



*Invoice Audit of the Financial
Statement/Government Accountability
Office Audit Support Services Contract -
TIRNO-03-K-00167*

April 23, 2007

Reference Number: 2007-10-069

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

April 23, 2007

MEMORANDUM FOR CHIEF, AGENCY-WIDE SHARED SERVICES

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

SUBJECT: Final Audit Report – Invoice Audit of the Financial
Statement/Government Accountability Office Audit Support Services
Contract – TIRNO-03-K-00167 (Audit # 200610030)

This report presents the results of our review of the Internal Revenue Service's (IRS) Financial Statement/Government Accountability Office Audit Support Services Contract TIRNO-03-K-00167. The overall objective of this review was to determine whether selected invoices submitted and paid under contract number TIRNO-03-K-00167 were appropriate and in accordance with the contract's terms and conditions. We initiated this audit to determine whether the invoices submitted by the contractor and paid by the IRS were accurate, supported, and allowable.

Impact on the Taxpayer

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. To the extent our reviews assist the IRS in identifying and recovering inaccurate, unsupported, and unallowable charges, contract expenditures are reduced and taxpayer funds are saved.

Synopsis

We initially identified questionable charges of \$744,340.78 because the contractor did not provide the necessary documentation to support that the charges were accurate and allocable to the contract. Specifically, these charges consisted of \$735,085.16 in unsupported labor charges and \$9,255.62 in unsupported travel charges. We provided both the IRS and contractor personnel details of these questionable charges in June 2006, October 2006, and December 2006.



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It was not until after we presented the questionable charges in a January 2007 discussion draft report that the IRS provided adequate documentation to support all but \$22,536.21 of the questionable labor charges. During the period when these charges were invoiced by the contractor, we did not identify any significant verification performed by the IRS of any source documents such as contractor-provided payroll or related payment records to confirm labor charges or receipts to confirm travel charges.

As part of this audit, we also examined contract correspondence files and interviewed the Contracting Officer, the Contract Specialist, and the Contracting Officer's Technical Representative to determine whether the contractor's deliverables were acceptable. 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 invoices included in our tests.

Recommendation

We recommended the Director, Procurement, require the appropriate Contracting Officer to review the identified questionable charges of \$22,536.21 and initiate any recovery actions deemed warranted.

Response

IRS management agreed with our recommendation. The Contracting Officer is working closely with the contractor to obtain additional documentation. Upon receipt of the supporting documentation, the Contracting Officer will conduct a thorough analysis, determine the amount of any recoverable costs, and initiate the appropriate action to recover those costs. 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 any questions or Nancy A. Nakamura, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.



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Abbreviations

CO	Contracting Officer
COTR	Contracting Officer's Technical Representative
IRS	Internal Revenue Service



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Background

In March 2003, the Internal Revenue Service (IRS) awarded contract number TIRNO-03-K-00167, a hybrid labor-hour/firm-fixed-price contract¹ to assist the IRS in complying with the Chief Financial Officers Act of 1990.² The contractor provided professional financial and accounting services to assist the IRS in preparing its annual financial statements and in the resolution of material weaknesses and other issues identified in audits of those financial statements.

The contract was awarded for a base period from March 2003 through March 31, 2004. The contract included options that would carry the term of the contract through December 31, 2005. According to the IRS Request Tracking System,³ as of March 8, 2006, the IRS awarded \$10,464,464.70 and approved \$9,640,811.87 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 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 facilities in Washington, D.C., during the period March 2006 through January 2007. Opinions expressed in this report pertain only to invoices 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.

¹ A labor-hour contract provides for acquiring direct labor hours at specified fixed hourly rates that include wages, overhead, general and administrative expenses, and profit. 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.

² Pub. L. No. 101-576, 104 Stat. 2838 (codified as amended in scattered sections of 5 U.S.C., 31 U.S.C., and 42 U.S.C.). This Act requires Federal agencies to develop auditable financial statements and to present these statements in an annual financial report. The Government Accountability Office audits the IRS' financial statements each fiscal year. These financial statements report the assets, liabilities, net position, net costs, changes in net position, budgetary resources, reconciliation of net costs to budgetary obligations, and custodial activity related to the IRS' administration of its responsibilities for implementing Federal tax legislation.

³ 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 interface with the Integrated Financial System (the IRS 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 judgmental sample of 53 invoices (see Appendix I for details). The 53 invoices were processed between May 2003 and January 2006, and involved \$8,490,128.98 in IRS payments. The primary expenses claimed by the contractor consisted of labor costs and travel costs.

Questionable contract charges

We initially identified questionable charges of \$744,340.78. Specifically, these charges consisted of \$735,085.16 in unsupported labor charges and \$9,255.62 in unsupported travel charges. The labor charges were considered questionable because the contractor did not provide the necessary documentation to support that the labor charges were accurate and allocable to the contract. The travel charges were considered questionable because there were no receipts provided to support the accuracy and allocability of such items as airfare, lodging, mileage, and car rental charges. We provided details of these charges to the contractor and the IRS in June 2006, October 2006, and December 2006.

It was not until after we presented the questionable charges in a January 2007 discussion draft report that the IRS provided adequate documentation to support all but \$22,536.21 of the questionable labor charges. The IRS' explanation for this delay was that it was most likely due to the lack of communication among the responsible parties when the questionable charges were initially provided to the IRS and the contractor. 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 contractor-provided payroll or related payment records to confirm labor charges or receipts to confirm travel charges.

The Federal Acquisition Regulation⁴ 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 Federal Acquisition Regulation also provides that costs shall be allowed to the extent they are reasonable, allocable, and allowable under the Federal Acquisition Regulation. Further, Federal Acquisition Regulation 52.232-7(a)(1), *Payments Under Time-and-Materials and Labor-Hour Contracts*, states, in part,

⁴ 48 C.F.R. ch. 1 (2005).



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“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 Federal Travel Regulation⁵ requires airline, lodging, and car rental receipts be provided and that reimbursement be based on the actual cost not to exceed the per diem rate or other required cost limitation policies. Additionally, the Federal Travel Regulation requires that any travel expenses in excess of \$75 must be supported by a receipt when claimed on a travel voucher.

Invoice verification process

Contracts may be entered into and signed on behalf of the Federal Government only by Contracting Officers (CO), who 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. Sometimes Contract Specialists may perform the same contract administrative responsibilities as the COs. However, they do not have the signing authority to bind the Federal Government to any legal contracting actions.

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 of each contract. The CO and 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 the COTRs.⁶ 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. Attachment E of the *Handbook* also offered, as a sample responsibility for time-and-materials contracts, that the COTRs are responsible for reviewing and signing off on the invoices to attest to their accuracy. Fifteen of the 53 invoices we reviewed during this audit 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*), published in October 1994. The *Guide* offers, as a practical technique, that COTRs reviewing vouchers under cost-reimbursement contracts should review, among other things, contractor timecards to help assess the reasonableness of direct labor costs.

⁵ 41 C.F.R. Chapter 301 (2005).

⁶ 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*.



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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. Although the *Guide* does not include a specific reference to labor-hour contracts, we believe it is reasonable to infer that administration requirements for cost-reimbursement contracts would also apply to labor-hour contracts.

The Contract Specialist and CO advised us they were both assigned to this contract within its final option year, February and September of 2005 respectively, and had limited involvement with the contract. They were, however, involved in initiating the last 2 contract modifications that added approximately \$1.2 million to extend the contract from July through December 2005. The Contract Specialist and CO informed us that since they have spent a short time on the contract, they relied upon the COTR to ensure the contractor's charges were accurate. The COTR's invoice review was to include an analysis of fixed-price expenses, labor cost and hours, and travel expenses to ensure expense accuracy and that nonlabor expenses were supported by receipts. However, except for the COTR handbook and his or her own process of verifying billing charges, he or she did not have any other procedures or guidance to follow for performing these duties. Further, we did not identify any significant verification performed by the COTR of actual hours worked, such as a review of contractor-provided payroll or related payment records. We also did not identify any significant verification performed to ensure travel costs were supported by receipts.

We believe the initial identification of the unsupported labor and travel charges was directly related to the incomplete invoice verification process described above. We conclude that if the IRS was periodically or routinely requiring the contractor to provide such documentation, the contractor would have been able to react in the same manner to our requests for support. We will continue to include a review of the IRS' invoice verification process in future contract invoice audits and, if warranted, recommend improvements to the process.

Recommendation

Recommendation 1: The Director, Procurement, should require the appropriate CO to review the identified questionable charges of \$22,536.21 and initiate any recovery actions deemed warranted.

Management's Response: IRS management agreed with our recommendation. The CO is working closely with the contractor to obtain additional documentation. Upon receipt of the supporting documentation, the CO will conduct a thorough analysis, determine the amount of any recoverable costs, and initiate the appropriate action to recover those costs.



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Contract Deliverables Were Acceptable

We examined contract correspondence files and interviewed the CO, Contract Specialist, and COTR to determine whether the contractor's deliverables were acceptable for the 53 invoices reviewed. This contract provided professional financial and accounting support services to assist the IRS in the development of its annual financial statements and in the resolution of material weaknesses and other issues identified in audits of those financial statements. The contractor provided the following deliverables to the IRS:

- Journal entries including workpapers bound, referenced, and maintained in electronic format.
- Financial statement workpapers including the working trail balances, general ledger balances, and information needed to cross reference key proprietary and budgetary balances.
- Government property expense usage reports.
- Depreciation schedules including proposed entries, monthly accounting, and reconciliation to expense data files.
- Integrated Financial System transition support.
- Project management reports providing the status of the deliverables and corresponding tasks.

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 invoices 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-00167 were appropriate and in accordance with the contract's terms and conditions. To accomplish this objective, we:

- I. Analyzed the IRS invoice verification process prior to certifying payment to the contractor.
 - A. Interviewed the CO and COTR 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. Identified a sample selection universe from recorded Request Tracking System¹ transactions as of March 8, 2006. This universe contained 98 expense transactions totaling \$9,640,811.87, which were processed between May 2003 and March 2006. We judgmentally selected 40 invoices for review. These 40 invoices, which were processed between May 2003 and January 2006, involved \$7,544,756.99 in IRS payments and represented approximately 78 percent of the total amount paid by the IRS.
 - B. Included additional invoices in our sample. When we opened our audit with the contractor, they provided us with what they considered sufficient documentation for 13 additional invoices processed between November 2003 and December 2005, which totaled \$945,371.99. Since these invoices and corresponding support were readily available, we decided to include these invoices in our review. Therefore, our judgmental sample consisted of 53 invoices totaling \$8,490,128.98 that represented

¹ 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 interface with the Integrated Financial System (the IRS financial accounting system) for payment processing.



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approximately 88 percent of the total amount paid by the IRS. We believed this decision was reasonable and would provide sufficient evidence to accomplish our audit objective and would result in acceptable management corrective action, if needed.

This audit did not include procedures to obtain evidence that computer-processed data within the IRS' Request Tracking System 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 only used the data within the Request Tracking System to reasonably verify the universe from which we selected our sample of transactions for substantive testing of their accuracy, supportability, and allowability. We concluded and reported 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.

- C. For the invoices in the sample, obtained supporting documentation 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 the contractor's performance and deliverables were acceptable, as stipulated in the contract, for the invoices included in our sample.



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Appendix II

Major Contributors to This Report

Nancy A. Nakamura, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs)
John R. Wright, Director
Thomas J. Brunetto, Audit Manager
Gary D. Pressley, Lead Auditor
Chinita M. Coates, Auditor
Rashme Sawhney, Auditor
Niurka M. Thomas, 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
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



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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; \$22,536.21 (see page 2).

Methodology Used to Measure the Reported Benefit:

We examined invoices and supporting documentation obtained from the IRS Office of Procurement, as well as documentation received directly from the contractor, to verify charges for a judgmental sample of 53 invoices. We selected our sample from a universe of \$9,640,811.87 in transactions processed by the IRS. The 53 invoices involved \$8,490,128.98 in IRS payments. Our review resulted in the identification of questionable labor charges of \$22,536.21 because the contractor did not provide the necessary documentation to support that the charges were accurate and allocable to the contract.



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Appendix V

Management's Response to the Draft Report



AGENCY-WIDE
SHARED SERVICES

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

RECEIVED
MAR 30 2007

March 30, 2007

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM:

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

SUBJECT:

Draft Audit Report – Invoice Audit of the Financial Statement/
Government Accountability Office Audit Support Services Contract
TIRNO-03-K-00167 (Audit # 200610030) (I-trak # 2007-21842)

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 judgmental sample consisting of 53 invoices totaling approximately \$8,490,128.98 in contractor charges and identified \$22,536.21 of those charges as questionable.

We are taking additional steps to validate the accuracy of the \$22,536.21 in charges you identified in your report as questionable. The Contracting Officer (CO) is working closely with the Contractor to obtain additional documentation and supporting records. Once we have completed our analysis of the documentation, we will determine the amount of any recoverable costs and initiate the appropriate action to recover those costs. Our detailed response to the audit findings and recommendation is attached.

We appreciate your continued support and the valuable assistance and guidance that your team provides. If you have any questions, please contact me or a member of your staff may contact Mary Jo Labriola, Acting Director, Office of Information Technology, at (202) 283-6903.

Attachment

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



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ATTACHMENT

Management response to Draft Audit Report – Invoice Audit of the Financial Statement/Government Accountability Office Audit Support Services Contract TIRNO-03-K-00167 (Audit # 200610030)

RECOMMENDATION #1: The Director, Procurement, should require the appropriate CO to review the identified questionable charges of \$22,536.21 and initiate any recovery actions deemed warranted.

CORRECTIVE ACTION TO RECOMMENDATION #1: We agree with this recommendation. The Contracting Officer (CO) is working closely with the contractor to obtain additional documentation. Upon receipt of the supporting documentation, the CO will conduct a thorough analysis, determine the amount of any recoverable costs and initiate the appropriate action to recover those costs.

IMPLEMENTATION DATE: August 31, 2007

RESPONSIBLE OFFICIAL: Director, Procurement OS:A:P

CORRECTIVE ACTION MONITORING PLAN: The CO and the COTR will monitor contractor invoices in accordance with the Federal Acquisition Regulation (FAR) and the contract terms and conditions.