DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

December 1, 2000

The Honorable Richard K. Armey
Majority Leader
Washington, D.C. 20515

Dear Mr. Armey:

Thank you for the letter dated October 12, 2000, jointly signed by you and 4 of your colleagues. Enclosed is the Treasury Inspector General for Tax Administration's (TIGTA) input on the major challenges facing the Internal Revenue Service (IRS) management in Fiscal Year (FY) 2001. I am also enclosing the Annual Audit Plan for FY 2001 that reflects the planned audits and overall objectives for the year.

The challenges facing IRS management in FY 2001 have not changed substantially from last year. As the IRS implements the new organizational structure, it will continue to struggle with the challenges the TIGTA identified in prior years.

The one challenge from last year that has been removed for FY 2001 is Year 2000 Compliance. The Office of Audit issued three management advisory reports in December 1999 that addressed the IRS' Year 2000 efforts, and the IRS successfully transitioned its computer systems to deal with the century date change.

The TIGTA believes the major management challenges, in order of priority, facing the IRS in FY 2001 are:

- Modernization of the Internal Revenue Service
  - Organizational Restructuring
  - Technology Modernization
- Financial Management
- Security of the Internal Revenue Service's Information Systems
- Processing Returns and Implementing Tax Law Changes During the Tax Filing Season
- Customer Service and Tax Compliance Initiatives
- Providing Quality Customer Service Operations
- Revenue Protection - Minimizing Tax Filing Fraud
- Taxpayer Protection and Rights
- Implementation of the Government Performance and Results Act of 1993
- Impact of the Global Economy on Tax Administration

A summary of each issue, including comments on the progress the IRS has made toward resolving the challenge or the vulnerabilities the IRS continues to face in achieving results, is included where appropriate. Appendix I is a listing of the audit reports issued in FY 2000 that impacted the major management challenge areas. Appendix II is a listing of significant open audit recommendations.

If we can provide additional information, please contact me at (202) 622-6500, or your staff may contact Pamela J. Gardiner, Deputy Inspector General for Audit, at (202) 622-6510.

Sincerely,

/s/

David C. Williams
Inspector General

Enclosures

Major Management Challenges Facing the Internal Revenue Service

Fiscal Year 2001

MODERNIZATION OF THE INTERNAL REVENUE SERVICE

The Internal Revenue Service (IRS) Restructuring and Reform Act of 1998 (RRA 98) mandated a restructured IRS organization and revamped business practices. The mission of the new IRS is to provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

ORGANIZATIONAL RESTRUCTURING

On October 1, 2000, the IRS achieved its first milestone on the way to modernizing by putting into effect (or standing up) a new organizational structure that should ultimately serve taxpayers better and support the employees in an improved work environment. Major components of the new IRS follow.

- The Wage and Investment (W&I) Operating Division will serve approximately 116 million customers, including those who file jointly, accounting for 88 million returns with wage and investment income only.
- The Small Business/Self Employed (SB/SE) Operating Division will serve approximately 45 million taxpayers, including fully or partially self-employed individuals and small businesses.
- The Large and Mid-Size Business (LMSB) Operating Division will serve corporations, sub-chapter S corporations, and partnerships with assets greater than $5 million, who generally deal with the IRS continuously and pay approximately $460 billion annually in taxes.
- The Tax Exempt and Government Entities (TE/GE) Operating Division will serve over 3 million customers ranging from small local community organizations and municipalities to major universities, huge pension funds, state and local governments, Indian tribal governments, and complex tax-exempt bond deals.
- The Appeals Function Unit serves as the alternative dispute resolution forum for any taxpayer contesting an IRS compliance action.
- The Taxpayer Advocate Service Functional Unit assists taxpayers in resolving problems that have not been resolved through prior contacts with the IRS or cannot be resolved through normal systemic processes.

- The Communications and Liaison Functional Unit provides services to both internal and external customers, including the media, the Congress, tax professionals, the states, and IRS employees.
- The Criminal Investigation Functional Unit investigates potential criminal violations of the Internal Revenue Code and related financial crimes in a manner that fosters confidence in the tax system and compliance with the law.
- The Information Systems organization is responsible for meeting the IRS' information technology needs.
- The Business Systems Modernization Office is leading the IRS' acquisition and implementation of new technology and revamped business practices.
- The National Headquarters provides strategic leadership, identity, capabilities, coordination and capital to the agency.
- The Agency-Wide Shared Services provides the expertise and advice necessary to deliver shared services in the areas of procurement, equal opportunity and diversity, real estate, facilities, and personnel.

The Internal Revenue Service Has Made Progress Toward Resolving This Challenge

The standup of the new organizations was an important step in the modernization of the IRS. The Treasury Inspector General for Tax Administration's (TIGTA) audits of the LMSB and SB/SE standups show that transition plans and templates were prepared, a majority of the executive selections were made, information system workarounds were established, transitional space was arranged, Treasury Integrated Management Information System databases were validated, and training plans were established. Additional actions, however, were needed to minimize the inherent risks associated with implementing the TE/GE modernization vision, according to an audit of that Division's standup. An audit assessing the standup of the W&I Division is in process, and other audits around the reorganization are planned for FY 2001.

The Internal Revenue Service Continues to Face Risks in Resolving This Challenge

The standup of the new IRS is far from the last step in the modernization process. Modernizing the IRS is a long-term effort, with probably a decade remaining of updating technology, revamping business practices, and refining balanced measures of organizational performance. Risks will remain throughout the process.

Over the next 2 years, the 10 IRS Submission Processing Sites will trade off workloads. As of January 1, 2001, taxpayers that file individual returns in 12 states will start sending their returns to Submission Processing Sites in different cities. A similar redistribution of work will occur in the year 2002. The result will be that a larger portion of individual returns will go to eight Submission Processing Sites aligned with the W&I Division. The remaining two Submission Processing Sites will process returns for the other three IRS Divisions: SB/SE, LMSB, and TE/GE. During this process, the IRS needs to remain alert to potential breakdowns in controls.

The IRS also faces challenges in defining new customer bases and determining customer needs. In addition, the IRS will need to develop processes to measure its progress toward improving customer service. TIGTA audits will continue to assess the IRS' organizational restructuring, including issues around changes in work processes, controls over casework, and effect on taxpayers.

TECHNOLOGY MODERNIZATION

Modernization of the IRS' computer systems and security of taxpayer information have been major concerns over the past several years. For more than a decade, at a cost of $4 billion, the IRS has been attempting to modernize its antiquated tax systems. These early efforts fell far short of what is required to prepare the IRS for the next century.

Modernization of the IRS' technology is crucial to implementing the new business vision, espoused by the IRS Commissioner and the Congress, of providing world-class service to taxpayers. Key goals, such as 80 percent of tax returns being filed electronically by the year 2007 and significantly improving levels of service in answering taxpayers questions, are contingent on the development of new technology. While the development of new technology evolves, existing operations must continue, and improvements must be made to meet the needs of tax administration and demonstrate to taxpayers the IRS' commitment to improved service.

The Internal Revenue Service Has Made Progress Toward Resolving This Challenge

The IRS is still in the very early stages of the latest attempt at modernizing its information and computer systems. Even though this modernization effort is expected to last for up to 10 years, the IRS has taken some positive steps to resolve the challenge. Examples of steps taken include: creating the position of the Business Systems Modernization Executive, establishing the Business Systems Modernization Office to manage and oversee the systems modernization efforts, and establishing a governance structure to review and approve projects at various points in the Enterprise Life Cycle (ELC). The IRS has also entered into a contract with a consortium of technology and business service providers, led by a major integrator, which will enable the IRS to achieve its modernization goals. This contract is commonly referred to as the PRIME contract, and is worth up to $10 billion over a 15-year period.

The IRS has taken many positive strides towards improving its processes and abilities at managing large modernization projects. In addition to hiring executives and top managers from private industry to plan and oversee these projects, the IRS has hired outside contractors to assist in the projects' technical aspects. The IRS is also using a vendor obtained through the Federally Funded Research and Development Center to assist in overseeing the PRIME contract. The Modernization Blueprint has been updated to reflect new architecture standards and business requirements, and key processes such as the ELC are being implemented throughout the Information Systems organization. These actions are a good first step at correcting the problems that were widespread during the Tax Systems Modernization projects.

The Internal Revenue Service Continues to Face Risks in Resolving This Challenge

The IRS will continue to face risks throughout the life of its technology modernization projects, and the TIGTA will continue to assess the IRS' efforts. A recent audit highlighted some issues. The TIGTA reported that the oversight of the systems modernization effort has been hampered by the lack of a stable program management organization. Program management staffing needs have not been determined, roles and responsibilities are not yet clearly defined, and key processes, such as performance monitoring and risk management, need to be improved. As a result, the IRS scaled back or delayed delivery of several modernization initiatives. Some of these initiatives were intended to provide improved service to taxpayers in the 2001 Filing Season.

Another TIGTA review of the IRS' efforts to develop its enterprise architecture and update its Modernization Blueprint reported that many efforts are underway to develop architecture products for the planned September 2000 Blueprint update. However, the IRS must strengthen its processes to ensure that these architecture products meet its needs and that systems development projects follow the architecture guidance.

FINANCIAL MANAGEMENT

Financial management continues to be a concern. The IRS' financial systems still cannot produce the reliable information necessary to prepare financial statements in accordance with federal accounting standards.

The General Accounting Office (GAO) rendered an unqualified opinion on the IRS' Fiscal Year (FY) 1999 statement of custodial activities, but rendered a qualified opinion on the balance sheet due to insufficient evidence about the reliability of the components of net position. In addition, the GAO was unable to render opinions on the FY 1999 statements of net cost, changes in net position, budgetary resources, and financing. This was due to insufficient evidence about the IRS' fund balance with the Department of Treasury, property and equipment, accounts payable and net position, and the reliability of program costs and budgetary balances. The GAO also concluded that the IRS' financial management systems do not substantially comply with the requirements of the Federal Financial Management Improvement Act (FFMIA).[1]

The TIGTA also identified financial management weaknesses associated with the IRS' control and accountability over automated data processing (ADP) assets. The TIGTA reported that ADP property certifications should be verified, adequate resources should be dedicated to the implementation of the IRS' Single Point Inventory Function (SPIF), and SPIF operating procedures should address internally developed software and annual physical inventory issues.

The TIGTA's audit of the IRS' FFMIA remediation plan concluded that the plan did not fully comply with all FFMIA requirements. For example, the plan did not include or was not clear on all reported weaknesses, target dates were not always identified or exceeded the 3-year time frame without the Office of Management and Budget's concurrence, and resource commitments were not always identified or were unclear. As a result, the IRS cannot ensure that all financial management weaknesses are adequately and timely resolved.

The Internal Revenue Service Has Made Progress Toward Resolving This Challenge

The financial management operation has been a long-standing problem for the IRS, and improvements are still needed. However, the overall methodology used by the IRS to develop the required FFMIA remediation plan is reasonable and is consistent with the Department of the Treasury's standard template. The remedies that are included in the remediation plan appear to be sound and should directly address the reported weaknesses and provide long-term solutions.

The IRS has incorporated all GAO-reported financial management weaknesses in its FFMIA remediation plan. Further, the IRS agreed with all recommendations contained in the TIGTA reports and plans to implement corrective actions that should eliminate the reported weaknesses.

The IRS has taken steps to organize and staff its Chief Financial Office function, which previously contributed to several of the reported financial management issues. The IRS also has made progress in assuming some responsibilities for analyzing the financial classifications of receivables on the custodial side of its operation. In addition, the IRS has improved its monthly reconciliation of its fund balance with the Department of the Treasury, including suspense account balances on the administrative side of the operation.

The Chief Financial Officers Act of 1990, as expanded by the Government Management Reform Act of 1994, requires the Inspector General to audit

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[1] *IRS' Fiscal Year 1999 Financial Statements,* Report Reference # GAO/AIMD-00-76.

agency financial statements in accordance with generally accepted government auditing standards. In FY 2001, the GAO will again exercise its prerogative to conduct the financial statement audit of the IRS' FY 2000 statements.

SECURITY OF THE INTERNAL REVENUE SERVICE'S INFORMATION SYSTEMS

The IRS Commissioner has stated that protecting taxpayer information and the systems used to deliver services to taxpayers is key to the success of a customer-focused IRS. In the past, the security of taxpayer data has been an Achilles heel for the IRS, particularly in the area of unauthorized browsing of taxpayer records. The TIGTA has attempted to work with the IRS, recommending that the IRS computer systems have an audit trail capability and that the audit trails be actively reviewed.

As the primary revenue collector for the United States, the IRS is a target for both terrorists and hackers. This threat has increased over the last few years with more interconnectivity of systems. Disgruntled employees also represent a major threat, particularly with the turmoil the IRS is experiencing during its reorganization process.

The Internal Revenue Service Has Made Progress Toward Resolving This Challenge

TIGTA audit reports this year noted that only 10 percent of the IRS' sensitive systems have been certified as having the appropriate security controls. To correct this problem, the IRS now has plans in place to certify new systems before they are implemented and to certify existing systems. The IRS also has plans to improve virus protection and responded very favorably to the latest major virus attack. The IRS, however, needs to remain vigilant on virus controls and computer systems security.

The Internal Revenue Service Continues to Face Risks in Resolving This Challenge

Information security will be a continuous challenge to the IRS as long as computer systems exist. New security vulnerabilities are always being discovered as new technology and equipment are added. Access control weaknesses also continue to be a perennial problem for the IRS. In addition, most existing IRS computer systems do not have effective audit trail capability. The TIGTA will conduct extensive audits around computer security during FY 2001.

PROCESSING RETURNS AND IMPLEMENTING TAX LAW CHANGES DURING THE TAX FILING SEASON

The filing season impacts every American taxpayer and is, therefore, always a highly critical program for the IRS. Many programs, activities, and resources have to be planned and managed effectively for the filing season to be successful. For example, more than 250 computer-programming changes were required for the 2000 Filing Season. This was further complicated by the IRS' modernization efforts to update and replace its core tax processing systems.

The IRS experienced no significant processing problems from either tax law changes or the Y2K conversion during the 2000 Filing Season. The TIGTA, however, reported that the IRS needs to ensure critical programming changes for the filing season receive priority over other programming requests.

As part of the IRS' modernization and workload transition efforts, the IRS is undergoing a transition at processing centers whereby eight centers will process only individual tax returns, while two will process only business returns. This transition, which has far-reaching effects, will be phased in over a 2-year period beginning in January 2001.

Also beginning in January 2001, the IRS will be required to process electronic partnership returns (Forms 1065) and related Schedules K-1 for partnerships with more than 100 partners, under guidelines established by the Taxpayer Relief Act of 1997. IRS projects more than 10 million Schedules K-1 will be filed electronically each year for partnership returns.

The Internal Revenue Service Continues to Face Risks in Resolving This Challenge

Although the IRS had a successful Tax Year (TY) 2000 Filing Season, opportunities still exist to more effectively implement tax law changes. Audit reports issued during FY 2000 indicate the IRS still has not taken appropriate steps to implement computer programming to identify potential erroneous claims on tax returns related to legislative changes. The TIGTA's review showed the IRS allowed over $351 million in potentially unqualified claims for the child tax credit (CTC) and the additional child tax credit on over 750,000 tax returns for 1998 and 1999. These potentially unqualified credits were allowed because the IRS had postponed computer programming changes designed to validate the date of birth for the CTC every year since the CTC was authorized in 1998. According to the IRS, the programming was postponed due to higher priorities and limited programming resources.

In addition, the IRS faces challenges in ensuring telecommunications and system size will accommodate the new electronic filing requirements to ensure the accuracy and usability of information received and processed. The IRS had initially planned to validate all secondary Social Security Numbers (SSNs) processed during the 2000 filing season. However, the IRS determined that continued processing of these returns would overload the computer systems it uses to resolve errors. Therefore, the IRS approved computer-programming changes to bypass the validation based on the early volumes of returns received.

Furthermore, the IRS requested additional Congressional funding from the FY 2001 Staffing Tax Administration for Balance and Equity initiative by claiming the request would allow the IRS to match data from Schedule K-1 documents with income tax returns. Prior years' matching of partnership information has not occurred because of excessive bad information.

The IRS also needs additional procedural and organizational changes to further reduce tax form complexity and taxpayer burden. The IRS currently does not have a toll-free telephone number that would provide individual taxpayers with a convenient method to provide the IRS with tax form improvement comments. In addition, the IRS should strengthen the system of controls over the tax form development process to ensure compliance with federal internal control standards.

Other challenges facing the IRS include: resolving problems associated with managing Excess Collections Accounts, accurately processing gift tax payments and associated extensions to file gift tax returns, remedying inequitable taxpayer treatment caused by its estimated tax penalty assessment processes, and protecting taxpayer remittances received at Submission Processing Centers.

The Internal Revenue Service Has Made Progress Toward Resolving This Challenge

TY 2000 was successful despite woeful predictions around the ability of computer systems to deal with the century date change. The IRS accurately processed Corporation Income Tax returns after TY 2000 changes were made. In addition, the IRS processed most of the TY 1999 estate and gift tax returns in accordance with the provisions of the Taxpayer Relief Act of 1997, even though the IRS' processing procedures were not designed to identify and correct overpayments in tax for an estimated one percent of estate tax filers using outdated tax forms.

The IRS also effectively implemented a tax law provision included in the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 that disqualified certain taxpayers receiving rental/royalty income from the Earned Income Tax Credit. The IRS also implemented a process to post review cases impacted by specific legislative provisions and developed a process for implementing new legislation in the new, modernized IRS structure.

CUSTOMER SERVICE AND TAX COMPLIANCE INITIATIVES

The IRS has embarked on a course to re-engineer its business processes and technology to focus on providing world-class service to taxpayers. The theory is that the overall rate of voluntary compliance with the tax laws will increase if the IRS provides the right mix of education and support to taxpayers.

Revenue receipts processed by the IRS increased from $1.5 trillion in FY 1996 to $1.9 trillion in FY 1999. However, revenue collected as a result of compliance activity decreased by $5 billion and gross accounts receivable increased by $41 billion during this same period. IRS management and many stakeholders, including some members of the Congress, are concerned about the reduction in resources allocated to compliance activities and the related decrease in business results. To help address this issue, Treasury's FY 2001 budget submission includes a request for 2,800 new positions over the next 2 fiscal years. These additional resources will be dedicated to enforcing tax laws and improving service to taxpayers.

The IRS' prior Taxpayer Compliance Measurement Program was considered too intrusive and was cancelled. Currently, the IRS has no reliable method to measure voluntary compliance or the impact that increased customer service and decreased enforcement are having on voluntary compliance. The IRS needs to strengthen its enforcement capacity before voluntary compliance is severely eroded.

Decreased enforcement has also been attributed to IRS employees' concerns over the mandatory termination provision in Section 1203 of RRA 98.[2] To help address these concerns, the TIGTA has continued to brief the IRS staff on investigations related to Section 1203 violations. During the last six months of FY 2000, the TIGTA briefed over 2,200 employees of the TE/GE and SB/SE Divisions.

The Internal Revenue Service Continues to Face Risks in Resolving This Challenge

To properly balance customer service with compliance, the IRS must adequately staff the Customer Service functions and, at the same time, properly manage the Compliance resources and processes. The recruiting, hiring, training, and scheduling of Customer Service Representatives remain a challenge. The TIGTA also believes that some programs, e.g., the Substitute for Return (SFR) programs and research activities, can be better managed.

Many employees who normally examine tax returns or collect taxes were detailed to the Customer Service function to answer taxpayer questions and assist taxpayers in preparing their returns. Compliance resources detailed to

[2] Provisions in Section 1203 of RRA 98 provide for the mandatory termination of IRS employees for specific categories of employee misconduct.

the Customer Service function increased from 165 staff years in FY 1996 to 748 staff years in FY 1999. For the 2001 Filing Season, the SB/SE Division plans to cut 40 to 45 percent of the support that was provided to the Customer Service function last year. This, coupled with the plans to discontinue the customer service support provided by Automated Collection System employees, may result in a severe downturn in the IRS' customer service unless the IRS effectively recruits and trains Customer Service function employees.

The IRS could also decrease risks by managing compliance initiatives more effectively. For example, the IRS' oversight of the SFR process is fragmented and does not provide uniform policies and procedures to ensure equitable treatment of all taxpayers. In addition, IRS management does not gather the necessary information to be able to effectively manage and measure the SFR process. The IRS should improve its coordination among functions processing SFR accounts and develop a method to determine if the SFR process is achieving its intended results. This could improve the service provided to over 1 million taxpayers contacted by the IRS annually.

Also, the IRS does not have effective controls over its research activities and cannot quantify its value to tax administration. Although the IRS recently implemented some new procedures to better manage its compliance research program, it cannot accurately measure the cost-effectiveness or the impact of the information provided to its functional programs.

PROVIDING QUALITY CUSTOMER SERVICE OPERATIONS

The IRS has invested heavily in technology but has not significantly improved telephone service to taxpayers. In addition, the IRS was surprised by the dramatic increase in demand for its Tax Return Preparation Assistance. As a result, the challenge of providing a quality customer service operation remains a top management challenge facing the IRS.

The IRS centralized the management of the toll-free telephone system, invested in new technology, committed significant enforcement resources to answering telephones, and expanded the hours of operation in an effort to better serve taxpayers. Nevertheless, in 1999, the IRS did not provide an increased level of quality telephone service to taxpayers in an economical manner.

In addition, the IRS' performance in providing toll-free telephone service compares unfavorably with private sector organizations recognized as providing "world class" service. The level of service provided to taxpayers on the 3 main telephone lines declined from 73 percent in the prior-filing season to 51 percent in 1999, and almost 16 million more taxpayers received busy signals. Also, during the first 6 months of FY 1999, the accuracy of answers to tax law questions declined from 79 percent to 72 percent. For the same period, total labor costs increased by over $30 million from the prior fiscal year, even though 1.4 million fewer calls were answered. TIGTA's report on the review of the effectiveness of the toll-free telephone program during the 2000 Filing Season is pending.

The public's demand for tax return preparation service has increased dramatically during the past 2 years. During FY 1998, the IRS prepared about 650,000 tax returns for taxpayers. It prepared almost 900,000 tax returns for taxpayers during FY 1999 and, if early indicators of the pace of tax preparation continue, over 1 million tax returns may have been prepared during FY 2000.

The Internal Revenue Service Continues to Face Risks in Resolving This Challenge

As stated above, the IRS' quality of toll-free service declined during FY 1999 despite new technology, significant enforcement resources committed to answering telephones, and expanded hours of operation. Audit reports issued throughout FY 2000 indicate the IRS either has not taken steps to adequately provide quality toll-free customer service to taxpayers seeking assistance from the IRS, or actions taken to make improvements have not achieved their desired result. Examples of problems identified include:

- The Quality Review Database does not have proper controls in place to ensure the reliability of system generated quality measures.
- Only 31 percent of the February 2000 toll-free quality review sampling plan was achieved causing the statistical validity of the overall quality measure to be questionable.
- Adequate monitoring coverage of toll-free calls is not provided when telephone calls from taxpayers are generally at the highest.
- The Level of Service and Level of Access data for IRS toll-free calls are computed using complex manual computations and may not be reliable.
- The IRS could improve the use of its telephone system and the quality of its responses during taxpayers' initial contact by routing calls to other call sites instead of preparing written responses when computer systems are down.

Providing return preparation service may also be a challenge in the 2001 Filing Season. If the trend of increasing demand continues next year, the IRS may have difficulty satisfying the demand with timely service and additional resources will have to be added to the Tax Return Preparation Program. In last year's filing season, some offices were straining to provide timely service because of limitations of computer equipment, office space, and employees. With substantial increases in volume again next year, the challenge to provide quality customer service will continue.

REVENUE PROTECTION – MINIMIZING TAX FILING FRAUD

The IRS must continually seek opportunities to protect revenue and minimize tax-filing fraud in its programs and operations. In October 1999, the GAO reported the Earned Income Credit (EIC) as a high-risk area. The IRS then reported EIC filing fraud as a Federal Managers' Financial Integrity Act of 1982 (FMFIA)[3] material weakness. The IRS' weaknesses are in three primary areas: achieving full participation by eligible taxpayers; ensuring compliance through verification of taxpayers' eligibility; and, reducing inherent vulnerabilities (multiple use of dependent Social Security Numbers).

With respect to revenue protection, the TIGTA reported that the IRS should expand early intervention efforts nationwide to further reduce unreported estate executor commissions. This action could potentially result in an additional $2.6 million in taxes and interest over the next 5 years.

The Internal Revenue Service Has Made Progress Toward Resolving This Challenge

In August 2000, the IRS released its most recent EIC compliance study: *Compliance Estimates for Earned Income Tax Credit Claimed on 1997 Tax Returns*. This study is significant because it provides a starting point from which the IRS will be able to evaluate future IRS efforts. Moreover, it describes recently launched enforcement initiatives. The study's central finding is that of the estimated $30.3 billion in EIC claims, approximately $7.8 billion (25.6 percent) should not have been paid. The amount of overclaims before accounting for enforcement activities was approximately $9.3 billion (30.6 percent of the amount claimed). (The study did not include data relating to those who may have qualified for the credit, but failed to claim it.) These results indicate that due to IRS enforcement practices, $1.5 billion of EIC overclaims for TY 1997 were recovered or prevented from being paid. They also show that the IRS needs to continue to be innovative and aggressive in its compliance efforts.

The IRS has launched promising new initiatives as part of these efforts. For example, partnerships with the Department of Health and Human Services and the Social Security Administration will permit the IRS to cross-check information regarding how the child is related to the taxpayer, the age of the child, and whether the taxpayer is the child's custodial parent. Beginning in 2001, the IRS will check all secondary Social Security Numbers, in addition to primary and qualifying child Social Security Numbers, on EIC returns. The IRS will reject returns if the names and numbers do not match Social Security records. Another initiative that improves the detection and prevention of erroneous EIC claims before tax refunds are paid permits the IRS to deny EIC claims when a return is first received if the taxpayer's EIC claim was denied the previous year

[3] 31 U.S.C. §§ 1105-1106, 1113, and 3512 (1994).

and the taxpayer did not follow recertification requirements that were enacted in 1997.

The last initiative is aimed at educating paid preparers who file about 60 percent of all EIC returns. Last fall, the IRS initiated a large-scale, multi-year outreach program aimed at thousands of preparers who had prepared at least 100 EIC returns during the previous filing season. During visits to these preparers, IRS employees provided one-on-one instruction on EIC compliance and on the preparers' due diligence responsibilities. These and other outreach programs to state and local governments, faith-based organizations, community groups, business leaders, and low-income taxpayer advocates are continuing.

The Internal Revenue Service Continues to Face Risks in Resolving This Challenge

The IRS still faces significant challenges in the business tax return arena. Despite extensive IRS programs and efforts it has made to detect and stop fraudulent claims, relatively little effort has been made to systematically identify refund schemes involving business returns and associated credits. A few business schemes have been identified but it has generally been through labor intensive manual procedures. The IRS is concerned that fraudulent refund claims may be expanding to include business returns and that scheme perpetrators continue to develop new methods to defraud the system. The TIGTA is concerned that current controls may be by-passed and, as a result, has initiated a review in this area.

Significant information received by the IRS is not effectively used to identify business taxpayer fraud. For example, although the IRS receives employers' Form W-2 information from the Social Security Administration, the IRS has not focused its efforts to ensure the accurate reporting of employment tax information on Forms 941 by matching forms and identifying errors. The payment of employment taxes accounts for over $500 billion of the federal budget and is a large part of our voluntary tax system. Similarly, income derived from partnership returns (Forms 1065) and related Schedules K-1 is currently not matched to individual income tax returns for compliance purposes. The IRS is attempting to address these issues and has requested additional funding to do so.

In addition, the IRS reports that increased underreporting of withholding taxes by self-employed taxpayers contributes to the growing population of refund fraud cases. The TIGTA reported that the IRS could improve its identification of unreported self-employment taxes while tax returns are being processed, and that the IRS could assess and collect significant amounts of unreported self-employment taxes each year before tax refunds are issued to taxpayers.

TAXPAYER PROTECTION AND RIGHTS

The legislative changes required by the RRA 98 continue to have a profound impact on the IRS. Most RRA 98 provisions, including massive training programs for thousands of IRS employees, have been modified or implemented. The IRS plans to test these reforms over the next 2 years. During this time, significant management attention will be required to evaluate the effectiveness of the reforms.

The TIGTA also protects taxpayers and their rights by investigating allegations of misconduct by IRS employees. Section 1203 of the RRA 98 provides for the mandatory termination of IRS employees for specific categories of employee misconduct. Some of the misconduct includes: violation of Constitutional or civil rights of taxpayers or IRS employees; intentional misconduct involving a taxpayer matter; threatening taxpayers with an audit; or willful understatement by an employee of his or her own federal tax liability.

The Internal Revenue Service Has Made Progress Toward Resolving This Challenge

The TIGTA has reported improvement in the IRS' compliance with many RRA 98 provisions. However, the degree of improvement often could not be quantified because strict comparisons between the 2 years could not be drawn. One area of improved compliance involved seizures. The TIGTA reported that the IRS complied with the specific Internal Revenue Code provisions and its own guidelines for all seizure cases reviewed. In addition, the IRS complied with RRA 98 provisions for all district office levies issued and for 99 percent of the Customer Service Automated Collection System call site levies reviewed.

The Internal Revenue Service Continues to Face Risks in Resolving This Challenge

Some RRA 98 provisions need continued monitoring because the IRS is not yet in full compliance. These include restricting the use of enforcement statistics to evaluate IRS employees, not designating taxpayers as illegal tax protesters, providing proper and timely notice that a federal tax lien has been filed, and not improperly withholding information in response to taxpayers' written requests for information under the Freedom of Information Act (FOIA) of 1988[4] or the Privacy Act (PA) of 1974[5].

The TIGTA is required to annually review the IRS' compliance with some RRA 98 provisions. The TIGTA has completed its second series of statutory reviews. A summary of the reviews is included in Appendix III.

[4] 5 U.S.C. § 552 (1996).
[5] 5 U.S.C. § 552a (1996).

IMPLEMENTATION OF THE GOVERNMENT PERFORMANCE AND RESULTS ACT OF 1993

The Government Performance and Results Act (GPRA) of 1993 requires government agencies to set goals, measure performance, and report on accomplishments. Within the last two years, the IRS has developed an "interim" Strategic Plan, and consistently provides budget justifications, which include the Annual Performance Plan(s). Collectively, these documents satisfy major requirements of the GPRA by identifying the IRS' mission, strategic objectives, goals, and strategies to achieve those goals. The documents also describe the IRS' priorities for the next six years and the key performance indicators (measures) used in assessing achievement of those goals.

The Internal Revenue Service Continues to Face Risks in Resolving This Challenge

The IRS Commissioner has indicated that it will take years to achieve a fully acceptable set of balanced measures that can be used at all levels of the organization. Due to the IRS' modernization efforts, the measures are being re-evaluated. While the IRS is implementing its new organizational structure and areas of responsibility are being re-defined, the IRS remains vulnerable to risks in this area.

The IRS has made some progress in implementing the GPRA. The IRS has recently revised its strategic planning, budgeting, and business review processes, and is updating the Strategic Plan. The Deputy Commissioner and Chief Financial Officer were designated the Servicewide GPRA executives. The Deputy Commissioner is responsible for the oversight and coordination of the Annual Program Performance Report, performance measurement, and any other issues which do not fall within a specific program or function. The Chief Financial Officer is responsible for the general oversight and coordination of the strategic planning and budgeting process, and development of the form and coordination of the IRS Strategic Plan and the Annual Program Performance Plan. Each Operating Unit executive is responsible for the overall implementation of GPRA for their respective programs or functions.

While the new operating units concentrate on implementing the new organizational structure, performance measures may not be a high priority. Based on our reviews to date, the TIGTA believes that the IRS can improve its measures, the data quality of its measures, and its reporting of annual accomplishments. In addition, the IRS agreed to some of the TIGTA recommendations to improve the data and reporting of customer satisfaction results and has recently committed to working with the vendors in addressing TIGTA concerns about sample methodologies and survey response rates. Also, more work can be done to address Congressional concerns with major management challenges.

IMPACT OF THE GLOBAL ECONOMY ON TAX ADMINISTRATION

The acceleration of world trade and e-commerce in the business world exceeds the government's capacity to administer taxes. In 1999, the United States (U.S.) exported over $1 trillion in goods and services and, at the same time imported over $1.3 trillion in goods and services. Foreign direct investment in the U.S. has grown from $50 billion in 1985 to $800 billion in 1999. Further, in the first half of 1998, 6,000 major corporations around the world merged with foreign entities for a value of a trillion dollars.

The GAO and the TIGTA have previously reported serious internal control and systemic weaknesses in the IRS' administration of its international programs. The IRS continues to struggle to increase compliance in an ever-growing international economy. Significant improvements are needed in international compliance programs to focus on nonfiling, transfers of assets by U.S. citizens to foreign trusts, foreign tax credit claims, and foreign-sourced income.

Corporate Tax Shelters often have international features that add to the complexity of the shelter structure. In the July 1999 Treasury White Paper entitled, *The Problem of Corporate Tax Shelters*, the Treasury presented the discussion on actions needed to combat abusive shelters. Estimated revenue loss attributable to abusive corporate tax shelters ranges between $6 billion and $10 billion per year. The IRS established the Office of Tax Shelter Analysis in July 2000. TIGTA has started an audit to determine the effectiveness of the IRS to combat abusive tax shelters.

The TIGTA is in the process of reviewing three areas of inbound and outbound transactions. The first project is the Withholding on Partnerships with Foreign Partners. The IRS estimates that there were approximately 36,000 partnerships with foreign partners in 1998. The income allocated to these foreign partners is in the billions of dollars each year. The second project is the Compliance Programs for United States residents with foreign-sourced income. From 1996 to 1998, foreign governments reported about $260 billion in foreign-sourced income paid to U.S. residents. The third project is the Compliance Program for Non-resident Alien Effectively Connected Income Withholding. In 1998 non-resident alien income exceeded $125 billion. The withholding rate for non-resident alien income has dropped from 2.75 percent in 1990 to 1.93 percent in 1998. New regulations are being implemented January 1, 2001.

The Internal Revenue Service Has Made Progress Toward Resolving This Challenge

The LMSB Division has made globalization a strategic initiative. The initiative is to build a tax administration system to effectively deal with the global economy. The Division is also improving the management information system for identifying specific case issues that were handled by international field specialists. In addition, the LMSB Division is providing Intranet access capability to increase the information available on international issues.

Challenge Area Removed from Major Management Challenges Facing the Internal Revenue Service

YEAR 2000 COMPLIANCE

One of the biggest FY 2000 concerns in the area of information technology was the effect the century date change (also known as Y2K) would have on agency systems. Virtually every aspect of tax administration could have been affected by the century date change since all the IRS functions rely to some degree on automated computer processes. The Y2K project cost approximately $1 billion and required the updating and testing of about 75,000 computer application programs, 1,400 minicomputers, over 100,000 desktop computers, over 80 mainframe computers, and data communications networks comprising more than 50,000 individual product components. It was imperative that all major tax-processing systems be Y2K-compliant to avoid processing shutdowns.

The IRS successfully transitioned its computer systems to deal with the century date change, and Year 2000 Compliance is no longer an issue. The TIGTA issued several reports on the Y2K area. The IRS agreed to our findings and recommendations, and took necessary actions to resolve any outstanding Y2K issues. A summary of the four TIGTA management advisory reports issued in FY 2000 identified the following risks and corrective actions:

Management Advisory Report: Various Risks Remain in the Year 2000 Conversion Effort for Personal Computer Systems
(Report Reference No. 2000-20-023, December 1999)

Although management of the personal computer conversion effort has improved, the IRS is facing various risks associated with conversion of personal computers and related systems. Additional attention and oversight of personal computer system conversion is needed through the end of the calendar year and into the Year 2000 to ensure that any problems resulting from these risks are quickly and effectively addressed.

Management Advisory Report: The Internal Revenue Service Took Actions to Correct Concerns Raised in Our Report on Computer Component Retirement Decisions for the Year 2000
(Report Reference No. 2000-20-019, December 1999)

Our review showed that IRS management has completed corrective actions designed to assure that computer components are properly retired. These actions were taken to address the three concerns we previously reported:

- Assure that decisions to retire computer components in the IRS' Systems Support Division are accurately reflected on the inventory system;
- Issue guidance for service centers scheduled to transfer retired computer components to the computing centers; and

- Require service centers to issue letters certifying that retired computer components were placed in archived or obsolete directories prior to their transfer to the computing centers.

Management Advisory Report: The Internal Revenue Service Has Made Significant Progress in Converting Minicomputer Systems for the Year 2000, But Risks Remain
(Report Reference No. 2000-20-024, December 1999)

The Tier II Risk Assessment Dashboard Report, which monitors conversion of minicomputer systems, now focuses on systems that have not yet been made Y2K compliant, and reports on their progress. The Independent Audit and Readiness Verification process was established to provide assurance that conversion activities are occurring as reported. Contingency planning has been ongoing and covers most IRS systems. However, late conversion dates and gaps in contingency planning result in continuing conversion risks for IRS minicomputer systems.

Management Advisory Report: Lessons the Internal Revenue Service Can Apply From Its Year 2000 Efforts to Improve the Management of Its Systems (Report Reference No. 2000-20-117, August 2000)

Although the Y2K conversion has been successfully completed, the IRS can still realize long-term benefits from this vast undertaking that cost approximately $1 billion. The IRS can preserve the resources, methodologies, and knowledge gained through the Y2K remediation efforts and deploy them in the future. There were a number of factors that contributed to the Y2K success, including effective project tracking, a standardized control structure, and the use of steering committees. The continued use of these management techniques can contribute significantly to the success of future IRS systems enhancement activities.

Appendix I

Listing of Audit Reports that Address the Challenge Areas

MODERNIZATION OF THE INTERNAL REVENUE SERVICE

ORGANIZATIONAL RESTRUCTURING

- *Management Advisory Report: The Large and Mid-Size Business Division Substantially Accomplished Organizational Stand-Up,* September 2000, Report Reference No. 2000-30-144
- *Management Advisory Report: The Small Business/Self -Employed Division Will Substantially Stand Up on October 1, 2000,* September 2000, Report Reference No. 2000-30-149
- *Additional Management Actions Are Needed to Ensure the Timely and Successful Modernization of the Tax Exempt and Government Entities Division*, Draft Report Issued October 11, 2000

TECHNOLOGY MODERNIZATION

- *Significant Risks Need to Be Addressed to Ensure Adequate Oversight of the Systems Modernization Effort,* June 2000, Report Reference No. 2000-20-099
- *Additional Actions Are Needed to Strengthen the Development and Enforcement of the Enterprise Architecture,* September 2000, Report Reference No. 2000-20-158

FINANCIAL MANAGEMENT

- *Improvements Are Needed to Ensure Control and Accountability Over Automated Data Processing Assets,* September 2000, Report Reference No. 2000-10-145
- *Improvements Are Needed in the Internal Revenue Service's Federal Financial Management Improvement Act Remediation Plan,* August 2000, Report Reference No. 2000-10-105

SECURITY OF THE INTERNAL REVENUE SERVICE'S INFORMATION SYSTEMS

- *The Internal Revenue Service Needs to Complete Disaster Recovery and Business Resumption Plans*, February 2000, Report Reference No. 2000-20-031
- *The Internal Revenue Service Can Improve Information Systems Physical Security,* February 2000, Report Reference No. 2000-20-039
- *The Internal Revenue Service Can Improve Software Based Access Controls to Enhance Security for Local Area Networks*, April 2000, Report Reference No. 2000-20-073

- *The General Controls Over a Critical Internal Revenue Service Tax Processing Computer System Can Be Strengthened*, May 2000, Report Reference No. 2000-20-072
- *The Internal Revenue Service Needs to Develop Security Policies for Local Area Networks*, May 2000, Report Reference No. 2000-20-074
- *Certifying the Security of IRS Computer Systems Is Still a Material Weakness*, June 2000, Report Reference No. 2000-20-092
- *A Comprehensive Program for Preventing and Detecting Computer Viruses Is Needed*, June 2000, Report Reference No. 2000-20-094
- *The Internal Revenue Service Should Improve Actions to Protect Its Critical Infrastructure*, June 2000, Report Reference No. 2000-20-097
- *Computer Security Controls Should Be Strengthened in the Houston District*, July 2000, Report Reference No. 2000-20-106
- *Security Over Taxpayer Data Used in Conducting Compliance Research Should Be Improved*, September 2000, Report Reference No. 2000-20-159

PROCESSING RETURNS AND IMPLEMENTING TAX LAW CHANGES DURING THE TAX FILING SEASON

- *The Internal Revenue Service Effectively Implemented a Tax Law that Disqualified Certain Taxpayers from the Earned Income Tax Credit*, May 2000, Report Reference No. 2000-30-076
- *Millions of Dollars in Internal Revenue Service Excess Collection Accounts Could be Credited to Taxpayers*, June 2000, Report Reference No. 2000-30-088
- *The Internal Revenue Service Processed Corporation Income Tax Returns Accurately After Year 2000 Changes Were Made*, July 2000, Report Reference No. 2000-30-107
- *The Internal Revenue Service Processed Most Estate and Gift Tax Returns Accurately, but Some Estates Did Not Receive the Maximum Tax Credits*, August 2000, Report Reference No. 2000-30-115
- *Estimated Tax Penalty Assessment Processes Create Significant Taxpayer Inequity*, August 2000, Report Reference No. 2000-30-112
- *Significant Improvements Are Needed in Processing Gift Tax Payments and Associated Extensions to File*, September 2000, Report Reference No. 2000-30-154
- *The Internal Revenue Service Should Take Additional Actions to Protect Taxpayer Remittances*, September 2000, Report Reference No. 2000-30-153
- *The Process of Developing Tax Forms for Individual Taxpayers Should Be Further Improved*, March 2000, Report Reference No. 2000-40-060
- *The Internal Revenue Service Could Enhance Its Process for Implementing New Tax Legislation*, March 2000, Report Reference No. Reference Number 2000-40-029
- *Taxpayers and the Internal Revenue Service Experienced Problems with Some New Tax Provisions*, March 2000, Report Reference No. 2000-40-045

- *The Internal Revenue Service's Process for Controlling Filing Season Computer Programming Changes Does Not Ensure Critical Changes Are Implemented*, May 2000, Report Reference No. 2000-40-069
- *The Integrated Submissions and Remittance Processing System Development Project Has Made Significant Progress, But Operating Risks Remain*, March 2000, Report Reference No. 2000-40-053
- *The Internal Revenue Service's Planning Process Needs Improving to Fully Resolve All Issues Affecting Tax Return Processing Activities,* March 2000, Report Reference No. 2000-40-054
- *The Internal Revenue Service Had a Successful 2000 Filing Season; However, Opportunities Exist to More Effectively Implement Tax Law Changes* Draft Report issued September 7, 2000. The IRS' response was due October 10, 2000; however, as of November 29, 2000, we had not received the response.

CUSTOMER SERVICE AND TAX COMPLIANCE INITIATIVES

- *The Internal Revenue Service Needs to Improve Its Coordinated Oversight of the Substitute for Return Program,* March 2000, Report Reference No. 2000-40-055
- *The Internal Revenue Service Needs to Improve Control of Its Compliance Research Program,* May 2000, Report Reference No. 2000-40-068
- *The Internal Revenue Service Can Improve the Estate Tax Collection Process,* March 2000, Report Reference No. 2000-30-059
- *Management Advisory Report: Evaluation of Reduction in the Internal Revenue Service's Compliance Activities,* May 2000, Report Reference No. 2000-30-075
- *The Internal Revenue Service Can Improve Treatment of Taxpayers During Examinations,* May 2000, Report Reference, No. 2000-30-077
- *Improvements Are Needed in Resolving In-Business Trust Fund Delinquencies to Prevent Tax Liabilities from Pyramiding,* August 2000, Report Reference No. 2000-30-111
- *The Internal Revenue Service Needs to Improve the Development and Management Oversight of the Collection Field Function Inventory Priorities,* August 2000, Report Reference No. 2000-30-128
- *Procedures for Installment Agreements With In-Business Taxpayers Need to Be Strengthened,* August 2000, Report Reference No. 2000-30-123
- *The Internal Revenue Service Should Strengthen System Controls and Reevaluate the Purpose of the Enforcement Revenue System* September 2000, Report Reference No. 2000-30-124
- *Improvements in the Quality Review Program of Large Corporate Examinations Are Needed to Demonstrate Its Effectiveness,* September 2000, Report Reference No. 2000-30-143
- *The Collection Quality Measurement System's Process Can be Enhanced,* September 2000, Report Reference No. 2000-30-161
- *Letter Report: Reliability Issues with the Coordinated Examination Information Management System,* September 2000, Report Reference No. 2000-30-135
- *Opportunities Exist to Improve Large Corporate Examination Results,* September 2000, Report Reference No. 2000-30-131

- *Opportunities Exist to Enhance the International Field Assistance Specialization Program,* September 2000, Report Reference No. 2000-30-130
- *Toll-Free Telephone Service Levels Declined in 1999 Despite Costly Efforts to Achieve World Class Performance,* March 2000, Report Reference No. 2000-30-062
- *Expanding the Electronic Tax Law Assistance Program,* August 2000, Report Reference No. 2000-30-120

PROVIDING QUALITY CUSTOMER SERVICE OPERATIONS

- *The Internal Revenue Service Effectively Implemented a Tax Law that Disqualified Certain Taxpayers from the Earned Income Tax Credit,* May 2000, Report Reference No. 2000-30-076
- *Toll-Free Telephone Service Levels Declined in 1999 Despite Costly Efforts to Achieve World Class Performance,* March 2000, Report Reference No. 2000-30-062
- *The Toll-Free Telephone Filing Season Planning Process is Adequate,* May 2000, Report Reference No. 2000-40-080
- *Customer Service's Quality Review System Does Not Provide Reliable and Accurate Quality Measurements of Its Toll-Free Telephone Service* **(Not Issued As of This Date)**
- *Effectiveness of the Toll-Free Telephone Program in Providing Quality Customer Service During the 2000 Filing Season* **(Not Issued As of This Date)**

REVENUE PROTECTION – MINIMIZING TAX FILING FRAUD

- *Management Advisory Report: Administration of the Earned Income Credit,* September 2000, Report Reference No. 2000-40-160
- *Opportunities Exist to Identify Unreported Taxes from Employer's Quarterly Federal Tax Returns*, September 2000, Report Reference No. 2000-30-146
- *The Internal Revenue Service Needs to Improve the Identification and Collection on Unreported Self-Employment Taxes,* September 2000, Report Reference No. 2000-30-151

TAXPAYER PROTECTION AND RIGHTS

- *Further Improvements Are Needed in Processes That Control and Report Misuse of Enforcement Statistics,* September 2000, Report Reference No. 2000-10-118
- *Letter Report: Improvements Have Been Implemented for Directly Contacting Taxpayers and Their Representatives*, September 2000, Report Reference No. 2000-10-132
- *Compliance With Requirements for Notifying Taxpayers of Federal Tax Lien Filings Has Not Yet Been Achieved,* September 2000, Report Reference No. 2000-10-152
- *The Internal Revenue Service Has Significantly Improved Compliance With Legal and Internal Guidelines When Seizing Taxpayers' Property,* August 2000, Report Reference No. 2000-10-114
- *The Internal Revenue Service Has Significantly Improved Its Compliance With Levy Requirements,* September 2000, Reference Number: 2000-10-150

- *Additional Action Is Needed to Eliminate Illegal Tax Protester Designations,* September 2000, Report Reference No. 2000-10-119
- *The Internal Revenue Service's Procedures for Responding to Written Requests for Collection Activity From Joint Return Filers Vary From Statutory Requirements,* September 1999, Report Reference No. 1999-10-077
- *Management Advisory Report: Reporting Taxpayer Complaints and Allegations of Employee Misconduct,* September 2000, Report Reference No. 2000-10-136
- *The Identification and Reporting of Potential Fair Debt Collection Practices Act Violations Can Be Improved,* August 2000, Report Reference No. 2000-10-109
- *Responses to Taxpayers' Requests for Information Did Not Always Comply With the Freedom of Information Act or Internal Revenue Service Procedures,* September 2000, , Report Reference No. 2000-10-147
- *Information Provided to Taxpayers When Requesting Extensions of the Assessment Statute of Limitations Can Be Improved,* September 2000, Report Reference No. 2000-10-142

IMPLEMENTATION OF THE GOVERNMENT PERFORMANCE AND RESULTS ACT OF 1993

- *The Internal Revenue Service Should Improve Its Process to Ensure That All Government Performance and Results Act Requirements Are Satisfied,* December 1999, Report Reference No. 2000-10-016
- *Letter Report: The Internal Revenue Service Should Improve Its Process to Ensure the Fiscal Year 1999 Performance Report Will Contain the Information Intended by the Congress,* March 2000, Report Reference No. 2000-10-061
- *Automated Collection System Customer Satisfaction Survey Results Should Be Qualified if Used for the GPRA,* May 2000, Report Reference No. 2000-10-078
- *Walk-In Customer Satisfaction Survey Results Should Be Qualified if Used for the GPRA*, May 2000, Report Reference No. 2000-10-079
- *GPRA: The Examination Division Should Ensure Proper Disclosure of the Sample Limitations Relating to Its Customer Satisfaction Measure,* May 2000, Report Reference No. 2000-10-082
- *GPRA: The Collection Division Should Ensure Proper Disclosure of the Sample Limitations Relating to Its Customer Satisfaction Measures,* June 2000, Report Reference No. 2000-10-100
- *Appeals Customer Satisfaction Survey Results Should Be Qualified if Used for the Government Performance and Results Act Requirements,* August 2000, Report Reference No. 2000-10-125
- *Toll-Free Customer Satisfaction Survey Results Should Be Qualified if Used for the Government Performance and Results Act,* September 2000, Report Reference No. 2000-10-137

IMPACT OF THE GLOBAL ECONOMY ON TAX ADMINISTRATION

- *Opportunities Exist to Enhance the International Field Assistance Specialization Program,* September 2000, Report Reference No. 2000-30-130

Appendix II

Significant Open Audit Recommendations[6] on Audits that Impacted Challenge Areas

(F = Finding Number, R = Recommendation Number, P = Plan Number)

MODERNIZATION OF THE INTERNAL REVENUE SERVICE

ORGANIZATIONAL RESTRUCTURING

None

TECHNOLOGY MODERNIZATION

The Security and Performance of Electronic Tax Return Processing Should Be Improved to Meet Future Goals*, June 2000, Report Reference No. 2000-20-095*

F-1, R-1, P-1. Evaluate the Electronic Management Systems' (EMS) performance capability to determine whether it can securely and timely process expected future volumes until the EMS completes transition to the modernized computer environment, and ensure that interim investment decisions include a cost and benefit analysis for relocating the Austin Service Center EMS computers to the Martinsburg Computing Center.

F-2, R-1, P-1. Develop and implement improved security standards and procedures for all tax return transmissions.

F-2, R-2, P-1. Integrate the improved procedures for the electronic transmission of tax returns from trading partners into the future IRS modernization architecture.

F-3, R-1, P-1. Ensure that the EMS computers properly control accesses from remote locations and procedures are established to manage and control access materials.

F-3, R-2, P-1. Ensure that EMS security administrators appropriately restrict access to sensitive information.

F-4, R-1, P-1. Ensure that EMS project management is improved by preparing and maintaining project management documents, including project and test plans, and strengthening oversight of the contractors' development and testing of future changes.

F-4, R-2, P-1. Assure that critical development or testing delays (e.g., computer program or equipment installation) that could affect tax processing are timely raised to the IRS Filing Season Readiness Executive Steering Committee for resolution.

[6] Significant audit recommendations as highlighted in the Treasury Inspector General for Tax Administration September 30, 2000, Semiannual Report to the Congress.

F-5, R-1, P-1. Ensure that the EMS disaster plan is completed and periodic recovery plan exercises are conducted.

Significant Risks Need to Be Addressed to Ensure Adequate Oversight of the Systems Modernization Effort, *June 2000, Report Reference No. 2000-20-099*

F-1, R-2, P-1. To ensure an effective Quality Assurance function, IRS management should provide for an independent Quality Assurance function within the approved Business Systems Modernization Office (BSMO) organizational structure.

F-1, R-3, P-1. To ensure an effective Quality Assurance function, IRS management should finalize and fully implement Quality Assurance policies and procedures throughout the organization.

F-2, R-1, P-1. To ensure that the Program Management Office (PMO) is adequately staffed and the personnel have proper training, IRS management should develop a staffing plan for the PMO that includes: A) The roles and responsibilities needed within each of the PMO division. B) The key skills needed to accomplish the PMO roles and responsibilities. C) The number of staff with key skills needed to accomplish the PMO roles and responsibilities. D) A plan for attaining and/or retaining needed PMO staff.

F-2, R-4, P-1. To ensure that the PMO is adequately staffed and the personnel have proper training, IRS management should develop a backup plan for key personnel that identifies: A) Key leadership and technical skills that are in short supply within the PMO based on the skills analysis. B) Methods for ensuring that these skills are always present when needed in the PMO.

F-2, R-5, P-1. To ensure that the PMO is adequately staffed and the personnel have proper training, IRS management should develop policies and procedures to regularly update the staffing plan, skills analysis, training plan, and backup plan for key personnel.

F-3, R-1, P-1. To ensure the IRS timely gathers and reviews needed performance monitoring information, IRS management should ensure that the approved PMO includes a single office responsible for developing policies and procedures to create a formal performance monitoring framework.

F-3, R-2, P-1. To improve the efficiency of the collection of performance monitoring data, IRS management should ensure that the MITRE Corporation timely completes the development and installation of an automated method for collecting and distributing project performance data.

F-3, R-3, P-1. To ensure that adequacy of the PRIME contractor's performance monitoring capabilities, IRS management should assess the PRIME contractor's processes to ensure that performance monitoring data being provided to the IRS are complete and accurate.

F-4, R-1, P-1. To ensure that risk management is fully implemented with the IRS, IRS management should implement and institutionalize PMO and project level risk management policies and procedures.

F-4, R-2, P-1. To ensure that risk management is fully implemented with the IRS, IRS management should enhance risk management capabilities, including providing training to personnel at the PMO and project levels, prior to initiating any high-risk projects.

***Actions to Correct Service Center Mainframe Consolidation Contract Administration Issues Have Not Been Completed, But Progress is Being Made**, September 2000, Report Reference No. 2000-20-140*

F-1, R-1, P-3. Ensure that all current delivery orders are completely definitized and future delivery orders are timely definitized.

FINANCIAL MANAGEMENT

***Improvements Are Needed to Ensure Control and Accountability over Automated Data Processing Assets**, September 2000, Report Reference No. 2000-10-145*

F-1, R-1, P-1. IRS management should take appropriate action on the recommendation to conduct quality reviews prior to forwarding the Automated Data Processing Property Certifications for final approval and certification to the Commissioner.

F-2, R-1, P-1. IRS senior executives should re-evaluate resource commitments needed to successfully implement the Single Point Inventory Function and elevate to the Deputy Commissioner Operations for resolution, any staffing shortages that imperil successful implementation.

F-3, R-1, P-1, P-2. The Asset Management Modernization Project Office Manager should ensure the Single Point Inventory Function Standard Operating Procedures are updated to include accountability and identification of internal use software and documentation for annual physical inventories.

SECURITY OF THE INTERNAL REVENUE SERVICE'S INFORMATION SYSTEMS

***Certifying the Security of Internal Revenue Computer Systems Is Still A Material Weakness**, June 2000, Report Reference No. 2000-20-092*

F-1, R-1, P-1. Place more emphasis on building security controls into new information systems.

F-1, R-2, P-1. Place additional emphasis on timely certification and accreditation for systems that have already been implemented.

F-1, R-3, P-1. Consider increasing the human resources within the IRS devoted to certifying and accrediting the security features of information systems.

F-1, R-4, P-1. Ensure that IRS' certification process includes follow-ups with the accrediting executives prior to the expiration of its systems security certification to ensure that they are aware that a new certification and accreditation is required.

F-1, R-5, P-1. Ensure that all functional executives for individual systems are fully aware of the overall certification and accreditation process.

F-1, R-6, P-1. Centralize the process for identifying and tracking of all information systems requiring certification and accreditation.

F-2, R-1, P-1. Ensure that IRS' certification process includes follow-ups with the accrediting executives to ensure that necessary information relevant to the official accreditation is provided and to educate them on the importance of providing this information.

A Comprehensive Program for Preventing and Detecting Computer Viruses Is Needed*, June 2000, Report Reference No. 2000-20-094*

F-1, R-1, P-1. IRS management should formally assign a senior official the responsibility for directing and overseeing the implementation and effectiveness of the IRS' virus prevention efforts.

F-2, R-1, P-1. Develop and implement IRS-wide procedures detailing the frequency and steps to be followed for reliably updating anti-virus software on both networked and portable notebook computers.

F-2, R-2, P-1. Establish controls for ensuring all updates have been successfully accomplished.

F-3, R-1, P-1. Develop a system for gathering information to help analyze and monitor the effectiveness of the program's virus detection and prevention activities.

F-4, R-1, P-1. Strengthen procedures for ensuring that employees comply with the Internal Revenue Manual requirements for preparing Virus Incident Reports.

F-5, R-1, P-1. Form a virus team and develop procedures for the various activities that need to be quickly coordinated and carried out when major virus outbreaks occur.

The Internal Revenue Service Should Improve Actions to Protect Its Critical Infrastructure, *June 2000, Report Reference No. 2000-20-097*

F-1, R-2, P-1. Ensure that vulnerabilities to all mission essential assets, including facilities, systems, applications, personnel, and data are assessed during future security reviews.

F-1, R-3, P-1. Develop a multi-year funding plan for reducing the vulnerabilities to mission essential assets.

F-1, R-4, P-1. Incorporate results of Presidential Decision Directive 63 efforts with security issues currently being tracked in strategic planning and performance measurement reports for the Government Performance and Results Act of 1993.

PROCESSING RETURNS AND IMPLEMENTING TAX LAW CHANGES DURING THE TAX FILING SEASON

Millions of Dollars in Internal Revenue Service Excess Collections Accounts Could Be Credited to Taxpayers*, June 2000, Report Reference No. 2000-30-088*

F-1, R-1, P-2. The Customer Service function should use the computer-matching techniques, developed by the Treasury Inspector General for Tax Administration, to identify and, where appropriate, transfer payments from the Excess Collections Accounts to the taxpayers' Masterfile accounts.

F-2, R-1, P-1, P-2, P-3, P-4. Coordinate education efforts for employees handling these accounts and develop strategies for increasing taxpayer and practitioner awareness of the law on the statute of limitations for refunding and crediting payments related to overdue tax returns.

F-2, R-2, P-1, P-2. Develop procedures for contacting taxpayers one last time prior to the statute of expiration date of payments in the Excess Collections Accounts and advise them of the possible forfeiture of payments if the necessary tax returns are not filed.

F-3, R-3, P-1. The IRS stakeholders should ensure that planned Tax Systems Modernization redesigns address-linking limitations between the Masterfile and the Excess Collections Accounts maintained by the ten service centers.

F-3, R-4, P-1, P-2. Pending implementation of systemic programming changes, the Chief Operations Officer should consider delaying the movement of payments from the taxpayers' Masterfile accounts to the Excess Collections Accounts until applicable statutory dates for refunding or crediting the overpayments expire.

Increased Attention Is Needed to Ensure Timely, Accurate Determinations on Innocent Spouse Claims for Relief*, May 2000, Report Reference No. 2000-40-063*

F-1, R-1, P-3. The IRS should set goals and standards for the Innocent Spouse Program.

F-1, R-2, P-3. The IRS should upgrade the current management information system and ensure that the system provides complete, accurate, timely, and useful feedback.

F-2, R-1, P-2. The IRS should design and implement a system of internal controls that addresses the quantity, cost, and timeliness of the Innocent Spouse Program to complement the existing internal controls over the quality of the Program.

Internal Revenue Service's Process for Controlling Filing Season Computer Programming Changes Does Not Ensure Critical Changes Are Effectively Implemented*, May 2000, Report Reference No. 2000-40-069*

F-2, R-1, P-3. Develop written criteria for prioritizing Request for Information Services (RIS) to ensure the RIS inventory is prioritized correctly for the filing season.

CUSTOMER SERVICE AND TAX COMPLIANCE INITIATIVES

***Improvements Are Needed in Resolving In-Business Trust Fund Delinquencies to Prevent Tax Liabilities from Pyramiding**, August 2000, Report Reference No. 2000-30-111*

F-1, R-1, P-1. Adopt quicker time frames for assigning in-business trust fund cases and contacting taxpayers.

F-2, R-1, P-1. Use all collection tools, including enforcement tools, and require the filing of monthly, rather than quarterly, returns.

F-2, R-2, P-1. Consider using paraprofessionals to help revenue officers perform less technical aspects of the job, such as monitoring Federal Tax Deposit payments.

F-2, R-4, P-1. Continue to emphasize, at the Commissioner and executive level, use of enforcement actions when necessary and management's support for employees when actions are appropriate.

F-2, R-5, P-1. Gather information on delinquent in-business trust fund taxpayers, such as the types of industries, and identify trends to pinpoint industry groups for education efforts.

***Expanding the Electronic Tax Law Assistance Program**,*
August 2000, Report Reference No. 2000-30-120

F-1, R-1, P-1. To meet its Electronic Tax Administration goals, the IRS needs to re-design the Electronic Tax Law Assistance (ETLA) program to leverage technology that will provide enhanced access to tax information, maximize efficiency, and improve electronic customer service.

F-2, R-1, P-1. To effectively administer the rapid growth of taxpayer demand, economically use resources, and design future enhancements of the program, the IRS needs to fully commit to the ETLA program by converting it from a long-term research project to a fully supported independent function.

F-3, R-1, P-1. Until there are technological changes and an organizational commitment, the IRS needs to delay the marketing of the ETLA program.

PROVIDING QUALITY CUSTOMER SERVICE OPERATIONS

None

REVENUE PROTECTION – MINIMIZING TAX FILING FRAUD

None

TAXPAYER PROTECTION AND RIGHTS

None

IMPLEMENTATION OF THE GOVERNMENT PERFORMANCE AND RESULTS ACT OF 1993

None

IMPACT OF THE GLOBAL ECONOMY ON TAX ADMINISTRATION

Opportunities Exist to Enhance the International Field Assistance Specialization Program*, September 2000, Report Reference No. 2000-30-130*

F-2, R-1, P-1. Improve the management information system by linking the International Field Assistance Specialization Program indicator to specific issues listed in the International Case Management System.

F-2, R-2, P-1. Ensure international examiners gain greater access to the IRS' Intranet so that the International Field Assistance Specialization Program (IFASP) can accumulate and disseminate more information electronically, including an electronic referral form for IFASP assistance.

Appendix III

TAXPAYER PROTECTION AND RIGHTS

Enforcement Statistics – Most employee evaluations and management documents did not contain tax enforcement results and did not impose production quotas and goals. However, there were some instances when records of tax enforcement results were used to evaluate employees or to impose or suggest production quotas or goals. In addition, employees were not always provided with or evaluated on the performance standard requiring the fair and equitable treatment of taxpayers.

Contacting Taxpayers – The TIGTA could not determine whether IRS employees complied with procedures when directly contacting taxpayers and their representatives because both the IRS and the TIGTA are still unable to readily identify cases for review. However, we did determine that the IRS has clarified procedures for employees to help protect taxpayers' rights during interviews. The IRS is also developing a taxpayer survey to monitor whether employees are complying with procedures for contacting taxpayers and representatives.

Liens – The TIGTA found that the IRS has improved its compliance with legal and internal guidelines for filing federal tax liens (FTLs), but it has not yet achieved full compliance with 26 U.S.C. § 6320 and its own internal guidelines. We also determined that quarterly compliance reviews implemented by the IRS do not evaluate compliance with IRS procedures for sending copies of Collection Due Process notices to the taxpayer's spouse, business partner, and/or representative. In addition, the compliance reviews do not determine if undeliverable notices are re-sent to other known addresses for the taxpayers.

Seizures – The TIGTA found that all actions taken by the IRS were in accordance with legal and internal guidelines for all cases reviewed. Additionally, the IRS advised us that the new specialist position for disposing of seized property was in place on July 22, 2000. We did identify one weakness in the IRS' procedures that can allow wrongful seizures to occur.

Levies – The TIGTA found the IRS has significantly improved its compliance with legal and internal guidelines to notify taxpayers of their appeal rights at least 30 days before levies are issued. However, we found that controls need to be improved so that internal records reflect levy actions that have been taken on taxpayers' accounts.

Taxpayer Designations – The TIGTA found that although IRS management took actions to prevent Illegal Tax Protester (ITP) designations, some actions were not properly performed. As a result, there were still instances when the ITP designation was used after the enactment of the RRA 98.

Joint Filer Notifications – The TIGTA found that the IRS procedures are different from the statutory requirements set out in 26 U.S.C. § 6103 (e)(8) (1986). This provision requires the IRS to send written responses to joint filer taxpayers or their representatives who request, in writing, collection information on their joint return liabilities, while the IRS' procedures allow the information to be provided orally. In addition, the IRS does not have a method to identify joint filer requests and responses. Therefore, the IRS cannot determine if it is in compliance with the provision, and cannot determine if IRS employees are protecting the taxpayers' right to receive written responses to their written requests for joint return collection information.

Complaints – The TIGTA found that the IRS has initiated planning to reduce the potential for duplicate complaints tracked on more than one system. In addition, the TIGTA Office of Investigations' complaint system has the ability to identify and eliminate duplicate information for those complaints received directly by the TIGTA.

Fair Debt – The process used to identify and report potential fair debt violations can be improved. For example, Collection Division management is not always effectively identifying employee actions as potential violations of the Fair Debt Collection Practices Act (FDCPA) when reporting these cases to the Labor Relations function for tracking on the Automated Labor and Employee Relations Tracking System (ALERTS). As a result, data captured on the ALERTS related to potential FDCPA violations might not always be complete and accurate.

Freedom of Information Act – The TIGTA found that the IRS disclosure offices could improve efforts to provide requesters with all the information they are entitled to in response to their written requests under the Freedom of Information Act (FOIA) (1988)[7], the Privacy Act (PA) of 1974,[8] and Internal Revenue Code (I.R.C.) § 6103. The IRS improperly withheld information that requesters were entitled to receive in 8.8 percent of the denied FOIA and PA requests and 6.3 percent of the denied I.R.C. § 6103 requests in our statistical samples. The types of requests that were improperly withheld by the IRS were similar to those included in our FY 1999 report.

Assessment Statutes – The TIGTA found that in most cases reviewed, examiners properly advised taxpayers of their right to refuse or restrict the scope of the statute extension. However, in some cases (5 percent of our sample) examiners did not indicate in case files whether taxpayers were advised of these rights.

[7] 5 U.S.C. § 552.
[8] 5 U.S.C. § 552a.