Management Advisory Report:
Review of Alleged Billing Discrepancies on the Exam Year 2000 Replacement Project (Contract TIR-NO-99-Z-00004)

July 2001

Reference Number: 2001-10-095

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INSPECTOR GENERAL
for TAX
ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

July 19, 2001

MEMORANDUM FOR CHIEF, AGENCY-WIDE SHARED SERVICES

FROM: Pamela J. Gardiner
Deputy Inspector General for Audit

SUBJECT: Final Management Advisory Report - Review of Alleged Billing Discrepancies on the Exam Year 2000 Replacement Project (Contract TIR-NO-99-Z-00004)

This report presents the results of our review of an allegation regarding billing discrepancies on the Exam Year 2000 Replacement Project contract. In summary, we determined that the contractor had failed to provide supporting documentation substantiating that all items ordered were in fact properly billed and delivered. The Internal Revenue Service (IRS) also authorized the receipt and acceptance of equipment and released payments without having received proper invoices from the contractor. Additionally, the IRS did not exercise a contract modification documenting a change in the terms and conditions of the original contract. Procurement management agreed with our observations and the full text of their comments is included as an appendix.

The Treasury Inspector General for Tax Administration (TIGTA) has designated this report as Limited Official Use (LOU) pursuant to Treasury Directive TD P-71-10, Chapter III, Section 2, "Limited Official Use Information and Other Legends" of the Department of Treasury Security Manual. Because this document has been designated LOU, it may only be made available to those officials who have a need to know the information contained within this report in the performance of their official duties. This report must be safeguarded and protected from unauthorized disclosure; therefore, all requests for disclosure of this report must be referred to the Disclosure Unit within the TIGTA's Office of Chief Counsel.

Please contact me at (202) 622-6510 if you have questions or Maurice S. Moody, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.

Objective and Scope

The objective of this review was to determine whether an allegation regarding billing discrepancies could be substantiated.

The objective of this review was to determine whether an allegation regarding billing discrepancies for contract TIR-NO-99-Z-00004 could be substantiated. The review was performed from September 2000 to March 2001 at the Internal Revenue Service (IRS) offices in Oxon Hill and Lanham, Maryland, and Beckley, West Virginia.

The scope of our work was limited to reviewing the specific allegation and related documentation concerning the contract and its administration. Fieldwork tests included reviewing the IRS contracting and accounts payable files, Automated Financial System payment records, electronic mail messages, and equipment inventory records. In addition, we interviewed IRS Procurement and Accounts Payable personnel associated with this contract. All of the work for this review was performed in accordance with the President's Council on Integrity and Efficiency's *Quality Standards for Inspections.*

Major contributors to this report are listed in Appendix I. Appendix II contains the Report Distribution List.

Background

In October 1998, the IRS Procurement Office entered into a Blanket Purchase Agreement (BPA) with a contractor to acquire computer equipment and related accessories (e.g., surge protectors and headphones). In addition to the equipment, the BPA called for the contractor to provide limited warranty, toll-free technical assistance, and equipment repair.

In October 1999, the IRS issued a requisition and subsequent delivery order against the BPA for

19,866 pieces of equipment at a cost of nearly $4.2 million. The order included 2,838 personal computers, an equal number of monitors, and 14,190 accessory items.

The Treasury Inspector General for Tax Administration (TIGTA) Office of Investigations received an allegation that the contractor had overbilled the IRS. Specifically, the allegation concerned whether the contractor had billed the IRS for personal computers that were not provided and overbilled the IRS by including the same computers on multiple invoices.

Results

We determined that the contractor failed to provide supporting documentation to substantiate that all items were properly billed and delivered.

In conjunction with the Office of Investigations, we performed a limited review and determined that the contractor had failed to provide supporting documentation substantiating that all items ordered were in fact properly billed and delivered. The purpose of this audit report is to provide Procurement management with additional information regarding the billing discrepancies and procedural practices that may need to be evaluated.

While numerous discrepancies with the contractor's invoices were noted, an analysis of IRS inventory records and interviews with IRS personnel provided reasonable assurance that the IRS received the personal computers in question. An additional analysis of contractor records indicated that many of the billing discrepancies resulted from an error in the contractor's computer program. However, we identified two areas where the IRS Procurement Office could have improved its contracting practices.

Specifically, contracting personnel certified the receipt and acceptance of computer equipment under this contract despite ongoing billing discrepancies and without documentation to support that all items were actually received. In addition, contracting personnel did not prepare a contract modification documenting a change in the terms and conditions of the contractor's original shipping instructions.

Contracting Practices of the Exam Year 2000 Replacement Project Could Have Been Improved

Contracting personnel certified the receipt of computer equipment despite invoice discrepancies and without documentation that all items were received.

Contracting personnel certified the receipt and acceptance of computer equipment despite discrepancies with the contractor's invoices and without documentation verifying that all items had been received. Once receipt and acceptance occurred, the contractor was entitled to payment, and the IRS was obligated to pay almost $3.9 million for the equipment even though supporting documentation to confirm receipt was lacking.

We identified numerous billing discrepancies that occurred prior to the termination of this BPA in March 2000. These discrepancies included invoices missing computer serial numbers (the number of individual serial numbers listed did not agree with the number of computers shipped) and identical serial numbers appearing on multiple invoices. The IRS began disputing these invoices in November 1999, and the Contracting Officer's Technical Representative (COTR) advised the IRS Administrative Services Center to withhold payment to the contractor.

Subsequently, the IRS and the contractor mutually agreed to terminate the BPA. In an effort to expedite the termination of the BPA, one of the IRS Contracting Officers (CO) certified the receipt and acceptance of 18,546 pieces of equipment valued at nearly

$3.9 million on February 27, 2000.[1] This action was taken without adequate documentation verifying that the IRS had received all the equipment and prior to resolution of the invoicing problems.

According to the contracting personnel who were involved in this action, verification that the IRS had received the equipment was based on verbal communications only. One of the COs acknowledged that no documentation verifying receipt of the equipment was provided by the COTR, but stressed that the COTR verbally confirmed that the IRS received all equipment. However, the COTR advised us that although equipment was received, he did not recommend receipt and acceptance because the invoices remained in dispute. The CO noted that when he authorized receipt and acceptance he was not concerned with the invoices, only that the equipment was received and working.

Although we were able to resolve the billing issues through the use of the IRS' computerized inventory records and discussions with IRS personnel, the Federal Acquisition Regulations (FAR)[2] provide that acceptance constitutes acknowledgement that the supplies or services conform to applicable contract quality and quantity requirements. By certifying receipt and acceptance without documentation verifying that all equipment had been received and without resolution of the disputed invoices, contracting personnel placed nearly $3.9 million at risk.

The IRS contracting personnel modified the terms and conditions of this contract based on a verbal request and approval only.

Additionally, contracting personnel verbally modified the terms and conditions of this contract without exercising a formal contract modification. On October 20, 1999, the IRS issued a delivery order against a BPA for 2,838 personal computers and

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[1] The requisitioning office had previously accepted the other 1,320 pieces on November 9, 1999.
[2] GENERAL SERVS. ADMIN., ET AL., FEDERAL ACQUISITION REG. ("FAR"), 48 C.F.R. parts 1-52 (1998).

monitors and 14,190 related accessories. The total cost of this order amounted to almost $4.2 million, of which the personal computers accounted for over $4 million. The delivery order required the contractor to ship all equipment to one central site in Carrollton, Texas, from where it would be redistributed to IRS offices around the country.

According to the contracting personnel involved, the contractor was to deliver 500 computers each week until the order was filled. However, due to problems the contractor experienced with its supplier, the contractor was unable to meet the IRS' delivery schedule.

In an effort to expedite the delivery of computer equipment, the requisitioning IRS office verbally requested that the contractor ship the equipment directly to the IRS offices rather than to the central distribution site. The CO verbally approved this change from the original delivery order but did not prepare a contract modification to document the new requirements. According to the CO, he made the decision not to prepare a modification because he did not believe anything could be gained by doing so.

By not properly exercising a zero-dollar contract modification, the CO placed the IRS at risk by entitling the contractor to a potential equitable adjustment.

This change in the delivery requirements from the original contract constituted a change in the terms and conditions of the contract. When changes are made to the scope of a contract, a contractor could be entitled to an equitable adjustment. An equitable adjustment results when a change occurs that causes an increase in the cost of, or the time required for, performance of any part of the work under a contract. The basic formula for an equitable adjustment is an estimate of the difference between what it would have reasonably cost to perform the work as originally required, and what it will reasonably cost to perform the work as changed. By not properly exercising a zero-dollar contract modification with the revised terms and conditions, the CO placed the IRS at risk by entitling the contractor to a potential equitable adjustment.

Conclusion

The allegation that the contractor had overbilled the IRS by charging for personal computers not provided and charging for the same computers on multiple invoices could not be substantiated. Although numerous billing discrepancies did occur prior to the termination of this BPA, an analysis of inventory records and interviews of contracting personnel provided reasonable assurance that the IRS received all equipment.

The IRS Procurement Office, in its effort to expedite termination of the BPA, authorized the receipt and acceptance of equipment and the release of payments totaling nearly $3.9 million without having received corrected invoices. Contracting personnel also took this action without documentation to support the physical receipt of all equipment. Additionally, the contracting personnel did not document a change in the terms and conditions of the original contract by exercising a contract modification. Because of these contracting practices, approximately $3.9 million was placed at risk. Since we did not evaluate the entire procurement process and the issues in this report are specific to one closed contract, we are not making any recommendations for corrective action at this time. This audit report is for informational purposes only. Procurement management agreed with our observations. The full text of their comments is presented in Appendix III.

Appendix I

Major Contributors to This Report

Maurice S. Moody, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs)
John Wright, Director
Nancy LaManna, Audit Manager
Dawn Smith, Senior Auditor
Chinita Coates, Auditor
Tom Dori, Auditor
Gerard Marini, Auditor

Appendix II

Report Distribution List

Commissioner N:C
Deputy Chief Financial Officer, Department of the Treasury
Director of Procurement A:P
Audit Liaison: Director of Procurement A:P

Appendix III

Management's Response to the Draft Report

DEPUTY CHIEF
AGENCY-WIDE
SHARED SERVICES

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

July 2, 2001

RECEIVED
JUL 06 2001

MEMORANDUM FOR PAMELA J. GARDINER
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Gregory D. Rothwell
Deputy Chief, Agency-Wide Shared Services

Greg Rothwell

SUBJECT: Draft Management Advisory Report - Review of Alleged Billing Discrepancies on the Exam Year 2000 Replacement Project (TIRNO-99-Z-00004)

Thank you for the opportunity to respond to your draft report. To summarize, the audit was initiated to determine whether there was substance to an allegation of overbilling under the subject blanket purchase agreement (BPA). The review disclosed the allegation was unsubstantiated and the discrepancies resulted primarily from an error in the contractor's computer program. We agree with your findings.

During the course of the review, your auditors detected two contract administration issues specific to the BPA in question:

- Contracting personnel authorized payment without complete documentation that all items were received.
- Contracting personnel did not prepare a contract modification to document changes to shipping instructions.

As the draft report acknowledges, the contracting officer was advised orally by the Contracting Officer's Technical Representative that all equipment had been received. He then certified receipt and acceptance in order to expeditiously complete all actions and facilitate termination of the BPA. This action avoided payment of substantial interest on the contractor's invoice. Further, because the contractor was experiencing difficulties with its supplier, the contracting officer duly authorized a change in shipping instructions to expedite delivery, although a modification to the BPA to reflect the change was not processed. While the risks were minimal in these situations, we agree that the contracting practices followed should have been more thorough.

2

Since the above issues relate to a single, closed contract, we appreciate that you are issuing the report for information and do not make specific recommendations. The contracting personnel in this case are aware of the risks they took and that their actions should have been immediately documented. The Office of Procurement has the highest standards in contracting and will continue to require sound contracting processes in the future.

Please call me at (202) 622-7500 if you have any questions or David Grant, Director of Procurement at (202) 622-8480.