan into the MeF Project should help stabilize the Project's release schedule and improve the Project team's ability to establish fixed-price contracts for future release development and deployment.

***Management's Response:*** The CIO agreed with this recommendation. Business Rules and Requirements Management office representatives attended MeF Release 5 requirements meetings. The MeF Project is in compliance with the IRS Enterprise Transition Plan, Volume 1: Enterprise Transition Strategy, dated September 30, 2006, which reflects MeF Releases 4, 5, and 6. During the next revision of this document, the MeF Project team will work with the Enterprise Architecture organization to reflect the full MeF Sequencing Strategy, as approved. The Project team has incorporated the 5-year plan into the Release Sequencing Strategy and will incorporate the Information Technology Modernization Vision and Strategy into future release processes. This will commence with Release 6 actions. The IRS believes the attempt to use fixed-price task orders should occur in Milestones 4B and 5, after the stabilization of each release's Logical Design (Milestone 3) and Physical Design (Milestone 4A). The MeF Project has



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been unable to use fixed-price contracts due to project funding uncertainties and delays in receiving required funding. The IRS understands the Treasury Inspector General for Tax Administration has discussed the issue of incremental funding with the Procurement Office; however, the MeF Project cannot enter into fixed-price arrangements until it receives all required funding. The IRS must enter into fixed-price contracts with appropriated, rather than anticipated, funding.

**Office of Audit Comment:** We appreciate the CIO's plans to involve the Business Rules and Requirements Management office in its efforts to define requirements and incorporate concepts and plans for the Modernization and Information Technology Services organization's Information Technology Modernization Vision and Strategy into the MeF Project. The CIO states the MeF Project has a defined sequencing plan that has been communicated to all levels of the IRS, the Department of the Treasury, and the Office of Management and Budget. However, its content and schedule were not approved by the Department of the Treasury or the Office of Management and Budget at the time this audit was conducted. Defined requirements and an approved release schedule will enable the IRS to enter into reasonable fixed-price contracts.

The CIO's response states the MeF Project has been unable to use fixed-priced contracts due to project funding uncertainties and delays in receiving required funding, and that the IRS must enter into fixed-price contracts with appropriated, rather than anticipated, funding. During our August 24, 2006, meeting to present our report findings, a discussion occurred about fixed-price contracting and project funding. The MeF Project managers were in attendance at this meeting when the IRS Director of Procurement stated incremental funding of Business Systems Modernization Projects was not a problem since it had been agreed to by the Office of Management and Budget. This funding agreement should alleviate the concern about the availability of funds to enter into fixed-price contracts and allow the MeF Project to comply with IRS guidance requiring fixed-price contracts and task orders for Business Systems Modernization acquisition projects at the appropriate life cycle development phase. In addition, implementation of Recommendation 2 below by including plans for reduced scope releases should also help alleviate the funding concerns.

**Recommendation 2:** The CIO should ensure the MeF Project team completes its plans for future MeF Project releases, including its plans for reduced scope releases. These plans should include the content of each release, the expected deployment dates, and the anticipated funding for the release work. Upon plan approval, the MeF Project team should attempt to use fixed-price contracts based on anticipated funding and the approved release scope in accordance with existing contract guidance.

**Management's Response:** The CIO agreed with this recommendation. The MeF Project has a defined sequencing plan that was developed in collaboration with IRS business partners. This plan, communicated to all levels of the IRS and to the



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Department of the Treasury and the Office of Management and Budget, is in the execution stage. The scheduled implementation date for Release 5 is January 2008, as documented in the plan. The IRS must enter into fixed-price contracts with appropriated, rather than anticipated, funding. The IRS believes the use of fixed-price task orders should occur in Milestones 4B and 5, after stabilization of each release's Logical Design (Milestone 3) and Physical Design (Milestone 4A) and development begins. As Release 6 activities begin, the MeF Project team will evaluate the appropriateness of using fixed-price contracts.

**Office of Audit Comment:** As previously stated, the CIO's response indicates the MeF Project has a defined sequencing plan that has been communicated to all levels of the IRS, the Department of the Treasury, and the Office of Management and Budget. However, its content and schedule were not approved by the Department of the Treasury or the Office of Management and Budget at the time this audit was conducted.

The CIO's response does not address the portion of the recommendation dealing with reduced scope releases. We continue to believe the MeF Project release schedule could benefit from dividing releases into smaller segments (e.g., semi-annual deployments instead of annual). The smaller releases would not only allow for a more manageable scope, but also enable the IRS to align the Project's release scope with available funding.

### ***Extended Development, Deferral, and Additions to Requirements Have Made Modernized e-File Project Funding and Contract Accounting Difficult***

In November 2005, MeF Project management identified the need to obtain additional funds to complete development and deployment of MeF Release 3.2. According to the MeF Project Release Manager, additional funding was needed to add controls to reduce potential system security threats. In addition, MeF Release 3.2 had to implement unplanned system changes enabling the processing of returns received due to the Treasury Decision 9175 electronic filing mandate. MeF Project management took the following actions:

- On September 28, 2005, the MeF Project team requested the use of \$2.65 million of reserve funds to complete MeF Release 3.2. The Filing and Processing Management Executive Steering Committee approved the request on October 20, 2005.
- On November 14, 2005, the Modernization and Information Technology Services organization's Enterprise Governance Committee approved the transfer of \$4.2 million from Release 4 to complete the development, testing, and implementation of Release 3.2. The minutes from the meeting noted

***MeF Project management needs to ensure funds are used for the authorized and approved purposes and are tracked to ensure their accountability.***





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that moving funds from Release 4 would not jeopardize the cost, schedule, or scope of that Release. The MeF Project's Cost Variance Statement describes the basis for the shifting of funds from Release 4 to Release 3.2 as follows, "As originally envisioned, Release 4 would include U.S. Partnership Return of Income (Form 1065), Form 1041, and Form 990-T. However, once the Fiscal Year 2005 budget was finalized it was clear that not enough Release 4 funding was received to cover all 3 forms so Forms 1041 and 990-T were removed from the Release. Removing those 2 forms freed up \$4.2 million for use."

- On May 15, 2006, the IRS Infrastructure Shared Services organization agreed to fund the security requirements that were deferred from Release 3.2 to Release 4.

As part of the approval of the IRS Fiscal Years 2005 and 2006 Business Systems Modernization expenditure plans, Congress specifically directed the IRS to stop shifting funds between releases. In May 2005, Congress reminded the IRS it should promptly notify the Congressional committees of any proposed changes to the expenditure plans. It added that this is consistent with previous Congressional efforts to be informed of project variances. Again in January 2006, Congress directed the IRS to disclose fully and timely the shifting of funds between Modernization projects and the associated effect.

In a May 26, 2006, email, the IRS Legislative Affairs office forwarded a message from the Associate CIO, Applications Development, notifying Congressional committee members about plans to make funding changes affecting the Business Systems Modernization Program across Fiscal Years 2004, 2005, and 2006. The email does not specify that \$4.2 million was shifted between MeF Project releases in November 2005. The MeF Project team could not provide any documentation about notifying the Congressional committees prior to shifting the funds.

As reported above, the MeF Project team could not complete development of all requirements planned for Release 3.2 and deferred them to Release 4 and later releases. Further, the Project team could not identify the costs associated with the deferred requirements. The Project team does not track the costs charged to requirements to ensure the IRS is not paying again in later releases for work already performed in Release 3.2.

Documentation was not available to show what payments were made for the development of Release 3.2 requirements that were deferred and what portion of the funding for those requirements was deferred to Release 4 and later releases. The MeF Project team has not performed an analysis to assess the cost effect on the current release and the requirements planned for deployment, as well as the effect on funding availability to develop the deferred requirements in future releases. Further, a definitive analysis has not been performed to determine what portion of the deferred work was already developed and paid.



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## **Recommendations**

**Recommendation 3:** The CIO should ensure prompt notification to the Congressional committees of any proposed changes to future expenditure plans.

**Management's Response:** The CIO agreed with this recommendation. On April 8, 2006, the CIO implemented a policy to manage and monitor cost and schedule changes to a Business Systems Modernization effort. This policy requires an impact assessment, governance presentation, and executive approval of the requested change. On August 2, 2006, the IRS' Resource Management organization implemented the use of a "Governance Chain for Funding Changes." This is a checklist of appropriate activities, including Congressional, associated with the approval. Following the IRS governance approval, Congressional email notification is provided within a reasonable time period, subject to Department of the Treasury and Office of Management and Budget approval.

**Recommendation 4:** The CIO should implement a process to identify the cost effect of deferring significant and material project release requirements or work segments to future releases. This process should help prevent payment for the same work more than once in the event significant and material requirements are deferred to another release.

**Management's Response:** The CIO disagreed with this recommendation. The CIO responded that project management best practices require proactive supervision of the triple constraints (cost, schedule, and scope). This can result in the decision to defer requirements to keep scope, cost, and schedule in alignment and achievable. It is not an appropriate or productive use of resources to cost deferred requirements. When it becomes necessary to defer or drop a requirement for which significant work is either completed or in-progress, the IRS performs an appropriate impact assessment to determine the best way to leverage these efforts in the future. Management judgment is required to handle these situations on a case-by-case basis.

**Office of Audit Comment:** Although the CIO responded that best practices require proactive supervision of the triple constraints (cost, schedule, and scope) and that it is not an appropriate or productive use of resources to cost deferred requirements, the process of assigning costs to deferred requirements is actively performed in the management of other projects such as the Customer Account Data Engine project, the foundation for the IRS' Business System Modernization program. For example, recent Customer Account Data Engine task order modifications included the associated costs assigned to eight requirements deferred to subsequent releases. The modifications described the equitable adjustments for work already initiated and to be completed in subsequent releases, as well as the negotiated contract adjustments for work de-scoped from the release in development. We continue to believe the practice used by the Customer Account Data Engine project should be implemented by other projects to help control the cost constraint.



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## ***The Modernized e-File Project Can Improve the Management of Expected Capabilities and Associated Costs***

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The CIO also responded that an impact assessment is performed to determine the best way to leverage requirement deferral efforts in the future. However, we requested but were never provided evidence of any requirement deferral impact assessments on current or future releases.

The Acquisition Project Manager has overall responsibility for the technical and management aspects of a project, as well as changes to the contract and task orders. Without the means to associate costs with project requirements or work segments, the Acquisition Project Manager cannot control the funds expended on a project to ensure the IRS pays only for work performed. Until a control is implemented to identify and account for project costs, the MeF Acquisition Project Manager has no means to identify the costs devoted to deferred requirements or partially completed work segments.

In addition, the *Standards for Internal Control in the Federal Government*<sup>7</sup> include the standard for control activities which states, "Internal Control activities help ensure that management's directives are carried out. Control activities should be effective and efficient in accomplishing the agency's control objectives." Examples of control activities include proper execution of transactions and events, accurate and timely recording of transactions and events, and appropriate documentation of transactions and internal controls.

### ***Negotiations and Approvals of Modernized e-File Project Contracting Actions Were Not Always Accomplished Timely***

The MeF Project team includes a contracting representative who works with the IRS Procurement Office to develop and execute project development activities with vendors. These development activities were not always timely negotiated or approved.

#### ***Costs for work on some project requirements are still being determined because of incomplete contract negotiations***

The IRS Procurement Office has experienced problems in completing some MeF Project contract negotiations with the PRIME contractor. For example, negotiations for costs of work completed by the PRIME contractor on July 31, 2005, have not been finalized. <sup>5</sup>

The Procurement Office has been working to negotiate this contract with the PRIME contractor since April 26, 2005. Gaps in Procurement Office project involvement occurred between February and July 2006. Although the contract work ended in July 2005 and a negotiated

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<sup>7</sup> *Standards for Internal Control in the Federal Government* (GAO/AIMD-00-21.3.1, dated November 1999).



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agreement with the PRIME contractor has not been accomplished, the Procurement Office has not escalated the issue to senior management for their assistance in resolving the problems.

When timely agreement on contract costs are not achieved, completion of project development and deployment activities is at risk. The contractor may cease work until contract negotiations are complete, or the contractor may continue work without the IRS' consent. Further, work performed during the time when terms have not been agreed to may result in subsequent claims and litigation.

### ***Recommendation***

**Recommendation 5:** The CIO should direct the MeF Project team to work with the Procurement Office to complete negotiations of work previously completed. Also, the CIO should work with the Procurement Office to clarify the policy for escalating failed negotiation attempts, specifically when work is billed and paid even though the billing amount has not been agreed to. The escalation policy should provide requirements for each level of management to advise and involve their superior when negotiation inactivity reaches a stated period of time, such as 15 calendar days.

**Management's Response:** The CIO agreed with this recommendation. On July 27, 2006, the Procurement Office completed negotiations in the case cited in the report. To clarify the policy for escalating failed negotiation attempts, the Procurement Office has revised its escalation policy as follows.

When the contractor insists on a price or demands a profit or fee that the Contracting Officer determines unreasonable and/or insists on terms and conditions that are not in the best interest of the Federal Government, and the Contracting Officer has considered all other available alternatives (e.g., revising requirements, terms and conditions, feasibility of alternative sources) without success in obtaining a final agreement with the contractor, an impasse in negotiation has occurred. The Contracting Officer shall elevate the contract action to the Branch Chief within 1 business day, after determining that an impasse has been reached, for resolution.

If the Branch Chief and the contractor are unable to resolve the impasse within 30 days, the Branch Chief shall inform the Office Director of the issue, and provide alternatives for the resolution of the impasse for concurrence. Only as a last resort will an issue be elevated above the Office Director level. The disposition of the contract action shall be documented in the file.

### **The MeF Project team did not ensure contracting activities were approved prior to work beginning**

The MeF Project has a contract for engineering and technical support that was modified for Release 3.2 and Release 4 through 12 contract modifications. Of the 12 contract modifications,



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5 contract modifications involving \$545,495 were approved by the IRS and the contractor after work began, and in 2 of the 5 contract modifications after the work was completed. The contract modifications were for work occurring from February 2005 through June 2006. Table 1 lists the modifications where the contract period of performance began or was completed before the modifications were approved.

**Table 1: MeF Contract Modifications Approved After Work Was Initiated**

<b>Period of Performance</b>	<b>Date Signed by Contracting Officer</b>	<b>Additional Amount of Modification</b>
2/1/2005 to 2/28/2005	2/28/2005	\$ 29,370
3/1/2005 to 3/31/2005	3/17/2005	90,725
4/1/2005 to 7/17/2005	9/13/2005	None
1/1/2006 to 1/31/2006	1/12/2006	65,000
2/1/2006 to 6/30/2006	2/14/2006	<u>360,400</u>
	<b>Total</b>	<b><u>\$ 545,495</u></b>

Source: Amendment of Solicitation/Modification of Contract.

The Federal Acquisition Regulation prescribes requirements for contract modification approvals and provides that only Contracting Officers acting within the scope of their authority are empowered to execute contract modifications on behalf of the Federal Government. The Regulation includes a discussion of the two types of contract modifications, unilateral and bilateral.<sup>8</sup> This section prescribes that bilateral modifications are used to make negotiated adjustments resulting from the issuance of a change order. The five contract modifications approved and signed after work began do not meet the process guidelines for bilateral modifications since the contractor began work before the IRS gave its approval.

Without adequate coordination between the Project team and the Procurement Office in all contract changes, the IRS could be paying the contractor for work that has not been authorized. In addition, protracted claim settlement activities with the contractor could occur if the IRS decides not to pay for unauthorized work. The absence of approval for work, unilaterally initiated by the contractor, may be in violation of the Federal Acquisition Regulation.

<sup>8</sup> Federal Acquisition Regulation, 48 C.F.R. pt 1-53 (2002).



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## **Recommendation**

**Recommendation 6:** The CIO should ensure the IRS Procurement Office develops additional guidance to work with project development teams to timely monitor contractor progress and ensure work is properly authorized. Imminent contract expiration dates should also be timely identified so contract modifications and extensions can be approved before contractors perform work, thereby helping prevent work stoppages or potential legal actions.

**Management's Response:** The CIO agreed with this recommendation and indicated the Acquisition Project Manager Assessment Template used for the Senior Management Dashboard Review was modified to identify potential schedule delays that may result in any undefinitized contract actions. IRS executives will use this information to ensure contract modifications and/or extensions are awarded in a timely manner to prevent work stoppages or potential legal actions. The Procurement Office will develop a systemic alert process within its Integrated Procurement System. This process will notify the Contracting Officer, the Contracting Officer's Technical Representative, and the Contracting Officer's manager of imminent expiration dates, along with a deadline for taking action to extend or renew periods of performance.



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**Appendix I**

***Detailed Objective, Scope, and Methodology***

The overall objective of this review was to determine whether the MeF Project's release activities are ensuring its electronic filing capabilities are efficiently providing the intended benefits to the IRS and taxpayers. This review is part of the Treasury Inspector General for Tax Administration's Fiscal Year 2006 Information Systems Programs audit plan for reviews of the IRS' modernization efforts. To accomplish this objective, we:

- I. Determined whether MeF Release 3.2 requirements were completed.
  - A. Determined the status of Release 3.2 testing and whether all defect resolutions were completed.
  - B. Determined the reasons and sources for additional Release 3.2 funding needs.
  - C. Determined [redacted] and display capabilities were meeting the acceptance criteria requested by the business operating divisions.
  - D. Determined the status of the States' ability to participate in the Federal/State Single Point Filing System.
- II. Determined the status of MeF Release 4 activities allowing the filing of Forms 1065 to ensure it was on schedule and whether there was sufficient funding to complete all the Release 4 requirements.
  - A. Assessed the status of Release 4 activities and the effect of the deferred capabilities from Release 3.2.
  - B. Reviewed MeF Release 4 task orders to determine whether funding was included to develop the electronic filing capability for Form 1041, which was previously scheduled to be included in Release 4 development.
  - C. Determined the effect of the Excise Tax e-File and Compliance project on the MeF Project release activities.
- III. Determined the IRS' ability to process returns that will be electronically filed due to the regulations mandating further electronic filing requirements for corporations and exempt



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organizations<sup>1</sup> and how they will assist taxpayers with problems in electronically filing their returns.

- IV. Followed-up on issues reported in the Treasury Inspector General for Tax Administration report *Controls Need to Be Strengthened to Ensure the Modernized e-File Project Meets Its Expectations* (Reference Number 2005-20-103, dated September 2005) to determine whether corrective actions have been taken.

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<sup>1</sup> Corporations filing at least 250 returns and with assets of \$50 million or more and exempt organizations filing at least 250 returns with assets of \$100 million or more with taxable years ending on or after December 31, 2005, must file electronically. This Decision lowers the asset amount to \$10 million or more for the above returns and adds returns for private foundations with taxable years ending on or after December 31, 2006.





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**Appendix II**

*Major Contributors to This Report*

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Edward A. Neuwirth, Audit Manager  
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## **Appendix III**

### *Report Distribution List*

Commissioner C  
Office of the Commissioner – Attn: Chief of Staff C  
Deputy Commissioner for Operations Support OS  
Deputy Commissioner for Services and Enforcement SE  
Commissioner, Large and Mid-Size Business Division SE:LM  
Commissioner, Small Business/Self-Employed Division SE:S  
Commissioner, Tax Exempt and Government Entities Division SE:T  
Commissioner, Wage and Investment Division SE:W  
Associate Chief Information Officer, Applications Development OS:CIO:B  
Associate Chief Information Officer, Enterprise Services OS:CIO:ES  
Director, Procurement OS:A:P  
Director, Stakeholder Management OS:CIO:SM  
Deputy Associate Chief Information Officer, Applications Development OS:CIO:AD  
Deputy Associate Chief Information Officer, Business Integration OS:CIO:ES:BI  
Deputy Associate Chief Information Officer, Systems Integration OS:CIO:ES:SI  
Chief Counsel CC  
National Taxpayer Advocate TA  
Director, Office of Legislative Affairs CL:LA  
Director, Office of Program Evaluation and Risk Analysis RAS:O  
Office of Internal Control OS:CFO:CPIC:IC  
Audit Liaisons:  
    Associate Chief Information Officer, Applications Development OS:CIO:B  
    Director, Procurement OS:A:P  
    Director, Program Oversight OS:CIO:SM:PO



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## **Appendix IV**

### *Enterprise Life Cycle Overview*

The ELC is the IRS standard approach to business change and information systems initiatives. It is a collection of program and project management best practices designed to manage business change in a successful and repeatable manner. The ELC addresses large and small projects developed internally and by contractors.

The ELC includes such requirements as:

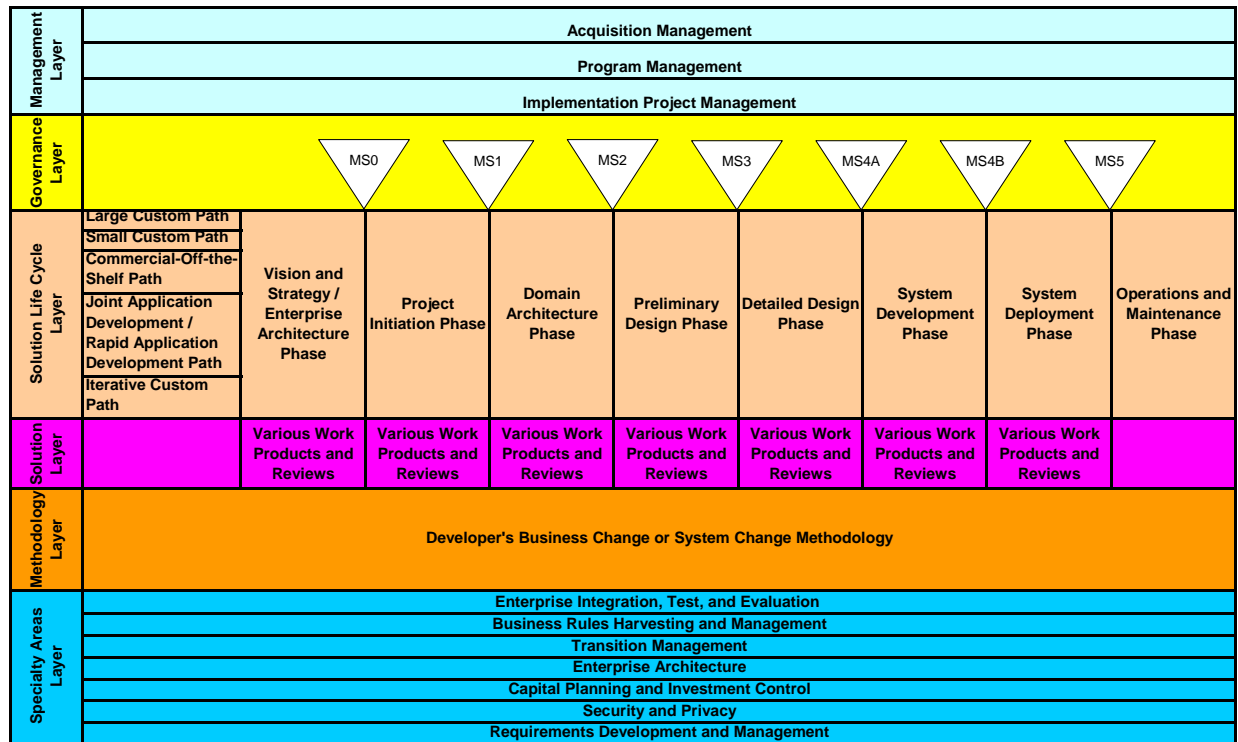
- Development of and conformance to an enterprise architecture.
- Improving business processes prior to automation.
- Use of prototyping and commercial software, where possible.
- Obtaining early benefit by implementing solutions in multiple releases.
- Financial justification, budgeting, and reporting of project status.

In addition, the ELC improves the IRS' ability to manage changes to the enterprise; estimate the cost of changes; and engineer, develop, and maintain systems effectively. Figure 1 provides an overview of the layers, paths, phases, and milestones (shown as "MS" in Figure 1) within the ELC Framework.



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Figure 1: ELC Framework



Source: Graphical representation of the ELC Framework modified from the ELC Guide.

## ELC Layers

The ELC is a framework for organizing and using IRS directives, processes, procedures, templates, and standards to accomplish business change. It is organized as a set of six interacting layers.

- The **Management Layer** specifies how to plan and control business change programs, projects, acquisitions, and solutions throughout the ELC.
- The **Governance Layer** specifies additional controls imposed from outside the project or program.
- The **Solution Life Cycle Layer** specifies what should be done but not how to do it.
- The **Solution Layer** manages the solution as it is produced, including providing standards for consistent solution specification and formal review of solution content. This Layer provides control over work products that may be produced by multiple internal and external developers using differing methodologies.



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- The **Methodology Layer** details how to do the work and specifies a unique set of work products to be produced. Specific methodologies are not part of the ELC Framework.
- The **Specialty Areas Layer** provides additional guidance for areas of particular importance within the IRS. These areas include Enterprise Integration, Test, and Evaluation;<sup>1</sup> Business Rules Harvesting<sup>2</sup> and Management; Transition Management;<sup>3</sup> Enterprise Architecture; Capital Planning and Investment Control;<sup>4</sup> Security and Privacy; and Requirements Development and Management.

### **ELC Paths**

A path specifies a unique “philosophy” or orientation for performing the work. Although the ELC specifies a standard for the work required to produce and operate business change solutions, there are multiple ways to approach and accomplish the required work. Paths are like alternate roads, each of which crosses different terrain, but all of which lead to the same destination. The ELC provides five distinct paths or approaches to developing systems:

- The **Large Custom Path** is for large projects.
- The **Small Custom Path** is for small projects.
- The **Commercial-Off-the-Shelf Path** is a commercial software-based approach.
- The **Joint Application Development/Rapid Application Development Path** is a highly accelerated, prototyping-based approach for very small, standalone solutions or solution components.
- The **Iterative Custom Path** is a hybrid approach that combines elements of the other approaches.

### **ELC Phases and Milestones**

A phase is a broad segment of work encompassing activities of similar scope, nature, and detail and providing a natural breakpoint in the life cycle. Each phase begins with a kickoff meeting and ends with an executive management decision point (called a milestone) at which IRS

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<sup>1</sup> Enterprise Integration, Test, and Evaluation includes processes for integrating multiple components of a solution and conducting various types and levels of testing on the solution.

<sup>2</sup> A business rule is a statement that defines or constrains some aspect of the business. Harvesting is a general term used to broadly describe the entire set of activities involved in gathering, formalizing, analyzing, and validating business rules for a particular scope.

<sup>3</sup> Transition Management helps ensure personnel and organizations are prepared to receive, use, operate, and maintain the business processes and technology provided by business change solutions.

<sup>4</sup> The Capital Planning Investment and Control process manages a central portfolio of information technology investments across the IRS.



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executives make “go/no-go” decisions for continuation of a project. Project funding decisions are often associated with milestones.

**Figure 2: ELC Phases and Milestones**

<b>Phase</b>	<b>General Nature of Work</b>	<b>Concluding Milestone</b>
Vision and Strategy/ Enterprise Architecture Phase	High-level direction setting. This is the only phase for enterprise planning projects.	0
Project Initiation Phase	Startup of development projects.	1
Domain Architecture Phase	Specification of the operating concept, requirements, and structure of the solution.	2
Preliminary Design Phase	Preliminary design of all solution components.	3
Detailed Design Phase	Detailed design of solution components.	4A
System Development Phase	Coding, integration, testing, and certification of solutions.	4B
System Deployment Phase	Expanding availability of the solution to all target users. This is usually the last phase for development projects.	5
Operations and Maintenance Phase	Ongoing management of operational systems.	System Retirement

Source: *The ELC Guide*.



## Appendix V

### Glossary of Terms

Term	Definition																		
Bilateral Contract Modification	<p>A bilateral contract modification is a contract modification that is signed by the contractor and the Contracting Officer. Bilateral modifications are used to make negotiated equitable adjustments resulting from the issuance of a change order, describe detailed terms of letter contracts, and reflect other agreements of the parties modifying the terms of contracts.</p>																		
Byte	<p>A byte is commonly used as a unit of storage measurement in computers, regardless of the type of data being stored. It is also one of the basic integral data types in many programming languages.</p> <table border="1" data-bbox="928 1236 1279 1612"> <thead> <tr> <th colspan="3">Popular Use and Standard Meaning</th> </tr> <tr> <th>Name</th> <th>Symbol</th> <th>Quantity</th> </tr> </thead> <tbody> <tr> <td>kilobyte</td> <td>KB</td> <td><math>2^{10}</math> (<math>10^3</math>)</td> </tr> <tr> <td>megabyte</td> <td>MB</td> <td><math>2^{20}</math> (<math>10^6</math>)</td> </tr> <tr> <td>gigabyte</td> <td>GB</td> <td><math>2^{30}</math> (<math>10^9</math>)</td> </tr> <tr> <td>terabyte</td> <td>TB</td> <td><math>2^{40}</math> (<math>10^{12}</math>)</td> </tr> </tbody> </table>	Popular Use and Standard Meaning			Name	Symbol	Quantity	kilobyte	KB	$2^{10}$ ( $10^3$ )	megabyte	MB	$2^{20}$ ( $10^6$ )	gigabyte	GB	$2^{30}$ ( $10^9$ )	terabyte	TB	$2^{40}$ ( $10^{12}$ )
Popular Use and Standard Meaning																			
Name	Symbol	Quantity																	
kilobyte	KB	$2^{10}$ ( $10^3$ )																	
megabyte	MB	$2^{20}$ ( $10^6$ )																	
gigabyte	GB	$2^{30}$ ( $10^9$ )																	
terabyte	TB	$2^{40}$ ( $10^{12}$ )																	



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<b>Term</b>	<b>Definition</b>
Cost-Plus-Fixed-Fee Contract	A cost-plus-fixed-fee contract is a cost-reimbursement contract that provides for payment to the contractor of a negotiated fee that is fixed at the inception of the contract. The fixed fee does not vary with actual cost but may be adjusted as a result of changes in the work to be performed under the contract.
Cost-Plus-Fixed-Fee (Completion) Contract	A cost-reimbursement contract typically used when the contractor is to <i>complete</i> and deliver a specified end product within the estimated cost as a condition for payment of the entire fixed fee.
Cost-Plus-Fixed-Fee (Term) Contract	A cost-reimbursement contract used when work is stated in general terms and the contractor is to provide a specific level of effort within a definite <i>term</i> or stated time period.
Cost-Plus-Incentive-Fee Contract	A cost-plus-incentive-fee contract is a cost-reimbursement contract that provides for an initially negotiated fee to be adjusted later by a formula based on the relationship of total allowable costs to total target costs.
Deferral	A deferral is an approved request for verification of a requirement or set of requirements to be moved to another phase of testing.
Electronic Management System	The Electronic Management System provides telecommunication structure, security, and data management support for electronic commerce, including electronic filing of tax returns.





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<b>Term</b>	<b>Definition</b>
Enterprise Life Cycle	The ELC is a structured business systems development method that requires the preparation of specific work products during different phases of the development process.
Excise Tax e-File and Compliance	The Excise Tax e-File and Compliance project will assist IRS agents who are assessing compliance on diesel fuel taxes.
Exhibit 300	Exhibit 300 is a Capital Asset Plan and Business Case required by the Office of Management and Budget.
Extensible Markup Language	Extensible markup language is the universal format for structured documents and data on the Internet.
Federal Acquisition Regulation	The Federal Acquisition Regulation is established for the codification and publication of uniform policies and procedures for acquisitions by all Executive Branch agencies.
Federal/State Single Point Filing System	The Federal/State Single Point Filing System permits tax return transmitters to submit multiple Federal and State tax return types within one transmission.
Fixed-Price Task Order	A fixed-price task order or contract sets a price that is not subject to any adjustment because of cost overruns incurred by the contractor.
Full-Time Equivalent	A FTE is a measure of labor hours in which 1 FTE is equal to 8 hours multiplied by the number of compensable days in a particular fiscal year.



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<b>Term</b>	<b>Definition</b>
Information Technology Modernization Vision and Strategy	The Information Technology Modernization Vision and Strategy establishes a 5-year plan that drives investment decisions, addresses the priorities around modernizing front-line tax administration and supporting technical capabilities, and leverages existing systems (where possible) and new development (where necessary) to optimize capacity, manage program costs, and deliver business value on a more incremental and frequent basis.
Infrastructure Shared Services	The Infrastructure Shared Services is a program to build and deliver an agile infrastructure that is scalable, interoperable, flexible, manageable, and features standardized operations and a single security and enterprise systems management framework.
Logical Design	Logical design describes the functions required of a system; that is, what is to be done, not how it will be done. Logical design is concerned with the processes to be performed.
Milestone	A milestone provides for “go/no-go” decision points in a project and is sometimes associated with funding approval to proceed.
Modernized e-File Project	The MeF Project develops the modernized, web-based platform for filing approximately 330 IRS forms electronically, beginning with the Form 1120, Form 1120S, and Form 990. The Project serves to streamline filing processes and reduce the costs associated with a paper-based process.



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<b>Term</b>	<b>Definition</b>
Physical Design	Physical design describes how the processing will be performed; for example, whether data is input by a person or read by a bar code reader, whether a file is electronic or print. Tools to represent the physical design include system flow charts and structure charts.
Platform	A platform is a computer system on which application programs can run.
PRIME Contractor	The PRIME contractor is the Computer Sciences Corporation, which heads an alliance of leading technology companies brought together to assist with the IRS' efforts to modernize its computer systems and related information technology.
Release	A release is a specific edition of software.
Requirement	A requirement is a formalization of a need and is the statement of a capability or condition that a system, subsystem, or system component must have or meet to satisfy a contract, standard, or specification.
Undefinitized Contract Action	An undefinitized contract action is any contract action (e.g., letter contract, task order, delivery order, change order, supplemental agreement, etc.) that authorizes the beginning of work prior to the establishment of the terms, specifications, or price.



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<b>Term</b>	<b>Definition</b>
Unilateral Contract Modification	A unilateral contract modification is a modification that is signed only by the Contracting Officer. Unilateral modifications are used to make administrative changes, issue change orders, make changes authorized by clauses other than a change clause (e.g., property clause, options clause, or suspension of work clause), and issue termination notices.



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Appendix VI

**Management's Response to the Draft Report**



CHIEF INFORMATION OFFICER

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

RECEIVED  
NOV 16 2006

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Richard A. Spires  
Chief Information Officer

SUBJECT: Draft Audit Report – The Modernized e-File Project Can Improve the  
Management of Expected Capabilities and Associated Costs (Audit  
#200620013) (i-Trak 2007-17688)

Thank you for the opportunity to review the subject draft audit report and to meet with the audit team to discuss prior draft report observations. As a result of these meetings, the audit team has incorporated some of our suggestions into the draft report.

We appreciate the acknowledgement that the Modernized e-File Project (MeF) completed four successful releases between February 2004 and January 2006. The report also acknowledged the significance of the June 2006 stress test. In addition, we appreciate the recognition of the successful MeF [redacted] and the completion of peak volume processing in September.

We also acknowledge and appreciate the audit team's advice on ways to further develop the MeF project. We are concerned that some of the statements contained in the draft audit report could be misinterpreted; therefore, we cannot fully agree with all of the report's currently worded recommendations.

Specifically, our concerns are:

1. The report states, "The MeF Project's plans for processing additional tax forms are uncertain, including plans to schedule development of the U.S. Individual Income Tax Return (Form 1040) family, which are pending approval from the Office of Management and Budget."

The MeF project provided the audit team with a defined sequencing plan that was developed in collaboration with our business partners. This plan, communicated to all levels of the IRS and to Treasury and the Office of Management and Budget (OMB), is in the execution stage. The scheduled implementation date for Release 5 is January 2008. The current sequencing plan outlines the development and deployment of the 1040 family of forms across three releases with the implementation of the first release scheduled for



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January 2009. Implementation of this plan is dependent upon the amount of approved funding provided to the MeF project.

2. We agree with the comments and recommendations contained in the report regarding the use of fixed price contracts and task orders once the project's logical and physical design are stabilized. The MeF project will evaluate the appropriateness of entering into fixed price agreements once funding to support the work is approved and appropriated.
3. The MeF project team has deferred closing the display requirement, as it is misstated. The current criteria addresses the number of documents; however, the requirement should instead address the number of pages. The MeF system has demonstrated that the largest expected returns are viewable in Return Request and Display (RRD). Testing has demonstrated that returns up to 1.5GB in size are viewable in RRD. The MeF system has demonstrated that pages are viewable as described in the requirements document. This meets the intended criteria. It is simply a matter of the requirements document needing to be updated to reflect a display of pages, rather than documents.
4. On two separate occasions (the August 24, 2006 meeting with the audit team to discuss the Summary paper and in written comments on the Discussion Draft Report provided October 5, 2006), the MeF Project Manager gave a detailed explanation for the deferral of Form 1041 and Form 990T from Release 4. In the Fiscal Year 2006 Business Systems Modernization (BSM) appropriation, funding to complete Milestones 4a through 5 for these two forms was not provided. This caused the deferral of this work from Release 4. Subsequent to these decisions, MITS collaborated with the business to develop a revised sequencing strategy. As a result, the plan moved Form 1041 and 990T to Release 10, scheduled for deployment in January 2013.
5. The report states, "On May 15, 2006, the IRS' Infrastructure Shared Services (ISS) organization agreed to fund the security requirements that were deferred from Release 3.2 to Release 4."

We concur with this statement; however, it is important to note that the ISS organization agreed to fund the Modernization infrastructure portion of the requirement, while the MeF project agreed to fund the application portion. These security requirements had larger enterprise-wide implications that affect the Modernization infrastructure. Thus, it was not appropriate for MeF to fully fund a requirement that was not specific to the MeF application.

We appreciate your continued support and the valuable assistance and guidance that your team provides. If you have any questions, please contact me at (202) 622-6800. Members of your staff may also contact Judy Mills, Director of Program Oversight, at (202) 283-4915.

Attachment



*The Modernized e-File Project Can Improve the Management of  
Expected Capabilities and Associated Costs*

Attachment

Draft Report – The Modernized e-File Project Can Improve the Management of Expected Capabilities and Associated Costs (Audit #200620013)

**RECOMMENDATION #1:** The CIO should ensure the MeF Project office involves the Enterprise Service organization's Business Rules and Requirements Management office in its efforts to define requirements. The definition of requirements should incorporate the concepts and plans for the Modernization and Information Technology Services organization's Information Technology Modernization Vision and Strategy. Incorporating this 5-year plan into the MeF Project should help stabilize the Project's release schedule and improve the Project's ability to establish fixed-price contracts for future release development and deployment.

**CORRECTIVE ACTION #1a:** We agree with the recommendation, "The CIO should ensure the MeF Project office involves the Enterprise Service organization's Business Rules and Requirements Management (BRRM) office in its efforts to define requirements." BRRM representatives attended MeF Release 5 requirements meetings.

**IMPLEMENTATION DATE:** September 18, 2006

**RESPONSIBLE OFFICIAL:** Director, Submission Processing, Applications Development

**CORRECTIVE ACTION MONITORING PLAN:** N/A

**CORRECTIVE ACTION #1b:** We agree with the recommendation, "The definition of requirements should incorporate the concepts and plans for the Modernization and Information Technology Services organization's Information Technology Modernization Vision and Strategy." This is currently included in the IRS Enterprise Transition Plan. The Modernized e-File (MeF) project is in compliance with the IRS Enterprise Transition Plan, Volume 1: Enterprise Transition Strategy dated September 30, 2006, which reflects MeF Releases 4, 5, and 6. During the next revision of this document, the MeF project will work with Enterprise Architecture to reflect the full MeF Sequencing Strategy, as approved.

**IMPLEMENTATION DATE:** April 1, 2007

**RESPONSIBLE OFFICIAL:** Director, Submission Processing, Applications Development

**CORRECTIVE ACTION MONITORING PLAN:** We enter accepted corrective actions into the Joint Audit Management Enterprise System (JAMES). These corrective actions are monitored on a monthly basis until completion.



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**CORRECTIVE ACTION #1c:** We agree with the recommendation, “Incorporating this 5-year plan into the MeF Project should help stabilize the Project’s release schedule and improve the Project’s ability to consider based on approved budgets and sound management practices, the use and establishment of fixed-price contracts for future release development and deployment.” The Project team has incorporated the 5-year plan into the Release Sequencing Strategy and will incorporate the MV&S strategies into future Release processes. This will commence with Release 6 actions.

The IRS believes that the attempt to use fixed-price task orders should occur in Milestones 4b and 5, after the stabilization of each release’s Logical Design (Milestone 3) and Physical Design (Milestone 4a). The MeF project has been unable to use fixed-price contracts due to project funding uncertainties and delays in receiving required funding. We understand that TIGTA has discussed the issue of incremental funding with procurement; however, the MeF project cannot enter into fixed-price arrangements until it receives all required funding. The Service must enter into fixed-price contracts with appropriated, rather than anticipated, funding.

**IMPLEMENTATION DATE:** February 1, 2007

**RESPONSIBLE OFFICIAL:** Director, Submission Processing, Applications Development

**CORRECTIVE ACTION MONITORING PLAN:** We enter accepted corrective actions into the Joint Audit Management Enterprise System (JAMES). These corrective actions are monitored on a monthly basis until completion.

**RECOMMENDATION # 2:** The CIO should ensure the MeF Project team completes its plans for future MeF Project releases, including its plans for reduced scope releases. These plans should include the content of each release, the expected deployment dates, and the anticipated funding for the release work. Upon plan approval, the MeF Project team should attempt to use fixed-price contracts based on anticipated funding and the approved release scope in accordance with existing contract guidance.

**CORRECTIVE ACTION #2a:** We agree with the recommendation, “The CIO should ensure the MeF Project team completes its plans for future MeF Project releases, including its plans for reduced scope releases. These plans should include the content of each release, the expected deployment dates, and the anticipated funding for the release work.” The MeF project has a defined sequencing plan that was developed in collaboration with our business partners. This plan, communicated to all levels of the IRS and to Treasury and the Office of Management and Budget (OMB), is in the execution stage. The scheduled implementation date for Release 5 is January 2008, as documented in the plan.

**IMPLEMENTATION DATE:** July 13, 2006

**RESPONSIBLE OFFICIAL:** Director, Submission Processing, Applications Development





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**CORRECTIVE ACTION MONITORING PLAN: N/A**

**CORRECTIVE ACTION #2b:** We agree with the recommendation, “Upon plan approval, the MeF project team should attempt to use fixed-price contracts based on anticipated funding and the approved release scope in accordance with existing contract guidance. The IRS must enter into fixed-price contracts with appropriated, rather than anticipated, funding. We believe that the use of fixed-price task orders should occur in Milestones 4b and 5, after stabilization of each release’s Logical Design (Milestone 3) and Physical Design (Milestone 4a) and development begins. As we begin Release 6 activities, the MeF project will evaluate the appropriateness of using fixed-price contracts.

**IMPLEMENTATION DATE:** February 1, 2007

**RESPONSIBLE OFFICIAL:** Director, Submission Processing, Applications Development

**CORRECTIVE ACTION MONITORING PLAN:** We enter accepted corrective actions into the Joint Audit Management Enterprise System (JAMES). These corrective actions are monitored on a monthly basis until completion.

**RECOMMENDATION #3:** The CIO should ensure prompt notification to the Congressional committees of any proposed changes to future expenditure plans.

**CORRECTIVE ACTION #3:** We agree with this recommendation. On April 8, 2006, the IRS’ Chief Information Officer (CIO) implemented a policy to manage and monitor cost and schedule changes to a Business Systems Modernization (BSM) effort. This policy requires an impact assessment, governance presentation, and executive approval of the requested change. On August 2, 2006, the IRS’ Resource Management (RM) organization implemented the use of a “Governance Chain for Funding Changes.” This is a checklist of appropriate activities, including Congressional, associated with the approval. Following the IRS governance approval, Congressional email notification is provided within a reasonable timeframe, subject to Treasury and OMB approval.

**IMPLEMENTATION DATE:** August 2, 2006

**RESPONSIBLE OFFICIAL:** Acting Director, Resource Management, Enterprise Services

**CORRECTIVE ACTION MONITORING PLAN:** N/A



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**RECOMMENDATION #4:** The CIO should implement a process to identify the cost effect of deferring significant and material project release requirements or work segments to future releases. This process should help prevent payment for the same work more than once in the event significant and material requirements are deferred to another release.

**CORRECTIVE ACTION #4:** We disagree with this recommendation. Project management best practices require proactive supervision of the triple constraints (cost, schedule, and scope). This can result in the decision to defer requirements to keep scope, cost, and schedule in alignment and achievable. It is not an appropriate or productive use of resources to cost deferred requirements. When it becomes necessary to defer or drop a requirement for which significant work is either completed or in-progress, we perform an appropriate impact assessment to determine the best way to leverage these efforts in the future. Management judgment is required to handle these situations on a case-by-case basis.

**IMPLEMENTATION DATE:** N/A

**RESPONSIBLE OFFICIAL:** N/A

**CORRECTIVE ACTION MONITORING PLAN:** N/A

**RECOMMENDATION #5:** The CIO should direct the MeF Project team to work with the Procurement Office to complete negotiations of work previously completed. Also, the CIO should work with the Procurement Office to clarify the policy for escalating failed negotiation attempts, specifically when work is billed and paid even though the billing amount has not been agreed to. The escalation policy should provide requirements for each level of management to advise and involve their superior when negotiation inactivity reaches a stated period of time, such as 15 calendar days.

**CORRECTIVE ACTION #5a:** We agree with this recommendation. On July 27, 2006, the Procurement Office completed negotiations in the case cited in the report.

**IMPLEMENTATION DATE:** July 27, 2006

**RESPONSIBLE OFFICIAL:** Director, Submission Processing, Applications Development

**CORRECTIVE ACTION MONITORING PLAN:** N/A



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**CORRECTIVE ACTION #5b:** We agree with this recommendation. To clarify the policy for escalating failed negotiation attempts, Procurement has revised its escalation policy as follows:

When the Contractor insists on a price or demands a profit or fee that the Contracting Officer determines unreasonable and/or insists on terms and conditions that are not in the best interest of the Government, and the Contracting Officer has considered all other available alternatives (e.g., revising requirements, terms and conditions, feasibility of alternative sources) without success in obtaining a final agreement with the contractor, an impasse in negotiation has occurred. The Contracting Officer shall elevate the contract action to the branch chief within one (1) business day, after determining that an impasse has been reached, for resolution.

If the Branch Chief and the Contractor are unable to resolve the impasse within thirty (30) days, the Branch Chief shall inform the Office Director of the issue, and provide alternatives for the resolution of the impasse, for concurrence. Only as a last resort, will an issue be elevated above the Office Director level. Disposition of contract action shall be documented in the file.

**IMPLEMENTATION DATE:** October 13, 2006

**RESPONSIBLE OFFICIAL:** Director, Office of Procurement

**CORRECTIVE ACTION MONITORING PLAN:** N/A

**RECOMMENDATION #6:** The CIO should ensure the IRS Procurement Office develops additional guidance to work with project development teams to timely monitor contractor progress and ensure work is properly authorized. Imminent contract expiration dates should also be timely identified so contract modifications and extensions can be approved before contractors perform work, thereby helping prevent work stoppages or potential legal actions.

**CORRECTIVE ACTION #6a:** We agree with this recommendation. We have modified the Acquisition Project Manager Assessment Template used for the Senior Management Dashboard Review (SMDR) to identify potential schedule delays that may result in any undefinitized Contract Actions (UCAs). IRS executives will use this information to ensure contract modifications and/or extensions are awarded in a timely manner to prevent work stoppages or potential legal actions.

**IMPLEMENTATION DATE:** November 15, 2006

**RESPONSIBLE OFFICIAL:** Director, Program Control & Process Management

**CORRECTIVE ACTION MONITORING PLAN:** NA



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**CORRECTIVE ACTION #6b:** We agree with this recommendation. Procurement will develop a systemic alert process within its Integrated Procurement System (IPS). This process will notify the Contracting Officer (CO), the Contracting Officer's Technical Representative (COTR), and the CO's manager of imminent expiration dates, along with a deadline for taking action to extend or renew periods of performance.

**IMPLEMENTATION DATE:** September 1, 2007

**RESPONSIBLE OFFICIAL:** Director, Office of Procurement

**CORRECTIVE ACTION MONITORING PLAN:** We enter accepted corrective actions into the Joint Audit Management Enterprise System (JAMES). These corrective actions are monitored on a monthly basis until completion.