



*Insufficient Controls Resulted in
Significant Delays in Processing
Tax-Exempt Bond Payments and Some
Unreliable Payment Posting Dates*

August 31, 2006

Reference Number: 2006-10-128

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

August 31, 2006

MEMORANDUM FOR COMMISSIONER, TAX EXEMPT AND GOVERNMENT ENTITIES
DIVISION

A handwritten signature in black ink, appearing to read "Michael R. Phillips".

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

SUBJECT: Final Audit Report – Insufficient Controls Resulted in Significant
Delays in Processing Tax-Exempt Bond Payments and Some
Unreliable Payment Posting Dates (Audit # 200610009)

This report presents the results of our review of the controls over closing agreement settlement payments in the Tax Exempt Bonds (TEB) office. The overall objective of this review was to determine whether TEB office management ensured payments received in settlement of closing agreements¹ were timely and accurately processed to the appropriate accounts. During Fiscal Year 2004, the TEB office received payments ranging from approximately \$300 to \$5 million (and totaling \$17 million) in settlement of compliance issues. Timely and accurate processing of settlement payments is important to comply with legal guidelines for depositing funds received by the Federal Government and to ensure customer accounts are accurately credited for payments made in settlement of compliance cases.

Synopsis

We determined all 436 settlement payments received by the TEB office between October 1, 2001, and September 30, 2005, were deposited and posted to Internal Revenue Service (IRS) customer accounts. However, the TEB office's internal control procedures were not adequate to ensure the timely deposit of payments received in settlement of closing agreements and the accurate posting of payments to customer accounts. Specifically:

¹ When noncompliance is identified, the TEB office attempts to reach an agreement with the bondholder or their representative to make payment to correct the noncompliance issue. When the bondholder or representative pays the agreed amount, it is known as a settlement payment.



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- There were extensive delays in the processing of payments from the TEB office through the Ogden Submission Processing Site in Ogden, Utah, including the deposit of large-dollar payments up to approximately \$11 million. Almost one-half of the payments (206 of 436) potentially were not deposited timely. These payments potentially were deposited between 1 and 301 calendar days late, with deposits being made an average of 23 calendar days after receipt. To comply with the law on financial management, the IRS must deposit payments by the third business day after receipt.

We could not determine the extent or the specific reasons for the delays because the TEB office had not established (1) sufficient internal controls to ensure payments are processed and mailed to the Ogden Submission Processing Site within the second business day of receipt or (2) procedures to identify trends of late deposits. As a result, we could not determine how much of the delays were attributable to the TEB office and how much were attributable to the Ogden Submission Processing Site. However, we did review the limited TEB office case documentation available and identified some examples of payments that were not processed by the TEB office within 2 business days. For example,¹

After our fieldwork ended, TEB office management reviewed case information for 40 Fiscal Year 2005 Voluntary Closing Agreement Program² payments. Based on their review, TEB office management believes that 27 of 40 (68 percent) payments were transmitted timely to the Ogden Submission Processing Site within 2 calendar days of receipt by the TEB office, 8 payments (20 percent) were transmitted after 2 calendar days, and there was insufficient documentation to determine timeliness for the remaining 5 payments.

- The controls over processing TEB office settlement payments were not adequate to ensure customer account information accurately and reliably posted to IRS computer systems. We identified 14 customer accounts for which the payments posted to a computer system other than the one intended by TEB office management (and the IRS had to manually transfer the payments to the correct system at a later date),¹

When settlement payments are not deposited timely or accurately, the IRS loses interest accruals on the undeposited amounts, payments can be applied to incorrect accounts thereby not giving

² The Volunteer Closing Agreement Program was established by IRS Notice 2001-60 issued on October 1, 2001. It is intended to supplement the TEB office's examination program and provides a means for bond issuers to self-identify Internal Revenue Code violations and report them to the IRS. The Voluntary Closing Agreement Program allows a reduced settlement amount of less than the amount the bond issuer would be assessed if the violation was identified during an examination.



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customers credit for making payments, and controls may not prevent the refunding of settlement payments to the payees.

Recommendations

We recommended the Director, TEB, establish effective controls over the processing of settlement payments by date stamping payments when received, controlling payments on an inventory list, preparing and sending payments to the Submission Processing site on the day of or the next business day after receipt, date stamping the transmittal document that accompanies payments to the Submission Processing site, ensuring follow-up is conducted when the acknowledgement of payments is not received, and conducting periodic reviews to ensure payment processing is timely and accurate. ¹

¹

Response

The Director, TEB, agreed with our recommendations and will take the following actions:

- TEB office management will use the Electronic Federal Tax Payment System for all settlement payments received for voluntary compliance, examination, and Internal Revenue Code Section 6700 assessments. Guidance will be drafted and training provided for TEB office revenue agents and specialists on the use of this system, and instructions will be provided for TEB office customers in September 2006.

- ¹

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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Abbreviations

GL	General Ledger
I.R.C.	Internal Revenue Code
IRS	Internal Revenue Service
OSPS	Ogden Submission Processing Site
TEB	Tax Exempt Bonds
VCAP	Voluntary Closing Agreement Program



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Background

The Tax Exempt Bonds (TEB) office within the Internal Revenue Service (IRS) Tax Exempt and Government Entities Division administers the Federal Government tax laws applicable to tax-exempt bonds. Tax-exempt bonds include governmental and qualified private activity certificates of debt issued by State and local governments or by organizations acting on their behalf, such as universities and nonprofit organizations. They are used to finance various tax-exempt projects that benefit the public, such as courthouses, hospitals, airport expansions, and highways.

Tax-exempt bond noncompliance is corrected through one of several TEB office compliance programs: the Voluntary Closing Agreement Program (VCAP),¹ Information Return for Tax-Exempt Private Activity Bond Issues (Form 8038)² examinations, and Internal Revenue Code (I.R.C.) Section (§) 6700³ examinations/ investigations. When noncompliance is identified, the TEB office attempts to reach an agreement with the bondholder or their representative to make payment to correct the noncompliance issue. When the bondholder or representative pays the agreed amount, it is known as a settlement payment. Settlement payments can vary widely. For example, in Fiscal Year 2004, the TEB office received settlement payments ranging from approximately \$300 to \$5 million and totaling \$17 million.

The TEB office received and processed payments ranging from approximately \$300 to \$5 million in Fiscal Year 2004.

Settlement payments can be received in the TEB Headquarters office as well as the various field offices. All TEB offices are responsible for timely processing payments received through the mail or delivered by hand and for submission of the payments to the IRS Ogden Submission Processing Site (OSPS) in Ogden, Utah, for deposit.

¹ The VCAP was established by IRS Notice 2001-60 issued on October 1, 2001. It is intended to supplement the TEB office's examination program and provides a means for bond issuers to self-identify Internal Revenue Code violations and report them to the IRS. The VCAP allows a reduced settlement amount of less than the amount the bond issuer would be assessed if the violation was identified during an examination.

² Form 8038 is filed one time, when a tax-exempt bond is issued.

³ I.R.C. § 6700 (2004) imposes a penalty for promoting an abusive tax shelter while making a false or fraudulent misrepresentation as to any material matter or for making a material gross valuation overstatement as to any material matter.



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Payments collected from most IRS customers generally post to the customers' Master File⁴ account. However, prior to January 2001, TEB office customers had accounts on the Non-Master File⁵ because the Master File was not set up to handle Forms 8038. As a result, payments by TEB office customers posted to an IRS General Ledger (GL) 6400⁶ account at the OSPS. In 2001, as the IRS began establishing tax-exempt bond accounts on the Master File, payments could be posted to these accounts and were no longer processed to the GL 6400 account. However, some payments to correct tax-exempt bond noncompliance issues are paid by third parties (e.g., bond counsel or bond underwriters) on behalf of the bond issuers. These payments cannot be posted to the Master File account and must be processed to the GL 6400 account.

This review was performed at the TEB Headquarters office in Washington, D.C., and in the OSPS Accounting Branch Office during the period December 2005 through May 2006. 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.

⁴ The Master File is a database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

⁵ The Non-Master File consists of transactions on tax accounts not included on the Master File.

⁶ The GL 6400 account is used to record miscellaneous collections that are not assessable on the IRS customer's account. It is also used to record the amount of collections received as a result of judgments for fines, penalties, or court costs asserted by Federal Government courts incident to evasion of payment of taxes, offers accepted in lieu of such liabilities, and other nonassessable specific penalty offers.



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Results of Review

Controls Did Not Ensure Tax-Exempt Bond Settlement Payments Were Timely Processed or Accurately Posted to Customer Accounts

The TEB office's internal control procedures were not adequate to ensure the timely deposit of payments received in settlement of closing agreements and the accurate posting of payments to customer accounts. We identified extensive delays in the processing of payments received by the TEB office from October 1, 2001, through September 30, 2005, and processed through the OSPS for deposit.¹

Internal control weaknesses prevented us from determining specific reasons for the delays. When settlement payments are not deposited timely or accurately, the IRS loses interest accruals on the undeposited amounts, payments can be applied to the incorrect accounts thereby not giving customers credit for making payments, and controls may not prevent the refunding of settlement payments to the payees.

Almost one-half of the TEB office settlement payments were potentially not deposited timely.

Our analysis determined all 436 settlement payments received by the TEB office were deposited and posted to IRS computer accounts. However, almost one-half of the payments potentially were not deposited timely. In addition, some posting inaccuracies made account information unreliable

¹

Significant delays occurred in processing tax-exempt bond settlement payments

Our analysis of the 436 TEB office settlement payments identified 206 payments that potentially were deposited between 1 and 301 calendar days late. In making this determination, we relied on the TEB office's records, OSPS GL 6400 account records, and Master File account data. In those instances for which TEB office records did not have the actual received

Of the 436 settlement payments we reviewed, 206 potentially were deposited between 1 and 301 days late.



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date, we used the TEB office's date received on the Payment Posting Voucher-Examination (Form 3244-A)⁷ or information contained in the case file for making this determination. To comply with the law on financial management,⁸ the IRS must deposit payments without delay by the third business day after receipt. IRS guidelines require that all payments be transmitted to the appropriate designated Submission Processing site⁹ on the day received, or as soon as possible on the next business day, to meet IRS goals for timely deposit and to avoid unnecessary delays in processing. IRS procedures also require recording the date money is received in IRS computer systems to ensure customers are given credit for making payments as of that date.

We could not determine the extent of the delays or the specific reasons for the delays in depositing payments for settlement agreements because the TEB office had not established (1) sufficient internal controls to ensure payments are processed and mailed within the second business day of receipt or (2) procedures to identify trends of late deposits.

Untimely Processing

The Internal Revenue Manual outlines procedures for processing payments received in closing agreements; however, the instructions are inadequate. For example, these instructions do not require shipment of payments by the next business day after receipt, and there is no requirement for payment processors to use the date the payment was received as the transaction/received date or to date and follow-up on the Document Transmittals (Form 3210) when transmitting payments to the OSPS.

Figure 1 compares IRS guidelines for processing payments to the general steps used by the TEB office to process the 436 settlement payments we reviewed.

⁷ Form 3244-A is a standard IRS form used to process payments received by the IRS and provides instructions for posting such as the amount, tax period, and transaction codes used to post the payment to the appropriate Master File account.

⁸ 31 United States Code § 3302 (2004).

⁹ The IRS has eight Submission Processing sites that process certain types of payments.



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Figure 1: Comparison of IRS Guidelines to TEB Office Payment Processing Steps

IRS Guidelines	TEB Office Payment Processing
Form 3244-A is prepared for payments without source documents on the day of or day after payments are received.	The TEB office could not determine how long after a payment was received that a Form 3244-A was prepared (see next line for explanation).
The date the payment is received from the customer should be input as the transaction/received date on Form 3244-A.	The date the Form 3244-A was prepared (not the date the payment was received) was input as the transaction/received date on the Form 3244-A.
Forms 3210 should be used to control payments transferred from one IRS office to another.	The TEB office used Forms 3210 to transfer payments to the OSPS. However, Forms 3210 were not always dated, so TEB office management could not determine if the payments were mailed timely to the OSPS.
When payments are received by the OSPS, the Form 3210 confirmation copy should be returned to the originating IRS office within 5 business days to acknowledge receipt of the payments. If the acknowledgment is not received within 10 business days, the sending office should follow up with the OSPS.	Most of the Form 3210 confirmation copies for the 436 payments were sent back to the TEB office; however, no follow-up was performed for those Forms 3210 not received after 10 business days or not received at all. As a result, the TEB office does not have assurance all payments were received by the OSPS.

Source: Internal Revenue Manual payment processing procedures compared to actual payment processing practices in the TEB office.

We initially intended to review a sample of 54 payments to determine the timeliness of deposit. When delays in making deposits were identified, testing was expanded to include all 436 payments. We were able to obtain documentation from TEB office management regarding payment processing for 13 VCAP cases included in the sample of 54 cases, but not for Form 8038 examinations or I.R.C. § 6700 examinations/investigations. We performed a review of the 13 VCAP cases for which the TEB office processed the payments to the OSPS to identify where the delays could have occurred.

- Two of the 13 letters accompanying the payments from customers were date stamped upon receipt in the TEB office, but the receipt dates were not input to the Master File.
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The dates stamped on the letters should have been input to the Master File. In addition, we could not determine the length of time the TEB office held the payments prior to sending them to the OSPS.

- The other 11 of 13 letters accompanying the payments from customers were not date stamped upon receipt in the TEB office. We reviewed case file documentation to determine when these payments were received in the TEB office.
 - For 6 of the 11, the payment received dates posted to the Master File agreed with case file documentation.
 - For 5 of the 11, the payment received dates posted to the Master File were between 1 and 20 calendar days later than the estimated received/transaction date determined by our review of the case file documentation.
- Two of the 13 Forms 3210 used to transmit the 13 VCAP payments to the OSPS were dated.

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- For the remaining 11 of 13 payments, we could not determine when the payments were sent to the OSPS because the Forms 3210 used to transmit the payments were not dated. In addition, TEB office management could not determine if or when the OSPS processed the payments because acknowledgement copies of the Forms 3210 were not available for review.

Untimely Deposits

To determine if all 436 payments were deposited timely in accordance with the law, we allowed 5 calendar days (based on the 3-day legal requirement) from the received date of the payment to the deposit date to allow for payments that may have been mailed over a weekend. We considered deposits made more than 5 calendar days after receipt of the payments as untimely.



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We determined 230 of the 436 settlement payments were deposited within 5 calendar days of receipt by the TEB office. The remaining 206 settlement payments totaling approximately \$57 million were deposited and posted to IRS records after the 5-calendar day period. The payments potentially were deposited between 1 and 301 calendar days late, with deposits being made an average of 23 calendar days after receipt. We could not determine how much of the 23 calendar days represented the TEB office's processing time to send the payments to the OSPS.

We also performed further analysis to determine the timeliness of deposits by the type of case. The settlement payments were associated with the following types of cases: 128 VCAP cases, 277 Form 8038 examinations, and 31 I.R.C. § 6700 examinations/investigations and totaled approximately \$103 million.

VCAP Settlement Payments – Of the 128 VCAP payments, 103 (80 percent) totaling approximately \$14 million were deposited more than 5 calendar days after receipt by the TEB office. For the 103 untimely deposits:

- The payments were deposited between 1 and 301 calendar days late.
- It took an average of 25 calendar days after receipt in the TEB office to deposit the payments.

Form 8038 Examination Settlement Payments – Of the 277 Form 8038 examination payments, 83 (30 percent) totaling approximately \$18 million were deposited more than 5 calendar days after receipt by the TEB office. For the 83 untimely deposits:

- The payments were deposited between 1 and 140 calendar days late.
- It took an average of 24 calendar days after receipt in the TEB office to deposit the payments.

I.R.C. § 6700 Settlement Payments – Of the 31 I.R.C. § 6700 payments, 20 (65 percent) totaling approximately \$25 million were deposited more than 5 calendar days after receipt by the TEB office. For the 20 untimely deposits:

- The payments were deposited between 1 and 45 calendar days late.
- It took an average of 15 calendar days after receipt in the TEB office to deposit the payments.

In a separate audit¹⁰ covering the timeliness of deposits for all Tax Exempt and Government Entities Division customer payments (not just the TEB office), the Treasury Inspector General for Tax Administration determined the OSPS does not always process deposits timely after it receives them. The audit analyzed 130,416 Tax Exempt and Government Entities Division customer payments received during the period October 1, 2004, through July 21, 2005, and

¹⁰ *Tax Exempt and Government Entities Customers Receive Adequate Service During Most Processing Activities; However, Remittances May Not be Deposited Timely* (Reference Number 2006-10-126, dated August 2006).



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determined that, for 17,778 (13.6 percent) payments, there were more than 6 calendar days¹¹ between the IRS received date and the deposit date, which indicates a potential delay in the depositing of payments. These potential late deposits totaled approximately \$53 million and ranged individually from less than \$10 up to approximately \$3 million.

When payments are not deposited timely to the appropriate Department of the Treasury account, there are several consequences, including goals not being met to achieve good cash management practices, the Federal Government not receiving the maximum availability of funds, and potentially losing interest income.

TEB office inventory systems did not adequately control all payments processed to the OSPS GL 6400 account

We analyzed 436 settlement payments closed by settlement agreements and determined all 436 payments posted to either the OSPS GL 6400 account or to the Master File.

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In addition, we traced all 174 TEB office settlement payments listed in the OSPS GL 6400 account to determine whether all payments were related to cases controlled on TEB office inventory records. We initially identified 49 of 174 payments that could not be associated with any case in the TEB office's inventory control records. TEB office management performed additional research and located a spreadsheet used to track cases processed through the TEB Headquarters office. This spreadsheet is not considered an inventory report; it simply provides information for the annual Business Performance Report. The spreadsheet listed cases associated with 41 of the 49 settlement payments. Based on the spreadsheet, we concluded the 41 cases and associated payments had been under TEB office management's control at the time they were worked. For the remaining eight payments, OSPS personnel and TEB office management performed additional research and concluded three payments related to TEB office cases and five payments did not. Although TEB office management was able to resolve all 49 payments, the difficulty in researching these payments indicates TEB office inventory systems do not provide adequate control over all cases and associated payments. We will consider reviewing the TEB office's inventory systems in a future audit.

Control weaknesses resulted in some inaccurate and unreliable customer account information

The controls over processing TEB office settlement payments were not adequate to ensure customer account information accurately and reliably posted to IRS computer

Some information posted inaccurately to customer accounts.

¹¹ During peak periods or when the payments in the deposit function exceed the deposit capacity, the deposit cycle may be extended 2 business days. However, the extended cycles must not exceed 5 business days.



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systems. The inaccuracies identified were not widespread. However, from a review of the 436 payments, we identified 14 customer accounts for which the payments either posted to a computer system other than the one intended by TEB office management,¹

- **Twelve payments were posted to the incorrect computer system.**

We determined 5 of 436 settlement payments posted to the OSPS GL 6400 account in error. IRS management subsequently identified and manually transferred the five payments to the appropriate Master File account. TEB office guidelines require that a settlement payment post to the Master File and not the OSPS GL 6400 account if the Form 8038 is controlled on the Master File. In addition, 7 of the 436 payments were erroneously posted to the Master File and IRS management subsequently identified and manually transferred the 7 payments to the OSPS GL 6400 account.

If a payment posts to a system other than the one intended, TEB office management may be unable to determine easily if the account is settled. Accounts in an unsettled status can result in increased burden on the TEB office to resolve the errors and on customers if they are asked to make payments they have already submitted.

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When a payment posts to a Master File account in advance of the penalty assessment, a credit condition is created. This credit condition could result in the payment refunding to the customer unless the account is frozen until the related assessment is posted to the account.

¹ there is always a risk of an improper refund when an account on the Master File is in a credit condition without an appropriate freeze to prevent the credit from refunding.

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All the conditions identified in this report are related to internal control weaknesses that allowed the conditions to occur. In many instances, TEB office management was not aware of the



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conditions we are reporting. TEB office management is responsible for establishing controls to provide reasonable assurance of the effective and efficient operation of their office. One of the challenges facing TEB office management was the creation of the Tax Exempt and Government Entities Division in December 1999 as part of the IRS reorganization. Prior to its organization as a separate office in Fiscal Year 2000, the TEB office was part of the Exempt Organizations function. During this transition, TEB office management faced several priorities, including hiring and training staff and developing initial office procedures. They also had to develop an inventory system and internal control procedures. We determined the procedures and controls related to processing payments were not effective. Specifically, at the time of our review:

- Payment received dates were not captured on Form 3244-A. Instead, the TEB office was using the date the Form 3244-A was prepared as the payment received date (which was sometimes much later), and that incorrect date was input to IRS computers as the payment received date.
- Forms 3210 were not always dated when sending payments to the OSPS, and procedures had not been established to follow up with the OSPS when the acknowledgement copy of a Form 3210 was not received timely. As a result, the TEB office did not have assurance all payments were timely mailed to and received by the OSPS.
- Procedures had not been established to review computer account information to identify trends of late deposit of payments or input of inaccurate account information. As a result, TEB office management was not aware of the extent of the issues identified in this report.

TEB office management advised us during our audit that they were in the process of reevaluating their procedures and controls and requested our input on where controls needed to be strengthened.

Recommendations

Recommendation 1: The Director, TEB, should establish effective controls over the receipt and processing of settlement payments received for TEB office cases. The controls should ensure the following:

- Each settlement payment is date stamped on the day received, to ensure the date the IRS received payment is captured.
- All payments received in the TEB Headquarters office and field offices are entered into a control list that is used to ensure no payments are lost or misdirected prior to posting to IRS computer accounts.
- The Form 3244-A is prepared the day a settlement payment is received (or the next business day) and the date the settlement payment was received by the TEB office is entered as the received/transaction date on the Form 3244-A.



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- Each settlement payment (including the Forms 3244-A and 3210) is express mailed to the OSPS on the day of or the next business day after receipt and the date the payment is express mailed is captured on the control list.
- The Form 3210 is dated on the date settlement payments are sent via overnight traceable mail to the OSPS and TEB office employees follow up with the OSPS when the acknowledgment copy of the Form 3210 has not been received.
- Periodic reviews are performed to ensure payments are processed timely and accurately by the TEB office.

Management's Response: The Director, TEB, agreed with this recommendation and will use the Electronic Federal Tax Payment System for all settlement payments received for voluntary compliance, examination, and I.R.C. § 6700 assessments. Guidance will be drafted and training provided for TEB office revenue agents and specialists on the use of this system, and instructions will be provided for TEB office customers in September 2006.

Recommendation 2: ¹

Management's Response: ¹



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Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to determine whether TEB office management ensured payments received in settlement of closing agreements were timely and accurately processed to the appropriate accounts. We did not conduct tests to determine the reliability of the data; however, various data elements such as payment received and deposit dates were verified to the Business Master File and the OSPS¹ Non-Master File GL 6400² account. Also, data from the inventory listings were traced to source documents in related VCAP³ case files for validation.

To accomplish our objective, we:

- I. Identified all 436 payments made to settle Information Return for Tax-Exempt Private Activity Bond Issues (Form 8038) examinations, I.R.C. § 6700 examinations/investigations, and VCAP cases closed with a closing agreement during the period October 1, 2001, through September 30, 2005.
 - A. From the Audit Information Management System,⁴ identified 277 Form 8038 examinations closed using Disposal Code 12.⁵
 - B. From TEB office lists, identified 31 closed I.R.C. § 6700 examinations/investigations.
 - C. From TEB office lists, identified 128 closed VCAP cases.

¹ The IRS has eight Submission Processing sites that process certain types of payments.

² The GL 6400 account is used to record miscellaneous collections that are not assessable on the IRS customer's account. It is also used to record the amount of collections received as a result of judgments for fines, penalties, or court costs asserted by Federal Government courts incident to evasion of payment of taxes, offers accepted in lieu of such liabilities, and other nonassessable specific penalty offers.

³ The VCAP was established by IRS Notice 2001-60 issued on October 1, 2001. It is intended to supplement the TEB office's examination program and provides a means for bond issuers to self-identify I.R.C. violations and report them to the IRS. The VCAP allows a reduced settlement amount of less than the amount the bond issuer would be assessed if the violation was identified during an examination.

⁴ The Audit Information Management System is an inventory control system for examinations. It provides control of assessments and up-to-date management reports.

⁵ Examinations closed with a "closing agreement."



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- II. Determined if all TEB office settlement payments were posted to the OSPS in Ogden, Utah, GL 6400 account or the appropriate Master File⁶ account and were accurately reflected in the TEB office's records.
- A. Compiled a list from the Payment Posting Voucher-Examination (Form 3244-A)⁷ of all 174 closing agreement settlement payments posted to the OSPS GL 6400 account.
 - B. Traced all 436 closing agreement settlement payments identified from TEB office records in Step I. to the list compiled from OSPS records in Step II.A.
 - C. Determined if closing agreement settlement payments not posted to the OSPS GL 6400 account posted to the appropriate Master File account and resolved discrepancies with TEB office management.
 - D. Determined there were 49 closing agreement settlement payments listed on OSPS GL 6400 account lists but not listed on TEB office payment records and resolved these discrepancies with TEB office management by reviewing case file documentation.
- III. Analyzed all 436 cases to evaluate the timeliness of processing TEB office settlement payments to the OSPS GL 6400 account and the Master File.
- A. Selected a judgmental sample of 54 payments from 436 payments for the period.
 - B. Identified receipt dates from TEB office records, the Master File, and OSPS GL 6400 account information and deposit dates from the Master File and OSPS GL 6400 account information to determine the length of time for deposit.
 - C. Reviewed all available case documentation (13 of 54 cases) from the TEB office to identify reasons for delays in processing payments.
 - D. Expanded analysis to include all 436 payments to determine the length of time for deposit.

⁶ The Master File is a database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

⁷ Form 3244-A is a standard IRS form used to process payments received by the IRS and provides instructions for posting such as the amount, tax period, and transaction codes used to post the payment to the appropriate Master File 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, Tax Exempt Bonds, Tax Exempt and Government Entities Division SE:T:GE:TEB
Director, Submission Processing SE:W:CAS:SP
Deputy Director, Submission Processing SE:W:CAS:SP:D
Field Director, Submission Processing SE:W:CAS:SP:O
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 Internal Control OS:CFO:CPIC:IC
Audit Liaison: Director, Communications and Liaison, Tax Exempt and Government Entities
Division SE:T:CL



Insufficient Controls Resulted in Significant Delays in Processing Tax-Exempt Bond Payments and Some Unreliable Payment Posting Dates

Appendix IV

Outcome Measures

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

Type and Value of Outcome Measure:

- Taxpayer Burden – Potential

¹

- Taxpayer Burden – Potential

Twelve payments were posted to the incorrect computer system and had to be manually transferred. The customers could have been asked to pay a settlement payment that had already been paid (see page 3).

- Revenue Protection – Actual

¹

Methodology Used to Measure the Reported Benefit:

- ¹

¹ The Master File is a 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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- Twelve payments were posted to the incorrect account and had to be manually transferred. Payments to settle VCAP² and examination cases should post to the Master File. Payments to settle I.R.C. § 6700 penalty cases should post to the OSPA GL 6400 account. We reviewed the Master File and GL 6400 account data and identified [REDACTED] [REDACTED] that posted to the GL 6400 account in error. We also identified seven I.R.C. § 6700 penalty payments that posted to the Master File in error. IRS management subsequently identified and manually transferred the 12 payments to the correct accounts.

These TEB office customers could have been asked to pay a settlement payment that had already been paid because the payments were posted to the incorrect computer account.

- [REDACTED]

² The VCAP was established by IRS Notice 2001-60 issued on October 1, 2001. It is intended to supplement the TEB office's examination program and provides a means for bond issuers to self-identify I.R.C. violations and report them to the IRS. The VCAP allows a reduced settlement amount of less than the amount the bond issuer would be assessed if the violation was identified during an examination.



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Appendix V

Management's Response to the Draft Report



COMMISSIONER
TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

RECEIVED
AUG 11 2006

AUG 11 2006

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM:


Steven T. Miller
Commissioner, Tax Exempt & Government Entities

SUBJECT:

Insufficient Controls Resulted in Significant Delays in Processing Tax-Exempt Bond Payments and Some Unreliable Payment Posting Dates (Audit #200610009)

I am pleased to respond to your report concerning the posting of settlement payments received by our Tax Exempt Bonds (TEB) office in connection with closing agreements executed during fiscal years 2001 through 2005. As you noted, TEB received over \$100,000,000 in settlement payments resolving tax violations in 436 examination and voluntary compliance cases during this period. We believe that these efforts are having a positive compliance impact on the tax-exempt bond market.

We agree with the importance of depositing received payments in conformity with federal financial management standards. We also agree that the timely processing of TEB related payments is a responsibility shared by several operating divisions and functions (see, Audit #200610012). While we remain confident that our business practices support these standards, we are concerned about the processing delays identified in your report.

Your findings focus on our internal controls and do not assign direct responsibility for any processing delays to TEB. However, your report offered us an opportunity to critically review our processing practices. Accordingly, we closely examined the records of payments TEB received in the 40 voluntary compliance cases closed in FY 2005. We concluded that the case file documentation clearly showed that TEB timely transmitted payments for deposit in 78% of these cases (31 of 40). Further, the timeliness rate rose to 90% when we employed certain reasonable assumptions about



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when we took certain processing actions. While we are concerned about not achieving 100% timeliness and agree that our recordkeeping warranted improvement, we believe that these results are reflective of TEB's recent payment processing practices.

Despite our differing assessments, we acknowledge with appreciation your work and report, and agree with its core conclusion that TEB's internal controls can be improved to achieve 100% timeliness of payment processing actions within our control. To achieve this goal, we are committed to implementing mandatory electronic payment processing for all examination and voluntary compliance cases beginning in FY 2007.

Our responses to the recommendations in the report follow.

RECOMMENDATION 1:

The Director, TEB, should establish effective controls over the receipt and processing of settlement payments received for TEB office cases.

CORRECTIVE ACTION 1:

TEB will use the Electronic Federal Tax Payment System (EFTPS) for all settlement payments received with respect to voluntary compliance and examination cases, including IRC 6700 promoter cases. We will draft guidance for TEB revenue agents and specialists on the use of EFTPS, and instructions for governmental issuers and other payors in TEB closing agreements. We plan to distribute this guidance and provide training during TEB's FY 2006 continuing professional education program in September, 2006. This will eliminate the problems associated with paper checks.

RESPONSIBLE OFFICIAL:

Director, TEB.

IMPLEMENTATION DATE 1:

October 15, 2006.

RECOMMENDATION 2:

1

CORRECTIVE ACTION 2:

1



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3

RESPONSIBLE OFFICIAL:

Director, TEB.

IMPLEMENTATION DATE 2:

Completed.

We concur with your descriptions of measurable benefits on tax administration.

If you have any questions, please contact Clifford Gannett at 202-283-9820 or Preston Butcher at 202-283-9738.

cc: Preston Butcher, Director, Government Entities, SE:T:GE
Clifford Gannett, Director, Tax Exempt Bonds, SE:T:GE:TEB