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TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION



*Invoice Audit of the Microsoft Consulting  
Services Contract – TIRNO-03-K-00191*

**June 2006**

**Reference Number: 2006-10-086**

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.

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TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

June 8, 2006

**MEMORANDUM FOR CHIEF, AGENCY-WIDE SHARED SERVICES**

*Michael R. Phillips*

**FROM:**

Michael R. Phillips  
Deputy Inspector General for Audit

**SUBJECT:**

Final Audit Report – Invoice Audit of the Microsoft Consulting  
Services Contract – TIRNO-03-K-00191 (Audit # 200510026)

This report presents the results of our review of the Internal Revenue Service's (IRS) Microsoft Consulting Services Contract – TIRNO-03-K-00191. The overall objective of this review was to determine whether selected invoices submitted and paid under contract number TIRNO-03-K-00191 were appropriate and in accordance with the contract's terms and conditions.

*Synopsis*

Contract expenditures represent a significant outlay of IRS funds. The Treasury Inspector General for Tax Administration has made a commitment to perform audits of these expenditures. We initiated this audit to determine whether the invoices submitted by the contractor and paid by the IRS were accurate, supported, and allowable.

We initially identified \$1,821,578.75 in questionable labor costs because the contractor stated it did not have in its possession the necessary documentation to support time charged by subcontractors. We provided both the IRS and contractor personnel a list of these questioned costs in September 2005.

However, it was not until we presented the questioned costs in a discussion draft report issued to the IRS in December 2005 that the contractor obtained the necessary documentation from its subcontractors to support all of the labor costs. During the period when these charges were invoiced by the contractor, the IRS did not review, as part of its invoice verification process, any source documents such as timecards to confirm labor hours charged.

We also initially determined the contractor could not provide résumés for 31 percent (23 of 75) of subcontractor-provided consultants listed on the invoices we tested. Charges associated with



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these consultants totaled \$650,176.37. On April 7, 2006, subsequent to the issuance of our draft report on February 28, 2006, the IRS provided 10 additional résumés, which it considered acceptable. According to the IRS, these résumés reduced the amount related to the remaining 13 consultants to \$444,430. As with labor hours, during the period when these charges were invoiced by the contractor, the IRS did not review subcontractor-provided consultant résumés to verify the qualifications of the consultants.

In a related matter that affects the control environment and risk associated with this contract, we determined that neither the contractor nor its subcontractor, which performed 100 percent of the work on this contract, is audited by the Defense Contract Audit Agency.<sup>1</sup> Thus, the Federal Government has not opined on the adequacy of the contractor's or subcontractor's financial, billing, and estimating systems of internal control. Because of these conditions on this contract, we believe the IRS was subjected to a higher level of risk for improper contractor payments.

As part of this audit, we also examined contract correspondence files and interviewed the Contracting Officer and the Contracting Officer's Technical Representative to determine whether the contractor's performance was satisfactory. Based on these limited auditing procedures, nothing came to our attention that would lead us to believe there were significant problems with the deliverables associated with the tasks included in our tests.

### *Recommendations*

We recommended the Director, Procurement, ensure Contracting Officers and Contracting Officer's Technical Representatives 1) adhere to Federal Acquisition Regulation 52.232-7(a)(1), Payments Under Time-and-Materials and Labor-Hour Contracts;<sup>2</sup> 2) are cognizant of the importance of requesting and reviewing résumés of contracted consultants; and 3) are cognizant of the extent of audit coverage, if any, by the Defense Contract Audit Agency and adjust invoice verification procedures accordingly.

### *Response*

IRS management disagreed with all of our recommendations and the reported outcome measure. They stated that they believe the invoices submitted and paid under the subject contract were appropriate according to its commercial terms. Management's complete response to the draft report is included as Appendix V.

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<sup>1</sup> The Defense Contract Audit Agency, under the authority, direction, and control of the Under Secretary of Defense (Comptroller), is responsible for performing all contract audits for the Department of Defense. It also provides contract audit services to some other Federal Government agencies.

<sup>2</sup> 48 C.F.R. ch. 1 (2005).



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*Office of Audit Comment*

Management asserts the invoices submitted and paid under the subject contract were appropriate according to its commercial terms and therefore disagrees with all of our recommendations. This assertion is based, in part, on our reporting of no identified questioned charges. However, the fact that no charges were found to be questionable should not be the basis to forgo the need to improve the IRS' overall invoice verification control environment, which is the intent of our recommendations. Further, we initially reported in our discussion draft report \$1.8 million in questioned costs, out of \$2.8 million reviewed, due to unsupported subcontractor labor charges. If this subcontractor-prepared documentation existed throughout the contract period, we question why it took over 4 months for the IRS to provide us the timecards and labor hour reports, especially since similar documentation was provided promptly for \$1 million of the \$2.8 million reviewed. Such documentation should be readily identifiable and retrievable from the business accounting and recordkeeping system.

We will continue to include a review of the IRS' voucher verification process in future contract invoice audits and, if warranted, recommend improvements to the process.

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 any questions or Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.



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## *Background*

In April 2003, the Internal Revenue Service (IRS) awarded task order (contract<sup>1</sup>) number TIRNO-03-K-00191 under General Services Administration (GSA) Contract GS-35F-0273L. The contract allowed various IRS offices to obtain information technology professional services. IRS offices requiring services could submit a work request, with proper approvals, and have the work assigned to the contract as appropriate. The services primarily involved time-and-materials tasks. A small proportion involved fixed-price tasks that provided for technical support for unforeseen incidents that required calling in a software technician.

The contract was initially awarded for 1 year, from April 4, 2003, through April 3, 2004. Three subsequent amendments extended its period of performance to February 28, 2005. According to the IRS Request Tracking System,<sup>2</sup> as of June 15, 2005, the IRS had awarded 33 tasks, with a total value not to exceed approximately \$8.3 million, and had recorded approximately \$7.7 million in transactions against these tasks. The contractor submitted invoices monthly; the invoices included charges for all tasks that had activity during the month. Subcontractors performed 100 percent of the work on the tasks.

Because contract expenditures represent a significant outlay of IRS funds, the Treasury Inspector General for Tax Administration (TIGTA) made a commitment to perform audits of these expenditures. This audit was designed to determine whether amounts paid by the IRS under this contract were accurate, supported, and allowable through a review of contractor invoices and supporting documentation.

This audit was performed at the Office of Procurement in the Office of Agency-Wide Shared Services in Oxon Hill, Maryland, and the contractor's facility in Fairfax, Virginia, during the period June 2005 through January 2006. Opinions expressed in this report pertain only to the tasks and invoices included in our judgmental sample.

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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<sup>1</sup> For simplicity of presentation, we will refer to this task order as a contract throughout this report.

<sup>2</sup> The Request Tracking System is a web-based application that allows IRS personnel to prepare, approve, fund, and track requests for the delivery of goods and services. The System also allows for electronic acceptance of items delivered and provides an electronic interface with the Integrated Financial System (the IRS' administrative financial accounting system) for payment processing.



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## *Results of Review*

### ***Questionable Contract Charges and Invoice Verification Process***

We examined supporting documentation obtained from the IRS Office of Procurement, as well as documentation received directly from the contractor, for a sample of seven monthly invoices. The invoices were selected using a judgmental sampling method (see Appendix I for details). The sampled invoices included charges related to 23 tasks with award amounts totaling approximately \$6.5 million and transactions of approximately \$5.8 million. The 7 invoices had performance dates from June 2003 to November 2004 and involved approximately \$2.8 million in IRS payments.

The primary expenses claimed by the contractor were subcontractor payments to one very large, well-known software developer. In fact, this subcontractor, including its own subcontractors, provided 100 percent of the labor on this contract. The contractor did not perform any work specifically related to the services delivered under this contract but functioned only to provide contract administrative support. We were informed by the Defense Contract Audit Agency (DCAA)<sup>3</sup> that, according to its records, neither the contractor nor the subcontractor is audited by the DCAA.

#### **Questionable contract charges**

The Contracting Officer's Technical Representative (COTR) did not examine source documents, such as timecards, in his or her review of labor hours. The COTR established various processes in an effort to ensure labor hours were reasonable; however, as described later in this report, we believe those procedures were insufficient. We initially identified \$1,821,578.75 in questioned labor costs because the contractor stated it did not have in its possession the necessary documentation to support time charged by subcontractors. We provided both IRS and contractor personnel a list of these questioned costs in September 2005. However, it was not until we presented the questioned costs in a discussion draft report issued to the IRS in December 2005 that the contractor obtained the necessary documentation from its subcontractors to support all of the labor costs, which we were provided on January 30, 2006.

We also initially determined the contractor could not provide résumés for 31 percent (23 of 75) of subcontractor-provided consultants listed on the invoices we tested. Charges associated with these consultants totaled \$650,176.37. On April 7, 2006, subsequent to the issuance of our draft

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<sup>3</sup> The DCAA, under the authority, direction, and control of the Under Secretary of Defense (Comptroller), is responsible for performing all contract audits for the Department of Defense. It also provides contract audit services to some other Federal Government agencies.



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report on February 28, 2006, the IRS provided 10 additional résumés, which it considered acceptable. According to the IRS, these résumés reduced the amount related to the remaining 13 consultants to \$444,430. Résumés or similar documentation are essential in ensuring individuals are technically qualified to be reimbursed at the stated labor category or rate.

Unsupported charges and unverified consultant qualifications, especially associated with this contract, are significant because neither the contractor nor the subcontractor is audited by the DCAA and because of what we believe to be insufficient invoice verification by the IRS, as discussed below. Unless adequate supporting documentation for invoiced charges and consultant qualifications is obtained, the IRS cannot assure the allowability of the charges or for services provided. This puts the IRS at risk of making improper contractor payments.

The Federal Acquisition Regulation (FAR)<sup>4</sup> stipulates a contractor is responsible for accounting for costs appropriately and for maintaining records, including supporting documentation, adequate to demonstrate that costs claimed have been incurred. The FAR also provides that costs shall be allowed to the extent they are reasonable, allocable, and allowable under the FAR.

### **Invoice verification process**

Contracts may be entered into and signed on behalf of the Federal Government only by Contracting Officers (CO). COs have the authority to administer or terminate contracts and make related determinations and findings. COs are responsible for ensuring performance of all necessary actions for effective contracting, ensuring compliance with the terms of the contract, and safeguarding the interests of the United States in its contractual relationships.

The requesting program office nominates a COTR, who is the CO's technical expert and representative in the administration of a contract or task order. Usually, the CO will appoint a COTR by issuing a signed letter of appointment tailored to meet the needs of each contract. The CO and the COTR are required to jointly review all appointed duties.

Prior to April 28, 2004, the Department of the Treasury *Contracting Officer's Technical Representatives Handbook* (the *Handbook*) was the primary guidance for COTRs.<sup>5</sup> Part IV of the *Handbook* stated, in part, COTRs are responsible for reviewing and approving invoices and vouchers on contracts. It also stated the COTR would receive instructions regarding involvement in the review and approval of invoices and vouchers from the CO. Attachment E of the *Handbook* offered, as a sample responsibility for time-and-materials contracts, that COTRs are responsible for reviewing and signing off on the invoices, attesting to their accuracy. Two of the seven invoices we reviewed during this audit were subject to this guidance.

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<sup>4</sup> 48 C.F.R. ch. 1 (2005).

<sup>5</sup> Department of the Treasury Acquisition Circular No. 02-01, dated April 28, 2004, deleted references to the *Handbook*. The Circular also stated the Department of the Treasury would no longer maintain the *Handbook*.





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On April 28, 2004, the IRS replaced the *Handbook* guidance, in part, with a reference to the Office of Federal Procurement Policy document *A Guide to Best Practices for Contract Administration* (the *Guide*). The *Guide* offers, as a practical technique, that COTRs reviewing vouchers under cost-reimbursement contracts should review the contractor's timecards, sign-in sheets, and overtime records to help assess the reasonableness of direct labor costs. The *Guide* also contains direction to review major cost categories such as travel, supplies, other direct costs, and subcontractor costs to again determine the reasonableness of the claimed costs. Although the *Guide*, which was published in October 1994, does not include a specific reference to time-and-materials contracts, we believe it is reasonable to infer that administration requirements for cost-reimbursement contracts would also apply to time-and-materials contracts.

FAR 52.232-7(a)(1), Payments Under Time-and-Materials and Labor-Hour Contracts, states, in part, "The Contractor shall substantiate vouchers by evidence of actual payment and by individual daily job timecards, or other substantiation approved by the Contracting Officer."

The COTR stated that he or she had no written procedures for reviewing invoices and was not familiar with the *Guide*. He or she receives monthly invoices and status reports directly from the contractor and then performs a detailed review of hours and labor rates. The contractor creates weekly status reports that include operational information and comparisons of funds expended to total funds available for each task. These status reports are reviewed during weekly teleconferences involving the COTR, IRS task managers, and contractor personnel.

The COTR stated that he or she relies on feedback obtained from task managers during the weekly teleconferences to determine whether hours charged for labor are reasonable. He or she stated that the Government task managers closely monitor hours worked and provide feedback to verify their accuracy. The COTR does not perform a detailed verification of actual hours worked, such as a review of contractor-provided payroll or related payment records. The COTR also stated that he or she does perform a thorough detailed review of travel charges.

Although we acknowledge that the COTR established procedures to determine whether hours charged for labor are reasonable, in our opinion and based on the guidance provided in FAR 52.232-7(a)(1), IRS officials should have reviewed original subcontractor-prepared supporting documentation, on at least a sample basis, to verify labor hours charged. This type of verification would be especially important because neither the contractor nor the subcontractor is audited by the DCAA. Thus, the Federal Government has not opined on the adequacy of the contractor's or subcontractor's financial, billing, and estimating systems of internal controls used to produce payroll and labor charges in support of Federal Government contracts and invoices. Further, we believe relying on contractor-prepared reports on subcontractor charges is inadequate because the report information is not generated directly from the subcontractor's accounting records.

In addition, the COTR did not review subcontractor-provided consultant résumés to verify the qualifications of the consultants. The COTR stated that he or she relied on the subcontractor to



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check the qualifications of the consultants it provided to the contractor. We requested résumés from the contractor; however, the contractor could not provide résumés for 23 of 75, or 31 percent, of the consultants listed on the invoices we tested.

The COTR stated that IRS personnel work closely with the subcontractor-provided consultants and would know if they were qualified to perform contract-related tasks. The COTR also stated that he or she had no concerns with this contractor, and his or her weekly discussions with end users revealed they were generally satisfied with the contractor’s performance. Further, the CO stated that he or she considered this contractor very qualified.

The GSA Federal Supply Schedule Contract item 16, entitled “Description of Services and Pricing,” provides specific educational and general experience qualifications that must be met to be eligible for the various labor categories included in the contract and establishes pricing for each labor category. Further, item 13, entitled “Résumés,” states that résumés shall be provided to the user ordering activity upon request.

In our opinion, relying solely on testimonial assertions to validate contract consultants’ technical qualifications is insufficient; résumés or similar documentation should be provided and reviewed to ensure proper labor rates are being used.

## ***Recommendations***

**Recommendation 1:** The Director, Procurement, should ensure COs and COTRs adhere to the requirements of FAR 52.232-7(a)(1), Payments Under Time-and-Materials and Labor-Hour Contracts, when appropriate.

**Management’s Response:** IRS management disagreed with our recommendation. The IRS believes it complied with FAR 52.232-7 (which states, “other substantiation” besides timecards is acceptable) because the CO approved the subcontractor providing weekly status reports generated directly from its accounting records, which listed daily hours and labor rates charged. These reports were reviewed in weekly meetings with the subcontractor. Both the contractor and the COTR then confirmed that the subsequent monthly subcontractor invoices traced to the weekly reports.

In addition, the IRS rejected our suggestion that it follow guidance in *A Guide to Best Practices for Contract Administration* to review the contractor’s timecards and sign-in sheets because this is a commercial time-and-materials contract awarded by the GSA. The IRS further offered that the Cost Accounting Standards Board affirmed that, for these types of contracts, “the application of Cost Accounting Standards from a pricing standpoint, is similar to a firm-fixed-price contract.”

Finally, the IRS believes the audit findings validated its approach, in that all hours charged traced to the monthly invoices and timecards.



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**Office of Audit Comment:** We did not identify any documentation within the IRS contract files to support that the IRS verified the contractor’s system contained reliable information (analogous with a DCAA review). In addition, contrary to the IRS’ response, the lists of labor hours attached to the contractor’s invoices that we reviewed were prepared by the contractor, not the subcontractor. We were provided only subcontractor-prepared documentation (timecards and labor hour reports) subsequent to our opening with the contractor. Further, we were not provided all the supporting documentation until we issued our discussion draft report at the conclusion of our fieldwork, which reported \$1.8 million in questioned costs, out of \$2.8 million reviewed, due to unsupported subcontractor labor charges. If this documentation, prepared by the subcontractor, existed throughout the contract period, we question why it took over 4 months to provide us the timecards and labor hour reports, especially since similar documentation was provided promptly for \$1 million of the \$2.8 million reviewed. Sound business practices dictate that such documentation should be readily identifiable and retrievable from the business accounting and recordkeeping system.

As mentioned in our report and highlighted in the IRS response, the IRS did develop a process to verify hours worked. However, we believe the process resulted only in the verification of hours listed on the summary sheets to the invoices, not in verification that the summary sheets were accurate. Since subcontractor timecards and labor hour reports did exist, we believe such documentation, instead of summary sheets, should have been used to verify subcontractor labor hour charges. Further, if reviewing all timecards and labor hour reports would be too cumbersome and time consuming, we believe the IRS should have reviewed, at a minimum, a sample of such documentation to verify the accuracy of the summary sheets.

We agree with the IRS’ conclusion that the application of Cost Accounting Standards to time-and-materials contracts, from a pricing standpoint, is similar to a firm fixed-price contract. However, pricing is not relevant to our issue. We continue to believe the CO should confirm that contracted employees were performing their assigned duties. Our primary criteria for this condition are in FAR 52.232-7, which states, “The Contractor shall substantiate vouchers by evidence of actual payment and by individual daily job timecards.” We agree that it also goes on to state “or other substantiation approved by the Contracting Officer.” However, for time-and-materials contracts, we would expect the CO to verify, on at least a sample basis, that the labor hours charged were supported by timecards or other documentation such as sign-in sheets, payroll records, etc., to ensure the accuracy of invoices and contract compliance. Depending on the verification results, the CO could then adjust the verification process and rely on other substantiation.

Finally, the fact that no charges were ultimately found to be questionable should not be the basis to forgo the need to improve the IRS’ overall invoice verification control environment, which is the intent of our recommendations. Our position is bolstered by



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the fact that it took the contractor and subcontractor an inordinately long time to produce documentation that should have been readily available.

**Recommendation 2:** The Director, Procurement, should ensure COs and COTRs are cognizant of the importance of requesting and reviewing résumés of contracted consultants.

**Management's Response:** IRS management disagreed with our recommendation. The IRS believes it did verify the consultants' qualifications by having the Government task manager directly interview, either over the telephone or in person, the subcontractor's proposed team members to determine if they were qualified to perform the task. Accordingly, the IRS believes oral interviews, where specific questions can be asked about experience and qualifications, are preferred to reviewing written résumés because individuals may misstate their experience in a résumé. Hence, the interviews appropriately reduced and managed risk while verifying whether the customer's requirements can be satisfied. An example was provided that, during one of the weekly status report reviews, errors were found in the subcontractor invoices where an incorrect rate was charged. This occurred in two of the invoices selected for the audit. The IRS reviewer determined an employee charged hours under the Senior Software Consultant rate that should have been charged at the lower Software Consultant rate. Accordingly, a subsequent voucher was reduced by those hours.

The IRS believes that, since no miscalculations were identified during the audit, it is reasonable to assume the résumés not reviewed are also appropriate. Consequently, the IRS believes the audit results substantiated its procedures, which included verbal interviews, verifying rates to weekly reports, obtaining proposals with hours and rates, and including employee names in contract modifications.

IRS management also disagreed with our reporting of a "Reliability of Information" outcome measure related to subcontractor employees for whom résumés were not provided. They stated the outcome significantly overstates the impact of the "alleged *potential* labor rate misclassification" and they believe there are no potential savings or measurable impact from the audit recommendations. Our originally reported outcome measure was \$650,176.37, which related to the total hours charged by 23 subcontractor employees for whom résumés were not provided.<sup>6</sup> After obtaining a list from us in early April 2006, the IRS provided résumés for 10 of the original 23 employees, then advised us the charges associated with the remaining 13 employees totaled \$444,430. In its official response to the draft report, the IRS stated that it is realistic to project and assume the remaining 13 résumés would also be found compliant, especially in light of its interviews and weekly and monthly reviews verifying who was working on this contract. The IRS stated that, to assume otherwise (i.e., these 13 résumés are incorrect contrary to the findings for the other 62), is not reasonable.

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<sup>6</sup> See Appendix IV for details. The 23 subcontractor employees were from a total of 75 employees reviewed.



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**Office of Audit Comment:** We did not identify any documentation within the contract files to substantiate that discussions were held with subcontractor employees to verify their qualifications. Further, we disagree with the IRS' contention that, in this situation, oral testimony is preferable to documentary evidence because individuals may misstate their experience in a résumé. While we acknowledge that individuals may misrepresent their qualifications on a résumé, certain technical requirements, such as college degrees or years of specific technical job experience, to meet specific positions are best identified through written documents such as résumés. If the veracity of the résumé is questioned, one can always confirm items in question with the listed source entities. Interviews with individuals to ascertain their level of competency, while beneficial, cannot substitute for ensuring specific technical requirements of the position have been met, unless the interviews specifically cover such technical requirements and the discussions are documented with the information that otherwise would be contained in the résumé.

We agree that labor hour verifications were conducted during the weekly status report reviews and errors were identified. We applaud the IRS' efforts to ensure correct rates were being used; however, these efforts had no bearing on the verification of the qualifications of the subcontractor employees to ensure the employees met the requirements for the positions in which they were classified.

Concerning the IRS' disagreement with the outcome measure, we have the following comments. The outcome measure does not concern questionable charges (questioned costs) because we were able to confirm through timecards and other supporting documentation that the labor hours were supported and accurately calculated based on the cited labor category. At issue is whether the employees met the requirements for their respective cited labor categories. Without résumés or other supporting documentation, we could not determine if such requirements were met. Accordingly, we measure the total value of labor charges on the affected employees under Reliability of Information, which we define as ensuring the accuracy, validity, relevance, and integrity of data, including the sources of data, used by the IRS to plan, monitor, and report on its financial and operational activities. As mentioned, subsequent to the draft report issuance in February 2006, the IRS in April 2006 provided us an additional 10 résumés from the original list of 23 employees we had provided to the IRS at the conclusion of our fieldwork on this issue in September 2005. Thus, we reduced the outcome measure to the total value of the hours charged by the remaining 13 employees, which was \$444,430.

Also, we understand the IRS' rationale for further reducing the value of this issue to the difference between the cited labor category and the lowest labor category for the respective positions. This would be acceptable if documentation existed to support the lowest labor category. However, since the IRS did not have any support in the contract files that these 13 contractor employees met even the minimum technical requirements



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specified for any labor category in those positions, we cannot be assured the employees should have been assigned to this contract. We thus calculated the value of this outcome measure at the total labor hour charges associated with these 13 employees.

**Recommendation 3:** The Director, Procurement, should ensure COs and COTRs are cognizant of the extent of audit coverage, if any, by the DCAA and adjust invoice verification procedures accordingly.

**Management's Response:** IRS management disagreed with our recommendation. The IRS contends that, prior to award, the GSA made a determination of responsibility, which requires that contracts be awarded to responsible prospective contractors only. To be determined responsible, contractors are required to have satisfactory records of performance, integrity, and business ethics and to possess the necessary organization, experience, and accounting and operational controls. Accordingly, the IRS relies on the GSA's determination of responsibility and reviews of the contractor's systems.

In addition, the GSA performs a postaward review of its contractors. Specifically, in September 2005, the GSA performed a postaward review of the contractor covering 4 main areas and over 25 subelements. The areas reviewed included ordering procedures and administrative, contract pricing, and financial concerns. Based upon its review, the GSA rated the contractor outstanding. The contractor is also audited yearly by an independent certified public accounting firm, which audits its financial statements, policies and procedures, and related internal controls (in addition to other audits by State and local agencies). During contract performance, in both 2003 and 2004, the independent auditors provided an unqualified opinion.

The IRS believes its review process was validated by the audit because, after all labor hours and over 60 percent of all résumés were audited, no questioned costs or rates were found.

**Office of Audit Comment:** We believe the IRS' position (i.e., the contractor was selected for a Federal Government contract, reviewed by the GSA, and audited by a certified public accounting firm, thus eliminating the risk of not being audited by the DCAA) is not reasonable. Using this argument would suggest the Federal Government's risk on a time-and-materials contract was so reduced by these activities that there was no need for Federal Government audit coverage or contract administration verification of invoices prior to payment.

Our recommendation is for the CO to be cognizant of the billing risk that could exist when neither the contractor nor the subcontractor is audited by the DCAA and to adjust invoice verification procedures accordingly. The Federal Government relies heavily on the DCAA in determining whether a business has adequate controls in place to ensure billing and estimating systems can be trusted to produce accurate invoices, in accordance with Federal regulations and standards and with contract terms and conditions. The



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aforementioned activities of the GSA and certified public accounting firm do not necessarily provide the same level of assurance that a DCAA audit would provide, given the differences in scope of such activities and audits.

Again, the fact that no charges were ultimately found to be questionable should not be the basis to forgo the need to improve the IRS' overall invoice verification control environment, which is the intent of our recommendations.

### ***Contract Deliverables Were Acceptable***

We examined contract correspondence files and interviewed the CO and COTR to determine whether the contractor's deliverables were acceptable. The contract involved performing information technology professional services for four primary tasks:

- Enterprise architecture design and implementation and migration planning for Microsoft's Active Directory Services.
- Architecture design and implementation and migration planning for Windows 2000 and Windows.NET server.
- Enterprise strategy consulting.
- Microsoft Consulting Manager and Premier Support Services Technical Account Manager services.

The contractor provided services for the following IRS projects and offices:

- Criminal Investigation National Operations Center.
- Large and Mid-Size Business Management System.
- Web Services, Web Development, and Hosting.
- Internal Revenue Manual E-Clearance Application.
- Servicewide<sup>7</sup> Policy, Directives, and Electronic Research.
- Criminal Investigation Electronic Records Management System.
- Tax Exempt and Government Entities Division.

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<sup>7</sup> "Servicewide" indicates IRS-wide.



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Based on our limited auditing procedures, nothing came to our attention that would lead us to believe there were significant problems with the deliverables associated with the tasks included in our tests.





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## **Appendix I**

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

The overall objective of this review was to determine whether selected invoices submitted and paid under contract number TIRNO-03-K-00191 were appropriate and in accordance with the contract's terms and conditions. To accomplish our objective, we:

- I. Analyzed the Internal Revenue Service's (IRS) invoice verification process prior to certifying payment to the contractor.
  - A. Interviewed the Contracting Officer and the Contracting Officer's Technical Representative to confirm our understanding of the invoice verification process.
  - B. Documented invoice processing risks including accuracy, supportability, and allowability of invoice charges and concluded as to the overall control environment.
  - C. Interviewed IRS personnel involved in the administration of the contract to identify any concerns that existed regarding the contractor, its billing practices, or any specific invoices.
- II. Verified whether invoice charges submitted by the contractor and paid by the IRS were accurate, supported, and allowable.
  - A. Researched the IRS Request Tracking System (RTS)<sup>1</sup> and prepared a list of transactions processed during the life of the contract (April 4, 2003, through June 15, 2005). The RTS listed 29 invoices submitted by the contractor. The 29 invoices included 184 charges against 33 tasks (equivalent to IRS work requests) and totaled \$7,673,842. Total task awards equaled \$8,348,704.

We judgmentally selected seven invoices for review. First, we selected the three invoices with the highest dollar amounts; then we selected four more invoices that would give us coverage of the most tasks. This sampling method resulted in the selection of 49 charges against 23 tasks that totaled \$2,806,086 in IRS payments. We believed this sampling method would provide sufficient evidence to accomplish our audit objective and would result in acceptable management corrective action without the need for a precise projection of sample results.

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<sup>1</sup> The RTS is a web-based application that allows IRS personnel to prepare, approve, fund, and track requests for the delivery of goods and services. The System also allows for electronic acceptance of items delivered and provides an electronic interface with the Integrated Financial System (the IRS' administrative financial accounting system) for payment processing.



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- This audit did not include audit procedures to obtain evidence that computer-processed data, within the IRS RTS, were valid and reliable. Although used during this audit, the data in general were not considered significant to the audit's objective or resultant findings. We used the data within the RTS only to reasonably identify the universe from which we selected our sample of transactions for substantive testing of their accuracy, supportability, and allowability. We concluded and reported only on those substantive tests. Therefore, there was no adverse effect on the audit as a result of not including reliability of computer-processed data audit procedures.
- B. Obtained supporting documentation for the invoices in the sample from the IRS and contractor and performed the following tests:
1. Verified the mathematical accuracy of the invoices and supporting documentation.
  2. Traced invoice charges to supporting documentation.
  3. Verified whether invoice charges were actually paid by the contractor through examination of payroll records and extracts from the contractor's financial records.
  4. Verified whether invoice charges were allowable under the terms and conditions of the contract.
- III. Verified through interviews with responsible officials and reviews of project files whether there was acceptable existence of deliverables, as stipulated in the contract, for all tasks.



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**Appendix II**

*Major Contributors to This Report*

Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs)  
John R. Wright, Director  
Thomas J. Brunetto, Audit Manager  
Robert W. Beel, Lead Auditor  
Thomas Dori, Senior Auditor  
Jeff K. Jones, Senior Auditor  
Melvin Lindsey, Auditor



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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  
Director, Procurement OS:A:P  
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    Director, Procurement OS:A:P



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## **Appendix IV**

### *Outcome Measure*

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. This benefit will be incorporated into our Semiannual Report to Congress.

#### **Type and Value of Outcome Measure:**

- Reliability of Information – Potential; \$444,430 (reduced from \$650,176.37 as originally cited in the draft report; see page 2).

#### **Methodology Used to Measure the Reported Benefit:**

We examined invoices and supporting documentation obtained from the Internal Revenue Service (IRS) Office of Procurement, as well as documentation received directly from the contractor, to verify charges for a judgmental sample of seven invoices. We selected our sample from a total population of approximately \$7.7 million in transactions processed by the IRS. The 7 invoices involved approximately \$2.8 million in IRS payments.

We identified \$650,176.37 (approximately 23 percent of the amount audited) in charges for which qualification résumés could not be provided by the contractor. On April 7, 2006, subsequent to the issuance of our draft report on February 28, 2006, the IRS provided 10 additional résumés, which it considered acceptable. According to the IRS, these résumés reduced the amount related to the remaining 13 consultants to \$444,430.



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**Appendix V**

*Management's Response to the Draft Report*



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

RECEIVED  
APR 28 2006

April 28, 2006

MEMORANDUM FOR MICHAEL PHILLIPS  
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: David A. Grant *David A. Grant*  
Director, Procurement

SUBJECT: Draft Audit Report—Invoice Audit of the Microsoft Consulting Services  
Contract No. TIRNO-03-K-00191 (Audit No. 200510026)

We appreciate the opportunity to respond to the subject draft audit report. The audit assessed whether invoices paid under the subject contract were appropriate and in accordance with its terms and conditions.

The audit focused on a sample of seven monthly invoices selected using a judgmental sampling method. Based on the audit samplings, the audit team identified \$650,176.37 in charges associated with consultants.

We believe the invoices submitted and paid under the subject contract were appropriate according to its commercial terms. Therefore, we disagree with the audit findings, the resulting recommendations, and the estimated \$650,176 benefit to tax administration. These benefits were identified as a result of 13 résumés that could not be provided for review. Over 62 résumés were reviewed and employees were found to be billed at the correct rate and classification. Therefore, it is reasonable to project that the remaining 13 résumés would be found to be compliant, especially in light of the oral interviews and the weekly COTR and GTM labor reviews.

Our detailed response to the audit findings, recommendations, and the measurement of tax benefits, is attached.

If you have any questions, please contact me at (202) 622-8480 or contact Linda Barrett, Director, Office of Information Technology, at (202) 283-1410.

Attachment

cc: Chief, Agency Wide Shared Services OS:A  
Management Controls Coordinator OS:A:F



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**ATTACHMENT**

**RECOMMENDATION 1:**

We recommend that the Director, Procurement, should ensure COs and COTRs adhere to the requirements of FAR 52.231-7(a)(1), Payments Under Time-and-Materials and Labor-Hour Contracts, when appropriate.

**RESPONSE:**

The report states that the "IRS did not review, as part of its invoice verification process, any source documents (such as timecards) to confirm labor hours charged." During the contract kick-off meeting, the contractor explained the monthly invoice process to the CO. Rather than obtaining timecards, the CO approved the subcontractor providing weekly status reports that list by task, the daily hours charged by individual and their corresponding labor rate. This complies with FAR 52.232-7 which states that "other substantiation" besides timecards is acceptable. Once the subcontractor submitted its labor reports, they were thoroughly reviewed by the prime contractor, Government Task Manager (GTM), COTR and CO in weekly meetings with the subcontractor. Both the prime contractor and the COTR then confirmed that the subsequent monthly subcontractor invoices traced to the weekly reports. If they differed, the prime contractor or the COTR would take exception to the invoiced hours and question them.

The report also states that reliance on the weekly "contractor-prepared reports on subcontractor charges is inadequate because the report information is not generated directly from the subcontractor's accounting records." However, the weekly information was generated directly from the accounting records. According to InfoReliance, the subcontract has an on-line time keeping system where employees enter their time directly into the computer system (rather than using manual timecards). The same system then *directly* generates the weekly status reports listing the individual's daily time charges by task.

In addition, the report recommends that we follow the verification techniques for cost-reimbursement contracts in the OFPP *Guide to Best Practices for Contract Administration* by reviewing the contractor's timecards and sign-in sheets to assess the reasonableness of direct labor costs. However, this is a *commercial* T&M contract awarded by GSA and therefore it is unlike a cost-type contract. The Cost Accounting Standards (CAS) Board recently affirmed this stating that for commercial T&M contracts "the application of CAS from a pricing standpoint, is similar to a *firm fixed-price contract* (1/ 4/06, Fed. Reg., Vol. 71, No. 2)." The Board then recommends "revis(ing) the CAS by providing an exemption for time-and-materials...contracts for the acquisition of commercial items."



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FAR 1.102-2(c) and (b) requires that the "Government shall exercise discretion, use(ing) sound business judgment" when complying "with applicable laws and regulations in dealing with contractors and prospective contractors," while "(m)inimiz(ing) administrative operating costs." Consequently, the Federal Acquisition System incorporates a best value or balanced approach to federal acquisition, as discussed in FAR 1.102-1(b):

Best value must be viewed from a broad perspective and is achieved by balancing the many competing interests in the System. The result is a system which works better and costs less.

However, we believe to associate cost-type techniques with a commercial contract and to require timecards would be contrary to this balanced approach, leads to risk avoidance rather than risk management, and increases administrative costs. Accordingly, such an approach would be contrary to FAR 1.102-2(c)(2), which requires:

*...the (Federal Acquisition) System must shift its focus from "risk avoidance" to one of "risk management." The cost to the taxpayer of attempting to eliminate all risk is prohibitive. The Executive Branch will accept and manage the risk associated with empowering local procurement officials to take independent action based on their professional judgment. (italics added)*

FAR 1.102-2(b)(1) further elaborates upon this and states:

In order to ensure that maximum efficiency is obtained, rules, regulations, and policies should be promulgated *only* when their benefits clearly exceed the costs of their development, implementation, administration, and enforcement. This applies to internal administrative processes, *including reviews*, and to rules and procedures applied to the *contractor community*. (italics added)

Accordingly, we believe requiring daily timecards rather than weekly status reports listing daily time charges—both generated from the same system—is one where the cost exceeds the benefit, particularly when the process already implemented complies with 52.232-7. In our opinion, the CO properly implemented this clause in accordance with FAR 1.102-4(a) which requires:

Government members of the Team must be *empowered to make acquisition decisions within their areas of responsibility*, including selection, negotiation, and *administration of contracts* consistent with the Guiding Principles. In particular, *the contracting officer must have the authority to the maximum extent practicable and consistent with law, to determine the application of rules, regulations, and policies, on a specific contract.* (italics added)

Finally, we believe the audit findings validated our approach. Specifically, after using risk avoidance techniques by reviewing 100% of the daily timecards, the audit found no exceptions—all hours charged traced to the monthly invoices and timecards.





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Consequently, we believe our method for substantiating time charges was compliant with FAR 1.102—it managed risk and minimized administrative costs while protecting and balancing the Government's interest.

**CORRECTIVE ACTION:**

Not Applicable

**IMPLEMENTATION DATE:**

Not Applicable

**RESPONSIBLE OFFICIAL:**

Director, Procurement OS:A:P

**CORRECTIVE ACTION MONITORING PLAN:**

Not Applicable



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**RECOMMENDATION 2:**

The Director, Procurement should ensure COs and COTRs are cognizant of the importance of requesting and reviewing résumés of contracted consultants.

**RESPONSE:**

The report states that "(a)s with labor hours, during the period when these charges were invoiced by the contractor, the IRS did not review subcontractor-provided consultant résumés or otherwise check their qualifications." However, we did verify the consultant's qualifications. Rather than obtaining résumés, the GTM directly interviewed the subcontractor's proposed team members to determine if they were qualified to perform the task. The subcontractor's task manager would often introduce the proposed team and brief their qualifications to the Government. Then the GTM held telephone or in-person interviews with the proposed staff to verify their qualifications and experience as a Senior Software Consultant, etc. Accordingly, we believe *oral* interviews where specific questions can be asked about experience and qualifications are preferred to reviewing *written* résumés since individuals may misstate their experience in a résumé. Hence, the interviews appropriately reduced and managed risk while verifying whether the customer's requirements can be satisfied.

Also, based on the oral interviews and the Government's verbal approval, the contractor would submit a proposal with estimated hours by labor category. A contract order or modification would then add those hours and funding, if approved, to the task order. At times, the CO even listed those individuals approved by labor category in the contract modification. For example, Contract Modification No. 25, dated June 10, 2004 lists six individuals and their respective labor rate categories. Once these employees were approved by the Government, the GTM monitored their hours and rates charged through the weekly status reports and traced them to the monthly invoices.

During these reviews, sometimes either the prime or COTR would find errors in the subcontractor invoices where an incorrect rate was charged. For example, this occurred in two of the invoices selected for the audit—Voucher Numbers 22 and 25. In Voucher 22, our reviewer determined that an employee charged 70 hours under the *Senior* Software Consultant rate which should have been charged at the lower *Software Consultant* rate. Accordingly, Voucher 25 is reduced by those 70 hours and then re-billed at the correct rate. Consequently, in accordance with the report's concerns, we believe we did ensure proper labor rates are being used.

Approximately 104 employees charged this contract, according to InfoReliance. The audit reviewed 62 of their résumés—over 60%—without finding any labor rate misclassifications. Accordingly, it is reasonable to assume that the résumés not reviewed are also appropriate. Consequently, we believe the audit results substantiated our procedures which included verbal interviews, verifying rates to weekly reports, obtaining proposals with hours and rates, and including employee names in contract



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modifications and found them properly and efficiently managing risk while balancing and protecting the Government's interests.

**CORRECTIVE ACTION:**

Not Applicable

**IMPLEMENTATION DATE:**

Not Applicable

**RESPONSIBLE OFFICIAL:**

Director, Procurement OS:A:P

**CORRECTIVE ACTION MONITORING PLAN:**

Not Applicable



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**RECOMMENDATION 3:**

The Director, Procurement should ensure COs and COTRs are cognizant of the extent of audit coverage by the Defense Contract Audit Agency, if any, and adjust invoice verification procedures accordingly.

**RESPONSE:**

Prior to award, GSA made a determination of responsibility under FAR 9.103 which requires that "contracts shall be awarded to, responsible prospective contractors only." To be determined responsible, FAR 9.104-1 requires that the Government must determine that prospective contractors have satisfactory records of "performance" and of "integrity and business ethics," and possess "the necessary organization, experience, accounting and operational controls..."

FAR 16.104(h) under "Adequacy of the Contractor's Accounting System" further states:

Before agreeing on a contract type other than firm-fixed-price, the contracting officer shall ensure that the contractor's accounting system will permit timely development of all necessary cost data in the form required by the proposed contract type.

Accordingly, the IRS (and all government agencies using GSA contracts) relies on GSA's determination of responsibility and reviews of the contractor's systems. Otherwise, each agency would be performing their own reviews, which in part, defeats the purpose of having GSA contracts.

In addition, GSA also performs a post-award review of its contractors. Specifically, in September 2005 (during the subject audit), GSA performed a post-award review of InfoReliance covering four main areas and over 25 sub-elements. The areas reviewed included ordering procedures, administrative, contract pricing, and financial concerns. Based upon their review, GSA rated InfoReliance outstanding.

InfoReliance is also audited yearly by an independent CPA, who audits their financial statements, policies and procedures, and related internal controls (in addition to other audits by state and local agencies). During contract performance, in both 2003 and 2004, the independent auditors provided a "clean" (i.e., unqualified) opinion.

Further, both the prime contractor and the government met with the subcontractor weekly (and often twice a week) during performance, to monitor progress and verify daily hours and rates charged. Also, monthly invoices were closely monitored and traced to these weekly reports and we interviewed perspective consultant employees prior to performance. These procedures were especially appropriate since DCAA may not have audit rights under commercial T&M contracts. Specifically, DCAA states:

Based on the FAR provisions, it appears that orders issued under the GSA Schedule contracts constitute acquisition of commercial items, *which are not subject to audit of*



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*contract performance costs* (italics added). (DCAA April 19, 2004 memorandum-04-PAC-022R)

The audit report also states that "the IRS cannot assure the allowability of the charges or for services provided. This puts the IRS at risk of making improper contractor payments." We disagree. The CO for this commercial contract obtained "best value" by balancing the many competing government interests and properly managing risk rather than avoiding it, pursuant to FAR 1.102-2(c)(2). This regulation states that the "cost to the taxpayer of attempting to eliminate all risk is prohibitive." Accordingly, consistent with this regulation, we empowered the CO, COTR, and GTM to take independent action based on their professional judgment. We believe our review process was validated by the audit—after auditing all labor hours and over 60 percent of all résumés—no questioned costs or rates were found.

**CORRECTIVE ACTION:**

Not Applicable

**IMPLEMENTATION DATE:**

Not Applicable

**RESPONSIBLE OFFICIAL:**

Director, Procurement OS:A:P

**CORRECTIVE ACTION MONITORING PLAN:**

Not Applicable

**OUTCOME MEASURES:**

The recommendations will provide the following measurable benefit to tax administration: reliability of information for \$650,176.37 in charges for which qualification résumés could not be provided by the contractor.

**RESPONSE:**

During the audit, résumés for 75 employees were requested. The report states that 23 résumés were not provided and that résumés "are essential" to ensure that employees are charging the correct "labor category or rate." The total hours these employees charged are then associated (or "questioned") as the measurable impact of the audit recommendations. We disagree for the reasons discussed below and believe there is no potential savings or measurable impact.



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1. Incorrect Number of Résumés Not Provided

On April 6, 2006, we obtained from the Lead Auditor the calculation of measurable savings that listed the hours and rates for the 23 individuals for which the report states résumés were not received. The next day, we provided résumés for 10 of these employees. Accordingly, only 13 employees did not have résumés (which we could not obtain since they are no longer employed by the subcontractor). Charges associated with these 13 individuals are \$444,430, rather than the \$650,176 mentioned in the report.

2. Incorrect to Report Savings as Total Hours Charged

The audit traced all the hours charged for these 13 employees to their timecards and did not find any exceptions—all the hours charged were valid. Therefore, it significantly overstates the impact of their alleged *potential* labor rate misclassification to “question” (or associate) all their hours as savings, since the employees did work these hours and the Government received the benefit of their labor. Rather, if these employees labor rates were misclassified, the maximum impact would be the *rate difference* between their alleged correct labor category and that which was incorrectly invoiced—not their total hours charged.

Accordingly, for each of these 13 employees, we lowered their labor category to the next lower position or rate category, multiplied by hours charged, and then summed. We then compared the two totals—“misclassified” versus “correct”—to determine the impact. For example, if the employee was invoiced at Software Consultant 2, we lowered the rate to Software Consultant 1 and multiplied the *difference* by hours charged; the result is the potential impact. However, if the person was already in the lowest labor category, we did not change the rate to a different category, since the risk of that employee being totally misclassified is low, e.g., a janitor would likely not be misclassified as an electrician (compared to an Electrician 1 being misclassified as an Electrician 2). Based on this, the *maximum* impact would be \$23,950—not \$444,430 or \$650,176.

3. Incorrect to Project Any Savings from Résumés Not Received

During the audit, 62 résumés out of 75 were obtained and reviewed—over 80% of the sample and 60% of all 104 résumés. For each of those résumés, the audit verified that the employees were billed at the correct rate and were correctly classified. Therefore, it is realistic to project and assume that the remaining 13 résumés would also be found compliant, especially in light of our interviews and weekly and monthly reviews verifying who was working on this contract. To assume otherwise—that these 13 résumés are incorrect contrary to the findings for the 62—is not reasonable. For instance, had the audit sample been random rather than judgmental, we could project with 95% certainty that the remaining 41 individuals who charged this contract were billed at the appropriate rate (with a confidence interval of 8). Accordingly, we believe there is no potential savings or measurable impact from the audit recommendations.