



**RECOVERY ACT**

*Deficiencies Continue to Exist in Verifying  
Contractor Labor Charges Prior to Payment*

**September 19, 2012**

**Reference Number: 2012-11-101**

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.

Redaction Legend: 10 = Trade Secret/Confidential Business Information

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## HIGHLIGHTS



### DEFICIENCIES CONTINUE TO EXIST IN VERIFYING CONTRACTOR LABOR CHARGES PRIOR TO PAYMENT

## Highlights

**Final Report issued on  
September 19, 2012**

Highlights of Reference Number: 2012-11-101 to the Internal Revenue Service Deputy Commissioner for Operations Support.

### IMPACT ON TAXPAYERS

The IRS received an appropriation of \$203 million in American Recovery and Reinvestment Act of 2009 (Recovery Act) funds. TIGTA determined that the IRS did not have documentation supporting \$394,430 of the invoiced labor hours that were paid. When labor hours are not adequately verified, there is no assurance that Recovery Act funds are being used for authorized purposes.

### WHY TIGTA DID THE AUDIT

This audit was initiated because TIGTA is required to monitor the IRS's implementation of Recovery Act provisions. The overall objective of this review was to assess the IRS's controls over contract invoice review, approval, and payment processes and to identify improper payments of Recovery Act funds made to contractors.

### WHAT TIGTA FOUND

Our review of a statistically valid sample of \$1 million in labor charges identified that the IRS did not have documentation supporting \$394,430 of the invoiced labor hours that were paid. Applying the results of our analysis to the \$5.3 million in labor charges for the procurement in which unsupported payments were identified, TIGTA estimates a total of \$927,992 may have been erroneously paid. IRS Contracting Officer's Technical Representatives (COTR) did not obtain required documentation supporting all billed labor charges. The unsupported labor charges relate to work performed by contractor and subcontractor employees. In contrast, our

review of a sample of \$34,306 in travel expenses found that COTRs obtained documentation supporting the travel expenses claimed. TIGTA confirmed that the travel expenses submitted and paid by the IRS were consistent with Federal Travel Regulations.

Our review also identified that some labor hours billed and paid were at higher or lower rates than established in the contract for the qualification level of the individual for whom the hours were billed. Finally, TIGTA found that although the Contracting Officers verified the qualifications and experience levels of those contractor employees who were designated as key personnel, a similar verification of a random sample of the remaining personnel was not performed by the responsible COTR as required by his or her appointment letter.

### WHAT TIGTA RECOMMENDED

TIGTA recommended that the Chief, Agency-Wide Shared Services: 1) ensure that established processes and procedures to verify all labor charges are followed prior to payment, 2) ensure the validity of all labor charges associated with the procurement TIGTA identified as having a total of \$394,430 paid for labor charges that were not supported by required documentation and initiate actions to recover any funds identified as being paid erroneously, and 3) ensure COTRs are in compliance with the requirement to perform random checks of resumes of individuals who are not considered to be key personnel if this requirement is included in their appointment letter.

IRS management agreed with our recommendations. In response, the IRS has revised receipt and acceptance policies and procedures, plans to review the labor charges associated with the procurement TIGTA identified as having labor charges not supported by required documentation, and plans to continue to remind the COTRs and their management of the importance of the appointment letter and that all duties within that letter must be fulfilled.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

September 19, 2012

**MEMORANDUM FOR DEPUTY COMMISSIONER FOR OPERATIONS SUPPORT**

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

**SUBJECT:** Final Audit Report – Deficiencies Continue to Exist in Verifying Contractor Labor Charges Prior to Payment (Audit # 201210104)

This report presents the results of our review to assess the Internal Revenue Service's (IRS) controls over contract invoice review, approval, and payment processes and to identify any improper payments of American Recovery and Reinvestment Act of 2009 (Recovery Act)<sup>1</sup> funds made to contractors. This review is included in our Fiscal Year 2012 Annual Audit Plan and addresses the major management challenge of Fraudulent Claims and Improper 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.

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. Please contact me at (202) 622-6510 if you have any questions or Russell P. Martin, Acting Assistant Inspector General for Audit (Management Services and Exempt Organizations), at (202) 622-8500.

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<sup>1</sup> Pub. L. No. 111-5, 123 Stat. 115 (2009).



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## *Abbreviations*

CO	Contracting Officer
COTR	Contracting Officer's Technical Representative
FAR	Federal Acquisition Regulation
IRS	Internal Revenue Service
TIGTA	Treasury Inspector General for Tax Administration



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## *Background*

On February 17, 2009, the American Recovery and Reinvestment Act of 2009 (Recovery Act)<sup>1</sup> was enacted. The provisions in this law are estimated to cost a total of \$787 billion over 11 years. The Recovery Act contains 56 tax provisions—20 individual taxpayer and 36 business taxpayer provisions. In addition, Congress appropriated \$203 million to the Internal Revenue Service (IRS) to oversee the administration of these tax provisions. This appropriation amount included \$80 million for the Health Coverage Tax Credit program and \$123 million to support tax provision changes cited in the Recovery Act. Additionally, the Treasury Inspector General for Tax Administration (TIGTA) received \$7 million in separate Recovery Act funding through September 30, 2013, to be used in oversight activities of IRS programs.

The IRS's Recovery Act funds expired on September 30, 2011. As such, only the funds that were obligated by the IRS prior to this date are available for the IRS to expend. As of October 11, 2011, the IRS awarded 25 procurement actions<sup>2</sup> to 17 contractor companies for Recovery Act program initiatives. These actions included procurements for reprogramming IRS computer systems, updating related tax forms and publications, and providing customer services to assist taxpayers with the new tax law provisions included in the Recovery Act. The total contract value of these initiatives was \$85.4 million, of which \$83.2 million had been disbursed to various contractors by October 1, 2011.

The IRS follows the same laws, principles, procedures, and practices in awarding and administering contracts with Recovery Act funds as it does with other funds. However, there are additional guidelines and requirements for Recovery Act procurements. The Office of Management and Budget issued a series of supplemental guidance documents that included requirements for the planning, awarding, and administering of procurements funded by the Recovery Act. These requirements include ensuring qualified personnel oversee procurements, ensuring the timely expenditure of funds, and minimizing cost overruns and improper payments. Figure 1 provides a summary of the Recovery Act procurement expenditures by category.

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<sup>1</sup> Pub. L. No. 111-5, 123 Stat. 115 (2009).

<sup>2</sup> For the purposes of this report, procurements include contracts and task orders, or delivery orders issued against existing contracts. Procurement actions are oral or written statements, or a step taken, that result in the formation or modification of a procurement.



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**Figure 1: Summary of Recovery Act Procurement Expenditures**

Fiscal Year	Labor	Products <sup>3</sup>	Travel	Fixed Fees <sup>4</sup>
2009	\$7,495,111	\$2,484,010	\$339,550	\$474,782
2010	\$37,353,029	\$7,755,552	\$2,937,537	\$2,031,791
2011	\$17,479,311	\$2,557,927	\$1,417,027	\$899,076
<b>Total</b>	<b>\$62,327,451</b>	<b>\$12,797,489</b>	<b>\$4,694,114</b>	<b>\$3,405,649</b>
<b>Total Recovery Act Expenditures Through Fiscal Year 2011</b>				<b>\$83,224,703</b>

Source: IRS contract files and financial records.

**Processing invoices for payment – labor and travel expenses**

**Labor Expenses** – Payments to contractors are based on the IRS’s receipt of an invoice (contractor’s bill or written request for payment) and confirmation of satisfactory contractor performance. The Federal Acquisition Regulation (FAR)<sup>5</sup> requires contractors to account for costs appropriately and to maintain records, including supporting documentation, adequate to demonstrate that costs claimed on invoices have been incurred.<sup>6</sup> For example, for some types of procurements, the FAR requires the contractor to substantiate invoices for labor hours, including any subcontractor labor hours.<sup>7</sup> Substantiation includes:

- Individual daily job timekeeping records.
- Records that verify the employees meet the qualifications for the labor categories specified in the contract.

<sup>3</sup> Products include hardware and software expenses and other direct costs incurred by the contractor.

<sup>4</sup> Contracts pay a predetermined fee that was agreed upon at the time the contract was awarded to the contractor.

<sup>5</sup> 48 C.F.R. ch. 1.

<sup>6</sup> FAR § 4.803, § 31.201-2, and § 52.232-7.

<sup>7</sup> A subcontractor is an entity that is awarded a portion of an existing contract by a prime contractor. The subcontractor performs work under a contract with a prime contractor, rather than with the agency that hired the prime contractor.



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A key control in the validation of labor charges is ensuring qualified personnel oversee procurements. Both the Contracting Officer (CO)<sup>8</sup> and Contracting Officer's Technical Representative (COTR)<sup>9</sup> play a critical role.<sup>10</sup> For example, IRS guidelines caution COTRs to maintain a close and careful check on the number of labor hours incurred by the contractor's employees. The COTRs are required to ensure:

- Hourly labor rates (including wages, indirect costs, general and administrative expenses, and profit) being charged are the same as specified in the contract.
- Timekeeping records have been provided substantiating the labor hours billed.
- Labor hour calculations can be verified by multiplying the appropriate hourly rate in the contract by the number of direct labor hours performed.
- Labor hours incurred to perform the tasks were completed by employees qualified under that specific labor category.

**Travel Expenses** – Allowable costs for contractor travel expenses are governed by the FAR travel cost principle.<sup>11</sup> The Federal Travel Regulation<sup>12</sup> requires that airline, lodging, and rental car receipts be maintained to support travel expenditures and that reimbursement be based on the actual cost not to exceed the per diem (daily subsistence) rate or other required cost limitation policies. IRS COTRs are required to ensure travel expenses sent for reimbursement are within reimbursement guidelines and are properly supported by receipts.

This audit is a continuation of our oversight of the IRS's Recovery Act procurement activities. This review was performed at the IRS Office of Procurement, Agency-Wide Shared Services, in Oxon Hill, Maryland; the Modernization and Information Technology Services organization in New Carrollton, Maryland; Wage and Investment Division program offices in Atlanta, Georgia; and the Offices of the Chief Financial Officer in Beckley Finance Center, West Virginia, during the period February through June 2012. 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

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<sup>8</sup> The Contracting Officer is an IRS employee who is responsible for ensuring performance of all necessary actions relating to the contract, including ensuring contractors are complying with contract terms.

<sup>9</sup> The Contracting Officer's Technical Representative is an IRS employee whose role is to provide technical oversight relating to the contract, including ensuring that the Government pays only for the services, materials, and travel authorized and delivered under the contract.

<sup>10</sup> While there is essentially no direct legal relationship between the Government and subcontractors, COs play a key role in subcontract oversight because they are responsible for the overall prime contract price and performance.

<sup>11</sup> FAR 31.205-46.

<sup>12</sup> 41 C.F.R. ch. 300-304.



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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*

We reviewed a statistically valid sample of \$1 million in labor charges invoiced and paid in Calendar Year 2011. Our review included two procurements from a universe of 25 Recovery Act procurement actions reflected on the October 11, 2011, Financial Activity Report, generated from the IRS's Integrated Financial System. We selected these two procurements as they had the highest dollar values based on our sampling criteria. The labor hour charges for these two procurements had a total value of approximately \$5.6 million.<sup>13</sup>

Based on our review, we identified that the IRS did not have documentation supporting \$394,430<sup>14</sup> in labor charges. Applying the results of our analysis to the \$5.3 million in labor charges for the procurement in which we identified unsupported payments, we estimate that there could be another \$533,562 in unsupported labor charges, for a total of \$927,992 that may have been erroneously paid. The COTRs did not obtain required documentation supporting all billed labor charges. The unsupported charges relate to work performed by both prime contractor employees and subcontractors used by the prime contractor. In contrast, our review of a sample of \$34,306 in travel expenses found that the COTRs obtained documentation supporting the travel expenses claimed. We confirmed that the travel expenses submitted and paid by the IRS were consistent with Federal Travel Regulations.

Our review also identified that some labor hours billed and paid were at higher or lower rates than what were established in the contract for the qualification level of the individual for whom the hours were billed. Finally, we found that although the COs verified the qualifications and experience levels of those contractor employees who were designated as key personnel, a similar verification of a random sample of the remaining personnel was not performed by the responsible COTR as required by his or her appointment letter.<sup>15</sup> Without this verification, the IRS is unable to ensure that the labor hours incurred for tasks specified in the contract are being performed by employees who meet qualifications specified in the contract.

To meet the commitment to spend Recovery Act dollars with an unprecedented level of transparency and accountability, the President established five broad requirements that all agencies must follow. The third requirement is that Federal agencies ensure Recovery Act funds are used for authorized purposes and that every step be taken to prevent instances of fraud,

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<sup>13</sup> The labor hours for the two procurements reviewed were 55,363,143 and 189,952, respectively, for a total of 55,553,095. We rounded this figure to \$5.6 million.

<sup>14</sup> The unsupported labor charges identified all related to one of the two procurements we reviewed.

<sup>15</sup> The COTR appointment letter is the official document in which the COTR is informed that his or her duties, responsibilities, and obligations are limited to those articulated in the appointment letter and must be exercised in accordance with agency policies.



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waste, and abuse. In our review, we found that IRS COs and COTRs did not take the required steps to ensure the validity of labor hours billed prior to payment.

### ***Documentation Supporting Labor Charges Was Not Always Obtained to Ensure the Validity of the Submitted Charges***

Our review determined that the IRS did not administer procurements funded by the Recovery Act in accordance with Office of Management and Budget Recovery Act guidance, relevant FAR provisions, and IRS policies and procedures. We determined that the COTRs who were responsible for the oversight of Recovery Act procurements did not always ensure documentation was received supporting billed labor charges. The unsupported labor charges related to work performed by both prime contractor employees and subcontractors used by the prime contractor. When we brought this concern to IRS management's attention, they responded that although they receive invoices totaling subcontractor labor charges, they did not ensure supporting documentation was obtained for these charges prior to payment. For the unsupported labor charges relating to the prime contractor employees, the IRS incorrectly identified these individuals as subcontractors and, as such, no support was obtained. This is not in compliance with IRS internal guidance, which states that an invoice by itself is not sufficient documentation to support charges.

The lack of verification of labor charges prior to payment is a continued deficiency reported by the TIGTA. Prior TIGTA reports<sup>16</sup> have identified that the IRS does not verify that charges submitted for vendor invoices are accurate and allowable. For example, one report identified that contractors did not provide adequate documentation to support invoice charges, and another identified that the IRS paid for unallowable labor and travel charges. The TIGTA's recommendations in these reports addressed the need for the IRS to enhance its reviews of vendor invoice submissions and recover any unsupported charges that constituted improper payments to the contractor. Many of these recurring findings relate to inadequate monitoring of procurements by the IRS Office of Procurement's COs and the program offices' COTRs.

### ***Labor rates used were not always in agreement with contract terms***

IRS guidelines require that labor rates charged (including wages, indirect costs, general and administrative expenses, and profits) are in agreement with contract requirements. Our review identified that some labor charges billed and paid were at a higher or lower rate than established in the terms of the contract. Of the approximately \$1 million in labor charges we reviewed, we identified \$26,048 in labor charges that were higher than the established rate and \$28,604 in labor charges that were lower than the established rate. For example:

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<sup>16</sup> TIGTA, Ref. No. 2000-10-028, *Cost Savings Can Be Achieved Through Improved Monitoring of the Treasury Communications System Contract* (Feb. 2000) and TIGTA, Ref. No. 2004-10-174, *Audit of the Asset Seizure and Forfeiture Program Contract* (Sept. 2004).



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*Employee A, who is an Information Technology Specialist on the contract, was listed in the contract schedule at a labor rate of \*\*10\*\* per hour. However, on one invoice we reviewed, this individual's labor was billed at \*\*10\*\* per hour—or \*\*10\*\* higher per hour than specified in the contract.*

*Employee B, who is a Senior Information Technology Specialist on the contract, was listed in the contract schedule at a labor rate of \*\*10\*\* per hour. However, on one invoice we reviewed, this particular individual's labor was billed at \*\*10\*\* per hour—or \*\*10\*\* lower per hour than specified in the contract.*

Erroneous acceptance of the labor rates billed resulted from the COTRs failing to verify labor rates, indirect costs, and general and administrative expense costs prior to payment. The responsible COTR indicated that the IRS relies on the Defense Contract Management Agency<sup>17</sup> audits to detect billing inaccuracies. However, as required by IRS procurement guidelines,<sup>18</sup> COTRs should be ensuring the labor rates charged are in agreement with contract requirements prior to payment.

### **Qualification verifications were not performed as required in the COTR appointment letter**

Our review identified that the IRS correctly verified via a resume review the qualifications and experience levels for all key personnel relating to the contracts we reviewed. Key personnel are those individuals considered to be essential to the work being performed under the contract. IRS management noted that the resumes of individuals not considered key personnel were not required to be reviewed. The majority of personnel relating to the contracts we reviewed were not considered key personnel. Management indicated that, although not required, qualification reviews were conducted for at least two employees who were not considered key personnel as a result of concerns relating to labor hours billed for these individuals.

However, management was incorrect that additional qualification reviews were not required for individuals who were not considered key personnel. The COTR appointment letter for this procurement specifically stated that the COTR should conduct random checks of the resumes of individuals not considered key personnel and notify the CO of any findings of noncompliance. Without such verification, the IRS cannot be assured that labor charges associated with individuals not considered key personnel are aligned with the qualifications and experience levels of these individuals.

<sup>17</sup> This agency monitors contractors' performance and management systems to ensure that cost, product performance, and delivery schedules are in compliance with the terms and conditions of the contracts.

<sup>18</sup> IRS "Procurement 101 Reference Guide," *Invoice Checklist*.



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## **Recommendations**

The Chief, Agency Wide Shared Services, should:

**Recommendation 1:** Ensure established processes and procedures to verify all labor charges are followed prior to payment.

**Management's Response:** IRS management agreed with this recommendation. In March 2012, the Chief Financial Officer developed and disseminated both a User Guide and a Manager Guide to assist business units in performing and monitoring Receipt and Acceptance according to established guidelines, processes, and controls. In addition, the IRS has conducted numerous training workshops, revised receipt and acceptance policies and procedures, and performed internal reviews of approximately 1,200 contract files to ensure Receipt and Acceptance procedures were followed.

**Recommendation 2:** Ensure the validity of all labor charges associated with the procurement we identified as having a total of \$394,430 paid for labor charges that were not supported by required documentation. Actions should be initiated to recover any funds identified as being paid erroneously.

**Management's Response:** IRS management agreed with this recommendation. The Office of Procurement Policy's Cost and Price Branch will review the labor charges associated with TIRNO-06-D-0000 task order to ensure all labor charges associated with the identified procurement are valid.

**Recommendation 3:** Ensure COTRs are in compliance with the performance of random checks of resumes of individuals not considered key personnel if this requirement is included in their appointment letter.

**Management's Response:** IRS management agreed with this recommendation. The Office of Procurement will continue to remind the COTRs and their management of the importance of the appointment letter and that all duties within that letter must be fulfilled.



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## Appendix I

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

The overall objective of this review was to assess the IRS's controls over contract invoice review, approval, and payment processes and to identify any improper payments of American Recovery and Reinvestment Act of 2009 (Recovery Act)<sup>1</sup> funds made to contractors. To accomplish our objective, we:

- I. Determined the IRS's invoice verification (hereafter referred to as receipt and acceptance) process from invoice receipt through certifying the invoice for payment to the contractor. In addition, we determined if there were any concerns about specific contractors' invoices or billing practices.
  - A. Obtained an understanding of the IRS's receipt and acceptance process through analysis of the applicable laws, regulations, and guidance.
  - B. Interviewed IRS procurement and program office personnel to confirm our understanding of the receipt and acceptance process; current invoice review, processing, and approval practices; and the separation of duties structure currently in place for those IRS personnel performing these responsibilities. We asked these same personnel if they had any concerns regarding a specific contractor, its billing practices (e.g., consistently billed unallowable charges), or specific invoices.
  - C. Obtained the COTR appointment letter/delegation of authority for our selected procurements (see Objective II) as prepared by the CO to verify official authorization and duties of the COTR.
  - D. Reviewed recent TIGTA, Government Accountability Office, and Defense Contract Audit Agency audit reports that may include adverse conditions concerning the accounting system or billing practices of the contractors involved in the procurements selected in Objective II.
  - E. Assessed the reliability of the Integrated Financial System computer-processed data and determined that the data are sufficiently reliable to use for our audit tests. The IRS Integrated Financial System is an established financial system used by the IRS to account for expenditures. We determined that all transactions in the data extracted were within our audit period.

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<sup>1</sup> Pub. L. No. 111-5, 123 Stat. 115 (2009).



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- F. We obtained the universe of 25 Recovery Act procurement actions reflected on the October 11, 2011, Financial Activity Report, generated from the Integrated Financial System. Our review focused on labor charges and travel expenditures. The following determination was used to select procurements for our statistical sample:
1. One procurement was removed from our universe because no payments had been disbursed on this procurement as of September 30, 2011.
  2. Thirteen procurements were excluded from our review because these charges solely involve the delivery of products (generally hardware and software), which we considered to be less of a risk.
  3. Four procurements were excluded because they were a fixed-price type contract in which the labor was all inclusive in the total procurement cost.
  4. The remaining seven procurements ranged in obligated value from a low of \$4,838 to a high of \$79,318,721. We selected the two procurements with the highest obligated value as our audit universe subject to statistical sampling.
- II. Verified that labor charges and travel expenses submitted by the contractors and paid by the IRS are accurate, supported, allocable, and allowable costs.
- A. Obtained a list of all invoices approved for payment on our two selected contractors (selected procurements from Step I.F.) during our audit period. For the first contractor, we reviewed all labor charges and travel expenses during our audit period. For the second contractor, we took a statically valid sample of labor and travel charges. We reviewed \$34,306 (11 percent) out of \$306,638 in travel charges and \$1 million (approximately 20 percent) out of \$5.3 million in labor charges for the second contractor.<sup>2</sup>
- B. For the invoices included in the sample, we confirmed through Integrated Financial System outputs the actual amount paid to the contractor.
- C. For the invoices included in our sample, we obtained all supporting documentation from the IRS or, if necessary, from the contractor and traced all invoice charges to supporting documentation. To determine if the invoice charges were accurate, allowable, and allocable we:
1. Traced all labor charges and travel expenses to supporting documentation.

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<sup>2</sup> We reviewed all labor charges and travel expenses for the first contractor because there were only two contractor employees who billed time across six invoices. For the second contractor, there were more than 400 employees who charged time to the contract. Audit resources drove the decision to sample rather than to do a complete review of the second contractor.



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2. Verified that labor rates and categories were consistent with the terms and conditions of the contract.
  3. Verified that overhead fees and other general and administrative costs were consistent with the terms and conditions of the contract.
- D. Applying the results of our analysis to our sample population, we projected a value for the total unsupported labor costs associated with the procurements in our review.<sup>3</sup>
- E. Determined whether CO/COTR contract file(s) were properly maintained in conformance with the applicable guidance to reflect adequate documentation for invoice expenditures and corresponding receipt and acceptance.
- F. Determined whether the contract personnel qualifications (education and experience) met contract requirements and were consistent with the labor category reflected in the invoice charges and reviewed the COTR's contract file for key personnel resumes.
- G. Confirmed through discussions with responsible procurement or program office personnel the facts surrounding any questioned charges.
- H. Obtained management's explanation in writing for any unsupported charges that were paid and could not be fully explained through discussions with procurement or project personnel.

**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: policies, procedures, and practices issued by the Office of Management and Budget, the Department of the Treasury, and the IRS Office of Procurement for the planning, awarding, and administering of procurements funded by the Recovery Act. This included the policies and procedures for reviewing contractor-invoiced charges and supporting documentation prior to recommending payment. We evaluated these controls by interviewing program office, procurement, and financial personnel and by reviewing contract files and financial reconciliation reports.

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<sup>3</sup> Our projection is based on a 95 percent confidence level and a precision (range of)  $\pm$  \$590,966 (\$337,026 - \$1,518,958) in unsupported labor charges.



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**Appendix II**

*Major Contributors to This Report*

Nancy Nakamura, Assistant Inspector General for Audit (Management Services and Exempt Organizations)  
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Melvin Lindsey, Auditor  
Joseph L. Katz, Ph.D., Contractor, Statistical Sampling Consultant



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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  
Commissioner, Small Business/Self-Employed Division SE:S  
Commissioner, Wage and Investment Division SE:W  
Acting Commissioner, Tax Exempt and Government Entities Division SE:T  
Chief, Agency-Wide Shared Services OS:A  
Chief Technology Officer OS:CTO  
Director, Procurement OS:A:P  
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Director, Office of Program Evaluation and Risk Analysis RAS:O  
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    Commissioner, Wage and Investment Division SE:W  
    Acting Commissioner, Tax Exempt and Government Entities Division SE:T  
    Director, Procurement OS:A:P



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## Appendix IV

### *Outcome Measure*

This appendix presents detailed information on the measurable impact that our recommended corrective 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) – Potential; \$927,992 (see page 5).

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

We reviewed the IRS contract files for the procurements in our audit sample, including invoices and invoice support, to verify labor charges.

Our review resulted in the identification of \$394,430.36 in unsupported labor charges that the IRS paid. To identify the \$394,430.36, we reviewed a statistically valid sample of 100 labor charges, drawn from a population of 529 labor charges. In 17 (17 percent) of the 100 cases, the IRS did not request supporting documentation to verify the charges.

We determined the 17 unsupported charges in the sample totaled \$394,430.36. However, because one of the 17 labor charges was an outlier, we removed it from our sample for the purposes of estimating the total value of unsupported labor charges. We determined that this charge was an outlier because the charge represented a roll-up of more than 1,200 hours of employee time that was charged as a lump sum in one monthly invoice. One 30-day month is made up of 720 hours (30 days times 24 hours a day); therefore, this charge could not realistically represent charges made by one employee in one month. After the \$219,006.52 charge was removed, we used a sample unsupported labor charge value of \$175,423.84 to make our projections. Dividing \$175,423.84 by the sample size of 100 results in a sample average of \$1,754.24. By multiplying \$1,754.24 by the population of 529, we projected that the IRS may have paid \$927,992.12 in unsupported labor charges.<sup>1</sup>

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<sup>1</sup> Our projection is based on a 95 percent confidence level and a precision (range) of  $\pm$  \$590,966 (range \$337,026 - \$1,518,958) in unsupported subcontractor charges.



Deficiencies Continue to Exist in Verifying Contractor Labor Charges Prior to Payment



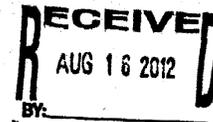
Appendix V

Management's Response to the Draft Report



CHIEF AGENCY-WIDE SHARED SERVICES

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



August 15, 2012

MEMORANDUM FOR MICHAEL E. MCKENNEY ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: David A. Grant Chief, Agency-Wide Shared Services

SUBJECT: Draft Audit Report – Deficiencies Continue to Exist in Verifying Contractor Labor Charges Prior to Payment (#201210104)

Thank you for the opportunity to respond to the subject audit report. This audit was conducted to assess the Internal Revenue Service's (IRS's) controls over contract invoice review, approval, and payment processes associated with the American Recovery and Reinvestment Act of 2009 (ARRA) expenditures. Our response is attached.

We appreciate your review and agree with the importance of assuring that funds used for the ARRA are adequately verified. To ensure that all taxpayer dollars continue to be expended efficiently and in accordance with contract terms, we have increased our oversight of the Receipt and Acceptance (R&A) function at the IRS. Additionally, in March 2012, the Chief Financial Officer developed and disseminated a User Guide and a Manager Guide to assist in performing and monitoring R&A activities in accordance with established regulations, processes, and controls. Also, the IRS conducted five R&A Workshops between January and April 2012 for over 900 participants, including Contracting Officers, Contracting Officer Representatives (CORs), managers of CORs, and end users.

We appreciate your continued support and the valuable assistance and guidance that your team provides. If you have any questions, please contact me at (202) 622-7500. For technical questions, a member of your staff may contact Barry Kearns, Director, Office of Procurement Policy, at (202) 283-1410. 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



*Deficiencies Continue to Exist in Verifying Contractor  
Labor Charges Prior to Payment*



**Attachment**

**RECOMMENDATION #1:** Ensure established processes and procedures to verify all labor charges are followed prior to payment.

**CORRECTIVE ACTION:** We agree with this recommendation. Receipt and Acceptance (R&A) is a vital part of the acquisition life cycle, and we take it very seriously at the Internal Revenue Service (IRS). As such, a review process and outreach program was established for the R&A process. In March 2012, the Chief Financial Officer (CFO) developed and disseminated both a User Guide and a Manager Guide to assist business units in performing and monitoring R&A according to established guidelines, processes, and controls. The CFO and the Agency-Wide Shared Services organization conducted five R&A Workshops between January and April 2012 for over 900 participants, including Contracting Officers, Contracting Officer Representatives (CORs), managers of CORs, and end users. Additionally, an online training course was created in May 2012 on receipt and acceptance procedures.

Additionally, in March 2012, the Office of Procurement revised Policy and Procedure (P&P) Memorandum 46.5, Receipt and Acceptance, to provide specific procedural requirements for obtaining and maintaining end user documentation of R&A of the goods and services, including the roles and responsibilities of each member of the acquisition team. The IRS Beckley Finance Center continues to work with business units to develop a review process and answer questions regarding proper R&A documentation procedures. In addition, multiple communications have been issued to users by the Office of Procurement and the CFO regarding the proper use of procedures.

To further strengthen our efforts in ensuring proper R&A procedures are followed, four internal reviews of a sampling of contract files were conducted by the IRS Beckley Finance Center between November 2011 and July 2012. Approximately 1200 files were reviewed to ensure procedures are followed prior to payment.

**IMPLEMENTATION DATE:** Completed July 15, 2012

**RESPONSIBLE OFFICIAL:** N/A

**CORRECTIVE ACTION MONITORING PLAN:** N/A

**RECOMMENDATION #2:** Ensure the validity of all labor charges associated with the procurement we identified as having a total of \$394,430 paid for labor charges that were not supported by required documentation. Actions should be initiated to recover any funds identified as being paid erroneously.



*Deficiencies Continue to Exist in Verifying Contractor  
Labor Charges Prior to Payment*



**CORRECTIVE ACTION:** We agree with this recommendation. The Office of Procurement Policy's Cost and Price Branch will review the labor charges associated with TIRNO-06-D-0000 task order to ensure all labor charges associated with the identified procurement are valid.

**IMPLEMENTATION DATE:** June 30, 2014

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

**CORRECTIVE ACTION MONITORING PLAN:** Corrective Actions will be monitored in the Joint Audit Management Enterprise System (JAMES). The corrective action will be monitored on a monthly basis until completion.

**RECOMMENDATION #3:** Ensure COTRs are in compliance with the performance of random checks of resumes of individuals not considered key personnel if this requirement is included in their appointment letter.

**CORRECTIVE ACTION:** We agree with this recommendation. Procurement will continue to remind the Contracting Officer Representatives (CORs) and their management of the importance of the appointment letter and that all duties within that letter must be fulfilled. The COR and receipt and acceptance training also emphasizes the requirement to review resumes in order to properly monitor procurements.

**IMPLEMENTATION DATE:** December 31, 2012

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

**CORRECTIVE ACTION MONITORING PLAN:** Corrective Actions will be monitored in the Joint Audit Management Enterprise System (JAMES). The corrective action will be monitored on a monthly basis until completion.