



*The Custodial Detail Database Should  
Help Improve Accountability; However,  
Significant Financial Management  
Issues Still Need to Be Addressed*

**December 2005**

**Reference Number: 2006-10-029**

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

December 30, 2005

**MEMORANDUM FOR CHIEF FINANCIAL OFFICER**

**FROM:**

*Michael R. Phillips*

Michael R. Phillips

Deputy Inspector General for Audit

**SUBJECT:**

Final Audit Report – The Custodial Detail Database Should Help Improve Accountability; However, Significant Financial Management Issues Still Need to Be Addressed (Audit # 200410039)

This report presents the results of our review to determine whether the Internal Revenue Service (IRS) has developed an effective plan to improve accountability over Federal tax revenues, and to ascertain whether applicable Federal financial accounting standards and requirements were addressed in any planned enhancements to the IRS' existing revenue accounting systems.

*Synopsis*

During Fiscal Year (FY) 2004, the IRS collected over \$2 trillion in Federal tax revenue, which constituted approximately 95 percent of all Federal revenue. However, as reported by the Government Accountability Office (GAO) for the last several years, the systems used to account for these revenues do not meet current Federal financial management guidelines. For example, the IRS' Federal tax revenue financial management systems lack adequate audit trails, cannot readily produce reliable information regarding unpaid assessments at interim periods, and cannot readily generate custodial financial information needed for year-end reporting.

To address these weaknesses, the IRS is currently in the process of developing the Custodial Detail Database (CDDDB). The purpose of the CDDDB is to provide sub-ledgers for the custodial financial activities of the IRS. The IRS also plans to use the CDDDB to track unpaid assessments throughout the year and to help support the lengthy extraction, reconciliation, and summarization process needed to produce the IRS' annual financial custodial statements.

Our preliminary assessment indicates the IRS faces a number of significant challenges in meeting these objectives, especially the development of a system that would support the production of current and reliable information regarding tax receivables throughout the year.



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Any system that the IRS develops to provide information regarding tax receivables at interim periods would need to address collectibility and accurately account for and eliminate duplicate assessments to be useful to end users and decision makers. For example, in FY 2004 the IRS estimated that only \$20 billion (22 percent) of the \$89 billion in gross Federal tax receivables in its records were reasonably collectible. Presently, the IRS only estimates the collectibility of tax receivables at year-end based on a detailed statistical analysis of unpaid assessments. Similarly, the IRS only identifies and accounts for duplicate compliance assessments in its source systems once per year through the expenditure of significant resources.

Although the CDDB should help improve custodial financial management, it will not by itself resolve all of the IRS' financial information-related internal control weaknesses. Specifically, the GAO reported in their most recent Financial Statement Audit Report,<sup>1</sup> that the IRS continues to be unable to determine the specific amount of revenue it actually collects for three of the Federal Government's four largest revenue sources—Social Security, hospital insurance, and individual income taxes. This is primarily because the accounting information needed to validate the taxpayer's liability and record the payment to the proper trust fund is provided on the tax return, which is received months after the payment is submitted. The IRS collected approximately \$1.7 trillion in individual income, Social Security, and hospital insurance taxes in FY 2004, but has to use statistical methods to estimate the amount of these taxes. The GAO also reported that the IRS continues to be unable to determine, at the time payments are received, collections for the Highway Trust Fund and other trust funds that receive excise tax receipts.

The IRS informed us that it plans to include the capability to accumulate additional data regarding revenue sources in the Customer Account Data Engine (CADE)<sup>2</sup> which is currently being developed. However, even with this enhanced ability to record revenue-related data the IRS will still not be able to fully determine the specific amount of revenue it actually collects for excise, individual income, Social Security, and hospital insurance taxes unless it requires taxpayers to provide more information at the time tax payments are made. The IRS studied the feasibility of collecting this additional information and decided in early 2003 to explore requiring employment tax filers to provide additional information at the time payments are made and to develop other potential solutions for gathering additional information regarding excise tax payments. The IRS did not, however, develop a detailed action plan or establish specific action items and expected completion dates in support of this approach. Overall, we found the IRS has not made significant progress in either requiring employment tax filers to provide additional information or developing potential solutions for gathering this information from excise tax filers since 2003.

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<sup>1</sup>*Financial Audit: IRS' Fiscal Years 2004 and 2003 Financial Statements* (GAO-05-103, dated November 2004).

<sup>2</sup> The CADE is an online modernized data infrastructure that will house taxpayer accounts and tax return data for more than 200 million individual and business taxpayers.



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In addition to developing the CDDB, the IRS recently prepared a crosswalk<sup>3</sup> that correlates its custodial general ledger accounts to the United States Standard General Ledger (USSGL) Chart of Accounts. Our review of the crosswalk indicated the IRS did not specify the source of the data, such as system names or account numbers, used to populate 18 required USSGL accounts. We reported this condition to the IRS on May 9, 2005, and it has already begun developing additional documentation in support of the 18 accounts. All Federal agencies are required to maintain their financial data in a manner consistent with the USSGL.

Finally, our review of the methodology the IRS uses to prepare its annual financial statements indicated that it currently relies on a series of complex data extractions from its detail taxpayer transaction records to identify and accumulate key revenue-related transactions. The IRS informed us that the CDDB will not eliminate this process but rather will provide a platform to help simplify and streamline the existing methodology. Our analysis of the IRS' FY 2005 extraction methodology identified several instances in which the extraction and compilation criteria were not consistent with the most current definition of the data fields being extracted. For example, the current extraction and compilation criteria incorrectly categorized financial transactions relating to potentially as many as 6,000 individual taxpayers as being business taxpayer related. We reported this condition to the IRS on June 10, 2005, and it advised us that it will adjust the data that has already been collected in preparation for the current financial reporting cycle, and revise the extraction criteria used for the next financial reporting cycle.

### *Recommendations*

The Chief Financial Officer (CFO) should develop a custodial interim reporting model in support of the CDDB. The model should address the methodology that will be used to calculate the collectibility of receivables and the presentation of this information in the IRS' custodial general ledger. The CFO should also coordinate the development of a detailed action plan including specific action items and expected completion dates in support of its efforts to 1) explore requiring employment tax filers to provide additional information at the time payments are made and 2) develop an approach for gathering this type of information from excise tax filers that does not involve an excessive burden on the taxpayer. In addition, the CFO should ensure the source financial systems and applicable subsidiary accounts used to populate all of the IRS' custodial general ledger accounts are clearly specified in its USSGL crosswalk. Finally, the CFO should develop procedures requiring a periodic review of the extraction and compilation criteria for consistency with current definitions of key data fields.

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<sup>3</sup> A crosswalk is a document which links two or more different classification systems.



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*Response*

The CFO agreed with the recommendations in the report. The CFO, through the Associate CFO for Revenue Financial Management, will evaluate prior reporting models to determine applicability and identify opportunities to improve the methodology. The Associate CFO for Revenue Financial Management, the appropriate IRS business owners, and other stakeholders will discuss ways to evaluate the information employment taxpayers are currently providing at the time of payment and alternative actions the IRS can take using the CDDDB. Options to acquire information from excise tax filers that do not involve an excessive burden on the taxpayer will also be explored and long-term plans will be developed for the CDDDB to capture enhanced revenue information from the CADE. Additional information regarding the IRS' custodial general ledger accounts will be included in the next revision of the applicable Internal Revenue Manual section. Finally, the extraction criteria will be reviewed for consistency with current Master File<sup>4</sup> processing each year. Management's complete response to the draft report is included as Appendix IV.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.

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<sup>4</sup> The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.



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## *Background*

Financial management in the Federal Government requires accountability of financial and program managers for financial results of actions taken, control over the Federal Government's financial resources, and protection of Federal assets. To meet these requirements, financial management systems must be in place to process and record financial events effectively and efficiently, and to provide complete, timely, reliable, and consistent information for decision makers and the public.<sup>1</sup>

Financial management within the Internal Revenue Service (IRS) is comprised of two primary components: custodial accounting and administrative accounting. Administrative accounting tracks and reports on salaries, rent, utilities, and other financial events related to the day-to-day operation of the IRS. Custodial accounting tracks and reports tax monies that are deposited into the Department of the Treasury's general fund and used to support overall United States governmental operations. Custodial accounting also tracks tax monies received for specific purposes that are transferred to other agencies or entities; for example, excise taxes and payroll taxes that constitute Social Security and Medicare payments.

During Fiscal Year (FY) 2004, the IRS collected over \$2 trillion in Federal tax revenue, which constituted approximately 95 percent of all Federal revenue. During this same period, the IRS also distributed approximately \$278 billion in Federal tax refunds. However, as reported by the Government Accountability Office (GAO) for the last several years,<sup>2</sup> the systems used to account for these revenues do not meet current Federal financial management guidelines. As a result, the IRS does not have the capacity to readily report on custodial operations throughout the year and has to annually expend significant resources to prepare reliable annual financial statements. To address these problems, the IRS has devoted significant resources over approximately the past 8 years to the development of the Custodial Accounting Project (CAP).

The CAP was designed to provide a comprehensive single, integrated data repository of financial management information related to taxpayer accounts and collection information. The CAP was also designed to support a large variety of financial performance information. Initially, over 190 potential users of the CAP financial performance information were identified.

However, the expected completion date and the developmental costs for the CAP greatly exceeded original estimates, and the IRS elected to cancel the CAP in FY 2005. In response to this, a new initiative with a significantly reduced scope, the Custodial Detail Database (CDDDB),

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<sup>1</sup> Office of Management and Budget Circular No. A-127, dated July 23, 1993.

<sup>2</sup> *Financial Audit: IRS' Fiscal Years 2004 and 2003 Financial Statements* (GAO-05-103, dated November 2004).  
*Financial Audit: IRS' Fiscal Years 2003 and 2002 Financial Statements* (GAO-04-126, dated November 2003).



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was designed. The CDDDB is designed to contain selected taxpayer and assessment data and will leverage the capabilities of other existing IRS systems to provide reporting capabilities. Query capabilities will be limited to selected Chief Financial Officer (CFO) personnel. A critical component of the CDDDB is the ability to trace all transactions in the database to their original source system. To accomplish this, the IRS plans to add a unique identifier for each financial event recorded in the CDDDB.

This review was performed at the Office of the CFO National Headquarters in Washington, D.C., and at the Andover Campus<sup>3</sup> during the period March through May 2005. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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<sup>3</sup> Campuses are the processing arm of the IRS. They process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.





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## *Results of Review*

### ***Detailed Plans Are Needed to Address Several Financial Management Issues***

The Federal Financial Management Improvement Act (FFMIA) of 1996<sup>4</sup> requires agencies to implement and maintain systems that substantially comply with Federal accounting standards and Federal financial management systems requirements. Specifically, agency financial systems must have the capability to capture, classify, process, store, and retrieve the financial data needed for their operations. Agency financial systems must also maintain adequate audit trails which support the transactions and balances maintained in the financial systems. For example, the systems must have the capability to trace transactions from their initial source through all stages of related system processing, summarization, and financial reporting. Agency financial systems must also provide complete, reliable, consistent, timely, and useful financial management information on operations. For financial information to be timely and useful, the financial systems must provide for ready access to the information they contain.

The GAO has repeatedly reported that the financial management systems the IRS uses to account for Federal tax revenues do not meet these requirements. In its most recent financial statement audit of the IRS, completed in November 2004, the GAO reported<sup>5</sup> the following ongoing weaknesses in the IRS' Federal tax revenue financial management systems:

- Inadequate audit trails and a lack of integration with supporting records.
- Inability to readily generate custodial financial information needed for year-end reporting.
- Inability to readily produce current and reliable information regarding unpaid assessments at interim periods.

To address these weaknesses, the IRS is currently in the process of developing the CDDDB. The purpose of the CDDDB is to provide sub-ledgers for the custodial activities of the IRS. These sub-ledgers are designed to provide an audit trail between the IRS' general ledger for custodial activities and the applicable detail transaction level information and support records.

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<sup>4</sup> Pub. L. No. 104-208, 110 Stat. 3009.

<sup>5</sup> *Financial Audit: IRS' Fiscal Years 2004 and 2003 Financial Statements* (GAO-05-103, dated November 2004).



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The IRS also plans to use the CDDDB to track unpaid assessments throughout the year and to help support the lengthy extraction, reconciliation, and summarization process needed to produce the IRS' annual financial custodial statements. The IRS plans to leverage the capabilities of other existing IRS systems to provide for reporting of information from the CDDDB, such as interim unpaid assessments.

The IRS' detailed plans for accomplishing these objectives are not yet sufficiently mature for us to evaluate this effort in detail. However, our preliminary assessment indicates the IRS faces a number of significant challenges in meeting these objectives, especially the development of a system that would support the production of current and reliable information regarding tax receivables throughout the year. For example, any system that the IRS develops to provide information regarding tax receivables at interim periods would need to address collectibility and accurately account for and eliminate duplicate assessments to be useful to end users and decision makers.

**Interim reporting of receivables needs to address collectibility**

At present, the IRS only estimates the collectibility of tax receivables at year-end based on a detailed statistical analysis of unpaid assessments. For example, in FY 2004 the IRS estimated that only \$20 billion (22 percent) of the \$89 billion in gross Federal tax receivables in its records were reasonably collectible. The IRS informed us that it is still in the process of developing a workable approach for determining collectible tax receivables on an interim basis, and has not developed detailed plans or a timetable. Also, the IRS has not yet determined how an interim calculation of collectible tax receivables would be recorded in its custodial general ledger. The IRS only added a provision for posting an allowance for doubtful accounts to its custodial general ledger this year, and has not yet developed procedures governing the periodic posting of data to this account.

**Duplicate assessments need to be reliably identified and reconciled on an ongoing basis**

Similarly, the IRS only identifies and accounts for duplicate assessments made in connection with the Trust Fund Recovery Penalty (TFRP)<sup>6</sup> Program once per year through the expenditure of significant resources. The reason this identification effort is so time consuming is the lack of reliable detailed information in the IRS' subsidiary records regarding individuals assessed this penalty. In FY 2004, the IRS identified that its source records included \$13 billion in duplicate assessments related to the TFRP. Accurate interim reporting would require that these duplicate assessments be reliably identified and accounted for on a more frequent basis. To address this

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<sup>6</sup> The TFRP Program is an enforcement tool the IRS uses to collect unpaid trust fund taxes. If a business taxpayer has failed to collect or pay trust fund taxes, the unpaid liability is assessed against the responsible officer(s). Although the IRS assesses this penalty on multiple taxpayers, these assessments represent only one liability. The IRS may collect the penalty from any combination of the business and related individual taxpayers.



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ongoing problem, the IRS plans to initially use the CDDDB to create a TFRP unpaid assessment database. The IRS informed us that the CDDDB TFRP database will allow it to identify inconsistencies in its subsidiary records relating to TFRP assessments for investigation and resolution on an ongoing basis throughout the year. We plan to begin a separate audit of the IRS' efforts to improve the reliability of its TFRP-related financial data in FY 2006.

**Other material financial information-related internal control weaknesses still need to be addressed**

Although the CDDDB should help improve custodial financial management, it will not by itself resolve all of the IRS' financial information-related internal control weaknesses. Specifically, the GAO reported in its most recent financial statement audit that the IRS continues to be unable to determine the specific amount of revenue it actually collects for three of the Federal Government's four largest revenue sources—Social Security, hospital insurance, and individual income taxes. This is primarily because the accounting information needed to validate the taxpayer's liability and record the payment to the proper trust fund is provided on the tax return, which is received months after the payment is submitted. The IRS collected \$1.696 trillion in individual income, Social Security, and hospital insurance taxes in FY 2004. However, to provide a further breakdown of these taxes, the IRS had to use statistical methods to estimate that \$990 billion was for individual income taxes, and \$706 billion was for Social Security and hospital insurance taxes.

The GAO has also reported that the IRS continues to be unable to determine, at the time payments are received, collections for the Highway Trust Fund and other trust funds that receive excise tax receipts. The IRS reported collecting \$55 billion in excise taxes in FY 2004. Currently, the annual excise tax receipts reported by recipient trust funds include 3 months of estimated receipts. The GAO concluded that this condition makes the Federal Government reliant on a complex, multi-step process to distribute excise taxes to the recipient trust funds that continues to be susceptible to error.

The IRS informed us that it plans to include the capability to accumulate additional data regarding revenue sources into the Customer Account Data Engine (CADE)<sup>7</sup> which is currently being implemented. However, even with this enhanced ability to record revenue-related data the IRS will still not be able to fully determine the specific amount of revenue it actually collects for excise, individual income, Social Security, and hospital insurance taxes unless it requires taxpayers to provide more information at the time tax payments are made. The IRS studied the feasibility of collecting the additional information it needs and concluded that in the case of individual income, Social Security, and hospital insurance taxes the burden on taxpayers would be minimal. The IRS also concluded, however, that the burden on excise tax taxpayers could be

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<sup>7</sup> The CADE is an online modernized data infrastructure that will house taxpayer accounts and tax return data for more than 200 million individual and business taxpayers.



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significant. Based on the results of this study, the IRS decided in early 2003 to explore the feasibility of requiring employment tax filers to provide additional information at the time payments are made and to explore other potential solutions for gathering additional information regarding excise tax payments.

The IRS did not, however, develop a detailed action plan or establish specific action items and expected completion dates in support of this approach. Overall, we found the IRS has not made significant progress in either requiring employment tax filers to provide additional information or developing potential solutions for gathering this information from excise tax filers since 2003. In addition, although the IRS informed us that it plans to include the capability to record additional data regarding revenue sources into the CADE, it has not yet developed any long-term plans as to how this type of data would be accumulated by the CDDB.

## **Recommendations**

**Recommendation 1:** The CFO should develop a custodial interim reporting model in support of the CDDB. The model should address the methodology that will be used to calculate collectibility of receivables on an interim basis. The model should also address the presentation of interim data and the recording of this information in the IRS' custodial general ledger.

**Management's Response:** IRS management agreed with this recommendation. The IRS will evaluate the prior models it developed to determine if they are still applicable and to identify opportunities to improve the methodology. The IRS will also meet with the GAO to determine when and how frequently the methodology should be revised. The IRS will continue to use the current sampling approach supported by the GAO until it has consistent historical data that has been approved by the GAO.

**Recommendation 2:** The CFO, in concert with the Wage and Investment Division's Offices of Tax Forms and Publications, and Submission Processing, and with the Office of the Associate Chief Information Officer Business Systems Development function, should coordinate the development of a detailed action plan, including specific action items and expected completion dates, in support of its efforts to 1) explore requiring employment tax filers to provide additional information at the time payments are made; and, 2) develop an approach for gathering this type of information from excise tax filers that does not involve an excessive burden on the taxpayer. The CFO should also incorporate the development of a methodology to capture enhanced revenue information from the CADE into the long-term planning for the CDDB.

**Management's Response:** IRS management agreed with this recommendation. On December 16, 2005, the appropriate IRS business owners and other stakeholders planned to meet to discuss this recommendation. The discussions were to center on ways to evaluate the information that employment taxpayers are currently providing at the time of payment to determine if there are alternative actions the IRS can take using the CDDB. The IRS will also explore options to acquire information from excise tax filers that does



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not involve an excessive burden on the taxpayer. The IRS will develop long-term plans for the CDDDB to capture enhanced revenue information from the CADE.

***Additional Documentation Regarding a Number of Custodial  
Accounts Would Improve the Usefulness of the Crosswalk Between  
the Internal Revenue Service’s General Ledger and the United States  
Standard General Ledger***

The FFMIA of 1996 requires agencies to implement and maintain systems that substantially comply with the United States Standard General Ledger (USSGL) at the transaction level. A standardized chart of accounts provides the basic structure for the USSGL. The chart of accounts incorporates both proprietary and budgetary accounts. Agencies may also create additional sub-accounts as necessary to accommodate agency-specific requirements; however, all subsidiary accounts must summarize or “roll-up” to the USSGL accounts.

In its most recent financial statement review of the IRS, the GAO reported that the IRS’ custodial general ledger does not use the standard Federal accounting classification structure. To begin addressing this nonconformance, the IRS developed a crosswalk<sup>8</sup> that correlates its custodial general ledger accounts to the USSGL Chart of Accounts. As a result of preparing this crosswalk, the IRS identified 18 USSGL required accounts that did not directly correlate to any existing accounts within its current custodial general ledger and created 18 new custodial accounts.

However, the IRS’ crosswalk does not include either the specific source of the data, such as system name and account numbers, which will be used to populate these 18 new accounts, or specify the frequency with which the accounts will be updated. For example, these accounts include other revenue, other custodial assets, seized monies, and miscellaneous revenue. We reported this condition to the IRS on May 9, 2005, and it has already begun developing additional documentation in support of the 18 accounts. The absence of key information on some accounts undercuts the usefulness of the crosswalk as a tool to improve the IRS’ compliance with the format requirements of the USSGL.

***Recommendation***

***Recommendation 3:*** The CFO should ensure the source financial systems and applicable subsidiary accounts used to populate all of the IRS’ custodial general ledger accounts are clearly specified in its USSGL crosswalk.

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<sup>8</sup> A crosswalk is a document which links two or more different classification systems.



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**Management's Response:** IRS management agreed with this recommendation. The IRS will include the information regarding these accounts in the next revision of the applicable Internal Revenue Manual section.

***Periodic Analysis of Criteria Used to Extract Data for the Internal Revenues Service's Annual Financial Statements Would Help Enhance the Long Term Reliability of This Process***

To prepare its annual financial statements, the IRS performs a series of complex data extractions from its detail taxpayer transaction records. The data compiled from the extractions form the basis of the information reported on the IRS' financial statements regarding custodial activities such as revenue receipts and tax account receivables. The IRS informed us that the CDDDB will not eliminate this process but rather will provide a platform to help simplify and streamline the existing methodology.

The data extraction criteria and compilation methodology are defined on a Request for Information Services (RIS), which is prepared by CFO personnel and submitted annually. One of the primary data elements which drive the extraction and compilation process is the Master File Tax (MFT)<sup>9</sup> code. The MFT code designates the particular type of tax attributable to a given transaction. The Internal Revenue Manual contains 75 current MFT codes as of January 1, 2005.

Our review of the IRS' 2005 extraction methodology identified several instances where extraction and compilation criteria are not consistent with the most current definition of the data fields being extracted. For example:

- The 2005 RIS contains compilation criteria incorrectly categorizing financial transactions relating to potentially as many as 6,000 individual taxpayers as being business taxpayer related. The mis-categorized data related to individual taxpayers who the IRS designated as meeting Innocent Spouse status.<sup>10</sup>
- The 2005 RIS contains extraction and compilation criteria relating to three MFT codes which have been obsolete for at least 6 years. One of the MFT codes was a Monthly Tax Return - Manufacturer of Cigarette Papers and Tubes (Form 2137) and has been obsolete since 1988.

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<sup>9</sup> The Master File is the IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data. The MFT codes are contained on the Master File and reduce the numerous types of taxes to a two digit code.

<sup>10</sup> Congress passed the IRS Restructuring and Reform Act of 1998 in part to address the concerns about protecting the innocent spouse who signed a joint return without knowledge of specific items on the tax return and became personally liable for the errors of his/her spouse.





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The IRS informed us that the RIS utilized for the annual data extraction and compilation selection process has not been materially updated since 1997. Periodic review of the extraction selection and compilation criteria is critical to ensuring the accuracy of data produced.

We reported this condition to IRS management on June 10, 2005, and they advised us that they will adjust the data that have already been collected in preparation for the current financial reporting cycle and revise the extraction criteria used for the next financial reporting cycle.

### ***Recommendation***

**Recommendation 4:** The CFO should develop procedures requiring a periodic review of the extraction and compilation criteria for consistency with current definitions of key data fields such as the MFT.

**Management's Response:** IRS management agreed with this recommendation. The IRS will review extraction criteria for consistency with current Master File processing each year. The IRS will also make necessary changes to the extraction criteria and submit the requirements in a RIS.



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## **Appendix I**

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

Our overall objective was to determine whether the Internal Revenue Service (IRS) has developed an effective plan to improve accountability over Federal tax revenues, and to ascertain whether applicable Federal financial accounting standards and requirements were addressed in any planned enhancements to the IRS' existing revenue accounting systems. To accomplish our objective, we:

- I. Ascertained whether the IRS has taken effective steps to develop a reliable methodology to accumulate and report Federal tax revenues, receivables, and collections data in a format compliant with the Federal financial accounting standards.
  - A. Interviewed applicable Chief Financial Officer (CFO) personnel regarding the progress to date on efforts to develop a United States Standard General Ledger (USSGL) based revenue accounting system.
  - B. Determined whether the IRS has developed a comprehensive action plan to guide its future efforts to develop a USSGL based revenue, receivables, and collections accounting system.
    1. Reviewed the action plan timetable, funding estimates, and staffing for reasonableness.
    2. Ascertained whether the action plan includes the inter-functional coordination necessary.
  - C. Ascertained whether the proposed Custodial Detail Database system design will result in the IRS improving compliance with the USSGL.
    1. Compared the proposed system chart of accounts with the USSGL chart of accounts and investigated any variances.
    2. Evaluated the adequacy of the proposed system audit trails and detailed subsidiary ledgers.
    3. Analyzed the ability of the proposed system to provide periodic agency-wide financial reporting.





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- D. Reviewed the proposed system documentation and design specifications and determined whether it meets all applicable Joint Financial Management Improvement Program/CFO-Financial Management Systems Checklist standards.
  - 1. Interviewed CFO personnel regarding the methodology used in determining the operation and control requirements for the proposed system.
  - 2. Compared the proposed system specifications with the applicable Joint Financial Management Improvement Program requirements.
- II. Determined whether the IRS has developed a workable approach for calculating actual annual receivables/receipts for the various types of taxes it is responsible for collecting.
  - A. Interviewed applicable CFO personnel regarding the progress to date on efforts to develop a methodology for calculating actual annual receivables/receipts for the various types of taxes it is responsible for collecting.
  - B. Reviewed any planned efforts to develop a methodology for calculating actual annual receivables/receipts for the various types of taxes it is responsible for collecting.
  - C. Evaluated the impact on taxpayer burden of any proposed enhanced information gathering approach.



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## **Appendix II**

### *Major Contributors to This Report*

Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs)

John R. Wright, Director

Anthony J. Choma, Audit Manager

Mildred Rita Woody, Lead Auditor

James Mills, Jr., Senior Auditor

Richard Loudon, Auditor



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**Appendix III**

*Report Distribution List*

Commissioner C  
Office of the Commissioner – Attn: Chief of Staff C  
Deputy Commissioner for Operations Support OS  
Deputy Commissioner for Services and Enforcement SE  
Chief Financial Officer OS:CFO  
Chief Information Officer OS:CIO  
Commissioner, Small Business/Self-Employed Division SE:S  
Commissioner, Wage and Investment Division SE:W  
Chief Counsel CC  
National Taxpayer Advocate TA  
Director, Office of Legislative Affairs CL:LA  
Director, Office of Program Evaluation and Risk Analysis RAS:O  
Office of Management Controls OS:CFO:AR:M  
Audit Liaison: Chief Financial Officer OS:CFO



*The Custodial Detail Database Should Help Improve  
Accountability; However, Significant Financial Management  
Issues Still Need to Be Addressed*

**Appendix IV**

*Management's Response to the Draft Report*



CHIEF FINANCIAL OFFICER

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

RECEIVED  
DEC 15 2005

December 8, 2005

MEMORANDUM FOR DANIEL R. DEVLIN  
ASSISTANT INSPECTOR GENERAL FOR AUDIT  
HEADQUARTERS OPERATIONS AND EXEMPT  
ORGANIZATIONS PROGRAMS

FROM: Janice Lambert *Janice Lambert*  
Chief Financial Officer

SUBJECT: Draft Audit Report - The Custodial Detail Database Should Help  
Improve Accountability; However, Significant Financial  
Management Issues Still Need to Be Addressed  
(Audit # 200410039)

Thank you for the opportunity to comment on your draft audit report. We appreciate your reviewing our initial plans to develop the Custodial Detail Database (CDDB), and overall, we agree with your recommendations. We believe our incremental approach to developing the CDDB will enable us to address your recommendations. Implementation of subsequent phases of the CDDB project, however, requires Fiscal Year 2007 funding.

Attached is a response to each of your recommendations along with management corrective actions, proposed implementation dates, and responsible officials as applicable.

If you have any questions, please contact me at (202) 622-6400, or have a member of your staff contact Gregory Kane, Associate Chief Financial Officer for Revenue Financial Management at (202) 435-5346.

Attachment



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**ATTACHMENT 1**

**RECOMMENDATION 1**

The Chief Financial Officer (CFO) should develop a custodial interim reporting model in support of the Custodial Detail Database (CDDDB). The model should address the methodology that will be used to calculate collectibility of receivables on an interim basis. The model should also address the presentation of interim data and the recording of this information in the Internal Revenue Service's custodial general ledger.

**CORRECTIVE ACTION**

We agree with this recommendation. We will work with the Office of Research to evaluate the prior models we have developed to determine if they are still applicable and to identify opportunities to improve the methodology. While we have shared these models in the past with the Government Accountability Office (GAO), they were not willing to test them because the underlying data were not reliable. We will meet with GAO to determine when and how frequently the methodology should be revised and add actions as appropriate to the material weakness action plan, IRS 4A-95-01: Financial Accounting of Revenue – Custodial, and the remediation plan for Custodial Financial Management Systems. We will continue to use the current sampling approach supported by the GAO until we have consistent historical data that has been approved by the GAO.

**IMPLEMENTATION DATE**

January 1, 2008

**RESPONSIBLE OFFICIAL**

Associate Chief Financial Officer for Revenue Financial Management

**CORRECTIVE ACTION MONITORING PLAN**

Not Applicable

**RECOMMENDATION 2**

The CFO, in concert with the Wage and Investment Division's Offices of Tax Forms and Publications, and Submission Processing, and with the Office of the Associate Chief Information Officer Business Systems Development function, should coordinate the development of a detailed action plan, including specific action items and expected completion dates, in support of its efforts to 1) explore requiring employment tax filers to provide additional information at the time payments are made; and 2) develop an approach for gathering this type of



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information from excise tax filers that does not involve an excessive burden on the taxpayer. The CFO should also incorporate the development of a methodology to capture enhanced revenue information from the Customer Account Data Engine (CADE) into the long-term planning for CDDB.

**CORRECTIVE ACTION**

We agree with this recommendation. On December 16, 2005, we are meeting with GAO, the appropriate IRS business owners, and Treasury officials to discuss this recommendation. Our discussions will center on ways to evaluate the information employment tax filers are currently providing at the time of payment to determine if there are alternative actions the IRS can take using CDDB. We also will explore options to acquire information from excise tax filers that does not involve an excessive burden on the taxpayer. We will meet with the Treasury Office of Tax Analysis to discuss the impact these options would have on the current estimation process used to fund the excise taxes. We will include any appropriate actions in the material weakness action plan, IRS 4A-95-01: Financial Accounting of Revenue – Custodial, and the remediation plan for Custodial Financial Management Systems.

We will develop long-term plans for CDDB to capture enhanced revenue information from CADE. We will continue discussions with CADE project managers to develop and define the requirements for sending CADE data to CDDB. We will include any appropriate actions in the material weakness action plan, IRS 4A-95-01: Financial Accounting of Revenue – Custodial, and the remediation plan for Custodial Financial Management Systems.

**IMPLEMENTATION DATE**

September 30, 2006

**RESPONSIBLE OFFICIAL**

Associate Chief Financial Officer for Revenue Financial Management

**CORRECTIVE ACTION MONITORING PLAN**

Not Applicable

**RECOMMENDATION 3**

The CFO should ensure the source financial systems and applicable subsidiary accounts used to populate all of the IRS' custodial general ledger accounts are clearly specified in its United States Standard General Ledger crosswalk.



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**CORRECTIVE ACTION**

We agree with this recommendation. We will include the information regarding these accounts in the next revision of Internal Revenue Manual 3.17.63, Revenue Accounting Control.

**IMPLEMENTATION DATE**

January 1, 2007

**RESPONSIBLE OFFICIAL**

Associate Chief Financial Officer for Revenue Financial Management

**CORRECTIVE ACTION MONITORING PLAN**

Not Applicable

**RECOMMENDATION 4**

The CFO should develop procedures requiring a periodic review of the extract and compilation criteria for consistency with current definitions of key data fields such as Master File Tax Class.

**CORRECTIVE ACTION**

We agree with this recommendation. We will review the extract criteria for consistency with current master file processing each year. We will make necessary changes to the extract criteria and submit the requirements in a Request for Information Services.

**IMPLEMENTATION DATE**

February 28, 2006

**RESPONSIBLE OFFICIAL**

Associate Chief Financial Officer for Revenue Financial Management

**CORRECTIVE ACTION MONITORING PLAN**

Not Applicable