



RECOVERY ACT

*Previously Reported Acquisition
Concerns That Are Relevant to the
American Recovery and Reinvestment
Act of 2009 Procurements*

September 15, 2010

Reference Number: 2010-11-102

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.



HIGHLIGHTS



PREVIOUSLY REPORTED ACQUISITION CONCERNS THAT ARE RELEVANT TO THE AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009 PROCUREMENTS

Highlights

Final Report issued on September 15, 2010

Highlights of Reference Number: 2010-11-102 to the Internal Revenue Service Deputy Commissioner for Operations Support.

IMPACT ON TAXPAYERS

The Internal Revenue Service (IRS) received an appropriation of \$203 million in American Recovery and Reinvestment Act of 2009 (Recovery Act) funds. TIGTA analysis of acquisitions audits conducted from Fiscal Year 1999 to June 2009 showed that while the IRS has taken steps to address the concerns identified in those audits, recurring problems exist which may put procurements funded by the Recovery Act at risk. Until the IRS implements effective internal controls, it will be unable to provide assurance that the Federal Government is receiving the best value for its Recovery Act procurements and/or that contractors are meeting the procurements' terms and conditions to deliver goods or services.

WHY TIGTA DID THE AUDIT

The Office of Management and Budget supplemental guidance for the Recovery Act requires Federal agencies to determine whether final action has been taken regarding weaknesses or deficiencies disclosed by prior audits and investigations in program areas under which Recovery Act funds are authorized. The guidance also requires that Recovery Act contracts be fixed-price to the maximum extent possible, acquisitions result in meaningful and measurable outcomes, and contracts receive the appropriate oversight to ensure that contract goals are met. The overall objective of this review was to provide observations regarding the applicable procurement findings identified during a prior TIGTA audit which evaluated

trends identified from TIGTA audits of IRS procurements from Fiscal Year 1999 to June 2009 that present a risk for procurements funded under the Recovery Act.

WHAT TIGTA FOUND

TIGTA found several repeat findings or concerns that are relevant to procurements funded by the Recovery Act. The most prevalent trends identified were the recommendations that the IRS use performance-based contracts and fixed-price contracts whenever possible.

TIGTA also identified trends where the IRS did not have sufficient monitoring controls or processes to ensure contractors were meeting the procurement's terms and conditions, the IRS did not ensure funding was properly controlled and project costs were not always charged to the appropriate accounting code, and modernization contracts failed to achieve their objectives or intended benefits.

The IRS took corrective actions at the time the original reports were issued to address many of the issues identified in the reports reviewed. The IRS appears to have mitigated risks associated with performance-based contracts. However, if contract oversight is not operating effectively, IRS Recovery Act procurements are at risk that goods and services will not meet the Government needs at the price and other contract requirements agreed upon. In addition, when fixed-price contract types are not used, generally there is an increased risk to the Federal Government that the contract costs are not adequately controlled.

In their response to the prior trending report, IRS officials agreed that addressing the two prevalent trends has been challenging but they have made significant progress and have identified new initiatives to address other trends. IRS officials stated that had TIGTA performed an analysis of corrective actions implemented, the prior report would more accurately reflect the progress the IRS has made.

WHAT TIGTA RECOMMENDED

TIGTA did not make any recommendations in this report. However, key IRS management officials reviewed it prior to issuance and agreed with the facts and conclusions presented.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

September 15, 2010

MEMORANDUM FOR DEPUTY COMMISSIONER FOR OPERATIONS SUPPORT

Michael R. Phillips

FROM:

Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – Previously Reported Acquisition Concerns That Are Relevant to the American Recovery and Reinvestment Act of 2009 Procurements (Audit # 201010116)

This report presents the results of our review of previously reported acquisition concerns that are relevant to the American Recovery and Reinvestment Act of 2009 (Recovery Act).¹ The overall objective of this review was to provide observations regarding the applicable procurement trends identified during our prior audit² that evaluated trends identified from Treasury Inspector General for Tax Administration audits of Internal Revenue Service (IRS) procurements from Fiscal Year 1999 to June 2009 that would also present a risk for procurements funded under the Recovery Act. This report is consistent with the Office of Management and Budget guidance³ to identify high-risk programs and create quicker turnaround reporting. This review is included in our Fiscal Year 2010 Annual Audit Plan and addresses the major management challenge of Erroneous and Improper Credits and Payments.

The Recovery Act provides separate funding to the Treasury Inspector General for Tax Administration through September 30, 2013, to be used in oversight activities of IRS programs. This audit was conducted using Recovery Act funds.

We did not make any recommendations in this report. However, key IRS management officials reviewed it prior to issuance and agreed with the facts and conclusions presented.

Copies of this report are also being sent to the IRS managers affected by the report finding. Please contact me at (202) 622-6510 if you have questions or Nancy A. Nakamura, Assistant

¹ Pub. L. No. 111-5, 123 Stat. 115 (2009).

² *Procurement Audit Results Indicate Problems Continue to Exist After Corrective Actions Were Implemented* (Reference Number 2010-10-088, dated September 14, 2010).

³ Updated Implementing Guidance for the American Recovery and Reinvestment Act of 2009 (dated April 3, 2009).



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Inspector General for Audit (Management Services and Exempt Organizations), at
(202) 622-8500.



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*Previously Reported Acquisition Concerns That Are
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Abbreviations

IRS	Internal Revenue Service
OMB	Office of Management and Budget
TIGTA	Treasury Inspector General for Tax Administration



*Previously Reported Acquisition Concerns That Are
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Background

Enacted on February 17, 2009, the American Recovery and Reinvestment Act of 2009 (Recovery Act)¹ contained both spending and tax provisions of \$787 billion over 10 years designed to stimulate the national economy by creating and retaining jobs. The Internal Revenue Service (IRS) is charged with administrating tax law changes² contained in the Recovery Act. In April 2009, the IRS received its appropriation of \$203 million in Recovery Act funds,³ which was to be used to implement the necessary tax changes as a result of the Recovery Act provisions. As of April 29, 2010, the IRS has initiated or is in the process of initiating 26 of the initial 40 planned procurement actions on Recovery Act program initiatives with a total contract value of \$81.9 million, of which approximately \$78.5 million has been obligated. The IRS is using these Recovery Act funds for procurements to support the reprogramming of its computer systems, the updating of corresponding tax forms and publications, and its customer services to assist taxpayers.

The Recovery Act has created specific guidelines and requirements for all contracts funded under the Act.⁴ The Office of Management and Budget (OMB)⁵ has also issued several supplemental guidance⁶ documents that outline steps for implementing the Recovery Act and also clarify the new requirements for processing procurements. The OMB's guidance includes the requirement for agencies to determine whether final action has been taken regarding weaknesses or deficiencies disclosed by prior audits and investigations in program areas under which Recovery Act funds are authorized. If final action has not been completed, agencies should: 1) expedite such action to preclude the continuance of such weaknesses or deficiencies in the administration of programs funded by the Recovery Act or 2) provide an explanation of why such corrective actions cannot or should not be taken in the administration of programs funded by the Recovery Act.

¹ Pub. L. No. 111-5, 123 Stat. 115 (2009).

² The Recovery Act included more than 50 tax law provisions that the IRS is charged with administering. These tax changes included refundable credits, such as the Making Work Pay and First-Time Homebuyer Credits.

³ This appropriation amount included \$80 million for the Health Coverage Tax Credit program and \$123 million for supporting tax provision changes cited in the Recovery Act.

⁴ The Recovery Act mandates that agencies must follow the same laws, principles, procedures, and practices in awarding contracts with Recovery Act funds as they do with other funds.

⁵ The OMB has the primary responsibility for developing Government-wide rules and procedures to ensure funds are awarded and distributed in a prompt and fair manner; uses of funds are transparent to the public; and steps are taken to mitigate fraud, waste, and abuse.

⁶ The OMB supplemental guidance includes OMB Memorandum M-09-10, *Initial Implementing Guidance for the American Recovery and Reinvestment Act of 2009*, dated February 18, 2009, and Memorandum M-09-15, *Updated Implementing Guidance for the American Recovery and Reinvestment Act of 2009*, dated April 3, 2009.



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In addition, the OMB supplemental guidance requires that Federal agencies must:

- To the maximum extent practicable, award contracts using Recovery Act funds as fixed-price contracts.
- Structure acquisitions to result in meaningful and measurable outcomes that are consistent with agency plans and that promote the goals of the Recovery Act.
- Provide for appropriate oversight of contracts to ensure performance, cost, and schedule goals are being met.

In September 2010, the Treasury Inspector General for Tax Administration (TIGTA) issued a report⁷ (referred to as trending report) that examined 74 TIGTA reports addressing IRS procurements during the period Fiscal Year 1999 through June 2009. The audit was conducted to identify and categorize IRS acquisition issues that were identified in these TIGTA reports. The report found several repeat recommendations relating to different aspects of IRS procurements that continued to occur throughout the audit period. For example, in two different audit reports issued in Fiscal Year 2002, the TIGTA recommended that the IRS use performance-based contracts⁸ and firm fixed-price contracts whenever possible. Subsequent to these reports, the TIGTA issued several additional reports containing similar recommendations.

We noted that these finding trends may also relate to Recovery Act procurements. In accordance with the OMB guidance to identify high-risk programs and create quicker turnaround reporting, in this report we are only highlighting the observations that are directly tied to the new requirements for Recovery Act procurements.

This review was performed at the IRS Office of Procurement in Oxon Hill, Maryland, during the period April through July 2010. This report includes observations based on a prior report, and no additional audit work was conducted; therefore, this audit was not conducted in accordance with generally accepted government auditing standards and was significantly reduced in scope. Under the Recovery Act, Inspectors General are expected to be proactive and focus on prevention. We believe this report is responsive to this intent. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

⁷ *Procurement Audit Results Indicate Problems Continue to Exist After Corrective Actions Were Implemented* (Reference Number 2010-10-088, dated September 14, 2010).

⁸ Performance-based contracting is a method of contracting for which the Government defines the results it is seeking, rather than the process by which those results are attained. The first benefit of performance-based contracting is better prices and performance. Second, the Government is released from having to develop detailed specifications and define the process. Third, the contractor has more flexibility on how it achieves the desired results. Finally, less day-to-day surveillance is required, and contractors are motivated to be innovative and to save money.



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Results of Review

Recurring Audit Findings Could Pose Risks for Recovery Act Procurements

Based on the prior trending report, the TIGTA found that there were repeat findings or concerns that are relevant to Recovery Act-funded procurements, including:

- The limited use of fixed-price contracts.
- The limited use of performance-based contracts.
- Inadequate monitoring of the procurements by IRS Office of Procurement Contracting Officers and the program offices' Contracting Officer's Technical Representatives.

The IRS took corrective actions to address many of these findings when the TIGTA reports were originally issued. However, the repeat findings and recommendations are an indication that the corrective actions were not effective.⁹ The IRS Office of Procurement advised us it has started new initiatives that address some of the issues and trends presented in the trending report. We did not perform followup audits on all of the 74 audits discussed in our trending report, nor did we conduct any additional fieldwork to determine if the IRS effectively implemented the agreed-upon corrective actions to fully address the identified problems or how the findings might impact Recovery Act requirements. In their response to the prior report, IRS officials agreed that increasing both performance-based and firm fixed-price contracting has been challenging over the past 10 years but added that they have made significant progress in both of these areas and have identified several new initiatives to address other trends. IRS officials stated that had the TIGTA performed an analysis of corrective actions implemented in response to past audit reports, the prior report would more accurately reflect the progress the IRS has made.

The IRS has an increased risk of not complying with the general Federal acquisition requirements for procurements funded by the Recovery Act if the steps taken did not correct the reported weaknesses. Until effective internal controls, processes, and practices are implemented, the IRS will be unable to provide assurance that the Federal Government is receiving the best value for its Recovery Act procurements or that contractors are meeting the procurements' terms and conditions to deliver goods or services in the most cost-effective manner.

⁹ Our review did not assess the effectiveness of the corrective actions that did not fall into the three categories discussed here, so we are not commenting on whether they adequately addressed the reported findings.



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Fixed-price contracts

The Recovery Act requires that, to the maximum extent possible, contracts funded under the Act shall be awarded as fixed-price contracts. The OMB guidance further emphasizes that fixed-price contracts provide maximum incentive for the contractor to control costs and perform effectively and impose a minimum burden upon the contracting parties.

The TIGTA reported in Fiscal Year 2002 that the IRS' use of fixed-price contracts had decreased and recommended that the IRS use fixed-price contracts whenever possible. The IRS agreed with this recommendation and implemented corrective actions to address our findings. However, in Fiscal Year 2005, the TIGTA issued another report addressing the need for the IRS to increase the use of fixed-price type contracts. While the IRS again agreed to the overall recommendation, the TIGTA stated that the IRS' corrective actions would not correct the identified issue. In Fiscal Years 2007 and 2009, the TIGTA issued two additional reports with similar findings and recommendations.

Through April 2010, the IRS indicated that 11 (42 percent) of 26 procurements awarded using Recovery Act funding were awarded as part of fixed-price contracts. Of the 26 Recovery Act procurements, 24 were contract modifications that added work or funds to existing awards. We did not review whether these 26 procurements were awarded with the appropriate contract type but, generally, when fixed-price contracts are not used, there is an increased risk to the Federal Government that the contract costs are not adequately controlled.

Structuring acquisitions to include quantifiable measures of performance

The OMB supplemental guidance requires that agencies structure acquisitions to result in meaningful and measurable outcomes consistent with agency plans as well as promoting the goals of the Recovery Act. The guidance also requires agencies to identify quantifiable measures of performance with clear and measurable outcomes that include ranges of acceptable performance. While the OMB supplemental guidance does not specifically require the use of performance-based contracting, these quantifiable measurement requirements are key elements of performance-based contracting, and increased use of performance-based contracting would help meet the intent of the OMB guidance.

In a Fiscal Year 2002 report, the TIGTA recommended that the IRS use performance-based contracting whenever possible. While the IRS agreed with the recommendation, it did not agree with the TIGTA's method for implementing the recommendation. As a result, the IRS did not implement any corrective actions for this recommendation. In Fiscal Year 2005, the TIGTA issued a second report containing a similar finding and recommendation. In this instance, while the IRS did not reject the TIGTA's recommendation, the TIGTA did not believe that the IRS' corrective action was adequate to address the issues noted in the report. Three additional reports containing similar findings and recommendations were issued since the Fiscal Year 2005



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report. The IRS implemented corrective actions in response to these reports when they were originally issued and has subsequently instituted additional initiatives.

Through April 2010, the IRS indicated that 9 (82 percent) of 11 eligible Recovery Act contracts were performance-based. Performance-based contracting increases performance, innovation, and competition among interested vendors, resulting in a better value for the IRS. The IRS appears to have mitigated risks associated with non-performance-based contracts for procurements funded by the Recovery Act. However, we did not evaluate whether these performance-based contracts meet Recovery Act requirements for quantifiable measures of performance.

Contract monitoring

The OMB supplemental Recovery Act guidance states that agencies must provide for appropriate oversight of contracts to ensure outcomes that are consistent with and measurable against agency plans and goals under the Act. Agencies provide this oversight by assuring that they are able to appoint sufficient qualified Contracting Officers and Contracting Officer's Technical Representatives with certification levels appropriate to the complexity of Recovery Act projects. In addition, agencies should actively monitor contracts to ensure that performance, cost, and schedule goals are being met.

We identified several broader trends involving similar findings throughout the procurement process. Many of the recurring findings relate to inadequate monitoring of the procurements by Office of Procurement Contracting Officers and the program offices' Contracting Officer's Technical Representatives. Examples of the trends included:

- The IRS lacked sufficient monitoring controls or processes to ensure that the contractors were meeting the contract terms and conditions. Specifically, the IRS did not verify that contractors were sufficiently qualified to perform their duties and that performance levels were met.
- The IRS failed to ensure that contractors complied with the IRS' internal procedures and processes. These included findings that funding was not properly controlled and project costs were not always charged to the appropriate accounting code.
- Modernization contracts failed to meet their scheduled completion dates or achieve their intended objective and benefits.

In addition to these contract monitoring issues, the TIGTA addressed concerns related to the Recovery Act and contract administration by Contracting Officer's Technical Representatives in a separate report.¹⁰ While that report stated that the IRS had begun to implement some of the

¹⁰ *Concerns About Contracting Officer's Technical Representatives That Are Relevant to the American Recovery and Reinvestment Act of 2009 Procurements* (Reference Number 2010-11-087, dated July 23, 2010).



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recommendations concerning contract administration, the IRS still needed to implement the remaining recommendations. If the IRS' contract oversight is not operating effectively, IRS Recovery Act procurements are at risk that goods and services will not meet the Government needs at the price and other contract requirements agreed upon.



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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to provide observations regarding the applicable procurement trends identified during our prior audit¹ that evaluated trends identified from TIGTA audits of IRS procurements from Fiscal Year 1999 to June 2009 that would also present a risk for procurements funded under the American Recovery and Reinvestment Act of 2009 (Recovery Act).² To accomplish the objective, we:

- I. Reviewed the Recovery Act and appropriate implementing guidance to identify all applicable requirements for Recovery Act-funded procurements.
- II. Reviewed observations identified during the prior audit to determine which recurring findings would also present risks for procurements funded under the Recovery Act and the recommendations that would mitigate those risks.
- III. From the IRS Office of Procurement, obtained Recovery Act procurement data to identify the number of fixed-price contracts and performance-based contracts. Due to the limited scope of this review, we did not conduct any audit testing to ensure the validity of these data.

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 did not assess internal controls because doing so was not applicable within the context of our objective.

¹ *Procurement Audit Results Indicate Problems Continue to Exist After Corrective Actions Were Implemented* (Reference Number 2010-10-088, dated September 14, 2010).

² Pub. L. No. 111-5, 123 Stat. 115 (2009).



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Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Chief, Agency-Wide Shared Services OS:A
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Director, Office of Legislative Affairs CL:LA
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