



*The Published Guidance Program
Needs Additional Controls to Minimize Risks
and Increase Public Awareness*

March 4, 2008

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TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

March 4, 2008

MEMORANDUM FOR CHIEF COUNSEL

Nancy A. Nakamura

FROM: (for) Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – The Published Guidance Program Needs
Additional Controls to Minimize Risks and Increase Public Awareness
(Audit #200710033)

This report presents the results of our review to evaluate the Office of Chief Counsel (Counsel) process and related controls for developing tax guidance, including the pilot guidance program described in Notice 2007-17.¹ This audit was conducted at the request of the Senate Finance Committee.

Impact on the Taxpayer

Counsel is responsible for interpreting the tax laws through its published guidance program, which is closely coordinated with the Department of the Treasury Office of Tax Policy. Although Counsel has increased the level of attention it places on the published guidance program, additional controls would further strengthen the process. These changes would minimize risks and increase public awareness of Counsel's efforts to develop and issue guidance. A strong published guidance program will help taxpayers understand and meet their tax responsibilities and help the Internal Revenue Service (IRS) apply the tax laws correctly and uniformly.

¹ Modifications of Commercial Mortgage Loans Held by a REMIC (Notice 2007-17), page 748 of Internal Revenue Bulletin 2007-12 (March 19, 2007). REMIC = Real Estate Mortgage Investment Conduit.



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Synopsis

During the 2006-2007 business year,² Counsel intensified its focus to develop more tax guidance, including starting a pilot program to determine if guidance could be issued using fewer resources. We reviewed Counsel's process for identifying, prioritizing, and issuing various types of guidance. Counsel's internal controls should ensure that guidance projects are focused on interpreting tax laws and addressing internal and external customer needs. However, additional internal controls are needed to further strengthen the process, minimize risks, and increase public awareness.

For example, although Counsel considers ideas from a wide variety of sources when selecting guidance projects for its annual business plan, it can improve its written procedures to ensure that the most important issues are selected. In addition, Counsel does not track all open projects on its guidance business plan. While guidance projects are recorded on Counsel's computer inventory system, some projects are not included in the guidance business plan. As a result, these projects have an increased risk of untimely actions, less management oversight, and less public awareness.

In addition, Counsel needs to improve how it monitors projects after it has started working on them. When a published guidance project is assigned, a paper project file is established to provide a record of actions taken and to support decisions made during the development of the guidance. However, Counsel could not locate all of the files we requested, and some of the located files were missing information. Also, Counsel's computer information system is not a useful tool to monitor open projects. Counsel employees do not always enter information such as milestone dates. In addition, missing computer logic checks allow the input of inconsistent data, and summary reports are not used to manage the projects. As a result, management may not identify delays in the process or gaps in activity. To compensate for weaknesses in the computer system, management relies on other tools to track the status of guidance projects.

When Notice 2007-17 was issued, it received attention from Congress and the media, both of which raised concerns about the influence of special interest groups in the IRS' published guidance program. We believe the pilot program explained in Notice 2007-17 does not present an increased risk of influence by special interest groups in the selection of guidance projects. The pilot program did not directly create tax guidance or circumvent existing internal controls. In our opinion, the pilot program resulted in increased public awareness. However, Counsel could have difficulty objectively evaluating the overall success of the pilot program because it does not have an adequate baseline against which to compare the results.

² Counsel's 2006-2007 business year began July 1, 2006, and ended June 30, 2007.



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Recommendations

We recommended the Chief Counsel expand written organizational procedures for developing and monitoring the guidance business plan, issue more frequent updates to and establish a reasonable expectation in the Priority Guidance Plan, publish the annual solicitation notice for guidance suggestions on any Federal Government website readily available to the public, review and revise—if necessary—the written procedures for maintaining paper project files, ensure the new computer tracking system provides management with complete and accurate information necessary to monitor the guidance program, and develop written organizational procedures for the pilot program described in Notice 2007-17, including a methodology by which to evaluate the results if the process is continued.

Response

IRS management agreed with six of our recommendations and partially agreed with one recommendation. Counsel will revise its written procedures for the guidance process to include a discussion of the steps for developing and monitoring the Priority Guidance Plan. Counsel plans to revise its written procedures to support the internal business goals in the Priority Guidance Plan. Further, Counsel plans to publish the annual solicitation notice for guidance suggestions on a Federal Government web site readily available to the general public. Counsel will review, and if necessary revise, the written procedures for maintaining paper project files and provide employees with additional training materials on file maintenance and storage. In addition, Counsel will continue to improve the manner in which published guidance is tracked on the computer inventory system. Finally, Counsel plans to develop written procedures if the pilot program becomes part of the future guidance process. The Chief Counsel partially agreed to our recommendation to issue more frequent updates to the plan, by responding that Counsel will discuss with the Office of Tax Policy the issue of publishing more frequent updates to the Priority Guidance Plan and including long-term projects. Although Counsel provided an alternative corrective action, we believe the planned action will meet our requirements. Management's complete response to the draft report is included as Appendix VI.

Please contact me at (202) 622-6510 if you have questions or Nancy A. Nakamura, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.



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Abbreviations

| | |
|--------|---|
| FY | Fiscal Year |
| I.R.C. | Internal Revenue Code |
| IRS | Internal Revenue Service |
| OTP | The Department of the Treasury Office of Tax Policy |
| TIGTA | Treasury Inspector General for Tax Administration |



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Background

The Internal Revenue Service (IRS) mission is to provide America's taxpayers with top-quality service by helping them understand and meet their tax responsibilities and by applying the tax laws with integrity and fairness to all. At the heart of sound tax administration is the interpretation of tax laws. The mission of the IRS Office of Chief Counsel (Counsel) is to serve America's taxpayers fairly and with integrity by providing correct and impartial interpretation of the internal revenue laws and the highest quality legal advice and representation for the IRS. Counsel's primary means of providing interpretation of the internal revenue laws is its published guidance program, which is closely coordinated with the Department of the Treasury Office of Tax Policy (OTP).

Counsel conducts a variety of guidance projects that could result in publication of regulations, revenue rulings, revenue procedures, and notices, as follows:

- Regulations – guidance for new legislation and issues that arise with respect to existing Internal Revenue Code (I.R.C.) sections (e.g., a court decision that invalidates part of a regulation, a new financial product, or an abusive transaction).
- Revenue Rulings – official interpretations of the I.R.C.; related statutes; tax treaties; and regulations, as applied to a specific set of facts.
- Revenue Procedures – official statements of procedures that affect the rights or duties of taxpayers or other members of the public under the I.R.C., related statutes, tax treaties, and regulations or information that should be a matter of public knowledge.
- Notices – public pronouncements that may contain guidance that involves substantive interpretations of the I.R.C. or other provisions of the law.

Each year, Counsel creates a guidance business plan that identifies the most important taxpayer and tax administration issues needing clarification. The guidance business plan consists of three categories: the Priority Guidance Plan, ministerial rulings,¹ and Associate lists. The Priority Guidance Plan represents the largest portion and describes to the public the projects expected to be completed by the end of the guidance business year, which runs from July 1 to June 30.

Ministerial rulings are routine guidance published each year, including adjustments to Federal Government rate tables, interest rates, and bond factor amounts used in the I.R.C. Ministerial ruling projects are made public in an appendix to the Priority Guidance Plan.

¹ The Priority Guidance Plan is jointly announced by the OTP, the IRS Commissioner, and the IRS Chief Counsel. The 2007-2008 Priority Guidance Plan with the appendix for ministerial rulings can be found in the Electronic Reading Room of the IRS web site (IRS.gov).



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Additionally, projects on the Associate lists include those projects not expected to be completed during the current business year and projects involving sensitive transactions.² These projects are worked within the seven Associate Counsel offices.

Since the 2003-2004 business year, the allocation of projects among the 3 categories has remained fairly consistent: approximately 66 percent to Priority Guidance Plans, 15 percent to ministerial rulings, and 19 percent to the Associate lists. Table 1 shows the composition of the last four guidance business plans at the end of each business year.

Table 1: Composition of Guidance Business Plans

| Guidance Business Year (July 1 – June 30) | Total Projects for All Categories | Priority Guidance Plan | | Ministerial Rulings | | Associate Lists | |
|---|-----------------------------------|------------------------|---------------------|---------------------|---------------------|-----------------|---------------------|
| | | Projects | Percentage of Total | Projects | Percentage of Total | Projects | Percentage of Total |
| 2003-2004 | 527 | 351 | 66.6% | 81 | 15.4% | 95 | 18.0% |
| 2004-2005 | 484 | 325 | 67.1% | 70 | 14.5% | 89 | 18.4% |
| 2005-2006 | 452 | 293 | 64.8% | 66 | 14.6% | 93 | 20.6% |
| 2006-2007 | 468 | 316 | 67.5% | 69 | 14.7% | 83 | 17.7% |
| Averages | 483 | 321 | 66.5% | 72 | 14.9% | 90 | 18.6% |

Source: Evaluation of Counsel's guidance computer inventory system.

In Calendar Year 2006, Counsel issued a private letter ruling³ to a taxpayer because the Real Estate Mortgage Investment Conduit regulations⁴ did not specifically address certain situations for financial institutions that issued commercial loans. An industry association asked Counsel to consider updating the regulations. After this meeting, Counsel believed it would be beneficial to seek information from the public to enable Counsel to better understand certain tax situations and to determine whether it should issue published guidance. Counsel believed upfront public participation might enable it to develop guidance that otherwise would not be started. In addition, Counsel believed this process would help it use its staff resources more efficiently because some of the background research would be provided by the public.

² For an example of a sensitive transaction, see Transaction of Interest – Contribution of Successor Member Interest (Notice 2007-72), page 544 of Internal Revenue Bulletin 2007-36 (September 4, 2007).

³ A private letter ruling is a written determination issued to a taxpayer by Counsel that interprets and applies the tax laws to the taxpayer's specific set of facts. Written determinations without proprietary ("Official Use Only") information are made available to the public and can be found in the Electronic Reading Room of the IRS web site (IRS.gov). However, pursuant to 26 U.S.C. § 6110(k)(3), such items cannot be used or cited as precedent.

⁴ Treasury Regulation Section 1.860G-2 (February 11, 1993).



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In coordination with the OTP in Calendar Year 2006, Counsel launched a pilot program using the Real Estate Mortgage Investment Conduit regulations. The pilot program is described in Notice 2007-17,⁵ and Counsel advised us it has three basic steps: develop the concept and issue a notice to the public, evaluate the public submissions, and consider changes to the existing regulations.

Several news articles questioned this pilot program, including a *New York Times* article⁶ that stated the IRS is allowing tax lawyers and accountants who create tax shelters and exploit tax loopholes to take the lead in writing new tax laws. In a letter to the Treasury Inspector General for Tax Administration (TIGTA), the Senate Finance Committee expressed concern that the IRS may be putting special interests before the public's interest when developing published tax guidance. The Committee asked the TIGTA to review the IRS' published guidance program and the pilot program described in Notice 2007-17.

This review⁷ was performed at the Counsel offices in Washington, D.C., during the period June 2007 through January 2008. We also interviewed representatives from the IRS Large and Mid-Size Business Division, Small Business/Self-Employed Division, Tax Exempt and Government Entities Division, Wage and Investment Division, Office of Appeals, and Office of the National Taxpayer Advocate and representatives from the American Bar Association, the American Institute of Certified Public Accountants, and the Mortgage Bankers Association. In addition, we coordinated with the Treasury Office of Inspector General, which reviewed the process and related controls for developing tax guidance within the Department of the Treasury. The Treasury Office of Inspector General will be issuing a separate audit report.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

⁵ Modifications of Commercial Mortgage Loans Held by a REMIC (Notice 2007-17), page 748 of Internal Revenue Bulletin 2007-12 (March 19, 2007). REMIC = Real Estate Mortgage Investment Conduit.

⁶ Johnston, David Cay. I.R.S. Letting Tax Lawyers Write Rules. *The New York Times*, March 9, 2007.

⁷ Our review focused on the process and internal controls for the published guidance program and did not evaluate Counsel's decisions to use specific language within published tax guidance.



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Results of Review

During the 2006-2007 business year,⁸ Counsel intensified its focus to develop more tax guidance, including starting a pilot program to determine if guidance could be issued using fewer resources. We reviewed Counsel's process for identifying, prioritizing, and issuing various types of guidance. Counsel's internal controls should ensure that guidance projects are focused on interpreting tax laws and addressing internal and external customer needs. However, additional internal controls are needed to further strengthen the process, minimize risks, and increase public awareness.

For example, although Counsel considers ideas from a wide variety of sources when selecting guidance projects for its annual business plan, it can improve its written procedures to ensure that the most important issues are selected. In addition, Counsel does not track all open projects on its guidance business plan. While guidance projects are recorded on Counsel's computer inventory system, some projects are not included in the guidance business plan. As a result, these projects have an increased risk of untimely actions, less management oversight, and less public awareness.

In addition, Counsel needs to improve how it monitors projects after it has started working on them. When a published guidance project is assigned, a paper project file is established to provide a record of actions taken and to support decisions made during the development of the guidance. However, Counsel could not locate all of the files we requested, and some of the located files were missing information. Also, Counsel's computer information system is not a useful tool to monitor open projects. Counsel employees do not always enter information such as milestone dates. In addition, missing computer logic checks allow the input of inconsistent data, and summary reports are not used to manage the projects. As a result, management may not identify delays in the process or gaps in activity. To compensate for weaknesses in the computer system, management relies on other tools to track the status of guidance projects.

When Notice 2007-17 was issued, it received attention from Congress and the media, both of which raised concerns about the influence of special interest groups in the IRS' published guidance program. We believe the pilot program explained in Notice 2007-17 does not present an increased risk of influence by special interest groups in the selection of guidance projects. The pilot program did not directly create tax guidance or circumvent existing internal controls. In our opinion, the pilot program resulted in increased public awareness. However, Counsel could have difficulty objectively evaluating the overall success of the pilot program because it does not have an adequate baseline against which to compare the results.

⁸ Counsel's 2006-2007 business year began July 1, 2006, and ended June 30, 2007.



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More Controls and Accountability Are Needed for Creating and Monitoring the Guidance Business Plan

The process Counsel uses to develop and monitor its annual published guidance business plan does not provide assurance that the most important projects are selected or that management and the public are aware of all ongoing projects. Specifically, Counsel:

- Has few written procedures to request and evaluate suggestions for the guidance business plan.
- Provides limited public information about the planned guidance projects.
- Provides limited public information about suggestions received for guidance consideration.

These conditions increase the risk that taxpayers will not properly comply with tax obligations and that the IRS may improperly interpret the tax code as part of its tax administration responsibilities. In addition, the public may be unaware that Counsel is developing guidance and may not have the opportunity to provide relevant information. Further, Counsel could strengthen its guidance process if it implemented a methodology to document the merits of suggestions from the IRS and the public when it considers projects for the business plan.

Counsel has few written procedures to request and evaluate suggestions for the guidance business plan

Although Counsel follows a process to request and evaluate suggestions, it has few written organizational procedures to ensure consistency and clarity. Furthermore, Counsel relies on the personal judgment of officials from Counsel, the Department of the Treasury, and other IRS divisions to prioritize suggestions. This subjective process could make it difficult for Counsel to explain how it decided to initiate a specific guidance project, particularly if the project(s) appears to benefit a small group of taxpayers.

The guidance business plan should address the most important taxpayer and tax administration issues. For example, Counsel includes guidance that is necessary because of recent legislation, such as changes to pension plans. Potential guidance suggestions can come from various internal and external sources⁹ and can involve various tax situations. Some issues may be suggested by multiple sources, which can commonly happen when new legislation is passed. Other suggestions may come from changing industry practices or tax court decisions.

⁹ Internal sources include employees within Counsel, IRS operations, and the Department of the Treasury. External sources include taxpayers, associations, trade groups, accounting/law firms, and other government agencies.



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In developing its 2007-2008 business plan,¹⁰ Counsel used formal and informal methods to request guidance suggestions and to explain that suggestions can be submitted any time. The common methods for requesting and encouraging guidance suggestions from the various sources included:

- Annual solicitation notice to the public.
- Reminder paragraph in the Priority Guidance Plans provided to the public, including subsequent updates also provided to the public.
- Public speeches and participation at public conferences, seminars, and panels.
- Discussions with external stakeholders involving guidance or other Counsel activity. This can include discussions at public hearings for published guidance.
- Annual reminder to IRS operations and their Division Counsels, and periodic meetings or other contact between IRS operations and Counsel personnel.
- Annual reminder to Counsel personnel and periodic meetings and coordination activities within Counsel and with Department of the Treasury personnel. Some offices have a template to record the information, but suggestions can also be informally communicated through the employee's management chain.

Associate Chief Counsel offices are responsible for initially evaluating and selecting new guidance suggestions, as well as projects already being worked within their assigned tax areas. Initial suggestions are then coordinated among Associate offices and discussed with the Deputy Chief Counsels, the Chief Counsel, and Department of the Treasury officials. Counsel and the OTP will then discuss and agree on the projects that will be included on the Priority Guidance Plan. Appendix IV presents an outline of the process Counsel used to evaluate suggestions for the 2007-2008 business plan.

IRS operations submitted 142 suggestions for the 2007-2008 guidance business plan, and Counsel incorporated 94 (66 percent). Counsel advised us that it cannot select every suggested project because it must balance what it can reasonably accomplish with its staff resources. In addition, Counsel advised us it often receives similar suggestions from different sources, so it may consolidate several suggestions into a single project. Table 2 shows the number of suggestions by each IRS operation and the number Counsel included in its 2007-2008 guidance business plan.

¹⁰ The 2007-2008 business plan began July 1, 2007, and will end June 30, 2008.



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Table 2: IRS Operations' Suggestions for the 2007-2008 Guidance Business Plan

| IRS Operation | Number of Suggestions Submitted | Number of Suggestions Included in the Guidance Business Plan | Percentage |
|---------------------------------------|---------------------------------|--|------------|
| Large and Mid-Size Business Division | 72 | 41 | 56.9% |
| Small Business/Self-Employed Division | 43 | 32 | 74.4% |
| Wage and Investment Division | 6 | 6 | 100.0% |
| Office of Appeals | 14 | 9 | 64.3% |
| National Taxpayer Advocate | 7 | 6 | 85.7% |
| TOTALS | 142 | 94 | 66.2% |

Source: Interviews with IRS operations personnel and applicable Division Counsels.

Because the process it uses for evaluating and selecting guidance projects is subjective, Counsel should establish written procedures for evaluating the projects it is considering and documenting its selection process. The written procedures for evaluating the projects should include suggested factors for determining priority, such as the number of taxpayers affected, recent tax law changes, stakeholders' concerns, revenues collected, critical or urgent need for guidance, etc. Written organizational procedures would help establish consistency and accountability and provide more assurance that the most important suggestions were selected.

Counsel provides limited public information about the planned guidance projects

When the annual guidance business plan is finalized, Counsel publishes one part of it, the Priority Guidance Plan, on the IRS web site (IRS.gov). This notification allows the public to be aware of the guidance projects Counsel intends to publish that plan year. It also gives the public the opportunity to provide input for consideration during the development of any particular guidance project.

However, some of Counsel's practices make it difficult for the public to obtain information about the guidance projects being worked during the guidance plan year. For example, some open projects are not included on the Priority Guidance Plan but are nevertheless worked by the Associate offices. This may be occurring because Counsel primarily includes on the Priority Guidance Plan only those projects expected to be published in the current business year. Projects initially expected to last beyond the plan year may not be placed on the Priority Guidance Plan until the guidance is issued. For example, in Fiscal Year (FY) 2006, 83 projects were not identified to the public until the guidance was published. Counsel advised us that some of the projects involved sensitive tax issues, such as abusive tax shelters, but others were discretionary projects.

We agree that those projects involving sensitive transactions should not be publicized in the Priority Guidance Plan. However, the projects that do not involve sensitive transactions should



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be disclosed to the public. Keeping these projects within Counsel's office until the guidance is published is not in line with Counsel's policy of developing and publishing guidance in a manner transparent to the public. As a result, there is less opportunity for public scrutiny and an increased risk of perceived undue influence in the selection of guidance projects.

Before 2004, Counsel updated the Priority Guidance Plan quarterly. A lack of resources required Counsel to start updating the Priority Guidance Plan only semiannually and to not provide a final list of the guidance projects published at each year's end. Because the Priority Guidance Plan does not include any projects that were added after the updated Plan was published, the public does not have access to current information about what guidance issues Counsel is considering or a complete list of the guidance that was published during the year. While we recognize the importance of identifying those projects that will be completed in 1 year on the Priority Guidance Plan, the public and the IRS may have an interest in other open projects.

Another Counsel practice results in different expectations between the Priority Guidance Plan and Counsel's internal business goal. For the Priority Guidance Plan, Counsel advises the public that the listed projects will be issued by the end of each guidance plan year (June 30). However, Counsel's business goal is to publish 76 percent of the projects on the Priority Guidance Plan. Table 3 shows the numbers and percentages of items published from the Priority Guidance Plan for the last 4 guidance business years. Last year, Counsel exceeded its business goal and published 97 percent of the projects from the 2006-2007 Priority Guidance Plan. However, Counsel did not meet its goal during the prior 3 years.¹¹ Counsel management advised us they focused greater attention in this area last year.

Table 3: Items Published Related to the Initial Priority Guidance Plan

| Guidance Business Year (July 1 – June 30) | Number of Items Listed on the Priority Guidance Plan | Number of Items Published From the Priority Guidance Plan | Percentage of Items Published |
|--|---|--|--------------------------------------|
| 2003-2004 | 385 | 283 | 73.5% |
| 2004-2005 | 349 | 211 | 60.5% |
| 2005-2006 | 254 | 161 | 63.4% |
| 2006-2007 | 264 | 255 | 96.6% |

Source: Counsel's Business Performance Reviews from December 10, 2004, to October 3, 2007.

Furthermore, not including projects on the guidance business plan can cause difficulty in assigning organizational accountability and accurately determining accomplishments. We analyzed Counsel's computer inventory system as of July 11, 2007, and identified 167 guidance projects¹² that were still in development (open) but not included in any category of the most

¹¹ Counsel's business goal was changed in 2005-2006, from a goal of 76 percent of the items on the final Priority Guidance Plan that included updates, to a goal of 76 percent of the items on the initial Priority Guidance Plan.

¹² This includes 62 regulation, 41 notice, 31 revenue procedure, and 33 revenue ruling projects.



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recent (2006-2007) guidance business plan. These projects were started in the last 4 business years and have been open an average of about 14 months.¹³

In addition, over the last 4 business years, 74 guidance projects¹⁴ have been published without having been listed in any category of a guidance business plan. Counsel does not have an accurate control list of the projects being worked. Counsel needs to develop a system to ensure that open projects are added to the guidance business plan regularly, so that the public is aware of the issues Counsel is considering before it publishes guidance. Because these open and closed projects were not on any guidance business plan, the public may be unaware that Counsel developed or is developing guidance on these issues. Furthermore, Counsel's business plan should contain all projects being worked to improve accountability for the timely completion of projects.

Counsel provides limited public information about suggestions received for guidance consideration

Counsel provides all guidance suggestions received from the public for business plan consideration to three tax news services¹⁵ that are available to anyone who subscribes to the news services. Although tax professionals we spoke with did not encounter problems obtaining this information because they subscribe to the tax news services, the general public may be unaware of these services.

Counsel has another option for requesting and providing public suggestions for new published guidance. For publishing regulation guidance, all Federal Government agencies were directed to begin using a centralized web site (Regulations.gov) that automatically attaches all public comments.¹⁶ Counsel already uses this centralized web site to publish its regulation guidance. However, the web site is not restricted to regulations, and Counsel could expand its use to include requests for public suggestions for new guidance projects. This option would be a more accessible, less expensive, and easier means of communication with the general public.

¹³ The projects range from being open 12 days to about 4 years, with an average of 189 staff hours applied (range from 1 staff hour to 1,421 staff hours).

¹⁴ This includes 3 regulation, 36 notice, 22 revenue procedure, and 13 revenue ruling projects.

¹⁵ Tax Analysts, Commerce Clearing House, and Bureau of National Affairs.

¹⁶ E-Government Act of 2002 (Public Law 107-347, 44 U.S.C. Ch 36).



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Recommendations

The Chief Counsel should:

Recommendation 1: Expand written organizational procedures for developing and monitoring the guidance business plan to establish accountability, ensure consistency, and increase public awareness. These procedures should address:

- Requesting and evaluating guidance suggestions for consideration in development of the guidance business plan.
- Reconciling all projects between the guidance business plan and the computer inventory system.

Management's Response: IRS management agreed with this recommendation. Management will revise the written procedures for the guidance process to include a discussion of the steps for developing and monitoring the Priority Guidance Plan. This includes the processes for soliciting and evaluating guidance suggestions and reporting on the annual business plan.

Recommendation 2: Issue more frequent updates to the Priority Guidance Plan that list all projects, excluding projects with sensitive transactions, regardless of whether the publication is expected for the current business year. For example, the Plan could also show in a separate attachment the long-term projects that are expected to take longer than 1 year to complete.

Management's Response: IRS management partially agreed with this recommendation. Management will discuss with the OTP the issue of publishing more frequent updates to the Priority Guidance Plan and including long-term projects. If agreed, changes will be made starting with the 2008-2009 Priority Guidance Plan.

Office of Audit Comment: Counsel provided an alternative corrective action to what we had proposed in Recommendation 2 because of the need to obtain the Department of the Treasury's agreement to any changes to the Priority Guidance Plan. We believe Counsel's planned action will meet our requirements.

Recommendation 3: Establish a reasonable expectation in the Priority Guidance Plan that matches internal business goals. This new process should be supported by written organizational procedures.

Management's Response: IRS management agreed with this recommendation. Management will revise written procedures to ensure that expectations in the Priority Guidance Plan are consistent with internal business goals.



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Recommendation 4: Publish the annual solicitation notice for guidance suggestions on any Federal Government website readily available to the public.

Management’s Response: IRS management agreed with this recommendation. Management will publish the annual solicitation notice for guidance suggestions on a Federal Government website readily available to the general public.

Counsel Has Produced More Guidance Projects, but Individual Guidance Projects Are Not Effectively Monitored

Counsel’s process for working individual guidance projects (researching, developing, and issuing guidance) includes extensive involvement with the Department of the Treasury, IRS divisions, and the public. This communication provides some assurance that published guidance projects address tax administration issues and meet internal and external customer needs. However, while Counsel’s internal controls are adequate to protect against influence from special interest groups during the development of guidance, Counsel still needs to strengthen its internal controls for managing guidance projects. For example, Counsel needs to improve how the paper project files are maintained because they provide the rationale and support for decisions Counsel makes during the development of guidance. In addition, Counsel needs an effective and efficient computer inventory system to alert management to potential problems and delays associated with publishing guidance.

Management monitoring of guidance projects has increased

Prior to FY 2006, Counsel published more than 300 guidance projects annually, while steadily improving efficiency by using fewer staff resources. In FY 2006, there was a significant decrease in the number of projects published and efficiency. This was noticeably reversed by FY 2007. Table 4 shows Counsel’s operational measures and an efficiency calculation for the published guidance program since FY 2003.

Table 4: Published Guidance Program Operational Measures

| Operational Measures | Actual for Fiscal Year | | | | |
|---|------------------------|------|------|------|------|
| | 2003 | 2004 | 2005 | 2006 | 2007 |
| Total Full-Time Equivalents ¹⁷ | 247 | 217 | 202 | 192 | 179 |
| Total Published Guidance | 332 | 320 | 323 | 269 | 391 |
| Guidance per Full-Time Equivalent ¹⁸ | 1.34 | 1.47 | 1.60 | 1.40 | 2.18 |

Source: Counsel’s Business Performance Reviews from December 8, 2003, to December 13, 2007.

¹⁷ A measure of labor hours in which 1 Full-Time Equivalent is equal to 8 hours multiplied by the number of compensable days in a particular fiscal year. For FY 2007, 1 Full-Time Equivalent was equal to 2,080 staff hours.

¹⁸ TIGTA calculation; total published guidance divided by total Full-Time Equivalents.



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Counsel acknowledges it was able to report more published guidance because an improved computer inventory query allowed it to better identify completed projects. However, management also increased their attention and oversight for the published guidance program. For example, in FY 2007, Counsel established biweekly briefing sessions with each Associate office and biweekly joint briefings with the OTP to discuss the progress and coordination of guidance projects. In addition, Counsel established eight milestone dates to be reviewed during the biweekly briefings. This increased management attention is an important step in strengthening the published guidance program.

Internal controls are adequate to balance public influence

Counsel has solicited and unsolicited communication with public stakeholders during the development of guidance because it cannot work in isolation and may need background and research information from external stakeholders to draft equitable and practical guidance. Therefore, Counsel will always face the risk of influence by special interest groups that may compete with the best interest of the Federal Government and tax administration. Counsel must minimize this risk by maintaining strong internal controls that ensure all sides of a tax administration issue are considered when determining what guidance is issued.

Overall, Counsel has adequate internal controls in place to balance public influence. For example, there are controls over contact between Counsel and the public while the guidance is being developed, and the guidance is reviewed by several layers of management both within the IRS and Department of the Treasury before it is approved and published. We made this assessment through research of the process, review of a judgmental sample of 25 guidance projects, and discussions with Counsel, IRS operations, and public stakeholders. A description of Counsel's internal controls is presented in Appendix V.

Some paper project files could not be located and others were incomplete

Counsel's Internal Revenue Manual, last updated in Calendar Year 2004, outlines the process to develop tax guidance, including maintenance of a paper project file. When a published guidance project is assigned, a paper project file is established to provide a record of actions taken and to support decisions made during development of the guidance. Counsel's guidance Manual lists the contents of the project file, which should include applicable case history sheets, draft versions of the guidance documents, administrative memoranda and forms, coordination notes, circulation and review control sheets, and public communication.

We requested the paper project files for a sample of 25 completed guidance projects. However, Counsel could not locate 5 (20 percent) of the 25 cases we requested. Although some files may be missing because of the June 2006 flood of the IRS Headquarters building at 1111 Constitution Avenue, all files are subject to disaster recovery and retention requirements. In addition, the paper project files we received did not always contain expected items required by Counsel's guidance Manual. After contacting a drafting team member or other source, we were able to find



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some missing information or obtain some substitute information for our review. However, Counsel's inability to locate and maintain paper project files increases the risk that adequate support is not available to substantiate that the guidance process was properly followed and the rationale behind the guidance position is sound.

Some employees advised us the Manual was not helpful, and that they rely more on other personnel for directions. This word-of-mouth direction can result in inconsistently documented and maintained project files. The missing project files demonstrate a potential problem with the control and retention of closed projects. Counsel is planning a nationwide continuing legal education program in August 2008 that will provide an opportunity to coordinate the release of an updated guidance Manual and provide timely refresher training for guidance paper project file creation, maintenance, and storage.

The computer inventory system is not effectively used to monitor guidance projects

The Counsel Automated System Environment Management Information System controls inventory for all Counsel programs, including litigation, technical advice, private letter rulings, and published guidance.¹⁹ Although Counsel's computer inventory system should be the primary management tool with which to monitor development of guidance projects, it is not effective.

The computer inventory system did not contain complete or accurate data about the ongoing guidance projects. For example:

- The computer system is overly complex, with more than 50 status codes used to track projects at each stage in the guidance development process. However, most of these status codes are rarely used and may be unnecessary.
- In response to a previous TIGTA report,²⁰ Counsel established target and milestone dates. However, the corrective action did not allow management to effectively monitor the status of projects because the target and milestone dates were rarely entered. We determined that fewer than 4 percent of the 468 guidance projects on the 2006-2007 guidance business plan had some of these dates. In addition, the system does not have completion dates for these targets and milestones to evaluate accomplishments. Further, these dates are in a restricted computer data file, which is unavailable to many employees, including the drafting team. As a result, Counsel could not use the computer information to determine if the projects were on schedule.

¹⁹ This computer system contains specific data files for guidance project details, business plans, assignments, and time reporting.

²⁰ *Improvements to the Office of Chief Counsel's Published Guidance Process Would Enhance Guidance Provided to Taxpayers and the Internal Revenue Service* (Reference Number 2003-10-081, dated March 2003).



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- The system may generate unreliable data because of missing computer checks. We evaluated a computer extract and found several potential problems on the system. For example, the computer allows employees to charge time to closed projects, employees can have open assignments although their responsibilities have changed or they have separated from the organization, a project can be closed before the date on which the guidance was published, and closed projects can be listed as open on the system.
- Computer inventory reports are not helpful to management because they do not include necessary information, such as milestone and completion dates, with which to monitor the guidance program. In response, management is using manually prepared reports to monitor guidance projects.

The computer system is not programmed to identify situations requiring management attention. For example, the ability to identify gaps in activity for employee time was not used. Using a computer extract and a sample of 25 guidance projects, we identified 16 projects with at least 1 gap (ranging from 28 calendar days to approximately 2.5 years) in which no employees applied time to the project.

We could not identify specific causes or justifications for these gaps due to missing information on the computer system and in the project files. However, Counsel employees advised us that the gaps occurred for a variety of reasons, including:

- Changing work priorities.
- Waiting for approval to start the final regulation.
- Changing employee assignments.
- Waiting for approvals from the Chief Counsel, IRS operations, and Department of the Treasury offices to publish guidance.

Guidance projects can take a long time to complete. To publish guidance, the 25 projects in our sample took an average of about 1.9 years, ranging from 31 days to about 4.4 years. Management needs to be able to quickly identify delays in publishing guidance. Our results are similar to those in a 2007 Counsel task force report that recommended better data input, standards for data input, different formatting, and different fields to produce the desired management reports. Counsel has already started preliminary steps to develop a new computer tracking system for published guidance items.

Recommendations

The Chief Counsel should:

Recommendation 5: Review and revise, if necessary, the written procedures for maintaining paper project files to ensure there is adequate available support for the development of guidance.



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In addition, the Chief Counsel should provide employees with refresher training for guidance paper project file maintenance and storage.

Management's Response: IRS management agreed with this recommendation. Management will review and, if necessary, revise the written procedures for maintaining paper project files. Management will prepare and provide employees with additional training materials on file maintenance and storage.

Recommendation 6: Ensure the new computer tracking system provides management with complete and accurate information necessary to monitor the guidance program. Required data should be entered and available to applicable users, computer checks should be established for consistency, computer summary reports should be accurate and beneficial to management, and system capabilities should be used to identify situations for management attention. In addition, written organizational procedures for entering and monitoring computer data should be established.

Management's Response: IRS management agreed with this recommendation. Management will continue improving the manner in which published guidance is tracked on the computer inventory system and explore the possibility of securing a replacement system with the IRS Modernization and Information Technology Systems organization.

The Pilot Program Increased Public Awareness Without Creating Additional Risk, but Success Could Not Be Objectively Measured

During the pilot program explained in Notice 2007-17, Counsel took the extra, upfront step of requesting information from the general public before it began working on the guidance to be published. During traditional guidance projects, Counsel may contact stakeholders that it thinks have information about the subject, but it does not request information from the general public. By announcing its need for information publicly in the pilot program, Counsel increased the public's awareness of the process. Furthermore, the pilot program did not directly create tax guidance and did not replace the traditional guidance process. It is a preliminary research step to obtain information and determine if a guidance project should be started. The development of the pilot program and subsequent evaluation of public submissions employed the same internal controls to ensure that public influence remained as equitable as in the traditional guidance process.

Counsel intended the pilot program to increase the public's participation during the initial development of some guidance projects. Because interested parties would provide the background research, Counsel hoped the pilot program would allow it to develop tax guidance faster and with fewer resources. However, Counsel could have difficulty in objectively evaluating the overall success of the pilot program because it does not have an adequate baseline against which to compare the results.



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The pilot program ensured equitable public influence and increased public awareness

As stated earlier, development of guidance under the pilot program followed the traditional process with the same internal controls, including the participation, circulation, and approval by Counsel, IRS operations, and the OTP. In addition, the evaluation of public submissions and subsequent clarification meeting also involved multiple Federal Government parties: Counsel, IRS operations, and the OTP. Further, the pilot program appears to be a more transparent process and resulted in greater public awareness. Specifically:

- The pilot publicly announced that Counsel and the OTP were seeking information. Had the traditional process been used, the drafting team would have made direct contact with public stakeholders that they thought would be able to provide the information. The general public would not have been informed of the contact.
- Public stakeholders involved with the traditional guidance process advised us that the pilot program's research step involved no differences from the traditional process, except for providing an opportunity for public scrutiny of the process and a written outline for specific information needed by Counsel.
- Counsel provided the public submissions received from the pilot program to three tax news services²¹ for posting to their web sites, so the public could view all of the submissions.
- Attention by Congress and the media not only put the pilot program on notice that it would be watched but possibly alerted more of the public to the guidance process.

Counsel did not create written procedures for the pilot program because it was testing the process. Future guidance projects following a process similar to that of the pilot will have an increased chance for success if Counsel has specific procedures that explain how the process works. Written procedures will also ensure consistency and accountability in different projects. However, if Counsel decides to continue with this process, it should develop written organizational procedures based on the lessons learned during the pilot program and any additional test projects conducted during the pilot.

Counsel may have difficulty evaluating the success of the pilot program

Counsel stated it will attempt to evaluate the success of the pilot program after the related proposed regulation is published. Although Counsel has not yet determined a means to evaluate the pilot program, it will consider whether it accomplished the following:

²¹ Tax Analysts, Commerce Clearing House, and Bureau of National Affairs.



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- Allowed interested parties an opportunity to provide input through a process that was transparent to other interested parties and the general public.
- Identified previously unknown members of the public interested in the guidance.
- Produced a quality product in less time than the traditional guidance process.
- Reduced staff resources used by Counsel and the OTP in developing and publishing guidance.
- Addressed concerns of all interested parties in the proposed regulation and reduced the likelihood that significant issues will be raised before publication of the final regulation.

Although the pilot program showed greater public awareness, the test project did not clearly demonstrate greater public participation or identify previously unknown members of the public interested in the guidance. Counsel received three public submissions to Notice 2007-17. The primary participants were known by Counsel before the pilot program started. Consequently, the pilot program did not appear to have resulted in more parties submitting information. In addition, Counsel does not know whether direct contact with known participants during the traditional process would have revealed similar information.

Counsel may find it difficult to evaluate whether the pilot process helped to improve timeliness of guidance and efficient use of resources because Counsel has incomplete baseline information for comparison. Counsel will need to manually review past traditional projects for comparable information on completion time and resources. In addition, many of the benefits could be subjective, such as assessing the public concerns, responses, and comments to the proposed and final regulation process related to the pilot program. This evaluation is important but can be judgmental and incomplete if not compared to results of similar projects developed using the traditional process.

Recommendation

Recommendation 7: If the process described in Notice 2007-17 is to be continued on future potential guidance projects, the Chief Counsel should develop written organizational procedures for the process, including a methodology by which to evaluate the results.

Management's Response: IRS management agreed with this recommendation. Management will work a few additional projects under the pilot process. If the pilot program becomes part of the guidance process in the future, management will develop written procedures for the process, including a methodology by which to evaluate results.



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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to evaluate the Office of Chief Counsel (Counsel) process and related controls for developing tax guidance, including the pilot guidance program described in Notice 2007-17.¹ Our review focused on the process and internal controls for the publishing guidance program and did not evaluate Counsel's decisions to use specific language within published tax guidance.

Throughout this review, we interviewed and obtained documentation from Counsel personnel that included the Chief Counsel, Deputy Chief Counsels, Associate Chief Counsels, Deputy Associate Chief Counsels, Division Counsels, Special Counsels, attorneys, assistants, and analysts. We also interviewed and obtained documentation from representatives within IRS operations, including the Large and Mid-Size Business Division, the Small Business/Self-Employed Division, the Tax Exempt and Government Entities Division, the Wage and Investment Division, the Office of Appeals, and the Office of the National Taxpayer Advocate. In addition, we contacted a group of public stakeholders by interviewing representatives from the American Bar Association, the American Institute of Certified Public Accountants, and the Mortgage Bankers Association.

To accomplish our objective, we:

- I. Evaluated the traditional process and related internal controls for developing published tax guidance.
 - A. Interviewed Counsel personnel and reviewed their manual for the procedures used to develop the guidance business plan and specific tax guidance.
 - B. Interviewed Counsel personnel and reviewed supporting documentation to evaluate how guidance issues were requested, obtained, and selected for the 2007-2008 Priority Guidance Plan. This included interviews with representatives from IRS operations, their applicable Division Counsels, and public stakeholders for their involvement in and opinions of the process.
 - C. Determined whether Counsel is communicating or meeting with public stakeholders and whether the general public is adequately informed of such contacts. This included an evaluation of the process to notify the public when projects are selected

¹ Modifications of Commercial Mortgage Loans Held by a REMIC (Notice 2007-17), page 748 of Internal Revenue Bulletin 2007-12 (March 19, 2007). REMIC = Real Estate Mortgage Investment Conduit.



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- and finalized, review of a judgmental sample of 25 guidance projects² for contacts during the development of published guidance, and interviews with representatives from IRS operations and public stakeholders for their involvement in and opinions of the process.
- D. Evaluated the development of guidance projects for common barriers that impede the issuance of tax guidance and to determine whether there were deviations from the standard process that may indicate a bias or inequitable public influence.
1. Reviewed a judgmental sample of 25 guidance projects to determine possible impediments (e.g., coordination problems, gaps in activity, and delays). We also reviewed the sample to determine whether there were adequate internal controls, including management review and approvals to prevent inequitable public influence. This involved reviewing paper case files and electronic data on the computer inventory system and interviewing a drafting team member involved with each of the sample projects.
 2. Interviewed representatives from IRS operations and public stakeholders for possible impediments and indications of inequitable public influence on Counsel actions to publish tax guidance.
- E. Evaluated how Counsel monitors the published guidance program.
1. Reviewed Counsel's Business Performance Reviews from FYs 2003 through 2007 for project time and staff resources used to develop tax guidance.
 2. Interviewed Counsel personnel to determine their methods of monitoring guidance projects. We also reviewed Counsel task force results for previously identified problems with the monitoring of guidance projects.
 3. Reviewed the content and distribution of computer inventory system reports and other summary reports used by Counsel management to monitor guidance projects.
 4. Analyzed a computer extract from the Counsel Automated System Environment Management Information System for all guidance projects in open status or created after the beginning of the 2003-2004 business year (July 1, 2003). This included a review for reliability of data on the system, completeness of the

² Due to resource constraints, we selected a judgmental sample of guidance projects to ensure we obtained a variety of projects (five regulations with a previous temporary regulation, five regulations with a previous proposed regulation, five notices, five revenue procedures, and five revenue rulings) and included projects from each of the seven Associate Chief Counsel offices responsible for different sections of the I.R.C. The population identified from the Counsel Automated System Environment Management Information System included 293 guidance projects completed during the 2006-2007 business year that ended June 30, 2007.



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guidance business plan, indicators of possible delays in publishing guidance, and adequacy of identifying administrative processing errors. We validated the extract by performing specialized queries and comparing extracted data for 25 test guidance projects to computer system screen prints.

- II. Evaluated the pilot guidance program described in Notice 2007-17 and its possible effect on developing published tax guidance.
 - A. Interviewed Counsel personnel and reviewed supporting documentation to determine the reason the pilot program was created, how it operated, how public submissions were evaluated, and the factors/expectations Counsel used to evaluate the pilot's results.
 - B. Reviewed the Notice 2007-17 paper case file and electronic data on the computer inventory system to determine the extent of tax law that will be developed under the pilot program and whether future tax guidance will be similarly developed.
 - C. Evaluated Counsel's contacts with outside stakeholders before and after the submission deadline, the number of public submissions—including who provided each submission—and Counsel's final determination. This included interviews with Counsel personnel, representatives from IRS operations, and representatives from the Mortgage Bankers Association.
 - D. Interviewed Counsel personnel and reviewed supporting documentation to determine how the pilot program differs from the traditional process for developing tax guidance. This included interviews with representatives from IRS operations and public stakeholders.
 - E. Determined whether Counsel had controls in place for the pilot program, such as a review process to prevent the appearance of inequitable public influence. This included interviews with representatives from IRS operations and public stakeholders for their perception of Counsel's ability to prevent inequitable influence.

Internal Controls Methodology

Internal controls relate to the plans, methods, and procedures management uses 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 objectives: Parts 30 and 32 of the Chief Counsel Directives Manual and the July 18, 2001, Chief Counsel Business Rules Handbook. We reviewed these controls by interviewing Counsel personnel, IRS division management, and outside stakeholders affected by published guidance, analyzing a judgmental sample of closed published guidance projects, and reviewing Manual and interim guidance for procedures used to develop published guidance.



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Appendix II

Major Contributors to This Report

Nancy A. Nakamura, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs)
Carl L. Aley, Director
Diana M. Tengesdal, Acting Director
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John W. Baxter, Senior Auditor
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Appendix III

Report Distribution List

Acting Commissioner C
Office of the Commissioner – Attn: Acting Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Commissioner, Large and Mid-Size Business Division SE:LM
Commissioner, Small Business/Self-Employed Division SE:S
Commissioner, Tax Exempt and Government Entities Division SE:T
Commissioner, Wage and Investment Division SE:W
Chief, Appeals AP
Chief, Communications and Liaison CL
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluations and Risk Analysis RAS:O
Office of Internal Control OS:CFO:CPIC:IC
Audit Liaison: Chief Counsel CC



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Appendix IV

Office of Chief Counsel General Process to Evaluate Suggestions for the 2007-2008 Guidance Business Plan

- Internal and external suggestions for guidance projects were sent to the applicable Associate office(s). Associate offices coordinated their work if a suggestion involved multiple tax areas.
- Each Associate office screened the suggestions, combining similar suggestions and rejecting others if guidance was not the appropriate avenue with which to solve the issue. Examples of rejected suggestions include when legislative change was required or when the law was clear but clarification may be necessary by the IRS (e.g., clarifying tax form instructions). If applicable, rejected suggestions were forwarded to IRS operations for consideration.
- If necessary, the Office of Chief Counsel (Counsel) contacted the Department of the Treasury, IRS operations, and/or external source(s) to clarify the suggestion or to obtain details from another source to determine if there was an alternative perspective.
- Each Associate office determined the number of carryover and mandatory projects expected for the coming business year. Mandatory projects can include requirements in which legislation specifies that Counsel will develop further guidance, new legislation with imminent enactment dates that need guidance, final regulations to replace temporary regulations that are set to expire, and ministerial rulings. In addition, each Associate office determined available staff resources for the coming business year, including the availability of Department of the Treasury personnel to assist with the guidance.
- Each Associate office initially selected new projects for the business plan as well as projects already being worked within its assigned tax areas. It considered new suggestions, old suggestions, research projects to be converted to a guidance project, and expected future legislation that will require guidance. Counsel also provided feedback and discussed with IRS operations the reasons it did not select some projects. Counsel has no quantifiable measuring process to prioritize suggestions. Each Associate office judgmentally ranked the suggestions based on factors such as how it promotes tax administration, how it affects taxpayers, uniform application of tax laws, and simplification of rules.
- After each Associate office made its initial selections, the projects were combined into a master list that was distributed among the Associate offices for review. This master list was



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discussed for related projects, resource requirements, and priority. If necessary, the master list was updated and redistributed.

- The master list was provided to the Deputy Chief Counsels and Chief Counsel for review and discussion.
- Counsel and the OTP discussed and agreed on the planned projects, including which projects would be included on the Priority Guidance Plan. Although this is the final step for developing the business plan, OTP personnel can be involved anywhere in the process that they or Counsel determine is necessary.



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Appendix V

Office of Chief Counsel Internal Controls for the Development of Published Guidance

- The Associate Chief Counsels are responsible for preparing published guidance and assigning an attorney and reviewer to a project. The OTP assigns an attorney-advisor to the project.
- Projects are discussed with higher levels of Counsel and OTP management. In FY 2007, Counsel established biweekly discussions for management to monitor progress and provide guidance.
- Both Counsel and OTP personnel are involved with public stakeholder contacts.
- Counsel discusses public stakeholders' information with the OTP and, if necessary, coordinates with IRS operations.
- Counsel does not discuss with public stakeholders how information will be used or the direction the guidance is taking during public contact (speeches, seminars, and panels) or during contact with a public stakeholder until after the guidance has been published.
- Contact with outside stakeholders is to be documented in the project file, which can be requested by the public under the Freedom of Information Act.¹ However, we determined the documentation and storage requirements for project files could be better enforced.
- Before being formally routed for approval, all draft guidance is circulated to Counsel offices, IRS operations, and the OTP. Comments or concerns raised at any level are shared with all parties and addressed before the draft guidance is forwarded for final approval.
- Formal routing for approval includes Counsel management (Branch, Associate, and Chief Counsel offices), the IRS Commissioner office, and Department of the Treasury offices.
- Approved guidance is provided to the public and may request comments from the public. All public written comments received by Counsel are made available, unedited, to the general public. In addition, there can be a public hearing before final regulation guidance is developed.

¹ 5 U.S.C. Section 552.



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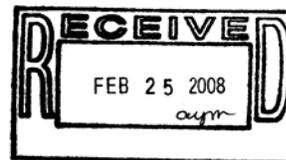
Appendix VI

Management's Response to the Draft Report



CHIEF COUNSEL

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



February 21, 2008

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Donald L. Korb
Chief Counsel
Internal Revenue Service

SUBJECT: Draft Audit Report – The Published Guidance Program Needs
Additional Controls to Minimize Risks and Increase Public
Awareness (Audit # 200710033)

Thank you for the opportunity to review and comment on your draft report, "The Published Guidance Program Needs Additional Controls to Minimize Risks and Increase Public Awareness." We are committed to having a robust published guidance program that addresses the needs of the agency and America's taxpayers with integrity and fairness to all. We, therefore, appreciate your acknowledgement of the accountability and internal controls in our program and our improved efficiency within the program. Also, as you state in your draft report, when Notice 2007-17 was issued, it received attention from Congress and the media, who raised concerns about the influence of special interest groups in the IRS' published guidance program. Thus, we appreciate your acknowledgement that the pilot program announced in Notice 2007-17 did not increase the risk of influence by special interest groups in the selection or preparation of guidance projects.

That said, the greater attention that management gave the Priority Guidance Plan for 2006-2007 permitted us to identify areas of weakness within our program, including the manner in which we track guidance projects on our computer inventory system. Accordingly, even before you had conducted your audit, we were working on improving the existing system and considering the possibility of securing a replacement system. We also acknowledge that our written procedures for developing and monitoring the Priority Guidance Plan can be expanded and that we may be able to increase public awareness of the guidance solicitation process by publishing the annual solicitation request on a Federal web site available to the general public. Thus, we generally concur with your recommendations. Specific responses to each of your recommendations are provided in the attached document.

If you have any questions or need additional information, please contact me or Clarissa Potter, Deputy Chief Counsel (Technical) at 202-622-3300.

Attachment



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Attachment

RECOMMENDATION 1

The Chief Counsel should expand its written organizational procedures for developing and monitoring the guidance business plan to establish accountability, ensure consistency, and increase public awareness. These procedures should include:

- Requesting and evaluating guidance suggestions for consideration in development of the guidance business plan.
- Reconciling all projects between the guidance business plan and the computer inventory system.

CORRECTIVE ACTION

We agree to revise our written procedures on the guidance process to include a discussion of the steps for developing and monitoring the Priority Guidance Plan, including the processes for soliciting and evaluating guidance suggestions and reporting on the annual business plan.

IMPLEMENTATION DATE

The revision should be completed and published in the Chief Counsel Directives Manual on or before January 1, 2009.

RESPONSIBLE OFFICIAL

Associate Chief Counsel (Procedure & Administration)

CORRECTIVE ACTION MONITORING PLAN

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

RECOMMENDATION 2

The Chief Counsel should issue more frequent updates to the Priority Guidance Plan that list all projects, excluding projects with sensitive transactions, regardless of whether or not the publication is expected for the current business year. For example, the Plan could also show in a separate attachment, the long-term projects that are expected to take longer than one year to complete.



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CORRECTIVE ACTION

We agree to discuss the issue of publishing more frequent updates to the Guidance Priority Plan and including long-term projects on the Guidance Priority Plan with the Office of Tax Policy. If, after these discussions, the Office of Tax Policy and our office concur that the publication of more frequent updates or the inclusion of long-term projects is warranted, we will make the appropriate changes to the Guidance Priority Plan for the 2008-2009 plan year.

IMPLEMENTATION DATE

We will have our conversation with the Office of Tax Policy on or before April 1, 2008.

RESPONSIBLE OFFICIAL

Deputy Chief Counsel (Technical)

CORRECTIVE ACTION MONITORING PLAN

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

RECOMMENDATION 3

The Chief Counsel should establish a reasonable expectation in the Priority Guidance Plan that matches internal business goals. This new process should be supported by written organizational procedures.

CORRECTIVE ACTION

The expectations in the Priority Guidance Plan should be consistent with our internal business goals. We agree that these expectations should be supported by our written procedures on the guidance process.

IMPLEMENTATION DATE

We will revise the Chief Counsel Directives Manual to support our expectations for the Priority Guidance Plan on or before January 1, 2009.

RESPONSIBLE OFFICIALS

Deputy Chief Counsel (Technical) and Associate Chief Counsel (Procedure & Administration)



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CORRECTIVE ACTION MONITORING PLAN

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

RECOMMENDATION 4

The Chief Counsel should publish the annual solicitation notice for guidance suggestions on any Federal web site readily available to the public.

CORRECTIVE ACTION

We agree that the general public should have greater access to the annual solicitation notice for guidance suggestions. We, therefore, will publish the annual solicitation notice for guidance suggestions on a Federal web site readily available to the general public.

IMPLEMENTATION DATE

On or before June 1, 2008.

RESPONSIBLE OFFICIAL

Deputy Chief Counsel (Technical)

CORRECTIVE ACTION MONITORING PLAN

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

RECOMMENDATION 5

The Chief Counsel should review and revise, if necessary, the written procedures for maintaining paper project files, to ensure there is adequate available support for the development of guidance. In addition, the Chief Counsel should provide employees with refresher training for guidance paper project file maintenance and storage.

CORRECTIVE ACTION

We agree to review and, if necessary, revise our written procedures for maintaining paper project files. We also agree to prepare and provide our employees with additional training materials on file maintenance and storage.

IMPLEMENTATION DATE



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On or before October 1, 2008

RESPONSIBLE OFFICIALS

Associate Chief Counsel and Division Counsel

CORRECTIVE ACTION MONITORING PLAN

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

RECOMMENDATION 6

The Chief Counsel should ensure the new computer tracking system provides management with the complete and accurate information necessary to monitor the guidance program. Required data should be entered and available to applicable users, computer checks should be established for consistency, computer summary reports should be accurate and beneficial to management, and system capabilities should be used to identify situations for management attention. In addition, written organizational procedures for entering and monitoring computer data should be established.

CORRECTIVE ACTION

We agree that our system for tracking published guidance can be improved. As you know, we were already working on improving our process for tracking published guidance before you conducted your audit, and, during your audit, we began work on improving the manner in which published guidance is tracked on our computer inventory system. In addition, we are exploring the possibility of securing a replacement system with the IRS' Modernization and Information Technology Systems Organization.

IMPLEMENTATION DATE

On or before October 1, 2008.

RESPONSIBLE OFFICIAL

Associate Chief Counsel (Finance & Management)

CORRECTIVE ACTION MONITORING PLAN

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



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RECOMMENDATION 7

If the process described in Notice 2007-17 is to be continued on future potential guidance projects, the Chief Counsel should develop written organizational procedures for the process, including a methodology by which to evaluate the results.

CORRECTIVE ACTION

We are encouraged by the results of the pilot program described in Notice 2007-17, but a few additional projects are required before a decision can be reached on the future of this program in our guidance process. If, however, we determine that the program will become part of our guidance process, we agree to eventually develop written procedures, including a methodology by which to evaluate results, for the process.

IMPLEMENTATION DATE

On or before July 1, 2010

RESPONSIBLE OFFICIAL

Deputy Chief Counsel (Technical)

CORRECTIVE ACTION MONITORING PLAN

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