



*The Internal Revenue Service Expects to
Spend About \$13 Million to Recover From the
2006 Flood of Its Headquarters Building*

July 13 2007

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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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FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

July 13, 2007

MEMORANDUM FOR ACTING COMMISSIONER, INTERNAL REVENUE SERVICE

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

SUBJECT: Final Audit Report – The Internal Revenue Service Expects to Spend About \$13 Million to Recover From the 2006 Flood of Its Headquarters Building (Audit # 200710031)

This report presents the results of our review of flood expenditures incurred by the Internal Revenue Service (IRS) when its National Headquarters building was flooded during 2006. The overall objective of this review, initiated at the request of the Ranking Member of the United States Senate Committee on Finance, was to determine the costs incurred by the IRS to recover from the flooding of its National Headquarters building, including whether the reported expenses were properly related to the flood and proper procurement processes were followed.

Impact on the Taxpayer

The IRS will spend about \$13 million to recover from the flood but did not require any new funding over its existing budget. There was minimal impact on the taxpayer because most of the funds did not come at the expense of IRS programs; rather, the funds came from yearend surpluses, rent credits from the damaged building, and user fees.¹

Synopsis

As of December 31, 2006, the IRS had spent about \$11.6 million to recover from the flood. It expects to spend another \$1.6 million, for a total cost of about \$13.2 million. These costs were approximately \$7.9 million (37 percent) less than the original estimate of \$21.1 million. IRS officials suggested several factors caused the initial estimate to be high, including estimates were

¹ User fees are charges individuals and businesses are required to pay for special benefits received beyond those received by the general public and, in general, can be used to supplement the funding of a variety of IRS operations.



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made before damages had been thoroughly assessed and technology improvements resulted in lower costs for some replacement items. Congress did not provide additional funding to pay for the flood damages. Instead, the IRS paid for these costs by using yearend savings (surpluses), rent credits from the damaged building, and user fees.

Although all IRS functions were affected by the flood, the four functions with the highest estimated costs were Agency-Wide Shared Services (about \$8 million), Modernization and Information Technology Services (about \$2.7 million), Chief Counsel (about \$1.6 million), and Criminal Investigation (about \$0.7 million). Approximately 70 percent of the costs were related to rent for temporary space, automated data processing equipment, services and maintenance, and salaries for those involved in the recovery efforts.

Our review of a statistical sample of flood-related purchase transactions showed the IRS purchases were appropriate. The purchases we examined were related to the flood, and existing Federal Government contracts with approved vendors were used to obtain the needed services and equipment. In addition, the office of the Chief Financial Officer monitored the functions' spending during the latter part of Fiscal Year 2006 to ensure sufficient funds were available to cover the costs to purchase replacement items.

Response

We made no specific recommendations as a result of the analyses performed during this audit. IRS management reviewed a draft of this report and agreed with the facts and findings presented; their comments have been considered and, where appropriate, incorporated into this report.

Copies of this report are also being sent to the IRS managers affected by the report results. Please contact me at (202) 622-6510 if you have 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

ADP	Automated Data Processing
GSA	General Services Administration
IFS	Integrated Financial System
IRS	Internal Revenue Service



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Background

In late June 2006, a low-pressure system stalled off the east coast and produced record rainfall in the Washington, D.C., area. According to the National Weather Service, the second greatest daily rainfall ever in Washington, D.C., occurred on June 25, 2006, when 7.09 inches of rain fell in the city. The heavy rains overwhelmed storm water drainage systems and flooded the subbasement and basement of the Internal Revenue Service (IRS) National Headquarters building with more than 20 feet of water.

This is the third report produced by the Treasury Inspector General for Tax Administration on the effects of the flooding of the IRS National Headquarters building.

The water from the storm severely damaged the building's electrical, heating, and air-conditioning systems in the subbasement and destroyed offices, vehicles, furniture, and computer equipment located in the basement and garage. The approximately 2,200 employees who worked in the building, including the top executives of the IRS' major functional areas, were assigned temporary space in other IRS facilities or began telecommuting during the repair and rebuilding efforts.

Because the IRS is a tenant in a building leased from the General Services Administration (GSA), it was not responsible for the costs to make structural repairs to the building. In September 2006, the GSA estimated that its cost to repair the building, grounds, and internal infrastructure items (e.g., plumbing, electrical system, heating and air-conditioning, and building wiring) was approximately \$36.8 million. This audit was limited to the costs incurred by the IRS to establish temporary worksites; move employees to those sites; assist with building cleanup; replace damaged equipment, vehicles, and furniture; and return displaced employees to their original posts of duty. We limited our testing to only those expenditures recorded in the IRS Integrated Financial System (IFS)¹ as of December 31, 2006. The Treasury Inspector General for Tax Administration has previously reported on the effect of the flood on 1) data security and computer operations² and 2) general business resumption activities.³

This review was performed at the IRS National Headquarters in Washington, D.C., in the offices of the Chief Counsel, Chief Financial Officer, Criminal Investigation, Modernization and Information Technology Services, and Agency-Wide Shared Services during the period

¹ IRS accounting system.

² *The Internal Revenue Service Adequately Protected Sensitive Data and Restored Computer Operations After the Flooding of Its Headquarters Building* (Reference Number 2007-20-023, dated January 26, 2007).

³ *The Internal Revenue Service Building Flood Caused No Measurable Impact on Tax Administration* (Reference Number 2007-30-028, dated February 7, 2007).



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November 2006 through April 2007. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.



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Results of Review

Costs to Recover From the Flood Were Less Than Initially Expected

Immediately following the flood, the IRS estimated it would spend \$21.1 million⁴ to rent temporary work space, move personnel to and from the temporary space, assist with building cleanup efforts, and replace damaged equipment. On December 8, 2006, the IRS and the GSA considered the building ready for reopening and IRS staff began to return.

As of December 31, 2006, the IRS had spent about \$11.6 million⁵ to recover from the flood. It expects to spend another \$1.6 million, for a total cost of about \$13.2 million. The costs were approximately \$7.9 million (37 percent) less than the original estimate of \$21.1 million. IRS officials suggested several factors caused the initial estimate to be high:

- The original estimates were developed before the functions had the opportunity to thoroughly assess the damage and research the costs to replace the equipment.
- The GSA paid more of the costs than expected.
- The original estimate included funds for contingencies that were not needed.
- Technology improvements resulted in lower costs for some replacement items.
- Not all items that were destroyed were replaced.

Congress did not provide additional funding to pay for the flood damages. Instead, the IRS paid for these costs by using yearend savings (surpluses), rent credits from the damaged building, and user fees.⁶ Approximately 70 percent of the costs were related to rent for temporary space, automated data processing (ADP) equipment, services and maintenance, and salaries for those involved in the recovery efforts. Figure 1 shows the amount spent for each of these four expense categories as of December 31, 2006 (see Appendix IV for a complete list of costs).

⁴ Reported as \$17.2 million in a previous Treasury Inspector General for Tax Administration report because of an expected rent credit of \$3.9 million. *The Internal Revenue Service Building Flood Caused No Measurable Impact on Tax Administration* (Reference Number 2007-30-028, dated February 7, 2007).

⁵ See Appendix IV for a description of the funds spent by December 31, 2006.

⁶ User fees are charges individuals and businesses are required to pay for special benefits received beyond those received by the general public and, in general, can be used to supplement the funding of a variety of IRS operations.



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Figure 1: Actual Flood Recovery Costs As of December 2006

IFS Code	Description	Cost	Percentage of Total
2311	Rent for Temporary Space	\$3,287,606	28.4%
31AD	ADP Equipment, Capitalized	1,944,739	16.8%
2546	Services and Maintenance to Buildings and Space	1,851,338	15.9%
11SP	Salaries – Full-Time Permanent	1,177,095	10.1%
Various	All Others (26 accounts)	3,335,217	28.8%
Totals		\$11,595,995	100%

Source: The IFS and interviews with IRS officials.

Although all IRS functions were affected by the flood, the four functions with the highest estimated costs were Agency-Wide Shared Services, Modernization and Information Technology Services, Chief Counsel, and Criminal Investigation. The Agency-Wide Shared Services function had overall responsibility for leading the recovery efforts. The other three functions had significant operations or assets in the affected areas of the building. Figure 2 shows the estimated total costs for each of these functions. The costs in Figure 2 include the approximately \$11.6 million spent as of December 2006, plus the estimated additional costs of \$1.6 million that have not yet been spent (total estimated costs of about \$13.2 million).

Figure 2: Estimated Total Recovery Costs for IRS Functions

Function	Estimated Cost	Percentage of Total
Agency-Wide Shared Services	\$7,964,851	60.4%
Modernization and Information Technology Services	2,686,771	20.4%
Chief Counsel	1,602,778	12.2%
Criminal Investigation	681,054	5.2%
All Other Functions ⁷	239,566	1.8%
Total Estimated Costs	\$13,175,020	100%

Source: The IFS and IRS functions.

Agency-Wide Shared Services

The Real Estate and Facilities Management unit within the Agency-Wide Shared Services function has overall responsibility for property management within the IRS. This unit conducted the initial assessment of the damage and arranged for pumping services to remove the flood

⁷ The other functions were Appeals, Chief Financial Officer, Chief Human Capital Officer, Communications and Liaison, Large and Mid-Size Business, National Headquarters staff, Small Business/Self Employed, Tax Exempt and Government Entities, and Wage and Investment.



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waters. It also coordinated with the GSA to arrange for the removal of damaged items and decontamination services that were necessary before restoring the building.

The basement included some rooms used as offices and others used for storage of office equipment and supplies, as well as the building fitness center. The Real Estate and Facilities Management unit was responsible for replacing the basic office furnishings that were lost in the flood, including desks, chairs, file cabinets, computer stands, coat racks, refrigerators, and other items common to a typical office.

The Agency-Wide Shared Services function anticipated spending a total of about \$8 million on the flood recovery efforts. Through December 31, 2006, it had spent about \$6.9 million of this amount on the following:

- Additional rent for temporary office space – \$3.3 million.
- Cleanup activities such as removing the damaged equipment and furniture, pumping out flood waters, and sanitizing the basement and subbasement – \$1.8 million.
- Salaries for employees directly involved in the recovery efforts – \$1 million.
- Criminal Investigation function office and storage space – \$354,000.
- Other expenses – \$387,000.

Modernization and Information Technology Services

Immediately after the flood, Modernization and Information Technology Services function officials estimated the flood damages for nonlabor costs in their organization to be approximately \$4 million. Most of this estimated cost was for replacing network infrastructure (Headquarters office and the temporary space), reestablishing telephone service, connecting the temporary offices, and handling some surplus equipment damaged by the flooding. However, the estimate of \$4 million was significantly higher than the amount the Modernization and Information Technology Services function will spend to recover from the flood. Figure 3 shows this function's actual flood-related expenses as of April 2007.



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**Figure 3: Modernization and Information Technology Services
Function Flood Expenses As of April 2007**

Type of Expense	Amount
Local Telephone Service	\$7,157
Support Transportation	14,028
Travel Costs to Temporary Offices	73,833
Support Supplies	102,944
ADP Components	199,936
Telecommunications Equipment	219,187
Labor Costs (not included in original damage estimate)	601,947
ADP Equipment	607,715
Working Capital Fund for Telephone and Data Network	860,024
Total Expenses	\$2,686,771

Source: The IFS and the Modernization and Information Technology Services function.

The reasons that actual costs were less than the estimated costs included:

- Surplus equipment valued at about \$335,000 will not be replaced.
- Telephone equipment estimated at \$1,000,000 was not needed.
- Various other overestimates of about \$600,000.

Chief Counsel

The Office of Chief Counsel used several rooms in the basement to temporarily store new equipment before it was to be distributed to its employees. This equipment was destroyed during the flood. The new items awaiting distribution included computers, printers, network equipment, laptop port replicators, carrying cases, locks, and power supply converters. As of December 31, 2006, the Office of Chief Counsel had completed all of its flood-related purchases. Figure 4 shows a detailed breakdown of this function's \$1.6 million in flood-related expenses.



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Figure 4: Office of Chief Counsel Flood Expenses

Type of Expense	Amount
Support Services	\$1,946
Mobile Telephones and Pagers	2,295
Maintenance – Computer Equipment	20,910
Travel Costs to Temporary Offices	27,603
ADP Equipment	1,550,024
Total Expenses	\$1,602,778

Source: The IFS.

Criminal Investigation

The Criminal Investigation function stored most of its headquarters surveillance equipment in its offices located in the basement of the IRS Headquarters office, including more than 700 items categorized as audio, optical/photographic, radio, telecommunications, tracking, video, or other miscellaneous equipment. None of the equipment that sustained water damage was usable. Additionally, two vehicles used by Criminal Investigation function agents and an additional vehicle assigned to the IRS Commissioner were damaged by the flood.

As of December 31, 2006, the Criminal Investigation function had spent a total of \$581,054 to replace the damaged surveillance equipment, acquire telecommunications equipment, and pay local travel expenses. Criminal Investigation function officials told us the replacement costs of the destroyed equipment were reduced as a result of technological advances and lower costs due to the advanced electronic surveillance equipment becoming more readily available. The Criminal Investigation function used a combination of asset forfeiture funds⁸ (\$400,000) and regularly appropriated funds (\$181,054) to cover the costs it incurred. It expects to purchase about another \$100,000 worth of equipment with the asset forfeiture funds in Fiscal Year 2007 and estimates its total flood-related costs to be about \$681,000.

No Procurement Irregularities Were Detected in the Sample of Flood Transactions Reviewed

Our review of a statistical sample of flood-related purchase transactions showed the IRS purchases were appropriate. The purchases we examined were related to the flood, and existing Federal Government contracts with approved vendors were used to obtain the needed services and equipment. In addition, the office of the Chief Financial Officer monitored the functions'

⁸ Purchasing investigative equipment is an appropriate use of asset forfeiture funds. Asset forfeiture funds are the net proceeds (resulting from the seizure and sale of property involved in illegal activities) shared by law enforcement agencies that participated in the investigation that led to the confiscation of the property.



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spending during the latter part of Fiscal Year 2006 to ensure sufficient funds were available to cover the costs to purchase replacement items.

We reviewed a statistical sample of 140 transactions, plus the 10 largest flood expenditures, to determine whether they were appropriate. We did not identify any improper transactions, and all expenditures appeared to be related to flood damages. We analyzed all available supporting documentation, which included travel vouchers, telephone vouchers, purchase card receipts, invoices, receiving reports, and employee requisitions. All of the expenditures were properly approved, and all purchases for more than \$2,500 were properly handled through the procurement process. The IRS used existing Federal Government contracts with approved vendors to purchase large-dollar items.



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Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to determine the costs incurred by the IRS to recover from the flooding of its National Headquarters building, including whether expenses were properly related to the flood and proper procurement processes were followed. We did not conduct any tests of the expenses paid by the GSA to repair the 1111 Constitution Avenue building. Those expenses are the burden of the GSA as the landlord of the building; the IRS is responsible only for those expenses typically incurred by a tenant. To accomplish our objective, we:

- I. Determined if the IRS limited its purchases of replacement items to only those that were damaged in the flooding.
 - A. Obtained lists of items damaged in the flood from the Agency-Wide Shared Services, Criminal Investigation, Chief Counsel, and Modernization and Information Technology Services functions.
 - B. Obtained a download from the IFS¹ of all transactions with an internal order code of "FLOOD."
 - C. Selected a sample of FLOOD-related purchases and determined if the items purchased could be matched to damaged items. Details about our sampling plan are included at the end of this Appendix.
 - D. Selected the 10 largest FLOOD transactions and determined if the items purchased could be matched to the damaged items.
 - E. Determined the reasons for any discrepancies.
- II. Determined if the costs incurred (such as, but not limited to, replacing damaged vehicles, computers, equipment, and supplies) were reasonable.
 - A. Determined the prices paid for a sample of selected items (e.g., vehicles, equipment, and services) and compared them to open market prices.
 - B. If any prices seemed excessive, determined the facts and circumstances of those particular purchases to determine if there were any valid extenuating circumstances that justified the higher than open market costs.

¹ IRS accounting system.



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- C. Because some employees were reimbursed for travel expenses to their temporary offices, determined the total amount reimbursed and assessed the reasonableness of the expenses claimed for those in our sample.
- III. For the items selected in Steps I and II, determined if the invoiced transactions were handled through negotiated Federal Government contracts, purchase card transactions were for less than \$2,500, and all transactions were approved by IRS managers. (We did not evaluate the actual contract negotiations that occurred when contracts were awarded. We cannot comment about whether the contracts were properly awarded by the IRS.)

Sampling Plan

We determined an unstratified random sample (attribute sampling) was appropriate and developed the following sampling plan:

Total population of expenditure line items	7,521
Confidence level of sample:	90%
Expected error rate:	5%
Precision level of sample:	±3%
Sample size:	140
Sample selection technique:	random
Type of sample:	attribute

We used attribute sampling because an exception will be defined as either a yes or no question (Was the expenditure appropriate?).

Computer-Processed Data

We did not attempt to validate the reliability of data from either the IFS or the Web-Requisition Tracking System.² However, we reviewed all individual transactions selected in our sample and determined if the information was complete and correct when matching data to source documents.

² IRS Automated Purchase/Acquisition System.



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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)

Carl L. Aley, Director

Kevin P. Riley, Audit Manager

Tom J. Cypert, Lead Auditor

Cheryl Medina, Senior Auditor



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Appendix III

Report Distribution List

Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Operations Support OS
Deputy Commissioner for Services and Enforcement SE
Chief Counsel CC
Chief, Agency-Wide Shared Services OS:A
Chief, Criminal Investigation SE:CI
Chief Financial Officer OS:CFO
Chief, Mission Assurance and Security Services OS:MA
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
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 Chief, Criminal Investigation SE:CI
 Chief Financial Officer OS:CFO



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Appendix IV

*Internal Revenue Service Flood Expenses Paid
(as of December 31, 2006)*

IFS¹ Code	Description	Dollar Amount
1171	Cash Awards	\$5,065
110T	Overtime and Holiday	216,807
11PP	Pay Differential (non-Administratively Uncontrollable Overtime)	4
11SP	Salaries – Full-Time Permanent	1,177,095
11ST	Salaries – Other Than Full-Time Permanent	8,013
12LA	Personnel Benefits	290,007
21TV	Operating Travel, Domestic	310,818
22SS	Support Transportation	11,730
2321	Rent – Enforcement	354,407
2331	Utility Services	652
2351	Mobile Telephones and Pagers	2,295
2353	Local Telephone Service	2,884
23SS	Support Rentals	267,119
2526	Contractual labor – Private Sector	10,053
2544	Custodial	230
2546	Services and Maintenance to Buildings and Space	1,851,338
25MA	Maintenance – Computer Equipment	20,910
25SS	Support Services – Private Sector	4,551
2634	ADP Components	246,252
267S	Other Supplies	5,979
26EE	Supplies, Firearms, Vehicle Costs – Enforcement	26,480
26SS	Support Supplies	125,921
3125	Non-Capitalized Non-ADP Equipment	17,253
3174	Non-Capitalized Property Telecommunications Equipment	18,117
31AD	ADP Equipment, Capitalized	1,944,739
31CO	Telecommunications Equipment, Capitalized	248,205
3202	Land, Buildings, and Other Structures – Other	9,168
Total Expenses Coded As Flood Expenses in the IFS		\$7,176,092
Estimated Criminal Investigation Equipment Expenses (not coded as flood expenses in the IFS)		\$400,000
Data and Voice Network Expenses (not coded as flood expenses in the IFS)		732,297
Additional Rent for Temporary Space (not coded as flood expenses in the IFS)		3,287,606
Total IRS Flood Expenses (as of 12/31/2006)		\$11,595,995

Source: *The IFS and interviews with IRS officials.*

¹ IRS accounting system.