



*Cost-Reimbursement Contracts  
Did Not Fully Comply With Federal  
Acquisition Regulation Revisions*

**April 30, 2013**

**Reference Number: 2013-10-046**

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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Phone Number | 202-622-6500

E-mail Address | [TIGTACommunications@tigta.treas.gov](mailto:TIGTACommunications@tigta.treas.gov)

Website | <http://www.treasury.gov/tigta>



## HIGHLIGHTS

### **COST-REIMBURSEMENT CONTRACTS DID NOT FULLY COMPLY WITH FEDERAL ACQUISITION REGULATION REVISIONS**

## Highlights

**Final Report issued on April 30, 2013**

Highlights of Reference Number: 2013-10-046 to the Internal Revenue Service Deputy Commissioner for Operations Support.

### **IMPACT ON TAXPAYERS**

On October 14, 2008, Congress passed the Duncan Hunter National Defense Authorization Act for Fiscal Year 2009 (hereafter referred to as the Act), in part, to address the use of high-risk contracts awarded throughout the Federal Government. The IRS generally did not comply with the Act and related Federal Acquisition Regulation (FAR) revisions for cost-reimbursement contracts that TIGTA reviewed. Consequently, this noncompliance increases the risk of inefficiency and waste by the IRS.

### **WHY TIGTA DID THE AUDIT**

This audit was initiated because provisions of the Act mandated that Federal Offices of Inspectors General determine agency compliance with new regulatory requirements. In addition, adequate planning and management of cost-reimbursement contracts is imperative given that these high-risk contracts provide few incentives for contractors to control costs.

### **WHAT TIGTA FOUND**

The IRS did not comply with the majority of the new FAR requirements for 46 of the 49 cost-reimbursement contracts entered into between March 17, 2011, and June 30, 2012, totaling nearly \$47 million. Specifically, the IRS did not always document required information to justify the selection of cost-reimbursement contracts and did not always assign acquisition workforce resources prior to award to manage these contracts. This occurred, in part, because the IRS did not develop any specific procurement policies and procedures

addressing the revised regulations associated with planning for and awarding cost-reimbursement contracts. As a result, IRS contracting officers were not aware of the new requirements.

For the 46 cost-reimbursement contracts awarded to the IRS's Federally Funded Research and Development contractor, the IRS was noncompliant with nearly all of the FAR revisions. In IRS management's opinion, there was no need to follow requirements for awards to the contractor because of the unique relationship between the IRS and the contractor. TIGTA found no justification for this opinion in acquisition regulations. Further, the IRS did not document the adequacy of contractor accounting systems prior to the award of cost-reimbursement contracts in the majority of contracts reviewed.

Finally, the IRS's Office of Procurement staff improperly coded three contracts as cost-reimbursement contracts within the Federal Procurement Data System—Next Generation.

### **WHAT TIGTA RECOMMENDED**

TIGTA recommended that the IRS establish and implement procurement policies and procedures that are in compliance with the Act and related FAR revisions, establish oversight procedures to ensure that future cost-reimbursement contracts comply with regulations, and review contracts issued during the audit period to ensure that they were properly coded in the IRS and Federal Procurement Data systems.

In its response, the IRS agreed with the recommendations and plans to develop and update policies and procedures to reflect the new FAR requirements and plans to provide related training to procurement staff. In addition, the IRS plans to implement oversight processes to ensure that FAR regulations are followed. Finally, the IRS agreed to review the IRS and Federal Procurement Data systems to ensure that contracts are properly categorized and coded.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

April 30, 2013

**MEMORANDUM FOR DEPUTY COMMISSIONER FOR OPERATIONS SUPPORT**

**FROM:** Michael E. McKenney  
Acting Deputy Inspector General for Audit

**SUBJECT:** Final Audit Report – Cost-Reimbursement Contracts Did Not Fully  
Comply With Federal Acquisition Regulation Revisions  
(Audit # 201210027)

This report presents the results of our review to determine whether the Internal Revenue Service (IRS) was in compliance with the Duncan Hunter National Defense Authorization Act for Fiscal Year 2009<sup>1</sup> and the related revisions to the Federal Acquisition Regulation. This review was conducted as part of the Treasury Inspector General for Tax Administration's Fiscal Year 2013 Annual Audit Plan and addresses the major management challenge of Achieving Program Efficiencies and Cost Savings.

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 recommendations. If you have any questions, please contact me or Gregory D. Kutz, Assistant Inspector General for Audit (Management Services and Exempt Organizations).

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<sup>1</sup> Public Law 110-417, 122 Stat. 4549 (Oct. 2008).



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*Abbreviations*

CO	Contracting Officer
COR	Contracting Officer's Representative
DCAA	Defense Contract Audit Agency
FAR	Federal Acquisition Regulation
FFRDC	Federally Funded Research and Development Center
FPDS-NG	Federal Procurement Data System–Next Generation
IRS	Internal Revenue Service



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## *Cost-Reimbursement Contracts Did Not Fully Comply With Federal Acquisition Regulation Revisions*

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### *Background*

Each year the Internal Revenue Service (IRS) awards more than \$1 billion to contractors using a variety of contract types. Between March 17, 2011, and June 30 2012, the IRS awarded approximately \$47 million in cost-reimbursement contracts. Certain contract types, such as cost-reimbursement contracts, pose risks of inefficiency and waste to the Federal Government because they provide no direct incentive for contractors to control costs. Under cost-reimbursement contracts, contractors are paid based on the incurrence of allowable costs, as opposed to the delivery of a completed product or service. This type of contract is used when an agency is unable to define its requirements sufficiently to allow for a fixed-price contract,<sup>1</sup> such as contracts for research and development or complex projects for which the costs of performance cannot be reasonably estimated with a high degree of accuracy.

As the Federal Government faces pressure to reduce spending, efforts to reform Government contracting have intensified. To address these concerns, both Congress and the Administration<sup>2</sup> have strengthened controls over the use and management of other than fixed-price contracts. On October 14, 2008, Congress passed the Duncan Hunter National Defense Authorization Act for Fiscal Year 2009<sup>3</sup> (hereafter referred to as the Act), in part, to address the use of high-risk contracts awarded throughout the Federal Government. Section 864 of the Act required the Federal Acquisition Regulation (FAR)<sup>4</sup> be revised to address the use and management of cost-reimbursement contracts.<sup>5</sup> As mandated by Section 864, an interim rule, *Proper Use and Management of Cost-Reimbursement Contracts*,<sup>6</sup> was published on March 16, 2011, outlining the FAR changes.

The Act required that the FAR be revised to include guidance regarding the development and documentation of acquisition plans to justify and support use of a cost-reimbursement contract, compliance with additional contracting officer (CO) and contracting officer's representative

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<sup>1</sup> Fixed-price contracts provide the contractor a set payment for achieving a specific set of deliverables.

<sup>2</sup> President Obama issued a Presidential Memorandum on Government Contracting on March 4, 2009, directing agencies to become more fiscally responsible in their contract actions and cut contract costs. Additionally, in July 2011, the Office of Management and Budget directed agencies to reduce the use of high-risk contracts.

<sup>3</sup> Public Law 110-417, 122 Stat. 4549 (Oct. 2008).

<sup>4</sup> 48 C.F.R. Chapter 1 (2011); the FAR is the primary regulation used by Federal agencies to purchase supplies and services.

<sup>5</sup> For purposes of this audit, we refer to newly issued contracts and task/delivery orders (an order for supplies or services placed against an established contract) as contracts. Both newly issued contracts and newly issued task/delivery orders are subject to requirements of the Act subsequent to the implementation of FAR changes.

<sup>6</sup> FAR Case 2008-030.



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(COR) responsibilities,<sup>7</sup> and the determination of the adequacy of accounting systems throughout the contract period. In the area of acquisition planning, some of the new requirements included that plans must document why a cost-reimbursement contract type was selected, the additional risks involved, how the Government would manage the risks, and resources available to mitigate risks. In addition, the FAR revisions required acquisition plans to be approved by someone at least one level above the CO. In the area of CO and COR responsibilities, the FAR revisions required that a COR be appointed prior to award of the contract and that the COR possess the appropriate level of training and experience necessary to administer the cost-reimbursement contract. Finally, in the area of contractor accounting systems, the FAR revisions required that agencies ensure that the contractor's accounting system is adequate, as determined by the Defense Contract Audit Agency (DCAA),<sup>8</sup> prior to award and during the life of the contract in order to ensure that cost data provided by the contractor are accurate. The Act also required each agency's Inspector General to determine the agency's compliance with the new requirements.

We reviewed the IRS's compliance with the FAR revisions to address a congressional mandate in the Act. To accomplish our objective, we reviewed all 52 cost-reimbursement contracts awarded by the IRS from March 17, 2011, to June 30, 2012. Several contracts related to the provision of system maintenance on the IRS's Integrated Financial System,<sup>9</sup> development of the Customer Account Data Engine 2,<sup>10</sup> and development of the Patient Protection and Affordable Care Act<sup>11</sup> data repository and totaled approximately \$12 million in contract awards. Forty-six cost-reimbursement contracts we reviewed were indefinite delivery, indefinite quantity<sup>12</sup> contracts awarded to the IRS's contractor for its Federally Funded Research and Development

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<sup>7</sup> Within the Federal acquisition area, the COs have the authority to enter into, 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 and conditions of the contract, and safeguarding the interest of the United States in its contractual relationships. The CORs assist in the technical monitoring or administration of a contract and maintain a file for each assigned contract.

<sup>8</sup> The DCAA performs all necessary contract audits for the Department of Defense. The DCAA also provides contract audit services to other Federal agencies as appropriate.

<sup>9</sup> The Integrated Financial System is the financial management system for the administrative activities in the IRS. It also provides financial statements and reports in accordance with the Federal accounting and reporting standards including information for budgeting, analysis, and Governmentwide reporting.

<sup>10</sup> The Customer Account Data Engine 2 is a single relational database designed to house all individual taxpayer accounts in a central data source.

<sup>11</sup> P.L. 111-148. (Mar. 2010).

<sup>12</sup> Indefinite delivery, indefinite quantity contracts are a type of contract that provides for an indefinite quantity of supplies or services during a fixed period of time.



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Center (FFRDC).<sup>13</sup> Those 46 contracts were used in support of the IRS's systems modernization efforts and totaled approximately \$35 million.

During our review, it was determined that three contracts, totaling approximately \$2.6 million, were miscoded by the IRS within the Federal Procurement Data System–Next Generation (FPDS-NG)<sup>14</sup> and were not cost-reimbursement contracts.<sup>15</sup> Thus, the scope of our review was limited due to data reliability issues related to the IRS's miscoding of contract types in the FPDS-NG. We did not attempt to determine if any contracts originally coded as fixed-price contracts or another contract type should have been categorized as a cost-reimbursement contract due to the volume of contracts awarded by the IRS during our audit period.

This review was performed at the Office of Procurement, Agency-Wide Shared Services, in Oxon Hill, Maryland, during the period August 2012 through January 2013. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. 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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<sup>13</sup> The FFRDC is an entity sponsored by Government agencies for the purpose of performing, analyzing, integrating, supporting, or managing basic research that receives 70 percent or more of its financial support from the Government. The IRS is currently conducting a multiyear, multibillion dollar effort to update its core business systems. To facilitate the modernization effort, the IRS hired an FFRDC contractor to provide strategic, technical, and program management advice, guidance, and support services.

<sup>14</sup> The FPDS-NG is a web-based electronic database system that is used to collect and report on Federal procurement spending.

<sup>15</sup> A total of 52 cost-reimbursement contracts were originally identified by the IRS as falling within the scope of our cost-reimbursement contract audit. Three of those contracts were subsequently determined not to be cost-reimbursement contracts by the IRS when we requested supporting documentation. The remaining 49 contracts were reviewed for compliance with revisions made to the FAR. Of the 49 contracts reviewed, 46 related to FFRDC contract awards.





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*Results of Review*

***The Internal Revenue Service Did Not Issue Guidance on Recent  
Federal Acquisition Regulation Revisions for Cost-Reimbursement  
Contracts***

The IRS did not issue internal procurement policy guidance to implement the FAR revisions that were required by the Act. Although the revised FAR became effective on March 17, 2011, the IRS has not issued any procurement policies and procedures to implement recent FAR changes for cost-reimbursement contracts. Instead, the IRS has used the prior FAR and its existing internal procurement policies and procedures to guide its COs, CORs, and program management staff in the conduct of their acquisition planning, award, and management of cost-reimbursement contracts. For example, IRS policies and procedures for acquisition plans<sup>16</sup> fail to address new FAR requirements associated with approval of the acquisition plan by management personnel at least one level above the CO, justifications to support the use of cost-reimbursement contracts, and designation of a COR prior to contract award.

The Office of Procurement stated that its reason for not issuing new internal procurement policies and procedures related to cost-reimbursement contracts was due to its belief that the new requirements were so clearly presented in the FAR that there was no need to issue internal IRS guidance. The Office of Procurement also stated that there were standard operating procedures for certain information technology contracts which provided guidance on acquisition planning and the appointment of CORs and alternate CORs. However, we determined that those procedures also did not comply with major parts of recent FAR revisions for cost-reimbursement contracts. For example, because no guidance had been provided, the COs who we interviewed were not aware of revisions to the FAR required by the Act as they related to documentation requirements in the contract file. One CO stated there was no communication from the Office of Procurement regarding any FAR revisions on the subject of cost-reimbursement contract documentation requirements. The lack of guidance by the IRS to implement FAR revisions increases the chances that high-risk, cost-reimbursement contracts may experience problems, resulting in higher costs to the Government.

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<sup>16</sup> Policy and Procedures Memorandum No. 7.1 (Jan. 1, 2010).



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## ***Recommendation***

***Recommendation 1:*** The Chief, Agency-Wide Shared Services, should establish and implement policies and procedures that are in compliance with recent FAR revisions associated with the Act.

***Management's Response:*** The IRS agreed with this recommendation and stated it has drafted and is circulating updated policies and procedures for approval that address the recent FAR revisions associated with Section 864 of the Act.

## ***Contracts Did Not Comply With New Federal Acquisition Regulation Requirements for Cost-Reimbursement Contracts***

None of the cost-reimbursement contracts that the IRS entered into between March 17, 2011, and June 30, 2012, fully complied with provisions of the Act and related FAR revisions in the areas of acquisition planning, CO and COR responsibilities, and adequacy of contractor accounting systems. Three contracts provided system maintenance on the IRS's Integrated Financial System and supported the development of the Customer Account Data Engine 2 and the Patient Protection and Affordable Care Act data repository. These three contracts totaled approximately \$12 million in contract awards. The remaining 46 cost-reimbursement contracts were indefinite delivery, indefinite quantity contracts awarded to the IRS's contractor for its FFRDC. Those 46 contracts were used in support of IRS's systems modernization efforts and totaled approximately \$35 million.

### ***Acquisition planning***

The acquisition plans for all of the 49 contracts we reviewed did not address at least one of the sections of the FAR related to acquisition planning for cost-reimbursement contracts. Figure 1 provides the details on compliance with acquisition planning requirements.



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**Figure 1: Acquisition Planning Requirements**

Federal Acquisition Regulations	Contract Compliance With Regulations				
	1	2	3	4 Through 49 (FFRDC)	Total
Acquisition plans should explain why the contract type selected must be used to meet the agency need.	Fail	Pass	Pass	Fail	2 of 49 Passed
Acquisition plans should discuss the Government’s additional risks and the burden to manage the contract type selected.	Fail	Fail	Pass	Fail	1 of 49 Passed
Acquisition plans should discuss how the Government identified the additional risks.	Fail	Fail	Fail	Fail	0 of 49 Passed
Acquisition plans should discuss the nature of the additional risks.	Pass	Fail	Pass	Fail	2 of 49 Passed
Acquisition plans should discuss Government plans to manage and mitigate the risks.	Fail	Pass	Fail	Fail	1 of 49 Passed
Acquisition plans should discuss the Government resources necessary to properly plan for, award, and administer the contract type selected.	Pass	Fail	Pass	Fail	2 of 49 Passed
Acquisition plans should provide a rationale that details the particular facts and circumstances and associated reasoning essential to support the contract type selection.	Fail	Pass	Pass	Fail	2 of 49 Passed
Acquisition plans should include a discussion of the actions planned to minimize the use of other than fixed-price contracts on future acquisitions.	Fail	Pass	Fail	Fail	1 of 49 Passed
Acquisition plans should include a discussion of why a level-of-effort, price redetermination, or fee provision was included.	Fail	Fail	Pass	Fail	1 of 49 Passed
For acquisition plans for other than fixed-price contracts, obtain an approval and signature from the appropriate acquisition official at least one level above the CO.	Fail	Fail	Pass	Fail	1 of 49 Passed

*Source: Our review of IRS Office of Procurement, Agency-Wide Shared Services, contract files.*



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In the three non-FFRDC cost-reimbursement contracts awarded totaling approximately \$12 million, we found that the IRS partially complied with the revisions to the FAR regarding acquisition planning. We found instances where the IRS appropriately documented in the acquisition plan key facts required by the FAR, such as the rationale for the use of a cost-reimbursement contract and the approval of the acquisition plan by an IRS official one level above the CO. However, in other cases, we found the intent of FAR revisions was addressed in other parts of the contract file but was not contained in the acquisition plan as required by the FAR. For example, in one file, an explanation of why a cost-reimbursement contract type was necessary was located in the Determination and Finding section of the contract file and not in the acquisition plan as required by the FAR revision. We found some requirements were addressed elsewhere in contract files, suggesting that the IRS could have complied with new FAR requirements, in some cases, by changing where key decisions and discussions are documented. Finally, we found some instances where FAR requirements were not addressed in any section of the contract file. For example, we found that one file failed to justify why a cost-reimbursement contract type was needed for the acquisition.

Our review found the 46 cost-reimbursement contracts awarded to the FFRDC, totaling approximately \$35 million, did not comply with any of the acquisition planning provisions of the Act and related FAR revisions. When asked about the noncompliance with FAR requirements for FFRDC contracts, Office of Procurement management stated it was the IRS's opinion that there was no need to follow the FAR requirements for FFRDC contracts because contracts awarded to the FFRDC were not subject to normal processes. IRS management further stated that because the intent of the FFRDC is to have a long-term relationship with the IRS and because the FFRDC employees are integrated seamlessly with IRS employees, the need for usual acquisition planning was unnecessary.<sup>17</sup> Upon reviewing the applicable provisions of the FAR, we found no evidence that FFRDC contracts in general are exempt from the revisions required by the Act. Our review found that Part 35 of the FAR specifically addresses the FFRDCs, and we determined that it does not include an exemption to the new requirements for cost-reimbursement contracts. FAR revisions were designed to ensure that adequate planning is performed on all cost-reimbursement contracts, including FFRDC contracts, to ensure that risks associated with cost-reimbursement contracts are considered and mitigated.

### **CO and COR responsibilities**

At least one of the provisions of the FAR related to the designation of a COR for cost-reimbursement contracts was not adhered to in all 49 contracts we reviewed. Figure 2 provides details on compliance with new CO and COR responsibility revisions to the FAR.

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<sup>17</sup> The establishment of the FFRDC contract we reviewed began in 1998.



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**Figure 2: CO/COR Responsibilities**

Federal Acquisition Regulations					
	1	2	3	4 Through 49 (FFRDC)	Total
The COR shall be certified and maintain certification in accordance with the current Office of Management and Budget memorandum on the Federal Acquisition Certification for Contracting Officer Representatives guidance.	Fail	Fail	Pass	Fail	1 of 49 Passed
The COR appointment letter shall state the authority is not redelegable.	Fail	Pass	Pass	Fail	2 of 49 Passed
The COR appointment letter shall state that the COR may be personally liable for unauthorized acts.	Fail	Pass	Pass	Fail	2 of 49 Passed
Copies of the COR appointment letter will be furnished to the contractor and the contract administration office.	Pass	Fail	Fail	Fail	1 of 49 Passed
Acquisition planning should include the designation of at least one COR prior to award of the contract.	Fail	Fail	Fail	Fail	0 of 49 Passed
The acquisition planner shall ensure that a COR is nominated by the requirements official as early as practicable in the acquisition process. The CO shall designate and authorize a COR as early as practicable after the nomination.	Pass	Fail	Fail	Fail	1 of 49 Passed

*Source: Our review of IRS Office of Procurement, Agency-Wide Shared Services, contract files.*

Appointment of a properly trained COR possessing the necessary experience prior to award is key to ensuring that risks associated with cost-reimbursement contracts are mitigated. The COR helps monitor the technical aspects of the contract and assists with contract administration. FAR 16.301-3(a)(4)(i) states that cost-reimbursement contracts may only be used when the COR, in accordance with FAR 1.602-2, is designated prior to award of the contract or order.

FAR 1.602-2(d)(6) requires that the designation be in writing and that it specify the COR's responsibilities, authorities, and limitations. FAR 1.602-2(d)(6) states that a copy of this written designation must be provided to the contractor. In addition, the Office of Federal Procurement Policy has prescribed specific levels of experience and training for the CORs in order for them to be adequately prepared to assist in the administration of cost-reimbursement contracts. The three non-FFRDC cost-reimbursement contract files reviewed complied with some of the FAR revisions and failed to comply with others in the area of CO and COR responsibilities. Our



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review of the 46 cost-reimbursement contracts awarded to the IRS’s FFRDC found that the IRS did not document appointment of a COR prior to award in any of the contract files.

**Adequacy of contractor accounting systems**

In 36 of the 49 contracts reviewed, we found evidence that the contractors may not have had accounting systems that adequately tracked their costs during the entire period of performance as required by FAR 42.302(a)(12). Government contractors are subject to Cost Accounting Standards by which contractors must estimate and report costs. Agency COs are responsible for ensuring that the DCAA has validated a contractor’s accounting systems and found their system in compliance with Cost Accounting Standards.<sup>18</sup> The FAR revisions state that agencies may only use cost-reimbursement contracts when the contractors accounting system is adequate for determining costs. The FAR also requires the COs to ensure that contractor accounting systems remain adequate during the entire period of performance for the contract. The adequacy of the contractor’s accounting and internal control system, and compliance with Cost Accounting Standards, affect the quality and validity of the contractor data which the Government must rely on for its management oversight of the contractor and contract performance. Figure 3 provides details on the IRS’s compliance with new FAR requirements associated with contractor accounting systems.

**Figure 3: Adequacy of Contractor Accounting System Requirements**

Federal Acquisition Regulations	Contract Compliance With Regulations				
	1	2	3	4 Through 49 (FFRDC)	Total
A cost-reimbursement contract may be used only when the contractor’s accounting system is adequate for determining costs applicable to the contract or order.	Fail	Fail	Pass	Pass 12 of 46	13 of 49 Passed
The COs must determine the continuing adequacy of the contractor’s accounting system prior to award and during the entire period of contract performance.	Fail	Fail	Pass	Pass 12 of 46	13 of 49 Passed

*Source: Our review of IRS contract files.*

In the two non-FFRDC contracts failing this requirement, contract file documents disclosed that the COR had obtained a DCAA report that found the contractor’s accounting system was compliant as of December 2005. However, another document in the contract file showed that the

<sup>18</sup> The adequacy of a contractor’s accounting system affects the quality and validity of the data the Government relies on for management oversight. This is especially important for cost-reimbursement contracts where the IRS pays the contractor directly based on charges generated from the accounting system.





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DCAA issued a report in 2009 that found the contractor's current accounting system to be inadequate. In this 2009 audit report, the DCAA opined that the internal control activities related to management reviews, policies and procedures, and implementation of policies and procedures were not adequate and were not operating effectively. The DCAA examination disclosed significant deficiencies that may affect the organization's ability to record, process, summarize, and report billings in a manner consistent with applicable Federal Government contract laws and regulations. The two contracts totaled \$3.6 million.<sup>19</sup> In addition, we found that only 12 (26 percent) of the 46 FFRDC contracts that we reviewed were supported by contractor accounting system compliance documentation from the DCAA. The remaining 34 FFRDC contract files did not contain documentation of the DCAA-reviewed accounting systems.

### ***Recommendations***

***Recommendation 2:*** The Chief, Agency-Wide Shared Services, should establish an oversight process to ensure that the new IRS policies and procedures (Recommendation 1) are satisfactorily implemented and that future cost-reimbursement contracts, including FFRDC contracts, and supporting contract files are in full compliance with current FAR requirements.

***Management's Response:*** The IRS agreed with this recommendation and stated the Chief, Agency-Wide Shared Services, would establish an oversight process to ensure that the new IRS policies and procedures are satisfactorily implemented and that future cost-reimbursement contracts, including FFRDC contracts, are in full compliance with current FAR requirements.

***Recommendation 3:*** The Deputy Commissioner for Operations Support should provide all acquisition workforce personnel (COs, CORs, technical points of contact, *etc.*) and appropriate program management staff with training on recent FAR revisions resulting from the Act.

***Management's Response:*** The IRS agreed with this recommendation and stated it would provide training on recent FAR revisions resulting from the Act to those acquisition personnel involved in the award and administration of cost-reimbursement contracts.

### ***The Contract Type Was Miscoded in the Federal Procurement Data System***

The IRS provided us with a list of all 52 cost-reimbursement contracts awarded from March 17, 2011, through June 30, 2012. In March 2007, the Office of Federal Procurement

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<sup>19</sup> In June 2012, the DCAA issued a report stating that the contractor had resolved deficiencies in its accounting system. However, this report would not have been available to the CO at the time of the award for the two contracts reviewed.



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Policy issued a memorandum that tasked all agency Chief Acquisition Officers with establishing processes to ensure that FPDS-NG data are accurate. During our review, we determined that three of the contracts in our population, totaling approximately \$2.6 million, were improperly coded as cost-reimbursement contracts and should have been correctly coded as fixed-price contracts. In discussion with IRS management, they stated that all three were coding errors and corrections to the FPDS-NG would be performed. We subsequently received documentation from the IRS showing that corrections had been made in the FPDS-NG. When contracts are miscoded, the IRS does not have accurate data on the type of contracts it awards. Complete, accurate, and timely Federal procurement data are essential for ensuring that the Government has the right information when planning, awarding, and performing oversight on Federal contracts.

### ***Recommendation***

**Recommendation 4:** The Chief, Agency-Wide Shared Services, should review contracts (and related task/delivery orders) awarded since implementation of new FAR requirements on March 17, 2011, to ensure that contracts are properly coded and categorized in IRS and Federal Procurement Data systems.

**Management's Response:** The IRS agreed with this recommendation to review contract data entered into the IRS and Federal Procurement Data systems. However, the IRS believes that the period of review should start as of April 2, 2012, when the FAR implementation of Section 864 of the Act became effective.

**Office of Audit Comment:** We agree with the IRS that the period of review should start as of April 2, 2012, when the FAR implementation of Section 864 of the Act became effective.





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## Appendix I

### *Detailed Objective, Scope, and Methodology*

The overall objective of this audit was to determine whether the IRS was in compliance with the Duncan Hunter National Defense Authorization Act for Fiscal Year 2009<sup>1</sup> (hereafter referred to as the Act) and the related revisions to the FAR<sup>2</sup> in appropriately justifying and planning for the use of cost-reimbursement contracts. To accomplish our objective, we:

- I. Obtained an understanding of the process the IRS uses to select the contract type and identified potential risks and related management controls.
  - A. Researched the FAR (Section 1, subparts 16, 7, and 42), Department of Treasury regulations, and IRS procurement policies and procedures regarding the selection of contract types and documented an understanding of the selection process.
  - B. Documented the risks regarding the process of the contract type selection and identified the controls to mitigate the risks identified.
  - C. Interviewed the Office of Procurement contracting personnel and program office staff to document the current process and practices used to develop the justification of contract type when cost-reimbursement procurement is being considered.
  - D. Determined if the IRS had issued guidance pertaining to cost-reimbursement contract FAR revisions that were required by the Act.
- II. Through a review of contracts, determined whether the IRS complied with recent FAR revisions associated with cost-reimbursement contract acquisition planning and awards.
  - A. Reviewed all cost-reimbursement contracts (and related task/delivery orders) awarded from March 17, 2011, through June 30, 2012. We assessed the reliability of the FPDS-NG computer-processed data and determined that the data were sufficiently reliable to use for our audit tests. We examined contract data fields such as Procurement Instrument Identifier, type of contract, vendor name, and product or service description.
  - B. Reviewed contracts to determine whether the contract files contain required documentation associated with recent FAR revisions for cost-reimbursement contracts.

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<sup>1</sup> Public Law 110-417, 122 Stat. 4549 (Oct. 2008).

<sup>2</sup> Interim rule FAR Case 2008-030, *Proper Use and Management of Cost-Reimbursement Contracts* (Mar. 16, 2011).



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- C. If contract files reviewed did not contain required documentation, followed up with relevant procurement officials, including the COs and the CORs, to determine why FAR requirements were not followed.

**Internal controls methodology**

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objective: the IRS's policies, procedures, and management controls to ensure that cost-reimbursement contracts comply with FAR requirements. We evaluated these internal controls by: 1) interviewing key personnel within the Office of Procurement, Agency-Wide Shared Services; 2) reviewing the IRS policies and procedures; 3) reviewing the FAR (Section 1, subparts 16, 7, and 42) and the Department of the Treasury regulations; and 4) reviewing 52 cost-reimbursement contracts and their supporting contract file documentation to determine compliance with the Act.



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**Appendix II**

*Major Contributors to This Report*

Gregory D. Kutz, Assistant Inspector General for Audit (Management Services and Exempt Organizations)

Russell P. Martin, Acting Assistant Inspector General for Audit (Management Services and Exempt Organizations)

Alicia P. Mrozowski, Director

Jonathan T. Meyer, Audit Manager

Gene A. Luevano, Lead Auditor

David Bueter, Auditor

Melvin Lindsey, Auditor



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**Appendix III**

*Report Distribution List*

Acting Commissioner C  
Office of the Commissioner – Attn: Chief of Staff C  
Deputy Commissioner for Services and Enforcement SE  
Chief, Agency-Wide Shared Services OS:A  
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 OA:S  
    Director, Procurement OS:A:P



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## Appendix IV

### *Outcome Measures*

This appendix presents detailed information on the measurable impacts that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to Congress.

#### **Type and Value of Outcome Measure:**

- Protection of Resources – Potential; \$3,600,000 in two contracts awarded to an ineligible contractor (see page 5).

#### **Methodology Used to Measure the Reported Benefit:**

The IRS provided us with a population of 52 cost-reimbursement contracts that were awarded from March 17, 2011, through June 30, 2012. During our review, we found that two contracts, associated with one contractor, failed to comply with FAR requirements on contractor accounting systems. Specifically, in order to adequately protect Government resources, FAR requirements state that cost-reimbursement contracts should only be awarded to contractors with adequate accounting systems. We found the DCAA,<sup>1</sup> the agency responsible for determining contractor accounting system adequacy, issued a report in 2009 that found the contractor's current accounting system to be inadequate. In the 2009 audit report, the DCAA opined that the internal control activities related to management reviews, policies and procedures, and implementation of policies and procedures were not adequate and were not operating effectively. The DCAA examination disclosed significant deficiencies that may affect the organization's ability to record, process, summarize, and report billings in a manner consistent with applicable Federal Government contract laws and regulations. Those two contracts totaled \$3.6 million. We found that in June 2012, the DCAA issued a report stating that the contractor had resolved deficiencies in its accounting system. However, this report would not have been available to the CO at the time of the award of the two contracts reviewed and was not part of the contract file.

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<sup>1</sup> The DCAA performs all required contract audits for the Department of Defense. The DCAA also provides contract audit services to other Federal agencies as appropriate.



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**Type and Value of Outcome Measure:**

- Reliability of Information – Actual; \$2,596,033 in three contracts for which the contract type was improperly coded (see page 10).

**Methodology Used to Measure the Reported Benefit:**

The IRS provided us with a universe of 52 cost-reimbursement contracts that were awarded from March 17, 2011, through June 30, 2012. During our review, the IRS determined that three of the contracts were improperly coded as cost-reimbursement contracts, rather than being correctly coded as fixed-price contracts. In discussion with IRS management, they stated that all three were coding errors and corrections in the FPDS-NG would be forthcoming. The total amount of the three miscoded contracts was \$2,596,033.



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**Appendix V**

*Management's Response to the Draft Report*



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

April 5, 2013

MEMORANDUM FOR MICHAEL MCKENNEY  
ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM:

David A. Grant   
Chief, Agency-Wide Shared Services

SUBJECT:

Draft Audit Report – Cost-Reimbursement Contracts Did Not  
Fully Comply With Federal Acquisition Regulation Revisions  
(Audit # 201210027)

Thank you for the opportunity to respond to the draft audit report. The overall objective was to determine whether the Internal Revenue Service (IRS) was in compliance with the Duncan Hunter National Defense Reauthorization Act for Fiscal Year 2009 and the related revisions to the Federal Acquisition Regulation (FAR) in appropriately justifying and planning for the use of cost-reimbursement contracts.

After reviewing the draft report, we concur with your recommendations and will develop corrective actions to address them. Full responses to the four recommendations are attached.

We appreciate the continued support and assistance provided by your office. If you have questions, please contact me at (202) 622-7500. If you have technical questions with respect to our responses, a member of your staff may contact Jacob Hansen, Director, Procurement, at (202) 283-1200. For matters concerning audit procedural follow-up, please contact Larry Pugh, Office of Strategy and Finance, Agency-Wide Shared Services, at (202) 622-4541.

Attachment



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Attachment

**RECOMMENDATION #1:** The Chief, Agency-Wide Shared Services, should establish and implement policies and procedures that are in compliance with recent FAR revisions associated with the Act.

**CORRECTIVE ACTION:** We agree with this recommendation. The IRS has already drafted and is circulating updated policies and procedures for approval that address the recent FAR revisions associated with Section 864 of the Duncan Hunter National Defense Authorization Act of Fiscal Year 2009. As an interim measure, on March 2, 2012, the Office of Procurement Policy issued a policy update to all IRS contracting personnel informing them of the changes to the Federal Acquisition Regulation (FAR) with respect to implementation of Section 864 of this Act.

**IMPLEMENTATION DATE:** May 15, 2013.

**RESPONSIBLE OFFICIAL:** Director, IRS Office of Procurement Policy, Agency-Wide Shared Services.

**CORRECTIVE ACTION MONITORING PLAN:** Procurement will enter accepted corrective actions into the Joint Audit Management Enterprise System (JAMES). These corrective actions are monitored on a monthly basis until completion.

**RECOMMENDATION #2:** The Chief, Agency-Wide Shared Services, should establish an oversight process to ensure that the new IRS policies and procedures (Recommendation 1) are satisfactorily implemented and that future cost-reimbursement contracts, including FFRDC contracts, and supporting contract files are in full compliance with current FAR requirements.

**CORRECTIVE ACTION:** We agree with this recommendation. The Chief, Agency-Wide Shared Services, will establish an oversight process to ensure that the new IRS policies and procedures (Recommendation 1) are satisfactorily implemented and that future cost-reimbursement contracts, including Federally Funded Research and Development Center FFRDC contracts, and supporting contract files are in full compliance with current FAR requirements. IRS contracting staff will be notified of the updated policies and the detailed FAR policies/requirements with respect to addressing cost reimbursement contracts in acquisition plans. Additionally, acquisition plans for cost reimbursement contracts over the simplified acquisition threshold will be reviewed during the internal review process with special attention paid to those areas affected by the implementation of the Duncan Hunter Act.

**IMPLEMENTATION DATE:** June 30, 2013.





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**RESPONSIBLE OFFICIAL:** Director, IRS Office of Procurement Policy, Agency-Wide Shared Services.

**CORRECTIVE ACTION MONITORING PLAN:** Procurement will enter accepted corrective actions into the Joint Audit Management Enterprise System (JAMES). These corrective actions are monitored on a monthly basis until completion.

**RECOMMENDATION #3:** The Deputy Commissioner for Operations Support should provide all acquisition workforce personnel (COs, CORs, technical points of contact, etc.), and appropriate program management staff with training on recent FAR revisions resulting from the Act.

**CORRECTIVE ACTION:** We agree with this recommendation and will provide training on recent FAR revisions resulting from the Act to those acquisition personnel involved in the award and administration of cost-reimbursement contracts.

**IMPLEMENTATION DATE:** March 31, 2014

**RESPONSIBLE OFFICIAL:** Director, IRS Office of Procurement Policy, Agency-Wide Shared Services.

**CORRECTIVE ACTION MONITORING PLAN:** Procurement will enter accepted corrective actions into the Joint Audit Management Enterprise System (JAMES). These corrective actions are monitored on a monthly basis until completion.

**RECOMMENDATION #4:** The Chief, Agency-Wide Shared Services, should review contracts (and related task/delivery orders) awarded since implementation of new FAR requirements on March 17, 2011, to ensure that contracts are properly coded and categorized in IRS and Federal Procurement Data systems.

**CORRECTIVE ACTION:** We agree with the recommendation to review contract data entered into the IRS and Federal Procurement Data Systems. However, we believe that the period of review should start as of April 2, 2012, when the FAR implementation of Section 864 became effective.

**IMPLEMENTATION DATE:** December 31, 2013

**RESPONSIBLE OFFICIAL:** Director, Office of Procurement, Agency-Wide Shared Services.

**CORRECTIVE ACTION MONITORING PLAN:** Procurement will enter accepted corrective actions into the Joint Audit Management Enterprise System (JAMES). These corrective actions are monitored on a monthly basis until completion.