TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Taxpayers Residing in the Hurricanes Katrina and Rita Disaster Areas Were Accurately Identified for Tax Relief

July 31, 2006

Reference Number: 2006-40-109

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

July 31, 2006

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED DIVISION

Michael R. Phillips

FROM: Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Taxpayers Residing in the Hurricanes Katrina and Rita Disaster Areas Were Accurately Identified for Tax Relief (Audit # 200640026)

This report presents the results of our review to determine whether the Internal Revenue Service (IRS) correctly identified both individual and business taxpayers affected by Hurricanes Katrina and Rita and accurately placed disaster indicators on these taxpayers' accounts. We also determined whether the IRS properly prevented notices from being sent to these taxpayers to collect a balance due.

This review was conducted in conjunction with the President's Council on Integrity and Efficiency (PCIE) as part of its examination of relief efforts provided by the Federal Government in the aftermath of Hurricanes Katrina and Rita. A copy of the report was forwarded to the PCIE Homeland Security Working Group, which is coordinating the Inspectors' General reviews of this important subject.

Synopsis

Natural disasters can have devastating effects on taxpayers both emotionally and financially. Hurricane Katrina made landfall at the Central Gulf Coast of the United States on August 29, 2005. It caused unprecedented damage to New Orleans, Louisiana, as well as the coastal areas of Mississippi and Alabama, and became the most destructive and costliest natural disaster in United States history. Hurricane Rita followed less than 1 month later and further damaged New Orleans and the Gulf Coast area of Texas. Together, these Hurricanes affected millions of taxpayers.

The IRS has the authority to grant extensions to file certain tax returns and pay certain taxes, waive penalties, and abate interest for taxpayers affected by natural disasters such as hurricanes. To provide this tax relief, the IRS identifies taxpayers residing in a disaster area based on their zip codes and then uses a computer application to place a disaster indicator on their accounts.[1] This disaster indicator includes information such as the beginning and ending dates of the disaster period and a Federal Emergency Management Agency (FEMA) disaster code indicating which disaster affected the taxpayer. The beginning and ending dates are used to determine the extent of tax relief that taxpayers receive. In addition, taxpayers may contact the IRS to request relief and have a disaster indicator manually input to their accounts.

> ***The IRS correctly identified taxpayers affected by Hurricanes Katrina and Rita and placed disaster indicators on their accounts to provide tax relief.***

The IRS correctly identified taxpayers affected by Hurricanes Katrina and Rita and placed disaster indicators on their accounts. Disaster indicators properly prevented balance-due notices from being issued to affected taxpayers. Systemically placed indicators accounted for almost all (over 99.9 percent) of the indicators placed on taxpayers' accounts. These systemically placed indicators had the correct disaster period beginning and ending dates.

However, manually input indicators, which accounted for less than 0.1 percent of the total, often had an incorrect disaster period beginning or ending date. We analyzed 1,150 manually input disaster indicators and identified 779 (68 percent) with an incorrect beginning and/or ending date. Taxpayers with these indicators on their accounts would have received less tax relief than they were entitled to.[2]

In addition, the IRS extended the disaster period ending date twice to grant additional tax relief for Hurricane Katrina victims.[3] When the IRS extended this date, accounts with manually input indicators were not updated. This occurred because the computer program used for the update identified only those accounts with systemically placed indicators. As a result, the ending date for 748 disaster indicators[4] was not properly extended, and the taxpayers with these indicators on their accounts would not have received the full benefit of the disaster relief provisions. We advised the IRS of this concern during our review, and IRS management took action to identify and manually input disaster indicators with corrected ending dates to these taxpayers' accounts.

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[1] Throughout this report, we refer to these computer-generated disaster indicators as systemically placed indicators.
[2] Although some date errors extended the relief period, most errors improperly shortened it.
[3] On September 8, 2005, the IRS extended the disaster relief to January 3, 2006. On September 28, 2005, the IRS extended the disaster relief to February 28, 2006. Near the end of our audit period, there was an additional extension to August 28, 2006, that was not considered in our review.
[4] Some of these indicators could also be included in those above that were input incorrectly.

Recommendations

The Commissioner, Small Business/Self-Employed (SB/SE) Division, should coordinate with the other IRS business units to provide employees with a regularly updated job aid for manually input disaster indicators and emphasize the importance of using the correct dates for interest and penalty calculations. In addition, when the IRS extends the disaster relief period, the Commissioner, SB/SE Division, should take appropriate actions to identify accounts with manually input disaster indicators and update the accounts with the extended ending date.

Response

The IRS agreed with both of our recommendations. The SB/SE Division will develop an enhanced online job aid that will be easily updated for use when manually inputting disaster indicators. The new version will provide information necessary to correctly extend filing and payment deadlines for taxpayers who self-identify. The IRS will also issue updated guidelines to all business units regarding the importance of using the most up-to-date information and dates to ensure interest and penalties are accurately calculated for taxpayers affected by disasters.

The IRS will create a new systemic account indicator, known as an "S freeze," that will decrease the number of manually placed indicators. The new S freeze will be used for limited-scope disasters when a determination is made that compliance activity should not be suspended; it will also further enhance the IRS' ability to avoid the errors associated with the self-identification process and reduce the volume of inputs of manual disaster indicators. The IRS is also examining the extension process and all manually input disaster indicators in an effort to identify additional system enhancements. 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 Michael E. McKenney, Assistant Inspector General for Audit (Wage and Investment Income Programs), at (202) 622-5916.

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Background

Hurricane Katrina made landfall at the Central Gulf Coast of the United States on August 29, 2005, and caused unprecedented damage to New Orleans, Louisiana, as well as the coastal areas of Alabama and Mississippi. The National Hurricane Center described Hurricane Katrina as one of the most powerful storms ever to form over the Atlantic Ocean. Several levee systems in New Orleans collapsed and most of the city was flooded by water, making this Hurricane the most destructive and costliest natural disaster in United States history. Less than 1 month later, Hurricane Rita made landfall in Florida and proceeded west to strike Louisiana and Texas. Hurricane Rita further damaged some of the levee breaches caused by Hurricane Katrina and again flooded parts of New Orleans. Also, postlandfall damage was extensive in the coastal areas of southwestern Louisiana and southern Texas.

Because of these 2 Hurricanes, over 430 counties across Alabama, Florida, Louisiana, Mississippi, and Texas were declared disaster areas. The Internal Revenue Service (IRS) has the authority to grant extensions to file certain tax returns and pay certain taxes, to waive penalties, and to abate interest for taxpayers affected by natural disasters such as hurricanes. Due to the large number of taxpayers affected by these Hurricanes, and interest expressed by the Senate Finance Committee about IRS tax relief efforts, we initiated this review to evaluate IRS actions to identify affected taxpayers, place indicators on their accounts for disaster relief, and prevent notices to collect a balance due. In addition, we conducted this review in conjunction with the President's Council on Integrity and Efficiency as part of its examination of relief efforts provided by the Federal Government in the aftermath of Hurricanes Katrina and Rita.

Over 430 counties in Alabama, Florida, Louisiana, Mississippi, and Texas were declared disaster areas.

This review was performed at the Small Business/Self-Employed (SB/SE) Division Headquarters in Washington, D.C., and the Modernization and Information Technology Services organization in New Carrollton, Maryland, during the period November 2005 through March 2006. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objectives, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

Results of Review

Taxpayers Residing in the Disaster Areas Were Correctly Identified, and Systemic Disaster Indicators Were Accurately Placed on Their Accounts

The IRS responded quickly and effectively to the Hurricanes Katrina and Rita disasters by placing disaster indicators on affected taxpayers' accounts. These indicators properly prevented notices to collect a balance due from being sent to these taxpayers. However, steps can be taken to improve the processes for future disaster relief efforts.

The IRS placed approximately 12.5 million disaster indicators on individual taxpayers' accounts and approximately 2.9 million disaster indicators on business taxpayers' accounts.

When a disaster is declared, the Federal Emergency Management Agency (FEMA) designates specific counties as eligible for assistance. The IRS then determines if taxpayers in those counties should qualify for tax relief based on the severity of the disaster. Once the IRS determines which counties are eligible for relief, it identifies the zip codes within those counties and identifies the taxpayers residing in the disaster area based on the zip codes. To provide tax relief to these taxpayers, the IRS then uses a computer application to place a disaster indicator on their accounts.[1] Disaster information placed on taxpayers' accounts includes a numeric FEMA disaster code that identifies the disaster and the disaster period beginning and ending dates, which are used to determine the extent of tax relief that taxpayers receive. To identify accounts for disaster relief for Hurricanes Katrina and Rita, the IRS placed approximately 12.5 million disaster indicators on individual taxpayers' accounts and approximately 2.9 million disaster indicators on business taxpayers' accounts.

The IRS identified the correct zip codes for Hurricanes Katrina and Rita and accurately identified taxpayers within these zip codes for disaster relief. We identified the zip codes associated with the declared disaster counties using both third-party and United States Postal Service data. We compared these zip codes to those the IRS used and reconciled any discrepancies. We also obtained computer extracts identifying taxpayer accounts with a disaster indicator for these Hurricanes and identifying accounts of taxpayers residing within the zip code areas for these Hurricanes. We analyzed these accounts and determined that the IRS placed the indicators on the correct accounts.

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[1] Throughout this report, we refer to these computer-generated disaster indicators as systemically placed indicators.

In addition, the disaster indicators the IRS systemically placed on taxpayers' accounts had the correct disaster period beginning and ending dates. These systemically placed indicators accounted for almost all (over 99.9 percent) of the disaster indicators placed on taxpayers' accounts.

Disaster Indicators Effectively Prevented Notices to Collect a Balance Due From Being Sent

The disaster indicators are intended to prevent certain notices from being mailed to taxpayers from the time the indicator is placed on the account until the disaster period ending date. During the disaster relief period, the IRS wants to prevent any notices that threaten serious enforcement actions and would worry taxpayers. Our review focused on notices to collect a balance due.[2]

The disaster indicators effectively prevented balance-due notices from being issued. From the extract of accounts with a disaster indicator, we researched 45 selected accounts with a balance due. We identified individual taxpayer accounts and business taxpayer accounts that would have had a balance-due notice issued if the disaster indicator had not been in effect. None of the identified accounts had a balance-due notice issued while the disaster indicator was in effect.

Most Manually Input Disaster Indicators Had an Incorrect Beginning or Ending Date

Taxpayers affected by a disaster whose accounts are not systemically identified for disaster relief by the IRS may contact the IRS to request relief or "self-identify." Taxpayers who self-identify will have a disaster indicator manually input to their account by an IRS employee. The disaster period beginning and ending dates are input to taxpayers' accounts along with the disaster indicator. The beginning date should be the date the disaster occurred, as determined by the FEMA. The ending date is established by the IRS. These dates determine the period for which the taxpayer receives tax relief.

The disaster period dates on manually input indicators for Hurricanes Katrina and Rita were often incorrect. The taxpayers with these indicators on their accounts would not have received the full protection of the disaster relief provisions to which they were entitled.[3] Although these incorrect dates involved only a small number of taxpayers (less than 0.1 percent of the indicators

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[2] This included the following notices issued to individual taxpayers: Computer Paragraph (CP) 501 First Notice – Balance Due, CP 503 Second Notice – Balance Due, and CP 504 – Notice of Intent to Levy. This also included Notice CP 504 – Notice of Intent to Levy for business taxpayers.

[3] Although some date errors extended the relief period, most errors improperly shortened it. When filing and payment due dates fall within the disaster relief period, the disaster coding should prevent the accrual of interest and certain penalties for the disaster period. In addition, certain notices to collect a balance due should be suppressed from the time the indicator is input until the disaster period ends.

were input manually), those with manually input indicators would be those who contacted the IRS to self-identify themselves as affected by the disaster. These taxpayers would likely be those who most needed tax relief.

Manually input indicators often had incorrect dates

Disaster indicators manually input to taxpayers' accounts were often input with incorrect disaster period beginning and/or ending dates. Of the 1,150 manually input indicators we analyzed, 779 (68 percent) were input with an incorrect beginning and/or ending date.[4]

Human error caused most of the incorrect dates. For example, some employees input the current date as the beginning date rather than the actual date of the disaster; other employees input old ending dates rather than revised ending dates. In addition, some errors were caused by misleading IRS procedures. For Hurricane Katrina, one of the FEMA disaster areas had a beginning date different from that for the other three areas. However, most IRS guidance issued to employees for Hurricane Katrina provided only one beginning date – the one that applied to the three areas.

The IRS did not systemically extend the disaster period ending date on manually input indicators

The disaster period ending date for Hurricane Katrina was extended twice by the IRS to grant affected taxpayers additional tax relief.[5] However, when the IRS updated the disaster period ending dates on taxpayers' accounts, those with manually input disaster indicators were not updated to the revised ending date. Of 1,825 disaster indicators manually input for Hurricane Katrina through mid-November 2005, 748 (41 percent) had an incorrect ending date[6] because the IRS did not systemically update it.

The disaster period ending date needs to accurately reflect the date established by the IRS. When the IRS extended the ending date for Hurricane Katrina, taxpayers' accounts should have been adjusted accordingly for all taxpayers eligible for relief, including both those with a systemically placed indicator and those with a manually input indicator.

The IRS used a computer application to update the disaster period ending date for taxpayers affected by Hurricane Katrina. To identify the accounts needing a revised ending date, it used the same data files used to systemically place the initial indicators on taxpayers' accounts. As a result, ending dates for accounts with manually input indicators were not updated.

[4] See Appendix IV for details on how this figure was calculated.
[5] On September 8, 2005, the IRS extended the disaster relief to January 3, 2006. On September 28, 2005, the IRS extended the disaster relief to February 28, 2006. Near the end of our audit period, there was an additional extension to August 28, 2006, that was not considered in our review.
[6] Some of these indicators are also included in the 779 figure noted earlier in this section of the report. See Appendix IV for details on the final calculation of our outcome measure.

Management Action: We advised the IRS of this concern during our review, and IRS management took action to identify and manually input on these taxpayers' accounts disaster indicators with corrected ending dates.

Recommendations

Recommendation 1: The Commissioner, SB/SE Division, should coordinate with the other IRS business units to provide employees with a regularly updated, online job aid to use for manually input disaster indicators. This job aid should summarize all current disasters, along with their beginning and ending dates. The Commissioner, SB/SE Division, should also coordinate with the other business units to emphasize to employees the importance of using the correct dates to ensure interest and penalties are accurately calculated for taxpayers affected by disasters.

> ***Management's Response:*** The IRS agreed with this recommendation. The SB/SE Division will develop an enhanced online job aid that will be easily updated for use in the manual input of disaster indicators. Other IRS business units will be consulted to ensure their needs are met. The new version of the job aid will provide information necessary to correctly extend filing and payment deadlines for taxpayers who self-identify. The IRS will also issue updated guidelines to all business units regarding the importance of using the most up-to-date information and dates to ensure interest and penalties are accurately calculated for taxpayers affected by disasters.

Recommendation 2: When the IRS extends the disaster relief period, the Commissioner, SB/SE Division, should take appropriate actions to identify accounts with manually input disaster indicators and update the accounts with the extended ending date.

> ***Management's Response:*** The IRS agreed with this recommendation. The IRS will create a new systemic account indicator, known as an "S freeze," that will decrease the number of manually placed indicators. The new S freeze will be used for limited-scope disasters when a determination is made that compliance activity should not be suspended and will further enhance the IRS' ability to avoid the errors associated with the self-identification process and reduce the volume of inputs of manual disaster indicators. The IRS is also examining the extension process and all manually input disaster indicators in an effort to identify additional system enhancements.

Appendix I

Detailed Objectives, Scope, and Methodology

The overall objective of this review was to determine whether the Internal Revenue Service (IRS) correctly identified both individual and business taxpayers affected by Hurricanes Katrina and Rita and accurately placed disaster indicators on these taxpayers' accounts. We also determined whether the IRS properly prevented notices from being sent to these taxpayers to collect a balance due. To accomplish our objectives, we:

I. Determined if the IRS identified the correct zip code areas for disaster area coding.

  A. Identified all counties affected by Hurricanes Katrina and Rita based on memoranda issued by the Federal Emergency Management Agency (FEMA).

  B. Identified the zip codes associated with these counties using United States Postal Service data and other third-party data.

  C. Matched the zip codes identified in Step I.B. to the zip code lists generated by the IRS as of October 13, 2005, and evaluated any discrepancies.

II. Determined if the IRS systemically[1] placed disaster indicators on the correct individual and business taxpayers' accounts.

  A. Obtained computer extracts from the IRS Individual Master File (IMF)[2] and Business Master File (BMF)[3] of all accounts with a disaster indicator for any of the six FEMA disaster areas for Hurricanes Katrina and Rita.[4] For each FEMA disaster area, we computer identified those accounts outside the IRS zip codes in Step I.C. We performed additional computer analyses to identify the accounts with potential erroneous systemically placed indicators and then researched and evaluated these accounts to determine if the indicators were appropriate.

    1. Evaluated small random interval samples of IMF accounts. For example, there were approximately 4 million IMF accounts extracted with a disaster indicator for

[1] The IRS identifies taxpayers residing in a disaster area based on their zip codes and then uses a computer application to place a disaster indicator on their accounts. We refer to these computer-generated indicators as systemically placed indicators.

[2] The IRS database that maintains transactions or records of individual tax accounts.

[3] 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.

[4] The FEMA disaster area codes for Hurricane Katrina were FEMA 1602 – Florida, FEMA 1603 – Louisiana, FEMA 1604 – Mississippi, and FEMA 1605 – Alabama. The FEMA disaster area codes for Hurricane Rita were FEMA 1606 – Texas and FEMA 1607 – Louisiana.

FEMA code 1602. We performed various computer analyses to identify 1,719 accounts with potential erroneous systemic indicators and evaluated a sample of 30. We performed similar steps to sample from the other five FEMA disaster areas. This sampling method was sufficient for our test purposes, and we did not plan to make projections.

2. Due to the small number of BMF accounts with potential erroneous systemic indicators, evaluated them all. For example, there were approximately 600,000 BMF accounts extracted with a disaster indicator for FEMA code 1603. We performed various computer analyses and identified [redacted] We performed similar steps for the other five FEMA disaster areas.

B. Obtained IMF and BMF extracts of accounts with an address in the IRS disaster zip code areas in Step I.C. but without the related disaster indicator. For selected FEMA disaster areas, we performed computer analyses to identify accounts that were potentially missing an indicator. We then researched random interval samples of these accounts to determine if the IRS should have placed a systemic indicator on the accounts. This sampling method was sufficient for our test purposes, and we did not plan to make projections.

1. For selected FEMA disaster areas, evaluated a random interval sample of 20 IMF accounts that were potentially missing an indicator. For example, from approximately 6,000 IMF accounts extracted for FEMA code 1603, our computer analyses identified 465 that were potentially missing the indicator. We selected and evaluated a random interval sample of 20 accounts. Due to time constraints, we performed similar steps for 4 additional FEMA disaster areas, reviewing a total of 100 accounts.

2. From each FEMA disaster area, evaluated a random interval sample of 30 BMF accounts that were potentially missing the indicator. For example, there were approximately 9,200 BMF accounts extracted for FEMA code 1603. Our computer analyses identified approximately 8,400 of these with a potential missing indicator. We selected and evaluated a random interval sample of 30 accounts. We performed similar steps for each of the other 5 FEMA disaster areas, reviewing a total of 180 accounts.

C. Determined that the data extracted in Step II.A. and Step II.B. were valid. We performed computer analyses and scanned the data to determine if the extract met our criteria and if the data appeared valid. We researched small samples of accounts on the Integrated Data Retrieval System (IDRS)[5] to ensure the data in the critical extract fields matched that on the IDRS.

III. Determined if the disaster indicators on individual and business taxpayers' accounts had correct disaster period beginning and ending dates. We computer analyzed accounts from the Step II.A. extracts to identify those with incorrect beginning or ending dates. We researched the IDRS to evaluate the accounts identified.

A. Computer analyzed the disaster period beginning and ending dates for both systemically and manually input disaster indicators on IMF and BMF accounts in three FEMA disaster areas.[6] We then evaluated the accounts with incorrect dates.

B. After identifying problems in Step III.A. with the ending dates for manually input indicators, computer analyzed the ending dates for those indicators for all IMF and BMF accounts in the four FEMA disaster areas for Hurricane Katrina. We then evaluated the accounts with incorrect dates to identify those that were not updated when the IRS extended the disaster relief period.

IV. Determined if balance-due notices were suppressed by the disaster indicators. We considered individual taxpayer notices Computer Paragraph (CP) 501 First Notice – Balance Due, CP 503 Second Notice – Balance Due, and CP 504 Notice of Intent to Levy. We considered business taxpayer notice CP 504 Notice of Intent to Levy.

A. From the Step II.A. extracts, identified accounts with a balance due. We researched a limited number of these on the IDRS and identified 23 individual taxpayer accounts and 22 business taxpayer accounts that would have had 1 of the specified notices issued if the disaster indicator had not been effective. These accounts included a variety of FEMA disaster areas and all of the specified notices. The total population of accounts that would have had one of the specified notices due to be issued during a disaster relief period was not known. This selection method was sufficient to determine if the notices were suppressed.

B. Evaluated the accounts in Step IV.A. to determine if the specified notices had been suppressed.

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[5] The IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.

[6] We evaluated FEMA disaster code areas 1602, 1604, and 1607 for IMF accounts and areas 1602, 1603, and 1606 for BMF accounts.

Appendix II

Major Contributors to This Report

Michael E. McKenney, Assistant Inspector General for Audit (Wage and Investment Income Programs)
Scott A. Macfarlane, Director
Richard J. Calderon, Audit Manager
Carola Gaylord, Lead Auditor
Sharla Robinson, Senior Auditor
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Appendix III

Report Distribution List

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- Chief, GAO/TIGTA/Legislative Implementation Branch SE:S:CLD:PSP:GTL

Appendix IV

Outcome Measure

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 Rights and Entitlements[1] – Actual; 1,470 taxpayers' accounts with an incorrect disaster period beginning and/or ending date (see page 3).

Methodology Used to Measure the Reported Benefit:

Accounts for which the beginning and/or ending date was incorrect due to input errors:

Our extract of Individual Master File (IMF)[2] accounts identified those with disaster indicators for Hurricanes Katrina and Rita as of November 13, 2005. From this, we analyzed the disaster period beginning and ending dates for 971 manually set disaster indicators for 3 Federal Emergency Management Agency (FEMA) disaster areas.[3] We identified 690 taxpayer accounts with an incorrect beginning and/or ending date. Of these, 57 also had update errors. Therefore, 633 IMF accounts had input errors only.

Similarly, our extract of Business Master File (BMF)[4] accounts identified those with disaster indicators for Hurricanes Katrina and Rita as of November 20, 2005. We analyzed the beginning and ending dates for 179 manually set disaster indicators for 3 FEMA disaster areas.[5] We identified 89 taxpayer accounts with an incorrect beginning and/or ending date.

Therefore, 722 (633 + 89) IMF and BMF taxpayer accounts had input errors only.

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[1] Although some date errors extended the tax relief period, most errors improperly shortened it. Therefore, we considered Taxpayer Rights and Entitlements to be the outcome of this condition.
[2] The Internal Revenue Service (IRS) database that maintains transactions or records of individual tax accounts.
[3] The disaster areas analyzed for IMF accounts were for FEMA codes 1602, 1604, and 1607.
[4] 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.
[5] The disaster areas analyzed for BMF accounts were for FEMA codes 1602, 1603, and 1606.

Accounts for which the ending date was incorrect because it was not properly updated:

Of the 1,659 accounts with manually set disaster indicators for Hurricane Katrina, 724 had a disaster period ending date that should have been updated,[6] but was not, when the Internal Revenue Service (IRS) systemically updated the ending date to February 28, 2006. Of the 724 IMF accounts which should have been updated but were not, 57 also had input errors. Therefore, 667 IMF accounts had update errors only.

Similarly, our extract of BMF accounts identified those with disaster indicators for Hurricanes Katrina and Rita as of November 20, 2005. Of the 166 accounts with manually set disaster indicators for Hurricane Katrina, 24 had a disaster period ending date that should have been updated, but was not, when the IRS systemically updated the end date to February 28, 2006.

Therefore, 691 (667 + 24) IMF and BMF accounts had update errors only.

Total number of accounts for which the beginning and/or ending date was incorrect:

722	IMF and BMF taxpayer accounts with input errors only
691	IMF and BMF taxpayer accounts with update errors only
57	IMF taxpayer accounts with both input and update errors
1,470	Total IMF and BMF taxpayer accounts with input and/or update errors

[6] Disaster ending dates other than February 28, 2006, input prior to the IRS systemic update should have been updated.

Appendix V

Management's Response to the Draft Report

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

COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

RECEIVED
JUN 29 2006

June 21, 2006

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Kevin M. Brown KMB
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – Taxpayers Residing in the Hurricanes Katrina and Rita Disaster Areas Were Accurately Identified for Tax Relief (Audit # 200640026)

We have reviewed your draft audit report, "Taxpayers Residing in the Hurricanes Katrina and Rita Disaster Areas Were Accurately Identified for Tax Relief". We appreciate your acknowledgment of our timely and effective response to provide taxpayers with much needed relief in the aftermath of Hurricanes Katrina and Rita. These actions resulted in correct placement of systemic disaster indicators on over 99.9% of affected taxpayers' accounts.

We also concur with your two recommendations to assist us in ongoing enhancement of our disaster assistance program.

The IRS' goal is to provide consolidated web based disaster information on one site for use by all IRS business units and to continue to take steps to improve processes for future disaster relief efforts. We have initiated actions to improve our on-line job aid that will provide the detailed information necessary to ensure manually extended filing and payment deadlines as described in Recommendation 1 are properly input.

The 9-11 Terrorist Attack and Hurricane Katrina are the only disasters during the last five years which warranted IRS extension of the original disaster relief period. In both instances, Modernization & Information Technology Services (MITS) identified accounts with manually input disaster indicators and, via systemic programming, updated the accounts with the appropriate relief timeframes. While the updating of the end date for an extended disaster relief period is a very time-consuming process, we will take action to identify accounts with manually input disaster indicators to ensure these accounts are updated as described in Recommendation 2.

Our comments on your recommendations follow:

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RECOMMENDATION 1

The Commissioner, SB/SE Division, should coordinate with the other IRS business units to provide employees with a regularly updated, on-line job aid to use for manually input disaster indicators. This job aid should summarize all current disasters, along with their beginning and ending dates. The Commissioner, SB/SE Division, should also coordinate with the other business units to emphasize to employees the importance of using the correct dates to ensure that interest and penalties are accurately calculated for taxpayers affected by disasters.

CORRECTIVE ACTION

We will work with MITS to develop an enhanced on-line job aid that will be easily updated for use in the manual input of disaster indicators. Other IRS business units will be consulted to ensure their needs are met. We will replace the current job aid with a new version that provides information necessary to correctly extend filing and payment deadlines for taxpayers who self-identify.

The Commissioner, SB/SE Division, will also issue updated guidance to all business units regarding the importance of using the most up to date information and dates to ensure that interest and penalties are accurately calculated for taxpayers affected by disasters.

IMPLEMENTATION DATE

January 31, 2007

RESPONSIBLE OFFICIAL(S)

The Director, Communications, Liaison and Disclosure, SB/SE Division

CORRECTIVE ACTION MONITORING PLAN

The Director, Communications, Liaison and Disclosure, SB/SE Division, will advise the SB/SE Commissioner of any delays in implementing this corrective action.

RECOMMENDATION 2

When the IRS extends the disaster relief period, the Commissioner, SB/SE Division, should take appropriate actions to identify accounts with manually input disaster indicators and update the accounts with the extended ending date.

3

CORRECTIVE ACTION

We have submitted a Request for Information Services (RIS) to create a new systemic account indicator, known as an "S freeze", which will decrease the number of manually placed indicators. The new S freeze will be used for limited scope disasters when a determination is made that compliance activity should not be suspended. This additional systemic indicator will further enhance our ability to avoid the errors associated with the self-identification process and reduce the volume of inputs of manual disaster indicators.

SB/SE and MITS are also examining the extension process and all manually input disaster indicators in an effort to identify additional systemic enhancements.

IMPLEMENTATION DATE

January 31, 2008

RESPONSIBLE OFFICIAL(S)

Director, Communications, Liaison and Disclosure, SB/SE Division

CORRECTIVE ACTION MONITORING PLAN

The Director, Communications, Liaison and Disclosure, SB/SE Division, will advise the SB/SE Commissioner of any delays in implementing this corrective action.

If you have any questions, please call me at (202) 622-0600 or Beth Tucker, Director, Communications, Liaison and Disclosure, Small Business/Self-Employed Division at (972) 308-1676.