



*Voucher Audit of the Federally Funded
Research and Development Center
Contract - TIRNO-99-D-00005*

August 31, 2006

Reference Number: 2006-10-140

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.

Phone Number | 202-927-7037

Email Address | Bonnie.Heald@tigta.treas.gov

Web Site | <http://www.tigta.gov>



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

August 31, 2006

MEMORANDUM FOR CHIEF, AGENCY-WIDE SHARED SERVICES

FROM:

(for) Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT:

Final Audit Report - Voucher Audit of the Federally Funded Research and Development Center Contract - TIRNO-99-D-00005
(Audit # 200610014)

This report presents the results of our review of the Internal Revenue Service's (IRS) Federally Funded Research and Development Center contract TIRNO-99-D-00005. The overall objective of this review was to determine whether selected vouchers submitted and paid under contract number TIRNO-99-D-00005 were appropriate and in accordance with the contract's terms and conditions.

Synopsis

Contract expenditures represent a significant outlay of Internal Revenue Service (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 vouchers submitted by the contractor and paid by the IRS were accurate, supported, and allowable.

Our review resulted in the identification of questionable charges of \$28,449.21. The questionable charges consisted of unallowable and unsupported costs.

The Treasury Inspector General for Tax Administration Office of Audit Information Systems Programs staff is currently performing a program audit of this contract's work products for specific task orders to determine whether the contractor effectively delivered services, and the IRS effectively and timely monitored the contractor's performance.¹ That audit's results will be reported separately. As part of this audit, we significantly limited our audit procedures regarding

¹ *Role and Cost of the Federally Funded Research and Development Center* (Audit Number 200620038).



*Voucher Audit of the Federally Funded Research and
Development Center Contract - TIRNO-99-D-00005*

contract deliverables to interviews with the Contracting Officer and the Contracting Officer's Technical Representative to determine whether contractor 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 contract. However, a final conclusion concerning contractor performance will depend on the results of the program audit.

Recommendation

We recommended the Director, Procurement, ensure the appropriate Contracting Officer reviews the identified questionable charges of \$28,449.21 and initiates any recovery actions deemed warranted.

Response

IRS management agreed with our recommendation. For the unsupported subcontractor costs, the Office of Procurement will periodically request invoice backup documentation to "spot check" the invoices and validate their accuracy. For the unallowable other direct charges and unallowable travel charges, the Office of Procurement will issue a letter to the contractor pursuing recovery of these charges. Management's complete response to the draft report is included as Appendix V.

Copies of this report are also being sent to the IRS managers affected by the report recommendation. Please contact me at (202) 622-6510 if you have questions, or Nancy A. Nakamura, Acting Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.



*Voucher Audit of the Federally Funded Research and
Development Center Contract - TIRNO-99-D-00005*

Table of Contents

| | |
|--|---------|
| Background | Page 1 |
| Results of Review | Page 3 |
| Questionable Contract Charges and Voucher Verification Process | Page 3 |
| <u>Recommendation 1:</u> | Page 5 |
| Contract Deliverables..... | Page 5 |
| Appendices | |
| Appendix I – Detailed Objective, Scope, and Methodology | Page 7 |
| Appendix II – Major Contributors to This Report | Page 9 |
| Appendix III – Report Distribution List | Page 10 |
| Appendix IV – Outcome Measure | Page 11 |
| Appendix V – Management’s Response to the Draft Report | Page 12 |



*Voucher Audit of the Federally Funded Research and
Development Center Contract - TIRNO-99-D-00005*

Background

In October 1998, the Internal Revenue Service (IRS) awarded contract number TIRNO-99-D-00005, a cost-plus-fixed-fee contract,¹ which established a Federally funded research and development center.² The mission of the center is to provide support for the modernization of systems and their operations. The contractor is a not-for-profit corporation organized to ensure that none of its assets will directly or indirectly benefit any private individual or entity.

The contract was awarded for a base period from October 1998 through September 30, 1999. The contract includes six option periods which carry the term of the contract through September 30, 2013.³ According to the IRS Request Tracking System,⁴ as of December 2005, the IRS had approved approximately \$53 million for payment to the contractor.

Because contract expenditures represent a significant outlay of IRS funds, the Treasury Inspector General for Tax Administration 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 the contractor vouchers and supporting documentation.

We conducted our voucher audit concurrently with a program audit of the Federally funded research and development center performed by the Treasury Inspector General for Tax Administration Office of Audit Information Systems Programs staff.⁵ The objectives of the program audit were to determine whether the contractor effectively delivered services that significantly contributed to achieving stated objectives, and to determine whether the IRS can effectively and timely monitor and report on the contractor's performance. As a result, we significantly limited our audit procedures regarding contract deliverables to interviews with the

¹ A cost-plus-fixed-fee acquisition provides for payment of allowable incurred costs, to the extent prescribed in the contract, and payment 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.

² Federally funded research and development centers enable agencies to use private sector resources to accomplish tasks that are integral to the agencies' missions and operations. The centers are operated, managed, and/or administered by either a university or a consortium of universities; another not-for-profit organization; or, an industrial firm, as an autonomous organization or as an identifiable separate operating unit of a parent organization.

³ Options 1 through 4 are for 1-year each; options 5 and 6 are for 5-year durations.

⁴ 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 receipt and acceptance of items delivered and provides an electronic interface with the Integrated Financial System (the IRS' administrative financial accounting systems) for payment processing.

⁵ *Role and Cost of the Federally Funded Research and Development Center* (Audit Number 200620038).



*Voucher Audit of the Federally Funded Research and
Development Center Contract - TIRNO-99-D-00005*

Contracting Officer and the Contracting Officer's Technical Representative to determine whether contractor performance was satisfactory.

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 Bedford, Massachusetts, during the period November 2005 through June 2006. Opinions expressed in this report pertain only to the vouchers included in our 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.



Results of Review

Questionable Contract Charges and Voucher Verification Process

We examined supporting documentation obtained from the IRS Office of Procurement, as well as documentation received directly from the contractor, for a judgmental sample of eight vouchers (see Appendix I for details). The 8 vouchers were processed between February 2004 and October 2005, and involved approximately \$13.8 million in IRS payments. The primary expenses claimed on the vouchers were labor costs, other direct costs (e.g., travel and subcontractor costs), and indirect costs (e.g., overhead, general and administrative expenses, and cost of money).

Questionable contract charges

Based on our audit tests, we identified questionable charges of \$28,449.21 as shown in Table 1. We provided details of these charges to the contractor and the IRS.

Table 1: Schedule of Questionable Charges

| Questioned Activity | Questionable Charges |
|---------------------------------|-----------------------------|
| Unsupported Subcontractor Costs | \$27,056.64 |
| Unallowable Other Direct Costs | \$775.57 |
| Unallowable Travel Charges | \$617.00 |
| Total | \$28,449.21 |

Source: Treasury Inspector General for Tax Administration analysis of eight vouchers submitted to the IRS.

All of the unsupported subcontractor costs involved an instance in which the documentation provided did not adequately support the expenses claimed for subcontractor labor. The unallowable other direct costs involved instances of catering expenses and cell phone charges. Finally, the unallowable travel charges related to costs that exceeded Federal Government-established per diem rates.

The Federal Acquisition Regulation (FAR)⁶ stipulates a contractor is responsible for accounting for costs appropriately and for maintaining records, including supporting documentation, adequate to demonstrate that costs claimed were incurred. The FAR also provides that costs

⁶ 48 C.F.R. pt 1-53 (2002).



*Voucher Audit of the Federally Funded Research and
Development Center Contract - TIRNO-99-D-00005*

shall be allowed to the extent they are reasonable, allocable, and allowable under the FAR. In addition, the contract stipulates that the contractor may be reimbursed for travel costs in accordance with the Federal Travel Regulations.⁷ The Federal Travel Regulations provide that the meals and incidental expense allowance on the first and last day of travel is 75 percent of the applicable meals and incidental expense rate; however, the contractor had claimed 90 percent. Additionally, the Principles of Federal Appropriations Law⁸ stipulates that appropriated funds may not be used for entertainment, and defines entertainment as including food and drink, either formal meals or snacks, and refreshments. The contractor had claimed catering expenses.

Voucher verification process

Contracts may be entered into and signed on behalf of the Federal Government only by Contracting Officers (CO). The COs have the authority to administer or terminate contracts and make related determinations and findings. The 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 Contracting Officer's Technical Representative (COTR), who is the CO's technical expert and representative in the administration of a contract or task order. Usually, the CO will appoint the COTR by issuing a signed letter of appointment tailored to meet the needs to 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* was the primary guidance for the COTRs.⁹ Part IV of the *Handbook* stated, in part, that the COTRs are responsible for reviewing and approving invoices and vouchers on contracts. It also stated the COTRs will receive instructions regarding involvement in the review and approval of invoices and vouchers from the CO. Two of the eight vouchers included in our sample were subject to this guidance.

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 the COTRs reviewing vouchers under cost-reimbursement contracts should review, among other things, contractor timecards to help assess the reasonableness of direct labor costs. The *Guide* also contains directions to review major cost categories, such as travel, supplies, other direct costs, and subcontractor costs, to again determine the reasonableness of the claimed costs.

⁷ 41 C.F.R. Chapter 301 (2005).

⁸ "Principles of Federal Appropriations Law," Third Edition, published by the Government Accountability Office.

⁹ Department of the Treasury Acquisition Circular No. 02-01, dated April 28, 2004, deleted references to the *Contracting Officer's Technical Representatives Handbook*. The Circular also stated the Department of the Treasury would no longer maintain the *Handbook*.



*Voucher Audit of the Federally Funded Research and
Development Center Contract - TIRNO-99-D-00005*

The COTR is responsible for receipt and acceptance of the vouchers. The COTR receives a monthly progress report which details the hours worked. The COTR forwards the progress report to the appropriate program offices for verification of the hours. If a problem is identified, the COTR works with the CO and the contractor to resolve the issue. Otherwise, the voucher is approved for payment. The IRS does not receive any documentation supporting labor hours (e.g., time reports) or other direct costs. Additionally, the IRS does not verify that the appropriate indirect rates were used to calculate indirect costs included on the vouchers. The CO explained the IRS relies on the Defense Contract Audit Agency to audit and ensure proper rate application.

We did not identify a significant amount of questionable charges on the vouchers reviewed, notwithstanding the incomplete voucher verification process relating to the documentation supporting labor hours and other direct costs. We will continue to include reviews of the IRS' voucher verification process in future contract voucher audits and, if warranted, recommend improvements to the process.

Recommendation

Recommendation 1: The Director, Procurement, should ensure the appropriate CO reviews the identified questionable charges of \$28,449.21 and initiates any recovery actions deemed warranted.

Management's Response: The IRS agreed with our recommendation. For the unsupported subcontractor costs, the Office of Procurement will periodically request invoice backup documentation to "spot check" the invoices and validate their accuracy. For the unallowable other direct charges and unallowable travel charges, the Office of Procurement will issue a letter to the contractor pursuing recovery of these charges.

Contract Deliverables

The Treasury Inspector General for Tax Administration Office of Audit Information Systems Programs staff is currently performing a program audit of this contract's work products for specific task orders to determine whether the contractor effectively delivered services and the IRS effectively and timely monitored the contractor's performance.¹⁰ That audit's results will be reported separately.

Therefore, as part of our audit, we limited our tests to interviewing the CO and COTR to determine whether contractor performance was satisfactory. Based on these limited auditing

¹⁰ *Role and Cost of the Federally Funded Research and Development Center* (Audit Number 200620038).



*Voucher Audit of the Federally Funded Research and
Development Center Contract - TIRNO-99-D-00005*

procedures, nothing came to our attention that would lead us to believe there were significant problems with the deliverables associated with the contract. However, a final conclusion concerning contractor performance will depend on the results of the program audit.



Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine whether selected vouchers submitted and paid under contract number TIRNO-99-D-00005 were appropriate and in accordance with the contract's terms and conditions. To accomplish this objective, we:

- I. Analyzed the Internal Revenue Service's (IRS) voucher 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 voucher verification process.
 - B. Documented voucher processing risks including accuracy, supportability, and allowability of voucher 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 vouchers.
- II. Verified whether voucher charges submitted by the contractor and paid by the IRS were accurate, supported, and allowable.
 - A. Identified a sample selection universe from a list of vouchers for Fiscal Years 2004 and 2005 provided by the Contracting Officer. This list consisted of 56 vouchers, which we reconciled to the IRS Request Tracking System (RTS).¹ From this list, we judgmentally selected eight vouchers for review. The 8 vouchers, which were issued between February 2004 and October 2005, involved approximately \$13.8 million in IRS payments and represented approximately 26 percent of the total amount paid by the IRS. The eight vouchers were broken down by projects. In considering the size and extent of the voucher charges against audit resource limitations, we further refined our sample to 34 projects to verify all other direct costs and a judgmental sample of contractor labor costs. In doing this, we selected approximately \$1 million, or 19 percent, of contractor labor charges; approximately \$541,000, or 57 percent, of other direct costs; and approximately \$4.8 million, or 66 percent, in indirect costs and fees included on the 8 vouchers. We believed this sampling method would provide sufficient evidence to accomplish our audit objective and would result in acceptable

¹ 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 RTS 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.



*Voucher Audit of the Federally Funded Research and
Development Center Contract - TIRNO-99-D-00005*

management corrective action without the need for precise projection of sample results.

This audit did not include procedures to obtain evidence that computer-processed data, within the IRS RTS, were valid and reliable. Though used during this audit, the data in general were not considered significant to the audit's objective or resultant findings. We only used the data within the RTS to reasonably verify the universe from which we selected our sample of transactions for substantive testing of their accuracy, supportability, and allowability. We only concluded and reported on those substantive tests. Therefore, there was no adverse effect on the audit results from not including procedures to assess the reliability of computer-processed data.

- B. Obtained supporting documentation for the vouchers in the sample from the IRS and the contractor and performed the following tests:
 - 1. Verified the mathematical accuracy of the vouchers and supporting documentation.
 - 2. Traced voucher charges to supporting documentation.
 - 3. Verified whether voucher charges were actually paid by the contractor through examination of payroll records and extracts from the contractor's financial records.
 - 4. Verified whether voucher charges were allowable under the terms and conditions of the contract.

- III. Verified through interviews with responsible officials whether there was acceptable existence of deliverables, as stipulated in the contract, for the vouchers included in our sample. This audit step was significantly limited due to a concurrent program audit of the contract's work products by the Treasury Inspector General for Tax Administration Office of Audit Information Systems Programs staff.



*Voucher Audit of the Federally Funded Research and
Development Center Contract - TIRNO-99-D-00005*

Appendix II

Major Contributors to This Report

Nancy A. Nakamura, Acting Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs)
John R. Wright, Director
Thomas J. Brunetto, Audit Manager
Terrey Haley, Senior Auditor
Debra Kisler, Senior Auditor
Rashme Sawhney, Auditor



*Voucher Audit of the Federally Funded Research and
Development Center Contract - TIRNO-99-D-00005*

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
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:
 Chief, Agency-Wide Shared Services OS:A
 Director, Procurement OS:A:P



Appendix IV

Outcome Measure

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

Type and Value of Outcome Measure:

- Questioned Costs – Potential; \$28,449.21 (see page 3).

Methodology Used to Measure the Reported Benefit:

We examined vouchers and supporting documentation obtained from the Internal Revenue Service Office of Procurement, as well as documentation received directly from the contractor, to verify charges for a judgmental sample of eight vouchers. We selected our sample from a universe of 56 vouchers. The 8 selected vouchers involved approximately \$13.8 million in Internal Revenue Service payments.

Our review resulted in the identification of questionable charges of \$28,449.21. Specifically, these charges consisted of \$27,056.64 in unsupported subcontractor costs, \$775.57 in unallowable other direct costs involving catering and cell phone expenses, and \$617.00 in unallowable travel charges.



*Voucher Audit of the Federally Funded Research and
Development Center Contract - TIRNO-99-D-00005*

Appendix V

Management's Response to the Draft Report



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

RECEIVED
AUG 25 2006

August 25, 2006

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

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

SUBJECT: Draft Audit Report # 200610014 – Voucher Audit of the Federally
Funded Research and Development Center Contract –
TIRNO-99-D-00005

We appreciate TIGTA's review and support, as well as the opportunity to respond to the subject draft audit report. The report provided an assessment and findings from the review of selected vouchers submitted and paid under various task orders issued under the subject contract. The focus of that review was to determine if those vouchers were appropriate and in accordance with the contract terms and conditions.

Your report recommends that the Director, Procurement, ensure the appropriate Contracting Officer (CO) reviews the identified questionable charges of \$28,449.21 and initiates any recovery actions deemed warranted. The questionable charges equate to .002% of the total invoice sample amount of \$13.8 million and we agree with your statement that the audit did not identify a significant amount of questionable charges.

Subsequent to your audit, we have engaged in discussions with The MITRE Corporation Contracts Manager to discuss the findings of the TIGTA audit. The discussions included the Unsupported Subcontractor Costs, Unallowable Other Direct Costs, and Unallowable Travel Charges.

The attachment provides our specific responses to the report's recommendations.

If you have any questions, please call me at (202) 622-8480 or Fred Martin, Deputy Director, Procurement, at (202) 283-1200.

Attachment

cc: Chief, Agency-Wide Shared Services OS:A



*Voucher Audit of the Federally Funded Research and
Development Center Contract - TIRNO-99-D-00005*

ATTACHMENT

RECOMMENDATION 1:

The Director, Procurement, ensures the appropriate Contracting Officer reviews the identified questionable charges of \$28,449.21 and initiates any recovery actions deemed warranted.

CORRECTIVE ACTION:

For Unsupported Subcontractor Costs in the amount of \$27,056.64, the IRS will periodically (once per fiscal quarter) request invoice backup documentation such as timesheets and travel receipts in order to "spot check" the invoices and validate their accuracy as to appropriate indirect rate applications and contract allowability, allocability, and reasonableness. Also, the Contractor has committed to providing more training for employees, subcontractors, and consultants to enable them to better prepare their individual timesheets to ensure proper allocation of Direct Labor and Other Direct Cost Charges.

For Unallowable Other Direct Costs in the amount of \$775.57, the Contracting Officer has requested the Contractor to be mindful as to the allowability and reasonableness of such costs and charges on future invoices. The CO will also issue a letter to MITRE, pursuing recovery of those charges.

For Unallowable Travel Charges in the amount of \$617.00, the CO will pursue recovery of these costs through the issuance of a letter to the Contractor. At this time, DCAA has similarly questioned this reimbursement practice in an examination of FY05 costs incurred. MITRE and DCAA are currently engaged in discussions regarding this practice. The outcome of those discussions will be shared with the IRS CO.

IMPLEMENTATION DATE:

January 15, 2007

RESPONSIBLE OFFICIAL:

Director, Procurement OS:A:P

CORRECTIVE ACTION MONITORING PLAN:

The Contracting Officer and the Contracting Officer's Technical Representative (COTR) will monitor contractor invoices in accordance with the Federal Acquisition Regulation (FAR).