TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

The Business Systems Development Organization Effectively Managed Its Contractors and Related Costs

March 2006

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DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

March 31, 2006

MEMORANDUM FOR CHIEF INFORMATION OFFICER

FROM: Michael R. Phillips
                Deputy Inspector General for Audit

SUBJECT: Final Audit Report – The Business Systems Development Organization
                Effectively Managed Its Contractors and Related Costs
                (Audit # 200520021)

This report presents the results of our review of the Business Systems Development (BSD) organization's controls over contract labor and related costs. The overall objective of this review was to determine whether the BSD organization had implemented effective controls to manage its contract labor and related costs.

Synopsis

The BSD organization within the Modernization and Information Technology Services organization is responsible for defining, building, testing, delivering, and maintaining integrated information applications systems that help achieve the business vision and objectives of the Internal Revenue Service (IRS). To accomplish these responsibilities, the BSD organization relies heavily on contractor support. The BSD organization budgeted $144 million in Fiscal Year 2005 for contractor support. This represents 39 percent of the BSD organization's total Fiscal Year 2005 budget of about $370 million. The types of support provided by the contractors include management and professional support and data processing services.

Our review of the Integrated Submission and Remittance Processing (ISRP) system,[1] the Service Center Recognition/Image Processing System (SCRIPS),[2] and the Product Assurance Technical

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[1] The ISRP system transcribes and formats data from paper documents such as tax returns for input into other IRS systems by key-entry operators. It also captures check images for archiving.
[2] The SCRIPS performs data capture by reading the printed bar codes if present or character recognition of data printed on certain IRS tax forms.

Support for Systems Acceptability Testing/Final Integration Test (SAT/FIT)[3] projects determined the BSD organization is effectively monitoring its contractors' performance and verifying related costs through the efforts of the Contracting Officer's Technical Representative (COTR) and Project Office personnel. For example, to monitor the contractors' progress in completing the task orders,[4] the COTRs and/or Project Office representatives attended various meetings and periodically met with the contractors. The COTRs for the three projects also reviewed status reports prepared by the contractors. In addition, to track and validate the SAT/FIT project's costs, the COTR

> **The BSD organization is effectively monitoring its contractors' performance and verifying related costs. Also, the invoices we reviewed were appropriately funded.**

compared the invoice[5] charges for travel costs against supporting travel receipts and, on a random basis, compared labor costs to timecards or timesheets. The ISRP system and SCRIPS projects were worked under a firm fixed-price contract,[6] and the costs were negotiated prior to the beginning of work. Therefore, an indepth review of the invoices by the COTRs was not required.

We also determined the 18 invoices we reviewed were appropriately funded using the Information Systems Fund or the Business Systems Modernization Fund. Business Systems Modernization funds were used for the SAT/FIT testing of two Business Systems Modernization projects.

In addition, we contacted IRS users of the systems reviewed to determine whether the goods and services provided by the contractors adequately met the business needs and were completed timely. The SCRIPS and SAT/FIT projects users stated the goods and services met the business needs and were completed timely. The ISRP system users reported problems with the Training On-Line Grader, which is a program used for training and testing potential employees. The users stated the upgrades for 2005 and 2006 did not perform as intended. Due to the deficiencies of the 2005 system upgrade, the IRS incurred 644 hours of overtime totaling approximately $10,798. BSD organization management explained the IRS received late legislative changes

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[3] The SAT is the process of testing a system or program to ensure it meets the original objectives outlined by the user in the requirement analysis document. The purpose of the FIT is to validate whether the tax processing system released to production each January operates with existing systems correctly, thus ensuring the IRS is ready for the new filing season. The filing season is the period from January through mid-April when most individual income tax returns are filed.

[4] A task order is an order for services placed against an established contract or with Federal Government sources of supply.

[5] An invoice is an itemized bill listing the cost of goods shipped or services rendered. One invoice may include the costs for more than one task order.

[6] A firm fixed-price contract provides for a price that is not subject to any adjustment on the basis of the contractor's cost experience in performing the contract. This contract type places upon the contractor maximum risk and full responsibility for all costs and resulting profit or loss. It provides maximum incentive for the contractor to control costs and perform effectively.

affecting the tax processing year. Therefore, the contractor was instructed to complete the legislative changes in the production system before completing the Training On-Line Grader corrections. On January 13, 2006, BSD organization management reported all Training On-Line Grader problems for 2005 have been corrected. The Office of Procurement stated the contractor met the terms of the contract. Therefore, the IRS will not take action to recover the $10,798 in overtime. On January 31, 2006, IRS management advised that, for 2006, the Training On-Line Grader was operating as planned and two minor outstanding problems would be corrected next year.

Recommendations

Because the BSD organization effectively monitored contractor performance and managed contract labor and related costs on the projects we reviewed, we made no recommendations in this report.

Response

Management agreed with the report and stated they were pleased that after reviewing the three projects it was determined the BSD organization is effectively monitoring its contractors' performance and verifying related costs through the efforts of the COTRs and Project Office personnel. Management's complete response to the draft report is included as Appendix IV.

Copies of this report are also being sent to the IRS managers affected by the report finding. 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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Background

One of the strategic goals in the Internal Revenue Service (IRS) Strategic Plan for Fiscal Years (FY) 2005 – 2009 is to modernize the IRS through its people, processes, and technology. The Business Systems Development (BSD) organization within the Modernization and Information Technology Services organization is responsible for defining, building, testing, delivering, and maintaining integrated information applications systems that help achieve the business vision and objectives of the IRS. To accomplish these responsibilities, the BSD organization relies heavily on contractor support. The BSD organization budgeted $144 million in FY 2005 for contractor support. This represents 39 percent of the BSD organization's total FY 2005 budget of about $370 million (see Figure 1).
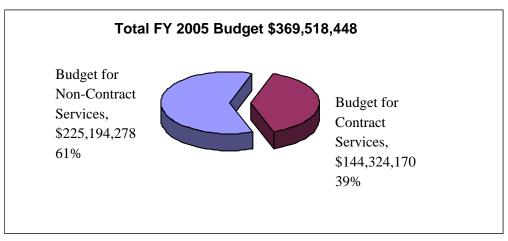
Figure 1: The BSD Organization's FY 2005 Budget

Total FY 2005 Budget $369,518,448

Budget for Non-Contract Services, $225,194,278 61%

Budget for Contract Services, $144,324,170 39%

Source: The Treasury Inspector General for Tax Administration's analysis of an extract of the BSD organization budget from the Integrated Financial System.[1]

The types of support provided by the contractors include management and professional support and data processing services. The management and professional support services include assistance, advice, or training for the efficient and effective management and operation of organizations, activities, or systems. The data processing services represent the direct operational costs of Federal Government-owned systems operated and maintained on contract by organizations other than the IRS. These costs include the use of computers and programming services, database services, transcription, testing time, and related clerical operations.

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[1] The Integrated Financial System is an administrative accounting system used by the IRS.

When we initiated this review, the BSD organization consisted of seven subordinate divisions. However, by the end of 2005, the Modernization and Information Technology Services organization planned to combine the BSD and Business Systems Modernization organizations to create one applications development organization to eliminate gaps and overlaps that exist throughout the development cycle.

This review was performed at the BSD office in New Carrollton, Maryland, during the period July 2005 through January 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.

Results of Review

Controls to Ensure Acceptable Contractor Performance and Validate Related Costs Were Effective

The Federal Acquisition Regulation holds contractors responsible for timely contract performance; however, the Federal Government is held responsible for monitoring contractor performance as necessary to protect its interest. Monitoring involves comparing a contractor's performance plans, schedules, controls, and industrial processes against the contractor's actual performance under them; determining the contractor's progress; and identifying any factors that may delay performance. In addition, the Office of Federal Procurement Policy *A Guide To Best Practices For Contract Administration*, dated October 1994, states the Contracting Officer's Technical Representatives (COTR) should perform periodic head counts, examine timecards and sign-in sheets, review the overtime, and maintain spreadsheets to track direct costs and expenses for cost-reimbursement contracts.[2]

The BSD organization provided a list of projects requiring contractor support for FYs 2005 and 2006. The types of contracts and task orders[3] used to acquire contractor support were firm fixed-price[4] or cost-reimbursement. We judgmentally selected the following three projects for review:

- Integrated Submission and Remittance Processing (ISRP) system – transcribes and formats data from paper documents such as tax returns for input into other IRS systems by key-entry operators. It also captures check images for archiving. We reviewed 11 task orders and 6 invoices[5] for this project.

- Service Center Recognition/Image Processing System (SCRIPS) – performs data capture by reading the printed bar codes if present or character recognition of data printed on certain IRS tax forms. We reviewed three task orders and six invoices for this project.

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[2] Cost-reimbursement types of contracts provide for payment of allowable incurred costs, to the extent prescribed in the contract. These contracts establish an estimate of total cost and a ceiling the contractor may not exceed (except at its own risk) without the approval of the Contracting Officer.

[3] A task order is an order for services placed against an established contract or with Federal Government sources of supply.

[4] A firm fixed-price contract provides for a price that is not subject to any adjustment on the basis of the contractor's cost experience in performing the contract. This contract type places upon the contractor maximum risk and full responsibility for all costs and resulting profit or loss. It provides maximum incentive for the contractor to control costs and perform effectively.

[5] An invoice is an itemized bill listing the cost of goods shipped or services rendered. One invoice may include the costs for more than one task order.

- Product Assurance Technical Support for Systems Acceptability Testing/Final Integration Test (SAT/FIT) – The SAT is the process of testing a system or program to ensure it meets the original objectives outlined by the user in the requirement analysis document. The purpose of the FIT is to validate whether the tax processing system released to production each January operates with existing systems correctly, thus ensuring the IRS is ready for the new filing season.[6] We reviewed two task orders and six invoices for this project.

Our review of the three projects determined the BSD organization is effectively monitoring its contractors' performance and verifying related costs through the efforts of the COTRs and Project Office personnel. For example, to monitor the contractors' progress in completing the task orders, the COTRs and/or Project Office representatives periodically met with the contractors and attended various meetings such as biweekly or monthly program management meetings and control configuration board meetings. The COTRs for the three projects also reviewed status reports prepared by the contractors.

In addition, the SAT/FIT cost-reimbursement task orders require project costs to be tracked and validated. To validate the project costs, the SAT/FIT COTR compared the invoice charges for travel costs against supporting travel receipts and, on a random basis, compared labor costs to timecards or timesheets. The ISRP system and SCRIPS projects were worked under a firm fixed-price contract, and the costs were negotiated prior to the beginning of work. Therefore, an indepth review of the invoices by the COTRs was not required.

> *The BSD organization is effectively monitoring its contractors' performance and verifying related costs. Also, the invoices we reviewed were appropriately funded.*

Although each SAT/FIT task order lists the contract work by projects, the invoices do not group the charges by projects. This made it difficult for the COTR to determine whether an individual project was operating within its budget. Prior to our review, the COTR submitted to the Office of Procurement a revised format for future invoices that will include the information needed to adequately account for the expenses for each SAT/FIT project. To ensure future SAT/FIT invoices provide the data in a usable format, the COTR reported to BSD organization management that the request to have expenses grouped by project in the SAT/FIT invoices will be included as a requirement in the next SAT/FIT contract.

In addition, we determined the 18 invoices we reviewed were appropriately funded using the Information Systems Fund or the Business Systems Modernization Fund. Business Systems Modernization funds were used for the SAT/FIT testing of two Business Systems Modernization projects.

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[6] The period from January through mid-April when most individual income tax returns are filed.

Also, we contacted IRS users of the systems reviewed to determine whether the goods and services provided by the contractors adequately met the business needs and were completed timely. The SCRIPS and SAT/FIT projects users stated the goods and services met the business needs and were completed timely. The ISRP system users reported problems with the Training On-Line Grader, which is a program used for training and testing potential employees. The users stated the upgrades for 2005 and 2006 did not perform as intended. Due to the deficiencies of the 2005 system upgrade, the IRS incurred 644 hours of overtime totaling approximately $10,798. BSD organization management explained that, when the contractor began correcting the Training On-Line Grader problems, the IRS received late legislative changes affecting the tax processing year. Therefore, the contractor was instructed to complete the legislative changes in the production system before completing the Training On-Line Grader corrections. On January 13, 2006, BSD organization management reported all Training On-Line Grader problems for 2005 had been corrected. The Office of Procurement stated the contractor met the terms of the contract. Therefore, the IRS will not take action to recover the $10,798 in overtime. On January 31, 2006, IRS management advised that, for 2006, the Training On-Line Grader was operating as planned and two minor outstanding problems would be corrected next year.

By implementing effective controls, the BSD organization ensures contractors for the ISRP system, SCRIPS, and SAT/FIT projects perform as expected and costs are properly supported. Because the BSD organization effectively monitored contractor performance and managed contract labor and related costs, we are making no recommendations in this report.

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine whether the Business Systems Development (BSD) organization had implemented effective controls to manage its contract labor and related costs. To accomplish this objective, we:

I.   Determined the amounts budgeted and expended by the BSD organization to fund contractor support for Fiscal Years (FY) 2005 and 2006. We received the contractor support budget and expenditures from the BSD organization but received only the budget for the Integrated Financial System.[1] We determined whether expenses on the 18 invoices[2] selected in subobjective II were charged to the appropriate funds.

II.   Determined the inventory of BSD organization projects for FY 2005 that required contractor support and selected a judgmental sample of projects for review in subobjective III to assess the BSD organization's effectiveness in managing contractors' and related costs. A judgmental sample was selected because the results would not be projected over the entire population. We prioritized by dollar amount the list of 50 FY 2005 BSD organization projects that required contractor support. We selected the three projects with the highest budgets, excluding projects that we had included in other current or prior audits, and reviewed all associated task orders[3] requesting contractor work to be performed in FY 2005. We reviewed the following 3 projects, which had a total of 16 task orders:

- Integrated Submission and Remittance Processing system – transcribes and formats data from paper documents such as tax returns for input into other Internal Revenue Service (IRS) systems by key-entry operators. It also captures check images for archiving. We reviewed 11 task orders and 6 invoices for this project.

- Service Center Recognition/Image Processing System – performs data capture by reading the printed bar codes if present or character recognition of data printed on certain IRS tax forms. We reviewed three task orders and six invoices for this project.

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[1] The Integrated Financial System is an administrative accounting system used by the Internal Revenue Service.
[2] An invoice is an itemized bill listing the cost of goods shipped or services rendered. One invoice may include the costs for more than one task order.
[3] A task order is an order for services placed against an established contract or with Federal Government sources of supply.

- Product Assurance Technical Support for Systems Acceptability Tests/Final Integration Test (SAT/FIT) – The SAT is the process of testing a system or program to ensure it meets the original objectives outlined by the user in the requirement analysis document. The purpose of the FIT is to validate whether the tax processing system released to production each January operates with existing systems correctly, thus ensuring the IRS is ready for the new filing season.[4] We reviewed two task orders and six invoices for this project.

For subobjective I, we reviewed all the Integrated Submission and Remittance Processing system and Service Center Recognition/Image Processing System invoices that included charges for work completed in FY 2005. For the SAT/FIT project, we reviewed six invoices that included charges for work completed in FY 2005 (three invoices for each of the two SAT/FIT contractors) because the invoices had voluminous documentation.

III. Determined whether the BSD organization's policies and procedures were effective to ensure information technology goods and services were received, the deliverables provided by the vendor were of value and benefit to the IRS, and hours worked and travel costs claimed by the contractor were validated for each of the requisition/task orders in the sample. To accomplish this, we interviewed IRS personnel (e.g., project managers and Contracting Officer's Technical Representatives) and reviewed task orders, invoices, status reports, and other documents used to monitor contractor performance. We contacted business unit management to determine whether the goods and services were completed timely and adequately met the business needs.

IV. We used computer-based BSD organization budget data for background information and in generating a list of projects for review. We compared the list of projects generated from the BSD organization data to a list of projects generated from the Integrated Financial System data to determine the accuracy of data used during the audit. Both sources of information generated the same list of projects in the same ranking order based on the budget and cost of the project.

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[4] The period from January through mid-April when most individual income tax returns are filed.

Major Contributors to This Report

Margaret E. Begg, Assistant Inspector General for Audit (Information Systems Programs)
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Management's Response to the Draft Report

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

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CHIEF INFORMATION OFFICER

March 17, 2006

MEMORANDUM FOR TREASURY INSPECTOR GENERAL FOR TAX
ADMINISTRATION

FROM: W. Todd Grams
                    Chief Information Officer

SUBJECT: Management Response to Draft Audit Report –
                    BSD's Use/Management of Contractors (Audit # 200520021)
                    (i-trak # 200608740)

Thank you for the opportunity to review and comment on the subject draft audit report.
The Business Systems Development (BSD) organization is committed to using the most
effective controls to manage its contract labor and related costs.

This audit consisted of the review of our Integrated Submission and Remittance
Processing System (ISRP), our Service Center Recognition/Image Processing System
(SCRIPS), and the Product Assurance Technical Support for Systems Acceptability
Testing/Final Integration Test (SAT/FIT). We were pleased that after reviewing the
three projects it was determined that the BSD organization is effectively monitoring its
contractors' performance and verifying related costs through the efforts of the Contract
Officer Technical Representatives (COTR) and Project Office personnel.

If you have questions, please call me at (202) 622-6800, or you may contact
Cecille Jones at (202) 283-3402.