



RECOVERY ACT

*The Internal Revenue Service Should
Strengthen Processes for Managing
Recovery Act Funds Used for the Health
Coverage Tax Credit*

September 13, 2010

Reference Number: 2010-21-110

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



THE INTERNAL REVENUE SERVICE SHOULD STRENGTHEN PROCESSES FOR MANAGING RECOVERY ACT FUNDS USED FOR THE HEALTH COVERAGE TAX CREDIT

Highlights

Final Report issued on September 13, 2010

Highlights of Reference Number: 2010-21-110 to the Internal Revenue Service Commissioner for Wage and Investment Division.

IMPACT ON TAXPAYERS

Taxpayers need assurance the Internal Revenue Service (IRS) properly administers the Health Coverage Tax Credit Program to ensure the enhancements required by the American Recovery and Reinvestment Act (Recovery Act) are provided. In addition, taxpayers need to know that Recovery Act funds are properly accounted for and their use is transparent.

WHY TIGTA DID THE AUDIT

The Recovery Act legislation mandates provisions designed to improve and expand the Health Coverage Tax Credit Program. This Program is responsible for providing income tax credits to subsidize health insurance coverage for taxpayers who, under specific circumstances, are displaced from their jobs and lose health insurance coverage benefits. Our review assessed the extent to which the Health Coverage Tax Credit Program Office complied with provisions of the Recovery Act and provided complete accountability and traceability of Recovery Act funding.

WHAT TIGTA FOUND

The IRS successfully delivered upgrades to the Health Coverage Tax Credit Program as required by the Recovery Act. These upgrades included raising the credit to 80 percent of the covered health insurance premiums, allowing family members to continue receiving benefits after certain life events, and expanding taxpayer eligibility in the Program.

The IRS also took actions to implement recommendations related to project development activities made in a prior audit.

However, improvements are needed to strengthen accountability and transparency over the \$80 million in Recovery Act funds that the IRS received for improvements to the Health Coverage Tax Credit Program. Specifically, subcontractor invoices listed third-party vendor purchases without having receipts or other comparable documentation to support the charges, and a work request has not been completed and issued to the Health Coverage Tax Credit contractor for enhancements to the Health Coverage Tax Credit Program.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Commissioner, Wage and Investment Division, require the Health Coverage Tax Credit Program Office to 1) ensure the Contracting Officer's Technical Representative completes the Voucher Review Checklist for all future contractor invoices prior to authorizing payments, 2) develop internal procedures that provide for complete financial accountability and traceability when subcontractor invoices are paid with Recovery Act funds, and 3) complete and provide a work order to the Health Coverage Tax Credit contractor for subsequent enhancements to the Health Coverage Tax Credit Program.

The IRS agreed with Recommendations 1 and 3, stating it plans to implement the recommended corrective actions. The IRS agreed with the intent of the outcome measure but disagreed with the recommendation that the Health Coverage Tax Credit Program Office develop internal procedures for the use of Recovery Act funds. The IRS stated the Health Coverage Tax Credit Program Office follows all Federal guidance and that Recovery Act fund policies should not be internal to the Health Coverage Tax Credit Program.

Our recommendation was that Health Coverage Tax Credit Program-specific guidance needed to be established to supplement existing guidance related to review and payment of contractor invoices. TIGTA believes this additional guidance would help ensure consistency in processing invoices.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

September 13, 2010

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

Michael R. Phillips

FROM:

Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – The Internal Revenue Service Should Strengthen Processes for Managing Recovery Act Funds Used for the Health Coverage Tax Credit (Audit # 201020101)

This report presents the results of our review of the Internal Revenue Service's (IRS) Release 10 upgrade to the Health Coverage Tax Credit (HCTC) Program. The overall objective of this review was to determine whether the IRS properly managed and implemented requirements for Release 10 of the HCTC Program. The American Recovery and Reinvestment Act of 2009 (Recovery Act)¹ included provisions and provided funding for upgrading the HCTC Program. This audit was conducted as part of the Treasury Inspector General for Tax Administration's Fiscal Year 2010 Annual Audit Plan and addresses the major management challenge of Modernization of the IRS.

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.

Management's complete response to the draft report is included as Appendix VI.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Alan R. Duncan, Assistant Inspector General for Audit (Security and Information Technology Services), at (202) 622-5894.

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



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Abbreviations

| | |
|------|--|
| COTR | Contracting Officer's Technical Representative |
| HCTC | Health Coverage Tax Credit |
| IRS | Internal Revenue Service |



The Internal Revenue Service Should Strengthen Processes for Managing Recovery Act Funds Used for the Health Coverage Tax Credit



Background

On February 17, 2009, the American Recovery and Reinvestment Act of 2009 (Recovery Act)¹ was signed into law to support the Nation's economic recovery. The Recovery Act's three main goals are to create and save jobs, spur economic activity in long-term economic growth, and foster unprecedented levels of accountability and transparency in Government spending of more than an estimated \$787 billion dollars. The President has required strict oversight of Recovery Act funding on the behalf of Federal agencies to allow American taxpayers to see where Recovery Act funds are being utilized.

Federal agencies need to be aware of strict requirements for accountability and transparency of Recovery Act funds

One of the programs within the Internal Revenue Service (IRS) to receive Recovery Act funds is the Health Coverage Tax Credit (HCTC) Program. The HCTC is a unique tax credit created by the Trade Adjustment Assistance Reform Act of 2002.² It targets a select group of taxpayers who might otherwise be uninsured due to certain conditions of job displacement. The HCTC helps eligible taxpayers to continue health insurance coverage by providing tax credits of up to 80 percent of the health insurance premiums for a specific period of time. The Recovery Act included provisions to enhance the HCTC Program, such as increasing the Government's portion of health premiums paid from 65 to 80 percent, reimbursing the taxpayers' portion of premiums paid during the enrollment period, allowing family members to continue receiving benefits after certain life events, and expanding taxpayer eligibility in the Program. Effective implementation of these provisions is critical to providing taxpayers the benefits mandated by the Recovery Act.

The IRS administers the HCTC in partnership with other Federal agencies. The IRS' Wage and Investment Division oversees the design, development, implementation, and operations of the HCTC Program. A total of \$80 million (38 percent of the total Recovery Act funds estimated for the IRS) was apportioned to enhance the HCTC Program. The use of Recovery Act funds requires transparency to show utilization of funds and increase accountability to guard against fraud, waste, and abuse. Federal agencies are required to ensure Recovery Act funds are used for authorized purposes. As such, the Treasury Inspector General for Tax Administration is required to monitor IRS implementation of Recovery Act provisions, and this audit was conducted to meet those requirements.

This review was performed at the IRS HCTC Program Office in Washington, D.C., during the period April through June 2010. We conducted this performance audit in accordance with

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

² Pub. L. No. 210-116; Stat. 933.



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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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Results of Review

The HCTC Program Office ensured that: 1) taxpayers received all health insurance subsidized payments as required by the Recovery Act, 2) HCTC provisions required to date were delivered and implemented in a timely manner, and 3) remaining actions and provisions that need implementing were identified. However, improvements are needed to strengthen management controls over Recovery Act funds to ensure provisions of the Recovery Act were met when reporting expenditures.

Recovery Act Upgrades to the Health Coverage Tax Credit Program Were Delivered

The HCTC Program Office successfully and timely implemented Recovery Act requirements³ to the HCTC Program in different phases. HCTC Release 9, completed in August 2009, focused on delivering legislative changes—which included increasing the Government’s portion of paying health insurance premiums from 65 to 80 percent, paying retroactive health care premium reimbursements, and expanding the number of eligible taxpayers. The focus of this audit was HCTC Release 10, deployed in December 2009. It added more functionalities, including allowing family members to extend benefits after certain events, and replaced or upgraded many computer system components. The HCTC Program Office also took management actions to address a previous Treasury Inspector General for Tax Administration audit report of HCTC Release 9.⁴

The HCTC Program Office exercised adequate management controls to better administer this tax credit. Specifically,

- **The HCTC Program Office:** Conducted weekly program status meetings with the contractor and relevant business divisions. The purpose of the meetings was to discuss implementation status of system upgrades, outstanding issues, and status of deliverables.
- **The HCTC Contractor:** Provided monthly program status reports summarizing milestone dates and deliverables. The contractor had processes in place for ensuring provisions were delivered in a timely manner.
- **The IRS Office of Procurement:** Ensured significant issues were documented and timely addressed with the contractor. For example, during the transition of Payment Processing

³ See Appendix V for a glossary of terms.

⁴ *Recovery Act Provisions for the Health Coverage Tax Credit Were Implemented, but Development Processes Could Be Improved* (Reference Number 2010-21-057, dated May 27, 2010).



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from one call site to another, the IRS Contracting Officer's Technical Representative (COTR) determined the contractor staff was not operating at optimal level, possibly incurring additional and unnecessary billable hours. As a result, the Contracting Officer and contractor discussed resolutions for ensuring efficient employee performance.

Management actions from the prior audit were implemented

The IRS reported having taken management actions to address some of the concerns reported in the previous HCTC Release 9 audit report. Specifically, the recommendations were that the HCTC Program Office should: 1) perform full traceability on the requirements traceability matrix, 2) ensure all configuration changes are properly documented and tracked, and 3) perform an in-depth analysis of test plans. During this current review, we validated that prior management actions were appropriately implemented as follows:

- Requirements traceability was accomplished. Previously, the HCTC Program Office requirements traceability matrix, which documents the life cycle of a requirement, was not all-inclusive and needed further development. The matrix did not trace to specific work products nor trace all system requirements to a test case. For ongoing and future system upgrades, we recommended the HCTC Program Office complete full traceability on the requirements traceability matrix, to include mapping of all requirements to high-level requirements and tracing to final product requirements. Subsequently, we obtained the November 12, 2009, requirements traceability matrix and determined it was updated to reflect that all requirements were traced to a test case and specific work products.
- The configuration management process was modified. The Change Control Log (a process used by the HCTC Program Office for documenting all change requests) did not formerly capture complete data for documenting and tracking change requests. We recommended that updates to the Configuration Management Plan include procedures to verify configuration changes be properly documented and tracked. In order to validate the IRS' response to the prior report, the revised Change Request Form was obtained that included the change requests identified in the prior review. The revised form sufficiently annotated the status of the change request and rejected or approved actions.
- Testing practices were strengthened. During the prior audit, it was determined test practices needed to be strengthened, test documents contained missing or incomplete information, and proper support and approval for changes to test cases were not accomplished. Although the IRS agreed with the recommendation, management actions did not entirely address the issue. The IRS responded that there were scripts included in the Release 9 test plan that are no longer applicable for the HCTC. These scripts represented historical requirements that were never implemented or were no longer necessary, as well as requirements with no system impact. During HCTC Release 9, test scripts that were not applicable were marked as "not tested" in the test script spreadsheet,



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per existing processes. At the time of the review, HCTC Release 9 scripts were correctly tested in accordance with the existing process in place at the time. Prior to HCTC Release 10 test execution, the test plan and detailed test scripts were updated to remove the test scripts and other references that were no longer applicable. The HCTC Release 10 testing documentation was obtained during June 2010 and included complete test cycle control sheets and expected test results (used by testers to determine whether test cases are non-tested, passed, or failed).

Improvements Are Needed to Strengthen Management of Recovery Act Funds

One of the Recovery Act's unique requirements was a high level of scrutiny over Recovery Act funds, whereby Federal activities are subject to unprecedented levels of transparency and accountability. As stated during a February 24, 2009, address to Congress, the President requires Federal agencies to maintain strict oversight of Recovery Act funding for "every dollar" spent for accurate reporting of expenditures. This entails ensuring Recovery Act funds be used for authorized purposes and appropriate measures are taken to prevent fraud, waste, and abuse. If strict oversight of Recovery Act funds is not maintained, the public may lose confidence that their tax dollars are being used to support the Nation's economic recovery as intended by the legislation.

Procurement professionals, primarily the Contracting Officer, serve as legal agents of the Federal Government and are responsible for integrity of the contracting process. Federal Acquisition Regulations⁵ state that Contracting Officer responsibilities include ensuring contractor compliance, performing all actions necessary for effective contracting, and safeguarding Federal Government interests. The Contracting Officer may delegate certain contracting technical oversight and administrative management aspects of the process to a COTR. Within the Federal Government, the COTR usually works in a program office and provides technical and program expertise necessary to develop and manage contracts.

- **Payment of Contractor Invoices.** For payment of contractor invoices, the Federal Acquisition Regulations provide that the "contractor is responsible for accounting for costs appropriately and for maintaining records, including supporting documentation adequate to demonstrate that costs claimed have been incurred and are allocable to the contract."⁶ Additionally, the IRS Office of Procurement, as part of its Guidelines for Acquisition Practices, developed Voucher Review Procedures to describe tasks and subtasks required for review and payment of invoices/vouchers.⁷ These procedures

⁵ Federal Acquisition Regulations, 48 C.F.R. Ch. 1 (2009).

⁶ Federal Acquisition Regulations, FAR, 2005-19, Section: 31-201-2 (d).

⁷ In Federal Acquisition Regulations and IRS Procurement Office criteria, voucher and invoice are used interchangeably.

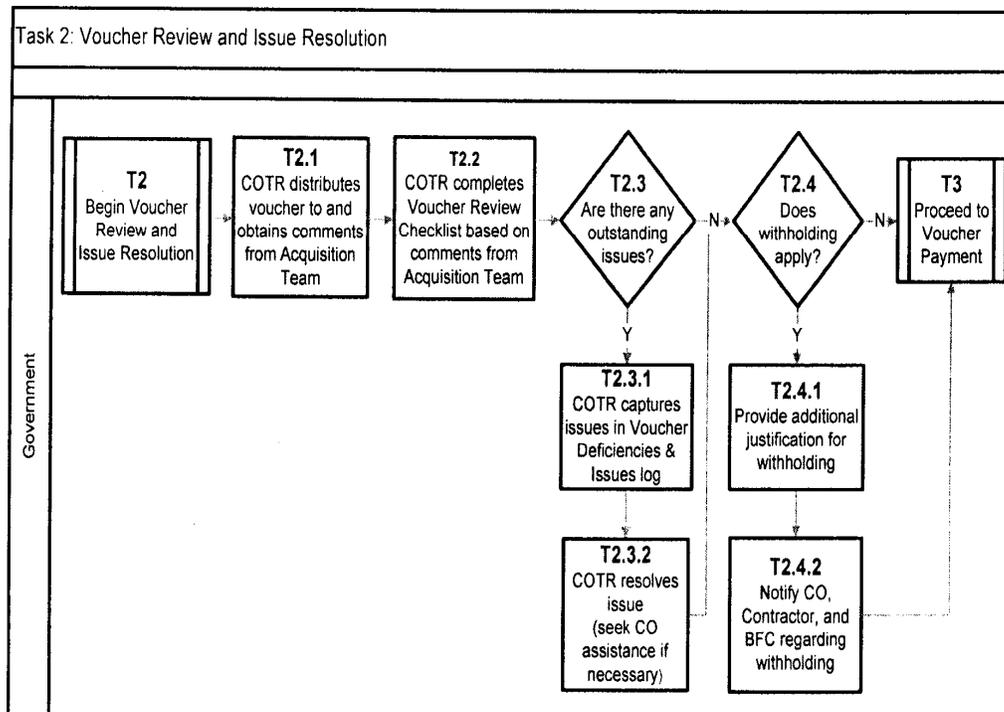


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require a Voucher Review Checklist be completed prior to payment of contractor invoices. If there are any issues in completing the Checklist, the COTR should coordinate resolution of the issue with the contractor and keep members of the acquisition team informed of the actions taken and status. The COTR may seek Contracting Officer assistance in attempting to resolve any issues. The COTR signs the Checklist after the issue has been resolved, and it is then sent to the Contracting Officer for review. If the Contracting Officer has any concerns, these are discussed with the COTR at that time. If one or more of the Checklist items is marked “no” or “false,” it is likely an indication of an issue that should be documented in the Voucher Deficiencies and Issues Log. Payment can be made on contractor invoices while issues are pending resolution, if annotated in the Voucher Deficiencies and Issues Log. Voucher Element 1d of the Voucher Review Procedures requires the COTR to ensure there is adequate supporting documentation for subcontractor invoices or quotes. If the answer is “no,” procedures should be followed prior to payment of the contractor invoice. In the Voucher Review Procedures Table, Task 2: Voucher Review and Issue Resolution, the process is depicted for adequate voucher review.

Figure 1: Excerpt From Voucher Review Procedures



Source: IRS Office of Procurement. CO refers to Contracting Officer.



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- **Work Requests.** The IRS is involved in a major modernization effort. To aid in this challenge, contracted services are obtained through use of task orders under the Department of the Treasury contract program. In accordance with guidelines, once a contractor is selected, the IRS Office of Procurement first prepares a task order outlining required tasks, and then work requests are subsequently developed, approved, and issued outlining details of work required to be performed. The Internal Revenue Manual defines the work request process as the framework to document, control, monitor, and track requests for changes to IRS computer systems and for additional system support. The Information Technology Infrastructure Library provides a framework of governance and best practice specific to Information Technology service, development, and operations. This framework recommends obtaining approval of all requests prior to changes of any aspect of Information Technology services. Currently, the HCTC Program Office is working on efficiencies release solutions, which are designed to provide enhancements to the HCTC Program. These enhancements include automating solutions, improving or streamlining processes, and providing improved customer service experience levels.

The review process for payment of contractor invoices needs improvement

We reviewed the HCTC contractor invoices dated August 2009 and January 2010, which included 60 hardware/software subcontractor invoices totaling \$2.6 million. From this universe, we selected a random sample of 14 subcontractor invoices valued at \$412,107 that listed third-party vendor charges. Documentation was incomplete to fully support charges of subcontractor invoices. Specifically,

- There were no receipts or comparable documentation to support and authenticate third-party charges actually incurred. Because invoices from third-party vendors were not attached to contractors' invoices, the IRS can not ensure that charges incurred by the subcontractor are accurate.
- A Voucher Review Checklist was not completed to ensure HCTC contractor invoices were appropriately scrutinized and reviewed prior to payments using Recovery Act funds. The COTR stated he or she accomplished the same tasks for numerous years and was aware of steps needed to process invoices without completing the Voucher Review Checklist.
- The HCTC Program Office followed all guidance issued by the Office of Management and Budget, Department of the Treasury, and the IRS' regarding managing Recovery Act funds. However, HCTC Program-specific guidance was not developed to ensure third-party charges were validated as necessary to ensure a higher level of accountability and transparency for managing Recovery Act funds.

Personnel from the HCTC Program Office informed us that they believe all required documentation was provided by the contractor and that the invoices and payments were



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processed in accordance with routine business practices. However, the documentation provided by the contractor did not include supporting documentation for third-party purchase or charges, so those charges could not be validated by the COTR.

Because the Recovery Act provision was a unique and unprecedented appropriation with a higher level of accountability and transparency, there were no specific guidelines in place to cover necessary steps to manage Recovery Act funds within the HCTC Program. Because swift delivery of HCTC Releases 9 and 10 were required, the HCTC Program Office was unable to develop specific procedures prior to implementation.

However, especially in the use of Recovery Act funds, the Voucher Review Checklist needs to be completed to ensure all necessary steps are accomplished prior to paying contractor invoices.⁸ Also, HCTC Program-specific guidance needs to be established to supplement the Voucher Review Procedures. The new guidance should require steps to ensure third-party vendor charges are strongly supported with receipts or comparable documentation prior to releasing Recovery Act funds.

Without completing the required Voucher Review Checklist to accomplish thorough invoice reviews, HCTC Program-specific guidance detailing necessary steps to ensure sufficient management of Recovery Act funds, and adequate documentation to validate subcontractor invoices, there is no way to ensure “every dollar spent” of Recovery Act funds is legitimate. This could result in a waste of taxpayer dollars and does not provide adequate fiduciary responsibility to ensure fraud, waste, and abuse is prevented over the use of Recovery Act Funds. A complete traceability of support documentation needs to be accomplished between contractor, subcontractor, and third-party invoices to ensure: 1) invoice inaccuracies are identified and corrected prior to payment; 2) erroneous payments or overpayments of Recovery Act funds are not incurred; and 3) fraud, waste, and abuse are prevented. Further, management of Recovery Act funds is unique, and HCTC Program-specific guidance is necessary to provide complete accountability and transparency as required by Recovery Act Federal legislation.

Recommendations

Recommendation 1: The Commissioner, Wage and Investment Division, should require the COTR assigned to the HCTC Program Office to complete the Voucher Review Checklist for all future contractor invoices prior to authorizing payments, in accordance with the Voucher Review Procedures established by the Office of Procurement.

Management’s Response: The IRS agreed with the recommendation. The HCTC Program Office COTR will continue using the Voucher Review Procedures developed by the IRS Office of Procurement for the review and payment of invoices. As an additional

⁸ Checking “no” to Checklist Element 1d would indicate subcontractor invoices were not adequately supported to validate charges.



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step to provide confidence in the HCTC Program's established review process, the COTR will now incorporate the Voucher Review Checklist as part of that procedure each month. The COTR will also submit the Voucher Review Checklist to the Contracting Officer for review and approval.

Recommendation 2: The Commissioner, Wage and Investment Division, should require the HCTC Program Office to develop internal procedures that provide for complete financial accountability and traceability when subcontractor invoices are paid with Recovery Act funds. Specifically, HCTC Program-specific guidance needs to be established to supplement the Voucher Review Procedures to ensure third-party receipts and other comparable documents are received prior to payment of Recovery Act funds.

Management's Response: The IRS disagreed with the recommendation. Management stated the HCTC Program follows all guidance issued by the Office of Management and Budget, Department of the Treasury, IRS, and IRS' American Recovery and Reinvestment Act Office, and that Recovery Act fund policies should not be internal to the HCTC Program Office, but rather issued by a policy office at a corporate level. Review and verification of third-party invoices for incidental hardware/software purchases is not required. The HCTC Program has special requirements for approval of these purchases that were put in place for the purpose of additional transparency as stated in Recovery Act legislation. The HCTC COTR will continue to validate and retain third-party receipts as part of the Voucher Review Process. The COTR has asked the contractor to provide third-party receipts for all purchases made during the Recovery Act period of performance on this contract and going forward. If provided, the COTR will incorporate this review for the validation and retention of third-party receipts for all expenditures into the ongoing monthly review. For expenditures made prior to this new step, the COTR will complete a random review of invoices to validate against third-party receipts similar to the random sample review performed by the Treasury Inspector General for Tax Administration. If any discrepancies are found with the third-party invoices, they will be escalated to the Contracting Officer for explanation and mediation.

Office of Audit Comment: The audit recommendation ensures the HCTC Program Office develops and uses the same documented procedures when approving all contractor invoices for payment. Specifically, steps to validate and account for every dollar being spent using Recovery Act funds. The IRS has agreed to take the additional actions to validate subcontractor invoices, so the IRS' disagreement to document the HCTC Program-specific guidelines for conducting the additional invoice review procedures is puzzling. The HCTC Program Office stated they put four special requirements in place to provide transparency for approval of purchases; however, these steps do not include validation of subcontractor invoices to ensure actual purchases were made by a third party without proof of purchase/receipts. Further, guidance established by the Office of



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Management and Budget, Department of the Treasury, IRS, and IRS' American Recovery and Reinvestment Act Office does not detail procedures needed for each business units' specific practices. As such, we believe the HCTC Program Office should develop guidelines to address Voucher Review Procedures to ensure third-party receipts and other comparable documents are received prior to payment of Recovery Act funds.

Contractor work performed needs documented formal approval

Support to document formal approval of contractor work performed was not sufficient. Specifically, the HCTC Program Office did not develop and issue a required work request prior to the contractor beginning and continuing performance of work. In September 2009, a task order for improvement initiatives was issued to the HCTC contractor to provide ongoing support for HCTC Program activities. The HCTC contractor work requests, based on the task order, existed for the following functions: systems operations, program management, campus management, stakeholder engagement, customer service, and payment processing. However, there was not a work request for efficiencies releases to describe, in detail, work required to be performed.

Allowing the contractor to initiate, and subsequently continue, work without having an approved work request results in a risk that the IRS' needs and expectations are not met. Additionally, without specific work requirements for this efficiency release effort, the contractor may not adequately support the HCTC Program and accountability of Recovery Act funds may not be adequate.

Recommendation

Recommendation 3: The Commissioner, Wage and Investment Division, should require the HCTC Program Office to complete and provide a work order to the HCTC contractor for the subsequent efficiency enhancements to the HCTC Program.

Management's Response: The IRS agreed with the recommendation. The HCTC COTR has submitted the final work request to the Contracting Officer for review and concurrence.



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Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to determine whether the IRS properly managed and implemented requirements¹ for Release 10 of the HCTC Program. Specifically, we reviewed whether the HCTC Program Office: 1) complied with provisions of the Recovery Act² when reporting expenditures, 2) ensured that taxpayers received all health insurance subsidized payments as required by the Recovery Act, 3) ensured all HCTC provisions required to date were delivered and implemented in a timely and cost-effective manner, and 4) adequately determined what remaining actions and provisions need implementing. To accomplish our objective, we:

- I. Determined if the IRS (Wage and Investment Division, HCTC Program Office, Budget/Finance) offices complied with provisions of the Recovery Act when reporting expenditures.
 - A. Identified the measures/directives implemented to meet program administrative, accountability, and transparency objectives of the Recovery Act.
 1. Reviewed the Recovery Act and Office of Management and Budget web sites and other documentation to identify procedures used to ensure compliance with the Recovery Act.
 2. Interviewed the HCTC Program Office and Budget officials, if applicable, to identify any additional written documentation and guidance used within the HCTC Program to meet the administrative, accountability, and transparency objectives of the Recovery Act.
 - B. Determined if the allocated Recovery Act funds are documented and supported.
 1. Obtained and reviewed HCTC and procurement written policies and procedures for contractor expenses for purchases, payroll, general accounting, and travel.
 2. Obtained and reviewed the contractors expenditures for the period August 2009 and January 2010 for hardware purchases.
 3. Obtained the contractor invoices and equipment sales quote for the August 2009 and January 2010 invoices. We used the sampling generator tool within Microsoft Excel to select 14 purchases at random. We used a judgmental sample because we did not plan to project the audit results.

¹ See Appendix V for a glossary of terms.

² The American Recovery and Reinvestment Act of 2009. Pub. L. No. 111-5, 123 Stat. 115 (2009).



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4. Verified the authenticity of the data by comparing the electronic expenditures from our sample to contractor source documentation. We reviewed project documentation for supporting hardware purchases.
- II. Determined if taxpayers are receiving full health insurance subsidized payments as required by the Recovery Act.
 - A. Discussed with HCTC Program Office how taxpayers are identified as eligible to receive the full Government reimbursement.
 - B. Obtained IRS data showing the actual number of taxpayers claiming the credit and the amount of credit claimed (health care premiums). We requested an inventory of participants from the IRS of taxpayers who are enrolled in the Program and eligible to receive the 80 percent reimbursement. We obtained an extract from the contractor for historical payment processing information. We received the contractor's extract of the payment processing application of 25,494 monthly enrollees for the period of March through May 2010. We used the sampling data generator tool within Microsoft Excel to pick 25 enrollees at random. We used a judgmental sample because we did not plan to project the audit results.
 - C. We determined the validity of data by reviewing the payment processing information for reasonableness. However, we did not conduct audit steps to verify the accuracy or completeness of the information because we did not use the information to make projections.
 - III. Determined whether all Recovery Act provisions required to date were delivered and implemented in a timely and cost-effective manner.
 - A. Discussed with HCTC Program Office and Office of Procurement management measures in place for ensuring Recovery Act provisions were implemented in a cost effective manner.
 1. Determined budget, expenditures, and tracking of total costs associated with delivery of the Recovery Act provisions.
 2. Obtained support documentation for Audit Step III.A.1.
 3. Obtained information and support on the contractor estimated costs and expenditures.
 4. Obtained support on measures in place for preventing fraud, waste, and abuse.
 - B. Discussed with the HCTC Program Office and the Office of Procurement management the measures in place for ensuring Recovery Act provisions were implemented in a timely manner.
 - C. Reviewed HCTC Release 10 Project Management controls.



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1. Reviewed and obtained supporting documentation for required deliverables to Recovery Act provisions.
 2. Reviewed and obtained milestone dates for enacting the HCTC Release 10 Recovery Act provisions.
 3. Interviewed Office of Procurement management and obtained information on the performance measures for ensuring contractor compliance.
- IV. Determined what remaining actions and provisions need implementing.
- A. Discussed, identified, and documented upcoming HCTC-mandated provisions to be implemented and determined whether Program officials have initiated planning for any upcoming releases.
 - B. Determined if the upcoming provisions were required or optional and, if optional, determined how the feature(s) were identified.
 - C. Obtained, reviewed, and validated documentation to support the costs and scope of all remaining activities using Recovery Act funds.
 - D. Determined if the IRS, especially the HCTC Program Office, is aware of any upcoming legislation under consideration for the HCTC Program.
 - E. Determined the plans the HCTC Program Office has to handle any increased demand for HCTC Program enrollment and volume.

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 internal controls over sound project management guidelines for managing Recovery Act funds were relevant to our audit objective. We evaluated these controls through discussions with appropriate personnel and through a review of HCTC Program requirements, invoice documentation, project management documentation, and procurement data.



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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
Deputy Commissioner for Services and Enforcement SE
Deputy Commissioner, Wage and Investment Division SE:W
Director, Electronic Tax Administration and Refundable Credits, Wage and Investment Division
SE:W:ETARC
Program Manager, Health Coverage Tax Credit, Wage and Investment Division SE:W:HCTC
Chief Counsel CC
National Taxpayer Advocate TA
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Audit Liaisons:
 Commissioner, Wage and Investment Division SE:W
 Chief, GAO/TIGTA/Legislative Implementation Branch SE:S:CLD:PSP:GTL



*The Internal Revenue Service Should Strengthen
Processes for Managing Recovery Act Funds Used for
the Health Coverage Tax Credit*



Appendix IV

Outcome Measure

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

Type and Value of Outcome Measure:

- Questioned Costs (Unsupported Costs) – Actual; \$412,107 (see page 5).

Methodology Used to Measure the Reported Benefit:

A review of HCTC contractor invoices dated August 2009 and January 2010 included 60 hardware/software subcontractor invoices totaling \$2.6 million. From this universe, a random sample of 14 subcontractor invoices valued at \$412,107 listed third-party vendor charges. Documentation was incomplete to fully support charges on the subcontractor invoices. Specifically, there were no receipts or comparable documentation to support and authenticate that third-party charges were actually incurred. Because invoices from third-party vendors were not attached to contractors' invoices, the IRS can not ensure that charges incurred by the subcontractor are accurate.



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Appendix V

Glossary of Terms

| | |
|--|--|
| Contracting Officer | An agent of the Federal Government, empowered to execute contracts and obligate Government funds. |
| Contracting Officer's Technical Representative (COTR) | Furnishes technical direction, monitors contract performance, and maintains appropriate segregation from the contractor. |
| Enterprise Life Cycle | A structured business systems development method that requires the preparation of specific work products during different phases of the development process. |
| Federal Acquisition Regulations | Federal legislation providing the codification and publication of uniform policies and procedures for acquisition by all Executive Branch agencies. |
| Requirement | A formalization of a need. It is the statement of a capability or condition that a system, subsystem, or system component must have or meet to satisfy a contract, standard, or specification. |
| Task Order | A written and approved order for services placed against an established contract or with Federal Government sources. |
| Voucher Review Procedure | Procedures developed and issued by the IRS Office of Procurement that outline the process used by the Contracting Officer and COTR for validating contractor invoices. |
| Work Request | Contains the specific details of the work to be performed in a task order, including the skill categories, estimated number of hours, required work products, and acceptance criteria. |



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Appendix VI

Management's Response to the Draft Report

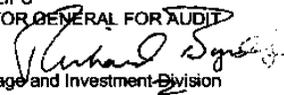


DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

RECEIVED
AUG 18 2010
BY: DAS

August 18, 2010

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Richard Byrd, Jr. 
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – The Internal Revenue Service Should Strengthen Processes for Managing Recovery Act Funds Used for the Health Coverage Tax Credit (Audit # 201020101)

We have reviewed the subject draft report and appreciate your acknowledgement that the IRS' Health Coverage Tax Credit (HCTC) Program Office ensured that taxpayers received all health insurance subsidized payments as required by the American Recovery and Reinvestment Act of 2009 (Recovery Act), and the HCTC provisions required to date were delivered and implemented in a timely manner. As noted in your report, the HCTC Program Office also successfully delivered the required upgrades to the HCTC system, including raising the credit to 80 percent of the covered health insurance premiums, allowing family members to continue receiving benefits after certain life events, and expanding taxpayer eligibility in the program. Your review also found that recommendations related to project development activities made in the prior Release 9 audit¹ were appropriately implemented.

The IRS has administered the HCTC since it was created in 2002. This tax credit is designed to provide assistance in paying for health insurance premiums to a select group of individuals who might otherwise be uninsured. For eligible taxpayers, the HCTC makes health insurance more affordable by paying 80 percent of the health insurance premiums (up from 65 percent prior to the Recovery Act).

We agree with some of your findings regarding strengthening the processes for management of Recovery Act funds, including the need to complete the work request for the efficiency enhancements, and have forwarded the work request to the Contracting Officer (CO) for review and concurrence. We agree with most of your recommendations and have already implemented corrective actions for some, based on this review.

¹ Recovery Act Provisions for the Health Coverage Tax Credit Were Implemented, but Development Processes Could Be Improved (Reference Number 2010-21-057, dated May 27, 2010).



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We acknowledge that the Voucher Review Checklist can assist the Contracting Officer's Technical Representative in completing a proper evaluation of the contractor's monthly invoice, even though it is not a formal requirement for the review of vouchers. We also acknowledge that third party invoices would increase the transparency of hardware and software purchases with Recovery Act funds. We have implemented special requirements in this area and have asked the contractor to provide third party receipts, but recognize that such documentation is not required.

Finally, we agree with the intent of the outcome measure in Appendix IV. It states that documentation was incomplete to fully support charges on the subcontractor invoices. However, Federal Acquisition Regulation (FAR) 32.905(b) (2) states that, "an interim payment request under a cost-reimbursement contract for services constitutes a proper invoice for purposes of this subsection if it includes all of the information required by the contract." As directed by the task order, the contractor submits receipts and invoices for approval. These receipts and invoices reference all purchases in detail for the expressed purpose of authentication and validation of hardware/software purchases. Furthermore, FAR 15.402(a)(3) states that, "Contracting Officers must not require unnecessarily the submission of cost or pricing data, because it leads to increased proposal preparation costs, generally extends acquisition lead time, and consumes additional contractor and Government resources."

Attached are our specific comments on your recommendations. If you have any questions, please contact me, or a member of your staff may contact Rinaldi Boykin, Acting Program Manager, Health Coverage Tax Credit, Wage and Investment Division, at (202) 283-9600.

Attachment



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Attachment

RECOMMENDATION 1

The Commissioner, Wage and Investment Division, should require the COTR assigned to the HCTC Program Office to complete the Voucher Review Checklist for all future contractor invoices prior to authorizing payments, in accordance with the Voucher Review Procedures established by the Office of Procurement.

CORRECTIVE ACTION

We agree with this recommendation. The review procedures and checklist are recommended guidelines for Contracting Officer's Technical Representatives (COTRs) and are not mandated procedures. The Voucher Review Procedure is part of the Guidebook for Acquisition Procedure, and, as the name suggests, this document provides guidance to COTRs on proper evaluation elements. The procedure and its checklist are not included in the COTR delegation memo and are currently not part of any official IRS procurement policy directive. The Health Coverage Tax Credit (HCTC) COTR will continue using the Voucher Review Procedures developed by the IRS Office of Procurement for the review and payment of invoices. As an additional step to provide confidence in the HCTC Program's established review process, we will now incorporate the Voucher Review Checklist as part of that procedure each month. The COTR will also submit the Voucher Review Checklist to the Contracting Officer (CO) for review and approval.

In order to receive prompt pay discounts on invoices, the COTR is required to pay the invoice early in the month. The invoice is validated as being reasonable prior to making the payment. The supporting invoice documentation is received each month between the 15th and the last day of the month; therefore, the formal review is completed during this time. If any issue arises based on backup documentation, the payment can be amended.

IMPLEMENTATION DATE

October 15, 2010

RESPONSIBLE OFFICIAL

Acting Program Manager, Health Coverage Tax Credit Office, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

The IRS will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 2

The Commissioner, Wage and Investment Division, should require the HCTC Program Office to develop internal procedures that provide for complete financial accountability and traceability when subcontractor invoices are paid with Recovery Act funds.



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Specifically, HCTC Program-specific guidance needs to be established to supplement the Voucher Review Procedures to ensure third party receipts and other comparable documents are received prior to payment of Recovery Act funds.

CORRECTIVE ACTION

We disagree with the recommendation that the HCTC Program should develop its own internal procedures for the use of Recovery Act funds. The HCTC Program follows all guidance issued by Office of Management and Budget, Treasury, IRS, and IRS' American Recovery and Reinvestment Act (ARRA) Office. Recovery Act fund policies should not be internal to HCTC, but rather issued by a policy office at a corporate level.

Review and verification of third party invoices for incidental hardware/software purchases is not required. The Program has special requirements for approval of these purchases that were put in place for the purpose of additional transparency as stated in the ARRA legislation.

The special requirements that were developed for this task because of the addition of Recovery Act funds are:

1. Before making any purchase of hardware/software, the contractor must request approval and submit, at a minimum, a detailed inventory list to the COTR and CO,
2. The detailed inventory list shall include at a minimum: device name, model number, delivery location, scheduled delivery date, quantity, unit price, and extended price,
3. The HCTC COTR and the CO shall provide written approval for all hardware/software purchases and a work request modification will be issued by the COTR using a comparative analysis and market research; and
4. The Government will only reimburse for the actual cost of the hardware/software and associated delivery charges and taxes for those purchases. Furthermore, the contractor is required to pass along to the Government any applicable discounts, refunds, or credits.

The HCTC COTR will continue to validate and retain third party receipts as part of the Voucher Review Process. We have asked the contractor to provide third party receipts for all purchases made during the ARRA period of performance on this contract and going forward. If provided, the COTR will incorporate this review for the validation and retention of third party receipts for all expenditures into the ongoing monthly review. For expenditures made prior to this new step, the COTR will complete a random review of invoices to validate against third party receipts similar to the random sample review performed by TIGTA. If any discrepancies are found with the third party invoices, they will be escalated to the CO for explanation and mediation.

IMPLEMENTATION DATE

N/A



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RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 3

The Commissioner, Wage and Investment Division, should require the HCTC Program Office to complete and provide a work order to the HCTC contractor for the subsequent efficiency enhancements to the HCTC Program.

CORRECTIVE ACTION

We agree with this recommendation to have a work request for the efficiency releases. The HCTC COTR has submitted the final work request to the CO for review and concurrence. The delay in completing the efficiency release work request was due to the fact that all scope was not defined at the time. Therefore, upon finalizing the scope, we amended the efficiency release work request to reflect the final version of the specific work requirements.

IMPLEMENTATION DATE

October 15, 2010

RESPONSIBLE OFFICIAL

Acting Program Manager, Health Coverage Tax Credit Office, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

The IRS will monitor this corrective action as part of our internal management control system.