



*The Tax Exempt Bonds Office Has
Established Controls, but Improvements
Are Needed to Prevent Improprieties*

December 21, 2007

Reference Number: 2008-10-052

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



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

December 21, 2007

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 – The Tax Exempt Bonds Office Has Established
Controls, but Improvements Are Needed to Prevent Improprieties
(Audit # 200610020)

This report presents the results of our review of examination closing actions by the Tax Exempt Bonds (TEB) office. The overall objectives of this review were to determine whether closing actions for tax-exempt bond examinations opened-in-error appropriately complied with Internal Revenue Service (IRS) guidelines and whether security and controls over closing actions for field examination cases were effective. This audit was requested by the Director, Government Entities, to determine whether actions to close tax-exempt bond examinations using the opened-in-error disposal code were appropriate. This audit was conducted as part of the Treasury Inspector General for Tax Administration Office of Audit Fiscal Year 2007 Annual Audit Plan.

Impact on the Taxpayer

Controls over examination closures are needed to provide assurance that capital raised from issuing tax-exempt bonds will be appropriately used for public works projects, and examinations are conducted with integrity and fairness. However, we identified control weaknesses that could allow employees to improperly close examinations without managers being aware of the actions. In addition, because of a lack of documentation, we could not determine if the high-risk opened-in-error disposal code was used correctly or if it was the appropriate action to take on the examination case.



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Synopsis

The TEB office established some significant controls for closing examinations established on the inventory system and ensured the ability to close cases from the inventory system was limited to authorized TEB employees. For example, examiners attest that conclusions are technically correct and procedurally accurate by preparing an examination closing record and then assembling the case file according to specific guidelines. The case files, including the examination closing record, are then reviewed by supervisors. The TEB office also performs limited-scope examinations on refund claims and limits the capability to close cases from the inventory system to just the inventory coordinators.

While the TEB office established several controls, there are still two key areas without controls. Specifically, examinations that are determined to be opened-in-error can be closed without documentation of managerial approval, and key procedures that should be completed by different individuals are being performed by the same employee. Both of these control weaknesses could allow employees to improperly close examinations without managerial approval.

For example, one of the higher risk disposal codes for closing an examination is reserved for examinations that were established on the inventory system in error. Due to the high risk, IRS procedures require both the supervisor and the Manager, Field Operations, to sign a form approving the closing action. These forms are required to be retained for 1 year. We determined the TEB office did not comply with the requirements to document and retain approval forms for any of the 521 examinations that were closed from the inventory system using the opened-in-error disposal code between Fiscal Years 2002 and 2006. Since approval forms were not used or retained, we could not determine if the high-risk opened-in-error disposal code was used correctly or if it was the appropriate action to take on the examination case.

In addition, once an examination is complete, the TEB office is required to send closing letters to bond issuers detailing the results of examinations. It is critical that evidence of adequate separation of duties exists between the processes of working the case, approving the closing letter, and mailing the closing letter to the bond issuer and other related stakeholders. Under the existing process, supervisors are provided with the full capability to perform all of these tasks with no requirement to maintain documentation of approvals in the examination case files.

Recommendations

We recommended the Director, TEB, ensure the inventory coordinator does not close examinations that were opened-in-error until the form approving the closing action is received. In addition, we recommended the Director, TEB, develop and implement controls to ensure the appropriate managerial approvals are obtained and documented for closing letters and refund claims.



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Response

IRS management agreed with our recommendations. The TEB office plans to update its procedures and ensure controls are followed for approving examinations opened-in-error. In addition, the TEB office plans to ensure appropriate managerial approvals are obtained and documented for closing letters and refund claims. Management's complete response to the draft report is included as Appendix IV.

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



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The Tax Exempt Bonds Office Has Established Controls, but Improvements Are Needed to Prevent Improprieties

Abbreviations

IRS	Internal Revenue Service
TEB	Tax Exempt Bonds



The Tax Exempt Bonds Office Has Established Controls, but Improvements Are Needed to Prevent Improprieties

Background

The Office of Tax Exempt Bonds (TEB) was established as part of the Internal Revenue Service's (IRS) Tax Exempt and Government Entities Division in Fiscal Year 1999 to administer the Federal tax laws applicable to tax-exempt municipal bonds. Municipal bonds provide tax-exempt financing for Governmental and other qualified purposes including the construction of airports, hospitals, schools, and road improvements, as well as facilities and equipment used in providing police, fire, and rescue services.

The TEB office is responsible for examining bonds after they are issued to ensure the bonds are being used for tax-exempt purposes and are complying with Federal tax laws.¹ The TEB office also performs limited-scope examinations of refund claims.

Most tax-exempt bond returns selected for examination are controlled on the TEB office's inventory control system.² Upon closing a case, the inventory coordinator assigns a disposal code which briefly describes the results of the examination or the reason the case was not examined.

One of the higher risk disposal codes is reserved for cases that were established on the inventory system in error. This code indicates that the examination should have never been started, so the inventory control is closed. For example, examinations are considered to be opened-in-error if the wrong tax year or incorrect taxpayer information was entered on the inventory system.

The Director, Government Entities, requested that we determine if actions to close tax-exempt bond examinations using the opened-in-error disposal code were appropriate. This review was performed at the TEB National Headquarters in Washington, D.C., and the TEB Field Group office in Englewood, Colorado, during the period March through July 2007. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Detailed information on our audit objectives, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

¹ Internal Revenue Code Section (§) 103(a) (2002) is the primary statutory provision that excludes interest on municipal bonds from Federal income tax.

² The inventory system used by the Tax Exempt and Government Entities Division to control examination returns, input assessments/adjustments to the taxpayer's account, and provide management information reports is known as the Audit Information Management System. This system tracks the location, age, and status of cases.



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Results of Review

While Several Controls Have Been Established, Controls for Closing Examination Cases Should Be Strengthened to Ensure Actions Are Appropriate and Properly Authorized

The TEB office established some significant controls for closing examinations established on the inventory system and ensured the ability to close cases from the inventory system was limited to authorized TEB employees. Specifically, these controls include:

- Attesting that conclusions are technically correct and procedurally accurate by completing an examination closing record. Examiners then assemble the case files in accordance with specific guidelines.
- Requiring supervisors to timely review the assembled case file, including the examination closing record and the special handling notice, prior to closing and determining whether the case is technically and procedurally accurate. Supervisors also ensure closing letters and any related documents are mailed to taxpayers, assess the quality of examinations, record the results on quality review checklists, and ensure the inventory system is updated to reflect that the case has been transmitted to the Manager, Field Operations.
- Performing limited-scope examinations on refund claims. Like standard examinations, the claims are controlled on an inventory system, but the examinations are typically limited to approving the validity of the claims. If the claim is determined to be appropriate, a refund voucher is submitted to a TEB specialist for validation that the claim should be paid. Upon approval, the refund voucher is forwarded to the Ogden Submission Processing Center for payment of the refund, and the examination is closed on the inventory system.
- Limiting the capability to close a case from the inventory system to inventory coordinators. The inventory coordinators reconcile the inventory system monthly by comparing closed records to a manual spreadsheet of cases submitted for closure to ensure the closing action was properly recorded. At the end of the quarter, the inventory coordinator researches the updated Master File³ information for each of the closed cases to determine where the case should be filed for retention.
- Reviewing samples of closed examination cases. Selected cases are quality reviewed quarterly by the Manager, Compliance and Program Management; Manager, Field

³ The Master File is the IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.



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Operations; and the Director, TEB. In addition, mandatory reviews of cases are performed by the Manager, Compliance and Program Management, when cases are referred to the IRS Appeals function or when examiners request technical advice from IRS Counsel regarding the procedural accuracy of potential closing agreements.

While the TEB office established several controls, there are still two key areas without controls. If TEB office management does not establish effective controls over these areas, there is a risk that improprieties could occur and go unnoticed by TEB office management. Specifically, examinations that are determined to be opened-in-error can be closed without documentation of managerial approval, and key procedures that should be completed by different individuals are being performed by the same employee. Both of these control weaknesses could allow employees to improperly close examinations without managerial approval.

Approvals to close examination cases that are opened-in-error were not documented and retained

Due to the high-risk nature of tax-exempt bond examination cases that are closed as opened-in-error, IRS procedures require both the supervisor and the Manager, Field Operations, to sign a form approving the closing action. These forms are required to be retained for 1 year after the inventory coordinator inputs the closing action into the inventory system.

We determined the TEB office did not comply with the requirements to document and retain approval forms for any of the 521 examinations that were closed from the inventory system using the opened-in-error disposal code between Fiscal Years 2002 and 2006. Since approval forms were not used or retained, we could not determine if the high-risk opened-in-error disposal code was used correctly or if it was the appropriate action to take on the examination case. While it is possible that all closings were appropriate, the lack of control over high-risk closures provides the opportunity for improprieties to occur and go undetected. For example, IRS examiners could close an examination with an opened-in-error disposal code in exchange for personal compensation since no records exist to show the closing action was approved by a supervisor and the Manager, Field Operations.

Lack of control over high-risk closures provides the opportunity for improprieties to occur and go undetected.

Between Fiscal Years 2002 and 2006, 2,025 examinations were closed. During the same period, an additional 521 examination cases were closed using the opened-in-error disposal code. Figure 1 shows the total volume of closed examination cases by fiscal year.



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Figure 1: Closed Examination Cases by Fiscal Year

Fiscal Year	2002	2003	2004	2005	2006	Total
Examinations Opened-in-Error	235	256	8	19	3	521
All Other Examination Closures	366	351	377	466	465	2,025

Source: TEB office inventory system data for Fiscal Years 2002 through 2006.⁴

Due to the high volume of opened-in-error disposal codes in Fiscal Years 2002 and 2003, we performed additional research to determine whether the disposal code was being used correctly. TEB office officials informed us that, in Fiscal Years 2002 and 2003, the TEB office began the process of converting the TEB account data from the old system to the IRS Master File. During the conversion process, examination cases had to be closed on the inventory system and established on the Master File. To accomplish this, TEB office management decided to use the opened-in-error disposal code, which was an incorrect use of the code because some of the inventory records were actual examinations that just needed to be moved to the Master File. As a result, the opened-in-error disposal code was used much more frequently during the process of converting records to the Master File in Fiscal Years 2002 and 2003 than in subsequent years.

We reviewed Master File data to determine if examinations were conducted on accounts after being converted to the Master File. We determined that 297 (60 percent) of 491 cases showed an examination was conducted or is currently being conducted. We reviewed 37 (13 percent) of the 287 closed cases⁵ and confirmed examinations were conducted. This is consistent with TEB office management's explanation of how the opened-in-error disposal code was used to establish accounts on the Master File, with examinations being completed afterwards. For the remaining 194 cases, we could not identify any examination activity because the case either did not exist on the Master File or the case existed but did not show any examination activity after the opened-in-error disposal code was input.

Controls for closing examinations and issuing refunds do not provide reasonable assurance actions are properly approved by TEB office management

Once examinations are complete, the TEB office sends closing letters to bond issuers detailing the results. In 2001, the former Director, TEB, issued a delegation order that authorized supervisors to sign the name of the Director, TEB, and the Manager, Field Operations, to closing

⁴ We did not verify the completeness of this information because we did not have a basis for comparison.

⁵ Of the 297 cases that showed an examination was conducted or is currently being conducted, 287 cases involved a closed examination and 10 involved an open examination.



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letters upon the completion of an examination resulting in an additional tax or in “no change” to tax. To carry out this action, supervisors were provided signature stamps to manually stamp the Director, TEB, or the Manager, Field Operations, signatures to closing letters. Examinations involving a claim for refund only require the signature of a refund claim specialist on the closing letter.⁶

The TEB office uses the following procedures to issue closing letters and refunds:

- If it is determined during an examination the bonds do not qualify for tax-exempt status, the examiners attempt to resolve the matter by entering into a closing agreement with the bond issuers. In other cases, the examiner may initiate a series of adverse closing letters.⁷ The closing letters are sent to the bond issuers. These closing letters generally are prepared by the examiner and forwarded to a supervisor for review. After the supervisor concurs, the letters are emailed to the Manager, Field Operations, for review and concurrence.⁸ Upon receiving approval, supervisors use the signature stamp to sign the letters for the Manager, Field Operations. The supervisors then mail the closing letters to the bond issuers and other related stakeholders.
- If it is determined during an examination that the bonds complied with Federal tax laws applicable to tax-exempt bonds, a “no change” closing letter⁹ is prepared by the examiner and forwarded to a supervisor for review and concurrence. Upon review, supervisors use the signature stamp to sign the “no change” closing letter on behalf of the Manager, Field Operations, without having to obtain the Manager, Field Operations’ concurrence.
- If it is determined during a refund claim examination that the bond issuer is due a refund, the examination case file is reviewed by a refund claim specialist who assesses whether the claim is accurate. Upon concurrence, the specialist signs the closing letter and authorizes payment of a refund.

In considering these TEB office procedures, we identified two control weaknesses. Specifically, controls that ensure concurrence is obtained from the Manager, Field Operations, and/or the Director, TEB, need to be strengthened to better assure closing letters proposing additional tax or “no change” to tax are appropriately approved. Under the current process, the Manager, Field

⁶ Claims for refunds more than \$1 million require mandatory reviews by the Manager, Field Operations, and Manager, Compliance and Program Management.

⁷ If a closing agreement cannot be initially negotiated, the TEB office may issue a Preliminary Adverse Letter and a Proposed Adverse Determination Letter to the bond issuer that includes details of the noncompliance. The bond issuer may choose to appeal the case, enter into a closing agreement, or not respond. If the bond issuer does not respond, a Final Determination of Tax Liability is issued, which forfeits the bond issuer’s rights for an appeal and generally results in taxation of the bondholders.

⁸ The draft Adverse Determination Letters are forwarded by supervisors to the Manager, Field Operations, via email because the supervisors are not in the same location as the Manager, Field Operations.

⁹ A “no change” letter is issued when the TEB office closes the examination with no change to the position that interest received by the bondholders is excludible from gross income under § 103 of the Internal Revenue Code.



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Operations, and the Director, TEB, either send an email to the appropriate supervisor or verbally communicate by telephone approval to use signature stamps. This procedure enables supervisors to sign and then mail the closing letters. Government Accountability Office *Standards for Internal Control in the Federal Government* state “key duties and responsibilities need to be divided or segregated among different people to reduce the risk of error or fraud.”¹⁰ However, without documentation of authorizations, there is no assurance that closing actions are approved by management and the process is more susceptible to inappropriate actions.

We reviewed 51 (10 percent) of 523 examination case files that were closed between October 1, 2005, and December 31, 2006, with a closing agreement proposing either an additional tax assessment or “no change” to tax. Additional tax assessments were proposed for 27 (53 percent) of the 51 examination case files reviewed, yet no evidence was found to indicate the Director, TEB, and/or the Manager, Field Operations, approved the related closing letters. As mentioned previously, no review was required by the Director, TEB, and/or the Manager, Field Operations, for the remaining 24 cases that involved “no change” to tax so we could not determine if these were appropriate closing actions.

The second control weakness we identified is key procedures are being performed by the same employee. It is critical that evidence of adequate separation of duties exists between the processes of working the case, approving the closing letter, and mailing the closing letter to the bond issuer and other related stakeholders. Under the existing process, supervisors are provided with the full capability to perform all of these tasks with no requirement to maintain documentation of approvals in the examination case files.

This process is especially important for cases involving refund claims. All examination case files for refund claims are reviewed to determine whether the claim is accurate. Claims determined to be accurate are forwarded to a refund claim specialist for quality review. For claims less than \$1 million, the refund claim specialist has the capability to prepare a refund voucher, approve payment, and sign the closing letter,¹¹ without being reviewed by the Manager, Compliance and Program Management. We did not identify any cases in which the refund claim specialist actually prepared the refund voucher or in which any improprieties had occurred; however, our review of 8 (11 percent) of 74 refund claims identified 1 refund claim totaling approximately \$20,000 in which the refund claim specialist quality reviewed the refund claim, approved the refund payment, and signed the closing letter without any evidence of managerial review.

These control weaknesses are magnified when considering the dollars involved in examination cases. In Fiscal Year 2004, TEB examination cases had noncompliance assessments averaging approximately \$19,000 per case but penalties for promoter misconduct averaged approximately

¹⁰ GAO/AIMD-00-21.3.1, dated November 1999.

¹¹ Employees authorized to approve refund requests must be listed on an official signature list.



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\$660,000 per case.¹² Based on the large amount of money involved and our concerns that TEB employees are performing multiple functions that should be separated among two or more people, there is substantial risk improprieties could go undetected (e.g., employees could, without managerial knowledge, accept payments for not making appropriate tax assessments or issue refunds when they are not justified). Developing processes that separate working the cases, approving the closing letters, and mailing the closing letters would substantially reduce the risk of improprieties. In addition, quality review processes should ensure each of these actions is appropriately documented in the examination case files. Strengthening controls over examination closures will provide better assurance that capital raised from issuing tax-exempt bonds will be appropriately used for public works projects, and examinations are conducted with integrity and fairness.

Recommendations

The Director, TEB should:

Recommendation 1: Ensure controls are followed that require the inventory coordinator to close examinations that were opened-in-error only after receiving a form approving the closing action. Copies of the forms should be maintained by the inventory coordinator or closing function according to existing guidelines.

Management's Response: IRS management agreed with the recommendation. During Fiscal Year 2008, the TEB office plans to update its Internal Revenue Manual procedures for examination processes. In doing so, the TEB office plans to ensure controls are followed that require the inventory coordinator to close opened-in-error examinations only after receiving a form approving the closing action. Copies of the forms will be maintained by the inventory coordinator or closing function according to existing guidelines, or electronically on the new Tax Exempt and Government Entities Division Reporting and Electronic Examination System.

Recommendation 2: Develop and implement controls to ensure the appropriate managerial approvals are obtained and documented for closing letters and refund claims.

Management's Response: IRS management agreed with the recommendation. During Fiscal Year 2008, the TEB office plans to update its Internal Revenue Manual procedures for examination processes. In doing so, the TEB office plans to ensure the

¹² *Statistical Portrayal of the Tax Exempt Bonds Office's Enforcement Activities From Fiscal Year 2002 Through Fiscal Year 2004* (Reference Number 2005-10-186, dated September 2005).



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appropriate managerial approvals are obtained and documented for closing letters and refund claims.

Management's response also included another new control: the Tax Exempt and Government Entities Division plans to implement a proposed quality review process that will require universal review of all closed TEB office examinations.



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Appendix I

Detailed Objectives, Scope, and Methodology

The overall objectives of this audit were to determine whether closing actions for tax-exempt bond examinations opened-in-error appropriately complied with IRS guidelines and whether security and controls over closing actions for field examination cases were effective. To accomplish our objectives, we:

- I. Determined whether TEB office management established effective processes for closing examinations that were opened-in-error. We (1) conducted research on the IRS Master File¹ for all 491 examinations that were closed as “opened-in-error” between Fiscal Years 2002 and 2003 to determine whether an examination was subsequently conducted, (2) reviewed a judgmental sample of 37 (13 percent) of 287 modules that were located on the Master File as being examined and determined whether the disposition of the case was properly approved by TEB office management, and (3) interviewed TEB office personnel to determine whether forms used to request and approve the decisions to close cases as opened-in-error were maintained for all 491 examinations. We used judgmental sampling because we did not plan to project our results.
- II. Determined whether TEB office management implemented effective security processes for examination cases established on their inventory system by limiting the capability to close a case from the inventory system to inventory coordinators.
- III. Determined whether TEB office management established effective processes for ensuring case closing and deletion actions on the inventory system were accurate and appropriately authorized. We (1) interviewed TEB office personnel to determine the process for reviewing and approving examination cases prior to closure, the post-review process for closed cases, and the process to ensure cases were properly closed from the inventory system and forwarded to the Ogden Submission Processing Center for filing; (2) reviewed a judgmental sample of 51 (10 percent) of 523 examination case files that were closed with a closing agreement or as “no change” on the TEB inventory system between October 1, 2005, and December 31, 2006, to determine the closing action taken and whether the action was appropriately approved; (3) reviewed a judgmental sample of 8 (11 percent) of 74 refund claim examinations that were closed from the inventory system between October 1, 2005, and December 31, 2006, to determine whether the claim was appropriately approved; and (4) analyzed all 30 cases that were opened-in-error between October 1, 2003, and September 30, 2006, and determined

¹ The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.



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whether any information existed to indicate the opened-in-error disposal action was properly approved by TEB office management. We used judgmental sampling because we did not plan to project our sample results.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objectives: the TEB office's policies, procedures, and practices for closing examinations that were established for its inventory system. We assessed these controls by interviewing relevant TEB office personnel and managers and by analyzing applicable processes and procedures.



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Appendix II

Major Contributors to This Report

Nancy A. Nakamura, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs)
Troy D. Paterson, Director
Gerald T. Hawkins, Acting Director
James V. Westcott, Audit Manager
Allen L. Brooks, Lead Auditor
Margaret A. Anketell, Senior Auditor
Stephanie K. Foster, Senior Auditor
Yolanda D. Brown, Auditor



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Appendix III

Report Distribution List

Acting Commissioner C
Office of the Commissioner – Attn: Acting Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Deputy Commissioner, Tax Exempt and Government Entities Division SE:T
Director, Tax Exempt Bonds, Tax Exempt and Government Entities Division SE:T:GE:TEB
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



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Appendix IV

Management's Response to the Draft Report



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

RECEIVED
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MEMORANDUM FOR MICHAEL R. PHILLIPS, DEPUTY INSPECTOR GENERAL FOR
AUDIT

FROM: Steven T. Miller 
Commissioner, Tax Exempt & Government Entities

SUBJECT: The Tax Exempt Bonds Office Has Established Controls, but
Improvements Are Needed to Prevent Improprieties
(Audit#200610020)

Thank you for conducting this review, and for your recommendations for improving examination closing control processes in our Tax Exempt Bonds (TEB) office. We requested that you undertake this review to determine if our actions to close tax-exempt bond examinations were appropriate, and we appreciate your insights in this area. We concur with your recommendations and will implement them.

As you note, TEB has controls in place that are intended to ensure the integrity of the closing processes for tax-exempt bond examinations. Between fiscal years 2002 and 2006, TEB has closed over 2,000 examinations, and its examination program has had a positive compliance impact on the tax-exempt bond market. In fiscal year 2008, TEB is undertaking a comprehensive review of its administrative procedures, including those relating to the Tax Exempt Bond examination closing process detailed in section 4.81 of the Internal Revenue Manual. Your report will be of great assistance to TEB in this review.

We agree that it is important to document managerial approval when we close opened-in-error exam cases. It is TEB's policy to document this approval on Form 10904, *Request for Deletion from AIMS/ERCS*, as directed in IRM 4.5.2.7. We have recently critically reviewed our procedures with respect to this policy, and are considering ways to improve the documentation of managerial approval for opened-in-error cases on the new TE/GE Reporting & Electronic Examination System. In addition, we have emphasized our current procedures to TEB staff to ensure documentation is obtained and retained.

We also agree that it is important to document managerial approval of closing agreements. TEB field group managers who are closing an examination resolved through a closing agreement are authorized to issue the closing letter using a signature



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stamp only after receiving approval from the Manager, TEB Field Operations (FO). The closing agreement itself is executed by the Director, TEB, following a review process that includes both a review by the Manager, FO and confirmation of the receipt of payments required under the closing agreement. TEB is currently clarifying and updating its IRM examination procedures, including those pertaining to the review and closing process for examinations resolved through a closing agreement.

With respect to no change examinations, we authorize TEB field group managers to close these cases without the review and concurrence of the Manager, FO, although the Manager FO's name is stamped on the closing letter. This closing process involves two distinct persons – the revenue agent who works the case, and the group manager who reviews the case and authorizes its closure. We believe that this process is consistent with the principle of the division of responsibilities among different persons. This division of responsibilities will be strengthened when we implement TEB's proposed quality review process which will require universal review of all closed TEB examinations. TEB's updated IRM will incorporate this new quality review process.

Finally, we believe the practice with respect to refund claims should also be consistent with the principle of the division of responsibilities among different persons. Under current procedures, refund claims are analyzed by a CPM specialist and reviewed by the CPM Arbitrage Team Leader. Only the CPM Manager, TEB Technical Advisor, or the TEB Director may authorize the payment of approved refund claims. Denied refund claims are issued only by the CPM Manager. TEB's updated IRM will include a new section covering arbitrage refund claims.

Our response to your recommendations is attached.

If you have any questions, please contact Clifford Gannett, Director, Tax Exempt Bonds at (202) 283-9820.

Attachment

cc: Clifford Gannett, Acting Director, Government Entities, SE:T:GE
Director, Tax Exempt Bonds, SE:T:GE:TEB.



The Tax Exempt Bonds Office Has Established Controls, but Improvements Are Needed to Prevent Improprieties

Attachment

RECOMMENDATION 1:

The Director, TEB should ensure controls are followed that require the inventory coordinator to close opened-in-error examinations only after receiving a form approving the closing action. Copies of the forms should be maintained by the inventory coordinator or closing function according to existing guidelines.

CORRECTIVE ACTION 1.

During FY 08, TEB will update its IRM procedures for examination processes. In doing so, TEB will ensure controls are followed that require the inventory coordinator to close opened-in-error examinations only after receiving a form approving the closing action. Copies of the forms will be maintained by the inventory coordinator or closing function according to existing guidelines, or electronically on the new TE/GE Reporting & Electronic Examination System.

RESPONSIBLE OFFICIAL.

Director, Tax Exempt Bonds

IMPLEMENTATION DATE.

September 30, 2008.

RECOMMENDATION 2.

The Director, TEB should develop and implement controls to ensure the appropriate managerial approvals are obtained and documented for closing letters and refund claims.

CORRECTIVE ACTION 2.

During FY 08, TEB will update its IRM procedures for examination processes. In doing so, TEB will ensure the appropriate managerial approvals are obtained and documented for closing letters and refunds claims.

RESPONSIBLE OFFICIAL.

Director, Tax Exempt Bonds.

IMPLEMENTATION DATE.

September 30, 2008.