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**GAO**

United States  
General Accounting Office  
Washington, D.C. 20548



146734

General Government Division  
B-248773

May 28, 1992

The Honorable William E. Dannemeyer  
House of Representatives

Dear Mr. Dannemeyer:

This letter responds to your request that we consider a number of allegations from your constituent concerning the Internal Revenue Service's (IRS) negotiation and administration of certain contracts for ADP support services. You requested that we determine whether proper safeguards were implemented against contract abuse and the resultant waste of tax dollars. To obtain the information presented in this letter, we reviewed the ADP support services contracts and related IRS Internal Audit reports. We also interviewed IRS Procurement staff and Internal Audit staff. We did not review the negotiation of individual task orders issued under the contracts.

BACKGROUND

The contracts involved are two successive ADP support service contracts. The first contract was awarded competitively to Vanguard Technologies Corp. in 1985 with a \$50 million ceiling price over 5 years. The second contract was awarded competitively to the OAO Corporation in 1989 with a ceiling price of \$500 million over 7 years.<sup>1</sup> In 1988, Cincinnati Bell Information Systems, Inc. (CBIS) acquired Vanguard. CBIS later purchased the assets of the OAO division that was awarded the second contract and, through agreement with IRS, became the successor party to that contract.

Both contracts provided IRS and other Treasury bureaus with needed ADP support services. The services to be performed included requirements definition, systems analysis and design, software development, testing, maintenance, and program and project management. The contracts established labor rates ranging from less than \$10 per hour to over \$40

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<sup>1</sup>GAO has reviewed aspects of the award of this contract. See IRS Automation: Procurement Practices Need Strengthening (GAO/IMTEC-90-24, Jan. 12, 1990).

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per hour for a wide variety of ADP skills. The hourly rates, which were competitively negotiated, included allowances for the contractor's overhead and profit.

IRS used individual fixed price task orders to obtain ADP services from contractors. IRS procedures provide that the IRS division needing the service (the user) furnish a statement of work. Recently revised procedures now require the user to also prepare a cost estimate. In response, the contractor submits a fixed price proposal. The proposal uses contract labor rates and sets forth the hours needed at various skill levels to accomplish the task as well as materials and any other anticipated costs. IRS reviews the contractor's proposed labor hours and skill mix and negotiates any differences before accepting the proposal. Each negotiated task order becomes, in effect, a separate, firm fixed-price contract.

#### RESULTS IN BRIEF

Your constituent alleged that IRS contract administration practices did not ensure that the contractor's estimates of labor hours and skill levels required were reasonable. He stated that IRS did not have the experienced staff to adequately review the contractor's task proposals even though the negotiation of proposals demanded that IRS have very technically qualified people to review them. Internal Audit staff identified similar weaknesses in the negotiation of task orders. In response, IRS managers revised procedures to strengthen the negotiation of task order prices as well as to increase the number of staff assigned to administer the contract, including the negotiation of task orders. IRS procurement managers stated the administration of the contracts remains a concern and that IRS is actively trying to hire additional staff with the technical and engineering qualifications necessary to more effectively review task order proposals.

#### IRS PROGRESS IN RESOLVING CONTRACTING PROBLEMS

In January 1989, IRS' Internal Audit Division reported that IRS did not have effective controls to ensure that services provided under the Vanguard contract were acquired at the most advantageous cost. According to Internal Audit, contributing factors included the lack of an effective method for IRS to use in determining whether contractor costs were reasonable. The auditors also reported that IRS evaluations of contractor-proposed labor hours and labor categories were not documented. Internal Audit recommended that responsible IRS managers

-- develop an effective cost-estimating methodology and establish procedures requiring detailed cost estimates for task orders,

- establish guidelines requiring negotiations whenever a material difference exists between the government cost estimate and the contractor's proposal, and
- develop guidelines requiring that users document their evaluation of the contractor's proposal.

In response to the Internal Audit report, IRS management officials acknowledged the problems cited and described a number of corrective actions to be taken. First, users were to prepare detailed cost estimates, and cost-estimating methodology was to be incorporated into IRS' procurement guidelines. Second, users were to provide a technical evaluation of contractor proposals addressing each area where the proposed cost significantly differed from the user's estimate. Negotiations were to be conducted for any unsupported differences. Third, procurement guidelines were to be revised to describe the extent of review and the expertise necessary to conduct the evaluation. Internal Audit later reported that appropriate corrective actions had been implemented.

Despite the corrective actions, evaluation of contractor proposals of the labor hours and skill mixes required to meet a task order remains a problem. In September 1991, Internal Audit reported on the administration of initial task orders issued under the OAO successor's ADP support services contract. The auditors reported that a cost- and quality-estimating model that had been acquired to evaluate contractor's cost proposals was not accurate. The model's cost estimates consistently exceeded both the contractor's and IRS' estimates. The auditors recommended that IRS management make certain that the model achieves its intended purpose. In response, IRS management officials said that the model is designed to estimate costs only for software development and that its usefulness for other purposes is limited and unreliable. Rather than seek a possibly expensive redesign of the estimating model from the vendor, IRS managers said they would develop procedures whereby technical personnel, contract specialists, and cost/price analysts and possibly cost/estimation engineers will analyze and verify cost proposals.

We interviewed IRS procurement staff, who told us that, while much has been done to strengthen IRS administration of ADP support services contracts, further actions are needed. They said guidelines for acquiring ADP support services have been revised. For instance, users are now required to prepare a cost estimate for each task order and to negotiate any material differences between this estimate and the contractor's proposal. Users are also required to document their acceptance of contractor estimates of hours and skill mixes required to accomplish a task. In addition, IRS staff advised us that additional personnel have been

assigned to administer the contract. One major remaining step is to acquire additional personnel with the necessary technical expertise to evaluate the number of labor hours and skill mixes required to perform a task. According to IRS staff, in May 1992, IRS has employed one computer specialist and was actively seeking up to two additional specialists to meet this need.

Your constituent also identified several potential weaknesses in certain subcontracts negotiated under the basic contracts. In view of IRS' recognition of the problem and the continuing changes in IRS procedures to negotiate task orders, we did not review the subcontracts. We did note certain aspects of the basic contracts that directly related to your constituent's concerns about the subcontracts' cost. First, subcontracts were not inherently more costly, because the basic contracts required that ADP support services, whether provided by the prime contractor or the subcontractor, be billed to IRS at the same hourly rate. Second, under the Vanguard contract, IRS was required to procure all ADP support services from Vanguard even though the services were furnished by a subcontractor. In contrast, the second contract permits IRS to procure ADP support services from any vendor.

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I have enclosed a copy of our report, IRS Automation: Procurement Practices Need Strengthening (IMTEC-90-24, Jan. 12, 1990), which discusses, among other things, Vanguard's protest of the contract award to OAO. As agreed with your office, we are sending a copy of this letter to the Chief Inspector, IRS, for use in future reviews of ADP support services contracts. Please contact me at (202) 275-6407 if you have any questions concerning this letter.

Sincerely yours,



Jennie S. Stathis  
Director, Tax Policy  
and Administration Issues

Enclosure

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