



*Resource and Computer Programming
Limitations Have Hindered the Progress of
the Federal, State, and Local Governments
Office in Identifying Its Customers*

September 12, 2006

Reference Number: 2006-10-124

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

Redaction Legend:

1 = Tax Return/Return Information

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TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

September 12, 2006

MEMORANDUM FOR COMMISSIONER, TAX EXEMPT AND GOVERNMENT ENTITIES
DIVISION

Michael R. Phillips

FROM:

Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – Resource and Computer Programming
Limitations Have Hindered the Progress of the Federal, State, and
Local Governments Office in Identifying Its Customers
(Audit # 200610021)

This report presents the results of our review of the Federal, State, and Local Governments (FSLG) office's progress in accurately identifying its customers and updating its computer system to properly categorize organizations as Federal, State, or local Governments.

To effectively ensure compliance, the FSLG office determined it needed to identify its customer base. In a prior audit,¹ we reviewed the FSLG office's initial attempts to identify its customers. We reported that, although the office had begun to identify its customers, it needed to take a more structured approach to ensure success. At that time, the office had obtained a download of the United States Census Bureau's 2002 Government Integrated Directory (Census Bureau database) containing active Federal, State, and local Governments to use in identifying incomplete or inaccurate customer information on the Internal Revenue Service (IRS) computer system.²

Impact on the Taxpayer

Accurate identification of FSLG office customers on IRS computer systems is a critical part of the office's efforts to provide quality customer service as well as ensure compliance with Federal

¹ *The Federal, State, and Local Governments Office Is Taking Action to Identify Its Customers, but Improvements Are Needed* (Reference Number 2004-10-104, dated May 2004).

² The Business Master File is the IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.



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tax laws. However, computer programming limitations hindered efforts to accurately code FSLG office customers. We determined the manual efforts to overcome the limitations caused the issuance of unnecessary IRS publications and possibly unnecessary tax delinquency notices, which may increase taxpayer burden.

Synopsis

Since our prior audit, the FSLG office has continued efforts to further identify its customers by matching the Census Bureau database to the IRS Returns Inventory and Classification System³ and through additional research. However, management has not made significant progress in these efforts. Results of the address match of organizations on the Census Bureau database and the IRS database need further analysis to ensure the organizations are recorded correctly on the IRS computer system and coded properly as FSLG office customers.

The process used to code some Government entities has caused unnecessary IRS publications to be issued. It also may initiate the incorrect issuance of tax delinquency notices, which may increase taxpayer burden.

At the time of our review, the FSLG office had not coded any additional entities as Federal, State, or local Governments on the IRS computer system from the comparison of the Census Bureau database and the IRS database. This effort has been delayed because of limited resources and management turnover. However, other efforts to identify Government entities resulted in 1,183 additional Federal, State, and local Governments being manually coded as such on the IRS computer system. Further efforts to accurately code some customers were hindered by computer programming limitations. The FSLG office was aware of some of the programming limitations and attempted to manually overcome them. However, we determined the manual process caused the issuance of unnecessary IRS publications and possibly unnecessary tax delinquency notices. As a result, taxpayers may contact the IRS to determine the reason for receiving the correspondence and/or the tax delinquency notices in error, which may increase taxpayer burden.

Recommendations

We recommended the Director, Government Entities, determine the best method to proceed with the identification of Federal, State, and local Governments and then develop a detailed action plan that includes tasks to be accomplished, responsible personnel, deadlines for completion of each task, and methods to monitor progress. This is the third time we have recommended this action. The Director, Government Entities, should make requests for three additional computer

³ The Returns Inventory and Classification System provides users access to return and filer information related to the filing and processing of employee plans, exempt organizations, and government entities forms.



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programming changes to allow the FSLG office to accurately code its customers on the IRS computer system. Finally, the Director, Government Entities, while waiting for computer programming changes to be made, should request that written IRS procedures be updated to reflect the revised process for coding Federal, State, and local Governments on the IRS computer system.

Response

The Commissioner, Tax Exempt and Government Entities Division, agreed with the finding and recommendations contained in the report. FSLG office management will determine how best to identify its customers and develop a detailed action plan. Management has requested that written IRS procedures be revised to ensure codes for identifying Federal, State, and local Governments are assigned on the IRS computer system. In addition, management will coordinate with the IRS Modernization and Information Technology Services organization to determine if two other computer programming change requests are necessary and, if so, will submit them. Finally, management will submit a computer programming change request to allow Government entities with unique filing requirements to be accurately coded on the IRS computer system. Management's complete response to the draft report is included as Appendix V.

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



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Background

The Federal, State, and Local Governments office (FSLG), part of the Government Entities function in the Tax Exempt and Government Entities (TE/GE) Division, is responsible for providing Federal Government agencies, State Governments, local governments, and quasi-governmental entities top-quality service by helping them understand and comply with the tax laws. FSLG office customers are generally not subject to Federal income tax; however, these customers are commonly required to file information returns and to file and pay employment taxes. These entities have 23 million employees (20 percent of the United States workforce).

To effectively ensure compliance, the FSLG office determined it needed to identify its customer base. The FSLG office was created as a new office within the TE/GE Division during the Internal Revenue Service (IRS) reorganization in Fiscal Year 2000. At that time, the IRS did not have an accurate database of all FSLG office customers. By May 2006, the FSLG office had identified and coded over 84,000 Government entities on the IRS computer system.¹ However, this figure did not include potentially thousands of subunits that provided employment tax and information return reporting data to a larger Government entity for consolidation and filing. Because these subunits may affect the compliance of another Government entity, the FSLG office decided to identify these customers as well.

In a prior audit,² we reviewed the FSLG office's initial attempts to identify its customers. We reported that, although the office had begun to identify its customers, it needed to take a more structured approach to ensure success. At that time, the office had obtained a download of the United States Census Bureau's 2002 Government Integrated Directory (Census Bureau database) to use in identifying incomplete or inaccurate customer information on the IRS computer system. However, both databases used a different format for entities' names and addresses, which made a systemic matching of the entities difficult. We recommended the IRS develop a detailed action plan that included the individuals assigned, responsible management official(s), completion dates, expected results, and methods to monitor and report performance. In addition, we recommended the IRS survey all Government entities appearing on the Census Bureau database that were not located on the IRS computer system.

FSLG office management expressed concerns regarding the accuracy of the Census Bureau database and its use in identifying Government entities on the IRS computer system. Specifically, management stated the Census Bureau database could contain entities that the IRS

¹ The Business Master File is the IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.

² *The Federal, State, and Local Governments Office Is Taking Action to Identify Its Customers, but Improvements Are Needed* (Reference Number 2004-10-104, dated May 2004).



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has no record of because the entities have never requested an Employer Identification Number.³ Some FSLG office customers are not required to file tax returns and, therefore, may not have obtained an Employer Identification Number. Additionally, some local government entities are created for short-term projects and may no longer exist. However, FSLG office management indicated the Census Bureau database is an important source of information to assist in identifying its customers. We did not receive or evaluate the Census Bureau database.

In October 2005, the FSLG office published a Research Plan to identify, quantify, and monitor its customers and their unique compliance issues. One of the Plan's goals is to identify all Government entity customers. The planned major milestones of this effort include:

- Continue to work with the TE/GE Division Research and Analysis office to ensure appropriate methodologies and processes are used in the completion of the Research Plan.
- Complete the matching process for the Census Bureau database data.
- Reestablish a working relationship with the United States Census Bureau.
- Reconcile entities to determine proper classification.
- Identify and correct errors in the codes used to identify FSLG office customers.
- Identify significant subunits through online research and other appropriate means.
- Identify and implement procedures to keep the database of customers current.

This review was performed at the FSLG office Compliance and Program Management⁴ office in Plantation, Florida, during the period February through June 2006. We also contacted personnel located in the FSLG office in Austin, Texas, and the TE/GE Division National Headquarters in Washington, D.C. 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.

³ A unique nine-digit number used to identify a taxpayer's business account.

⁴ This was formerly known as the Operations, Planning, and Review office within the FSLG office.



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Results of Review

Limited Progress Has Been Made in Identifying Federal, State, and Local Governments Office Customers Due to a Lack of Resources, Management Turnover, and Computer Programming Restrictions

Since our May 2004 audit, the FSLG office has attempted to further identify its customers. Specifically, FSLG office personnel coordinated with the TE/GE Division Research and Analysis office to match the Census Bureau database and the IRS Returns Inventory and Classification System (RICS)⁵ based on the address information shown on the databases. The Census Bureau database included approximately 87,900 active Governments,⁶ and the RICS included over 84,000 Government entities.⁷ By the end of our fieldwork, the FSLG office had completed the comparison of the two databases but had not yet coded any additional entities as its customers on the IRS computer system based on the results. However, as a result of additional RICS queries performed by the office, 1,168 entities have been coded as FSLG office customers on the IRS computer system. Further, the office coded an additional 15 entities as FSLG office customers based upon information received from Chief Financial Officers of various Federal Government agencies.

However, we determined further actions are necessary to ensure the FSLG office identifies the population of its customers and accurately updates the IRS computer system based on its analysis of the match between the Census Bureau database and the RICS. The results of the address match of organizations on the Census Bureau database and the RICS need further analysis to ensure the organizations are recorded correctly on the IRS computer system and coded properly as FSLG office customers.

Several factors have contributed to the FSLG office's lack of significant progress in achieving the goals of identifying its customers and updating its computer system.

- Given the scope and complexity of the project, we believe insufficient resources were allocated to it by management from April 2004 through August 2005. Also, the assigned personnel were unfamiliar with the various IRS computer systems and Microsoft Office™ software necessary to successfully complete the project.

⁵ The RICS provides users access to return and filer information related to the filing and processing of employee plans, exempt organizations, and government entities forms.

⁶ As of June 30, 2002.

⁷ As of May 3, 2006.



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- The office did not prepare a detailed action plan with all necessary information to successfully complete the project, including actions planned, individuals assigned, responsible management officials, and methods to monitor and report performance. We have previously recommended management prepare this action plan to help identify their customers.⁸
- There was high turnover of key management officials within the FSLG office. Since Fiscal Year 2003, the office has had four acting or permanent Directors, and the FSLG office Compliance and Program Management office has had six acting or permanent managers. FSLG office management informed us that, as a result, action plans were not updated when an action item proved not to be viable, thus impeding the progress in identifying their customers. We believe use of a detailed action plan during this period could have enabled management to achieve further progress in identifying their customers.
- Computer programming limitations are preventing the FSLG office from accurately coding FSLG office customers without an Employer's QUARTERLY Federal Tax Return (Form 941) filing requirement on the IRS computer system.

Identification of its customers is a critical part of the FSLG office's efforts to provide quality customer service as well as ensure compliance with Federal tax laws. To address noncompliance issues, while maximizing its limited resources, the office needs to identify its at-risk customers most in need of educational assistance, effectively communicate tax law changes, and, if necessary, undertake compliance checks and examinations. In addition, more accurate identification of its customers on IRS computer systems will help the IRS identify filing noncompliance and effectively apply tax payments to the proper taxpayer accounts.

Results of the address match of organizations on the Census Bureau and IRS databases need further analysis

The FSLG office has had limited success in matching the entities on the Census Bureau database to the entities on the RICS. The two databases cannot be systemically matched because the Census Bureau database does not contain a unique identifier, such as an Employer Identification Number, to use for matching purposes. Further, both databases use a different format for entities' names and addresses. Nevertheless, the TE/GE Division Research and Analysis office matched addresses on the Census Bureau database to addresses on the RICS, which included data from the TE/GE Division as well as the Small Business/Self-Employed Division and the Large and Mid-Size Business Division, to help identify FSLG office customers miscoded on the IRS computer system as customers of other IRS operating divisions. This address match was

⁸ *The Federal, State, and Local Governments Office Is Taking Action to Identify Its Customers, but Improvements Are Needed* (Reference Number 2004-10-104, dated May 2004) and *To Provide Quality Service, the Government Entities Organization First Needs to Identify Its Customers* (Reference Number 2002-10-102, dated July 2002).



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completed in August 2005, and the results were provided to the FSLG office in two Microsoft Access™ databases. The FSLG office needs to perform additional research on the organizations contained on these databases to ascertain if they are properly coded as its customers.

After receiving the results of the address match, the FSLG office continued to pursue other methods to more effectively identify its customers on the IRS computer system by entity name instead of entity address. The office subsequently determined the IRS had computer programmers who could match the Census Bureau's database to an IRS database used to locate entity's names and their corresponding Taxpayer Identification Numbers⁹ using the name field. This match resulted in the identification of over 70,000 entities on the Census Bureau database that had the same names as entities on the IRS computer system. The FSLG office has also requested that an additional name match be performed of the Census Bureau database and another IRS database to further identify its customers. The results of this additional match will not be received by the FSLG office until August 2006. The FSLG office believes these additional analyses based on the organizations' names are more accurate than the previous matches by address and plans to continue with the customer identification efforts using the results of these matches. After we completed our fieldwork, management advised us they will send letters to the remaining organizations listed on the Census Bureau database that could not be located on the IRS computer system by the name match, to determine if they are FSLG office customers. Specifically, management stated they will begin mailing approximately 8,600 letters to such organizations in August 2006.

The FSLG office also has identified some customers using other methods. Specifically, office personnel performed several queries of the RICS to further identify potential customers. Personnel researched the RICS by certain key terms (e.g., "fire department," "city of") and identified 1,168 organizations that were not properly coded as FSLG office customers. These organizations were manually coded as FSLG office entities on the IRS computer system.¹⁰ Further, the office issued letters to 27 Chief Financial Officers of various Federal Government agencies and requested their Employer Identification Numbers and the purpose of each Number. The office researched the responses of 10 agencies, many providing multiple Employer Identification Numbers; determined 16 entities were not properly coded as its customers; and took actions to properly code 15 of them.¹¹

⁹ A nine-digit number assigned to taxpayers for identification purposes. Depending upon the nature of the taxpayer, the Taxpayer Identification Number is an Employer Identification Number, a Social Security Number, or an Individual Taxpayer Identification Number.

¹⁰ We reviewed a random sample of 75 cases and researched IRS computer systems and the Internet to determine whether the updated codes used to identify FSLG office customers were accurate. All 75 entities were properly coded as FSLG office customers.

¹¹ We reviewed all 16 cases and determined 15 were accurately updated.



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Programming limitations do not allow all FSLG office customers to be properly coded on the IRS computer system

The FSLG office is identifying its customers with a code on the IRS computer system that categorizes the entities as Federal, State, or local Government agencies. Specifically, information contained on an organization's Application for Employer Identification Number (Form SS-4) is used to categorize the type of organization when an account is established on the IRS computer system. However, FSLG office entities that request an Employer Identification Number, but do not indicate on their Forms SS-4 they have employees, cannot be coded as FSLG office customers due to programming restrictions. Only entities with a Form 941 filing requirement can be coded as FSLG office customers. Further, IRS procedures for processing Form SS-4 do not allow the code identifying FSLG office customers to be added to an account without a filing requirement code¹² being input. This programming prevents new organizations from being coded as FSLG office customers and precludes existing organizations without a Form 941 filing requirement from being updated with a code identifying them as FSLG office customers. To work around these programming limitations, office personnel took steps to manually code 1,183 entities (1,168 + 15) as FSLG office customers. However, these steps resulted in some unintended consequences that may increase taxpayer burden.

Through various research and matching efforts, the office identified FSLG office customers that were not coded as such on the IRS computer system. However, some of these entities were not required to file a Form 941. For these entities to be coded as FSLG office customers, personnel needed to input a Form 941 filing requirement code on each account and then delete it.

However, deleting the filing requirement code caused unintended systemic actions to occur. When an existing Form 941 filing requirement code is deleted, the computer system automatically inputs a different filing requirement code that signifies the organization is no longer liable for filing Forms 941 and causes a *Federal Employment Tax Forms* (Publication 393) to be automatically issued to the organization. This Publication contains copies of and instructions for information returns. In addition, the computer programming will subsequently delete the code used to identify any Federal Government agencies as FSLG office customers after the filing requirement code is deleted.¹³

To resolve these programming limitations, FSLG office management has submitted a Request for Information Services¹⁴ to allow organizations that are not required to file employment tax returns to be coded as FSLG office entities on the IRS computer system. This change is scheduled for implementation in July 2007. However, this Request may not address the coding

¹² A filing requirement code identifies what type of return an entity is required to file.

¹³ Based on our review of the computer programming manuals and contact with IRS programming personnel, we were unable to determine whether the code used to identify State and local Government organizations as FSLG office customers is systemically deleted after the filing requirement code has been deleted.

¹⁴ The Request for Information Services process entails a common framework to document, control, monitor, and track requests for changes to IRS computer systems and for support.



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problems of existing entities that have had their filing requirement codes deleted. Because the computer system inputs a different filing requirement code when the existing code is deleted, the FSLG office may be unable to properly code these entities as its customers without again having to manually delete the additional filing requirement code added to the accounts. This additional deletion may again cause a Publication 393 to be issued to the organizations.

Our review of the 1,183 entities updated by the FSLG office identified 27 entities that had a filing requirement added to and subsequently deleted from the organizations' accounts. Nine of these 27 organizations were Federal Government agencies, so the FSLG office code that was manually input will be systemically deleted from the accounts in the future. In addition, we determined a filing requirement was added to the accounts of seven Federal Government entities that had previously reported to the IRS they do not file Forms 941, but the filing requirements had not been deleted at the end of our fieldwork. Most of these seven entities reported the Employer Identification Numbers are used to file information returns (not Forms 941). We researched the IRS computer system and determined 6 of the 7 entities have not used the Employer Identification Numbers to file Forms 941 in the last 2 years. As a result, delinquency notices may be issued to these seven Federal Government entities due to the apparent nonfiling of required tax returns, resulting in increased taxpayer burden (see Appendix IV).

There are additional coding problems associated with government employers that have unique filing requirements. Specifically, the FSLG office identified some Puerto Rican entities that file a Planilla para la Declaración Federal TRIMESTRAL del Patrono (Form 941-PR), which has a unique filing requirement code. Puerto Rican Government entities that file a Form 941-PR should be coded as FSLG office customers. However, as stated earlier, the system allows only those entities filing a Form 941 to be coded as FSLG office customers on the IRS computer system. The same situation exists for filers of Employer's QUARTERLY Federal Tax Return (Form 941-SS) from the Virgin Islands, Guam, and American Samoa, which also has a unique filing requirement code. As a result, systemic programming limitations are hindering the FSLG office's ability to code Governmental entities filing a different Form 941 as its customers.

Our review of the 1,168 entities coded as newly identified FSLG office entities showed 15 were Puerto Rican Government entities. We determined that, for ¹ of these entities, the incorrect filing requirement code was input so the computer system would identify these entities as FSLG office customers. As a result, these entities may receive delinquency notices or be assessed penalties for not filing the Form 941 (based on the improper coding of the accounts).

¹ [redacted]

¹ [redacted] The responsible FSLG office personnel could not recall what steps were taken to code these entities as FSLG office customers.



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Recommendations

Recommendation 1: The Director, Government Entities, should determine the best method to identify FSLG office customers, including, but not limited to, the Census Bureau database. This approach should be included in a detailed action plan that outlines what is to be accomplished, who will accomplish each task, deadlines for each task, management officials providing oversight, expected results, and methods to monitor performance. Government Entities function management should also prepare updates to the plan if scheduled actions are no longer viable.

Management's Response: TE/GE Division management agreed with this recommendation. They will determine how best to identify their customers and develop a detailed action plan.

Recommendation 2: While waiting for implementation of the Request for Information Services that will allow a code identifying FSLG office customers to be input without a filing requirement in July 2007, the Director, Government Entities, should request that all relevant procedures be revised to ensure codes used to identify FSLG office customers are assigned even if there are no filing requirements.

Management's Response: TE/GE Division management agreed with this recommendation. They have identified and contacted the respective systems owners for Individual and Business Master File accounts and requested that all relevant procedures to identify FSLG office customers be revised to ensure codes used to identify those customers are assigned even if there are no filing requirements.

Recommendation 3: The Director, Government Entities, should submit a Request for Information Services that revises computer programming to ensure the code used to identify Federal Government agencies is not deleted if the Form 941 filing requirement is removed from an agency's account.

Management's Response: TE/GE Division management agreed with this recommendation. They will discuss this process with the Modernization and Information Technology Services organization to determine if a Request for Information Services is required or if the work can be completed without it. Management will submit a Request for Information Services, if necessary.

Recommendation 4: The Director, Government Entities, should research IRS computer programming and, if necessary, submit a Request for Information Services to eliminate any unintended consequences of deleting filing requirements (such as the issuance of Publication 393) for Federal, State, and local Governments.

Management's Response: TE/GE Division management agreed with this recommendation. They will contact personnel who specialize in Master File changes and coordinate with the Modernization and Information Technology Services organization,



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determine if a Request for Information Services is necessary, and submit a Request for Information Services if required.

Recommendation 5: The Director, Government Entities, should submit a Request for Information Services to allow Government entities with unique filing requirement codes, such as Puerto Rican, Virgin Islands, Guam, and American Samoa filers, to be coded as FSLG office customers.

Management's Response: TE/GE Division management agreed with this recommendation. They will submit the Request for Information Services.



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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to assess the Federal, State, and Local Governments (FSLG) office's progress in accurately identifying its customers and updating its computer system to properly categorize organizations as Federal, State, or local Governments. Specifically, we assessed the status of the customer identification efforts and the process used to code customer accounts. We attempted to validate the two databases received from the FSLG office by querying various fields to determine if the data in the fields were appropriate. This was not the case for one database, so we did not complete additional validations. For the other database, we also verified there were no duplicate records and that each entity's account had been updated on the Internal Revenue Service computer system¹ as indicated by the FSLG office. We concluded that one database may be unreliable and the other was reliable. We did not use the potentially unreliable database during our review, so there are no impairments to report. Due to resource limitations, we did not obtain or validate the United States Census Bureau's 2002 Government Integrated Directory (Census Bureau database). To accomplish the audit objective, we:

- I. Determined all currently planned efforts or those initiated since the May 2004 Treasury Inspector General for Tax Administration report² to identify Federal, State, and local Government customers.
 - A. Interviewed FSLG office Compliance and Program Management³ office personnel to obtain information on all currently planned identification efforts or those initiated since May 2004.
 - B. Obtained documentation (e.g., planning documents, action plans, status reports) related to efforts to identify FSLG office customers.
- II. Determined whether Tax Exempt and Government Entities Division management took adequate corrective action in response to two recommendations made to improve the process used to identify customers (related to the FSLG office) contained in our May 2004 report.

¹ The Business Master File is the Internal Revenue Service database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.

² We identified all identification efforts that were initiated after the issuance of the report entitled *The Federal, State, and Local Governments Office Is Taking Action to Identify Its Customers, but Improvements Are Needed* (Reference Number 2004-10-104, dated May 2004).

³ This was formerly known as the Operations, Planning, and Review office within the FSLG office.



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- A. Reviewed the FSLG office action plan obtained in Step I. to determine whether it included management officials responsible for providing oversight, specific actions needed to identify customers, individuals assigned to the project, completion dates, expected results, and methods to monitor performance.
 - B. Determined whether a survey was mailed to each Government entity included on the Census Bureau database that was not on the Internal Revenue Service computer system, to confirm the name and address of the entity and request its Employer Identification Number⁴ (if applicable).
- III. Assessed the FSLG office's progress in identifying its customers and updating its computer system to properly categorize organizations as Federal, State, or local Governments.
- A. Determined whether the identification efforts identified in Step I.A. were on schedule.
 - B. Determined whether updated information related to FSLG office customers had been identified since May 2004.
 - C. Determined whether accurate codes identifying FSLG office customers had been input to the Internal Revenue Service computer system if new information had been identified for Federal, State, and local Governments. We selected a random sample of 75 cases from a universe of 1,168 entities that had had their codes updated to verify the changes made to the accounts. We used a random sampling technique to ensure each entity had an equal chance of being selected for review. We also reviewed the total universe of 16 cases from a separate effort to update entities' accounts.

⁴ A unique nine-digit number used to identify a taxpayer's business account.



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Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Deputy Commissioner, Tax Exempt and Government Entities Division SE:T
Director, Government Entities, Tax Exempt and Government Entities Division SE:T:GE
Director, Research and Analysis, Tax Exempt and Government Entities Division SE:T:RA
Director, Federal, State, and Local Governments, Tax Exempt and Government Entities Division
SE:T:GE:FSL
Chief Counsel CC
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Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
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Appendix IV

Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to Congress.

Type and Value of Outcome Measure:

- Taxpayer Burden – Potential; 27 taxpayer accounts affected (see page 3).

Methodology Used to Measure the Reported Benefit:

We queried the database of 1,168 accounts that had been updated with a code identifying them as Federal, State, and Local Governments (FSLG) office customers to determine the current filing requirement codes¹ on those accounts. We also reviewed 15 other accounts that had been updated based on information received from Chief Financial Officers of various Federal Government agencies. Based upon our reviews, we determined 27 tax accounts had the filing requirement code added and subsequently deleted from the accounts, causing *Federal Employment Tax Forms* (Publication 393) to be issued to the entities.

Type and Value of Outcome Measure:

- Taxpayer Burden – Potential; 7 taxpayer accounts affected (see page 3).

Methodology Used to Measure the Reported Benefit:

We reviewed 15 tax accounts that had been updated with a code identifying them as FSLG office customers based on information received from Chief Financial Officers of various Federal Government agencies. We determined that a filing requirement code had been added to the accounts of seven entities that had previously reported to the Internal Revenue Service they do not file employment tax returns; the filing requirement codes had not been deleted at the end of our fieldwork. We researched the Internal Revenue Service computer system² and determined

¹ A filing requirement code identifies what type of return an entity is required to file.

² The Business Master File is the Internal Revenue Service database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.



Resource and Computer Programming Limitations Have Hindered the Progress of the Federal, State, and Local Governments Office in Identifying Its Customers

6 of the 7 entities had not used the Employer Identification Numbers to file an employment tax return in the last 2 years. These seven Federal Government entities may receive delinquency notices for not filing employment tax returns.



Resource and Computer Programming Limitations Have Hindered the Progress of the Federal, State, and Local Governments Office in Identifying Its Customers

Appendix V

Management's Response to the Draft Report




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

RECEIVED
SEP 06 2006

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MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM:


Steven T. Miller
Commissioner, Tax Exempt and Government Entities

SUBJECT:

Resource and Computer Programming Limitations Have Hindered the Progress of the Federal, State and Local Governments Office in Identifying Its Customers (Audit # 200610021)

I am pleased to respond to your report concerning the progress of our Federal, State and Local Governments Office (FSLG) in identifying its customers. We agree that FSLG's identification of its customers is a critical part of its effort to provide quality service as well as ensure compliance with Federal tax laws.

Your findings focus on FSLG's efforts to identify its customers and update its computer records. A key component of these efforts was to analyze the results of matching Census Bureau data to IRS records. We completed this analysis and identified unmatched records. We are now contacting the unmatched entities to ensure they are properly identified and coded.

Our response to your recommendations follows.

RECOMMENDATION 1

The Director, Government Entities, should determine the best method to identify FSLG office customers, including, but not limited to, the Census Bureau database. This approach should include a detailed action plan that outlines what is to be accomplished, who will accomplish each task, deadlines for each task, management officials providing oversight, expected results, and methods to monitor performance. Government Entities function management should also prepare updates to the plan if scheduled actions are no longer viable.

CORRECTIVE ACTION 1

FSLG will determine how best to identify its customers and will develop a detailed action plan.



Resource and Computer Programming Limitations Have Hindered the Progress of the Federal, State, and Local Governments Office in Identifying Its Customers

RESPONSIBLE OFFICIAL

Director, Government Entities

IMPLEMENTATION DATE 1

November 30, 2006

RECOMMENDATION 2

While waiting for implementation of the Request for Information Services (RIS) that will allow a code identifying FSLG office customers to be input without a filing requirement in July 2007, the Director, Government Entities, should request that all relevant procedures be revised to ensure codes used to identify FSLG office customers are assigned even if there are no filing requirements.

CORRECTIVE ACTION 2

FSLG has identified and contacted the respective systems owners for Individual and Business Master File accounts and requested that all relevant procedures to identify FSLG customers be revised to ensure codes used to identify FSLG office customers are assigned even if there are no filing requirements.

RESPONSIBLE OFFICIAL

Director, Government Entities

IMPLEMENTATION DATE 2

Implemented, July 2006

RECOMMENDATION 3

The Director, Government Entities, should submit a Request for Information Services that revises computer programming to ensure the code used to identify Federal Government agencies is not deleted if the Form 941 filing requirement is removed from an agency's account.

CORRECTIVE ACTION 3

FSLG will discuss with Modernization and Information Technology Services (MITS) the systemic process outlined in PRP 180 which shows a progression of filing requirement codes for Forms 941 to determine if a RIS is required or if the work can be completed without a RIS. If a RIS is required, we will submit one.



Resource and Computer Programming Limitations Have Hindered the Progress of the Federal, State, and Local Governments Office in Identifying Its Customers

RESPONSIBLE OFFICIAL

Director, Government Entities

IMPLEMENTATION DATE 3

January 15, 2007

RECOMMENDATION 4

The Director, Government Entities, should research IRS computer programming and, if necessary, submit a Request for Information Services to eliminate any unintended consequences of deleting filing requirements (such as the issuance of Publication 393) for Federal, State, and Local Governments.

CORRECTIVE ACTION 4

FSLG will establish a contact with Campus personnel who specialize in the effect of Master File changes and will coordinate with MITS – Application Development, as the PRP 160 owner, to determine if a RIS is necessary. If a RIS is required, we will submit one.

RESPONSIBLE OFFICIAL

Director, Government Entities

IMPLEMENTATION DATE 4

January 15, 2007

RECOMMENDATION 5

The Director, Government Entities, should submit a Request for Information Services to allow Government entities with unique filing requirement codes, such as Puerto Rican, Virgin Islands, Guam, and American Samoa filers, to be coded as FSLG office customers.

CORRECTIVE ACTION 5

We will submit the RIS.

RESPONSIBLE OFFICIAL

Director, Government Entities



*Resource and Computer Programming Limitations Have
Hindered the Progress of the Federal, State, and Local
Governments Office in Identifying Its Customers*

IMPLEMENTATION DATE 5

January 15, 2007

We concur with your description of measurable benefit on tax administration.

If you have any questions, please contact Sunita Lough, (Director, FSLG), at 202-283-9818 or Preston Butcher, (Director, GE), at 202-283-9738.