Fiscal Year 2004 Statutory Audit of Compliance With Legal Guidelines Restricting the Use of Records of Tax Enforcement Results

March 2004

Reference Number: 2004-40-066

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

March 19, 2004

MEMORANDUM FOR DEPUTY COMMISSIONER FOR SERVICES AND ENFORCEMENT

FROM: Gordon C. Milbourn III
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report - Fiscal Year 2004 Statutory Audit of Compliance With Legal Guidelines Restricting the Use of Records of Tax Enforcement Results (Audit # 200340051)

This report presents the results of our review of compliance with legal guidelines restricting the use of records of tax enforcement results (ROTERs). The overall objective of this review was to determine if the Internal Revenue Service (IRS) complied with legal guidelines set forth in the IRS Restructuring and Reform Act of 1998 (RRA 98) Section (§) 1204.[1]

RRA 98 § 1204 (a) prohibits the IRS from using a ROTER to evaluate employees or to impose or suggest production quotas or goals. Section 1204 (b) requires that employees be evaluated using the fair and equitable treatment of taxpayers as a performance standard. Section 1204 (c) requires each appropriate supervisor to certify quarterly whether tax enforcement results were used in a prohibited manner. The Treasury Inspector General for Tax Administration is required under Internal Revenue Code § 7803(d)(1) (2000) to annually evaluate the IRS' compliance with the provisions of RRA 98 § 1204.

In summary, a review of 75 judgmentally sampled enforcement employees' performance and related supervisory documentation prepared between October 1, 2002, and August 31, 2003, showed the IRS is in compliance with RRA 98 §§ 1204 (a) and (b). No instances of potential violations of the use of ROTERs were found, and the evaluations documented that employees were evaluated on the fair and

[1] Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

equitable treatment of taxpayers. In addition, a review of a statistical sample of 43 appropriate supervisors' certifications indicated the IRS was in compliance with RRA 98 § 1204 (c). All 43 of the appropriate supervisors completed a consolidated office certification memorandum to the Commissioner certifying that ROTERs were not used in a prohibited manner.

Management's Response: IRS management is working to continue improving the § 1204 Program. 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 results. Please contact me at (202) 622-6510 if you have questions or Michael R. Phillips, Assistant Inspector General for Audit (Wage and Investment Income Programs), at (202) 927-0597.

Table of Contents

Background ....Page 1

The Internal Revenue Service Is Complying With the Law........................Page 3

Appendix I – Detailed Objective, Scope, and Methodology ....Page 5

Appendix II – Major Contributors to This Report.......................................Page 7

Appendix III – Report Distribution List ....Page 8

Appendix IV – Sampling Methodology...Page 9

Appendix V – Management’s Response to the Draft Report ....Page 12

Background

On July 22, 1998, the President signed the Internal Revenue Service (IRS) Restructuring and Reform Act of 1998 (RRA 98) into law.[1] Among many other requirements contained in the law, Section (§) 1204 restricts the use of enforcement statistics. Specifically, RRA 98 § 1204 (a) prohibits the IRS from using a record of tax enforcement results (ROTER) to evaluate employees or to impose or suggest production quotas or goals.

The IRS defines ROTERs as data, statistics, compilations of information, or other numerical or quantitative recordation of the tax enforcement results reached in one or more cases. A ROTER does not include the tax enforcement results of an individual case when used to determine whether an employee exercised appropriate judgment in pursuing enforcement of the tax laws based upon a review of the employee's work on that individual case. Examples of ROTERs include the amount of dollars collected or assessed, the number of fraud referrals, and the number of seizures conducted.

RRA 98 § 1204 (b) requires that employees be evaluated using the fair and equitable treatment of taxpayers as a performance standard. The IRS requires that employees administer the tax laws fairly and equitably; protect all taxpayers' rights; and treat each taxpayer ethically with honesty, integrity, and respect. This provision of the law was enacted to provide assurance that employee performance is focused on providing quality service to taxpayers instead of achieving enforcement results.

RRA 98 § 1204 (c) requires each appropriate supervisor to certify quarterly whether tax enforcement results were used in a prohibited manner. The IRS defines an appropriate supervisor as the highest-ranking executive in a distinct organizational unit that supervises directly or indirectly one or more § 1204 employees.[2] IRS procedures require that, beginning with first-line managers of § 1204 employees,

---

[1] Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).
[2] An enforcement employee (§ 1204 employee) is one who exercises judgment in recommending or determining whether or how the IRS should pursue enforcement of the tax laws.

each level of management self-certify that they have not used ROTERs in a manner prohibited by RRA 98 § 1204 (a). The appropriate supervisor is to then prepare a consolidated office certification covering the entire organizational unit.

Internal Revenue Code § 7803(d)(1) (2000) requires the Treasury Inspector General for Tax Administration (TIGTA) to determine annually whether the IRS is in compliance with restrictions on the use of enforcement statistics. The TIGTA previously performed five mandatory reviews of the IRS' use of enforcement statistics in employee evaluations.

There has been an overall improvement in the IRS' compliance with the law. The Fiscal Year (FY) 2003[3] audit revealed no instances of the use of ROTERs or production quotas or goals to evaluate employee performance. There was also improvement over previous years in documenting the evaluation of employees on the fair and equitable treatment of taxpayers. In addition, a review of a statistical sample of appropriate supervisors showed the IRS was completing the required consolidated office certification memoranda on whether ROTERs were used in a prohibited manner.

This audit was performed during the period August 2003 through January 2004. The review included testing in the Corporate Planning and Performance Division in the IRS National Headquarters in Washington, D.C. The review also included visits to the Large and Mid-Size Business, Small Business/Self-Employed, Tax Exempt and Government Entities, and Wage and Investment Divisions; the Criminal Investigation and Appeals functions; and the National Taxpayer Advocate offices located in Birmingham, Alabama; Phoenix, Arizona; Miami, Florida; and Ogden and Salt Lake City, Utah. This audit was conducted in accordance with *Government Auditing Standards* with the following scope limitation.

---

[3] *Fiscal Year 2003 Statutory Audit of Compliance With Legal Guidelines Restricting the Use of Records of Tax Enforcement Results* (Reference Number 2003-40-090, dated March 2003).

While performing tests in the IRS Criminal Investigation function, auditors were not allowed direct access to performance documentation. The performance documentation is maintained electronically, and the TIGTA was not allowed direct access to this electronic system due to the Grand Jury information maintained on that same system. Therefore, the auditors had to rely on documents provided by the Criminal Investigation function managers sampled. The managers provided copies of documents such as annual evaluations, performance plans, drop files, workload reviews, midyear reviews, and award narratives. Grand Jury information was redacted from these documents as deemed necessary by Criminal Investigation function managers.

Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

The Internal Revenue Service Is Complying With the Law

A review of 75 judgmentally sampled enforcement employees' performance and related supervisory documentation prepared between October 1, 2002, and August 31, 2003, revealed no instances of the use of ROTERs or production quotas or goals to evaluate employee performance. In all of the 75 performance files reviewed, there was documentation that the employees were being evaluated on the fair and equitable treatment of taxpayers. In addition, our review of 43 statistically sampled appropriate supervisors showed the IRS completed the required consolidated office certification memoranda on whether ROTERs were used in a prohibited manner.

ROTERs were not identified in evaluation files, and employees were evaluated on the fair and equitable treatment of taxpayers

The TIGTA conducted 5 unannounced site visits[4] in October 2003 to review the performance and related supervisory files of 75 judgmentally selected enforcement employees. For the sites visited, we found the IRS was in compliance with RRA 98 §§ 1204 (a) and (b). We did not identify any ROTERs in the sampled employees'

[4] The sites visited were Birmingham, Alabama; Phoenix, Arizona; Miami, Florida; and Ogden and Salt Lake City, Utah.

performance documentation from October 1, 2002, through August 31, 2003. There was no indication that ROTERs were used to impose or suggest production quotas or goals. In addition, all of the 75 Employee Personnel Files included documentation that the employees were being evaluated on the fair and equitable treatment of taxpayers. The managers used the evaluation form required as of October 1, 2001, that included an assessment of the employees' performance on the fair and equitable treatment of taxpayers.

Appropriate supervisors completed the quarterly consolidated office certification memorandum to the Commissioner

A review of 43 statistically sampled appropriate supervisors for the first 3 quarters of FY 2003 showed the IRS was in compliance with RRA 98 § 1204 (c). The IRS had completed the required consolidated office certification memoranda and maintained the required supporting documentation. The IRS designated executive-level managers to serve as appropriate supervisors at various times during FY 2003 for the purpose of certifying that no RRA 98 § 1204 violations had occurred during the applicable time period. These executive-level managers included the highest-level managers in each IRS office; for example, the Chief, Appeals; Chief, Criminal Investigation; and National Taxpayer Advocate.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine if the Internal Revenue Service (IRS) complied with legal guidelines set forth in the IRS Restructuring and Reform Act of 1998 (RRA 98) Section (§) 1204.[1] We conducted the following tests to accomplish the objective:

I. To determine if the IRS complied with provisions of RRA 98 § 1204 (a), which states the IRS shall not use records of tax enforcement results (ROTERs) to evaluate employees or to impose production goals or quotas, and § 1204 (b), which states the IRS shall use the fair and equitable treatment of taxpayers by employees as one of the standards for evaluating employee performance, we:

A. Identified procedures used to ensure compliance with the provisions of RRA 98 §§ 1204 (a) and (b) by interviewing IRS management and reviewing the Internal Revenue Manual (IRM), IRS memoranda, and the IRS 1204 Intranet web site.

B. Identified the potential enforcement employee population using Treasury Integrated Management Information System data and validated the information using the IRS Discovery Directory.[2] We judgmentally selected five audit sites and made unannounced visits to each site. We judgmentally selected 5 managers per site to review and then judgmentally selected 3 employees per manager for review, for a total of 75 enforcement employees. (See Appendix IV for details on how the population of potential enforcement employees was identified and the audit sites were selected.)

C. Reviewed 75 enforcement employees' Employee Personnel Files, including the annual performance appraisal/performance rating, performance plans, award justifications, written performance feedback, self-assessments, case and workload reviews, drop files, and 25 related enforcement employee managers' meeting minutes, to determine if ROTERs were used in evaluating employees or to impose production goals or quotas. We determined whether there was documentation that the employees were being evaluated on the fair and equitable treatment of taxpayers and whether the required evaluation form was used. Documents prepared during the period October 1, 2002, through August 31, 2003, were included in the review. The Criminal Investigation function maintains its evaluation documentation electronically.

[1] Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).
[2] The Discovery Directory is a system that allows users to locate and view personal contact information for IRS employees.

The Treasury Inspector General for Tax Administration is not allowed access to this electronic system due to the Grand Jury information maintained on the same system. Therefore, auditors had to rely upon documentation provided by the IRS for the six Criminal Investigation function employees in the sample.

II. To determine if the IRS complied with provisions of RRA 98 § 1204 (c), which states each appropriate supervisor shall certify quarterly by letter to the IRS Commissioner whether tax enforcement results are being used in a manner prohibited by RRA 98 § 1204 (a), we:

A. Identified procedures used to ensure compliance with the provisions of RRA 98 § 1204 (c) by interviewing IRS management and reviewing the IRM, IRS memoranda, and the IRS 1204 Intranet web site.

B. Obtained a listing from the IRS of the appropriate supervisors for the first 3 quarters of Fiscal Year 2003. We compared the listing received to IRM examples of potential appropriate supervisors to validate the reliability of information received. We selected a statistical sample of 43 appropriate supervisors from the total population of 111 appropriate supervisors using a desired confidence level of 90 percent, an expected error rate of 4.2 percent, and a precision level of ± 4 percent. (See Appendix IV for details on how the population and sample were selected.) We obtained from the IRS the quarterly self-certification documentation for 43 appropriate supervisors. The supporting documentation for one of the appropriate supervisors' consolidated certifications was not available.

C. Reviewed the supporting documentation received to determine if all managers completed the required quarterly self-certification documents.

Appendix II

Major Contributors to This Report

Michael R. Phillips, Assistant Inspector General for Audit (Wage and Investment Income Programs)
Mary V. Baker, Director
James D. O'Hara, Audit Manager
Kristi L. Larson, Senior Auditor
Sharon Summers, Senior Auditor
James M. Traynor, Senior Auditor
Gwendolyn M. Green, Auditor
Sylvia Sloan-Copeland, Auditor

Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Operations Support OS
Commissioner, Large and Mid-Size Business Division SE:LM
Commissioner, Small Business/Self-Employed Division SE:S
Commissioner, Tax Exempt and Government Entities Division SE:T
Commissioner, Wage and Investment Division SE:W
Chief, Appeals AP
Chief, Criminal Investigation SE:CI
Chief Financial Officer OS:CFO
Associate Chief Financial Officer for Corporate Planning and Performance OS:CFO:CP
Director, Communications and Liaison, Small Business/Self-Employed Division SE:S:MS:CL
Director, Tax Administration Coordination SE:OTAC
Director, Strategy and Finance, Wage and Investment Division SE:W:S
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Management Controls OS:CFO:AR:M
Audit Liaisons:

- Commissioner, Large and Mid-Size Business Division SE:LM
- Commissioner, Tax Exempt and Government Entities Division SE:T
- Chief, Appeals AP
- Chief, Customer Liaison, Small Business/Self-Employed Division SE:S:COM
- Chief, Criminal Investigation SE:CI
- Chief Financial Officer OS:CFO
- Associate Chief Financial Officer for Corporate Planning and Performance OS:CFO:CP
- Director, Tax Administration Coordination SE:OTAC
- National Taxpayer Advocate TA
- GAO/TIGTA Liaison, Wage and Investment Division SE:W:S:PA

Appendix IV

Sampling Methodology

Judgmental sample of enforcement employees

Because the Internal Revenue Service (IRS) has no systemic way to identify which employees have enforcement-related responsibilities, and since an employee's duties may change regularly, there is no way of knowing at any given time the total number of employees engaged in enforcement activities. To conduct the audit, it was necessary for the Treasury Inspector General for Tax Administration to identify a potential enforcement employee population from which to select employee documentation for review. We obtained a computer download of the Treasury Integrated Management Information System (TIMIS)[1] data for all IRS employees for the period July 13, 2003, through July 26, 2003. We relied on the data obtained from the TIMIS and validated the information during the audit using the IRS Discovery Directory[2] and the employees' personnel files.

To create the potential population of enforcement employees, we extracted from the TIMIS database a listing of enforcement employees based on the following criteria:

- Work location in the 48 contiguous states and the District of Columbia except for employees in functional areas that received a waiver from the IRS Commissioner in Fiscal Year (FY) 2002 because the function did not have duties covered by the IRS Restructuring and Reform Act of 1998 (RRA 98) Section (§) 1204.[3]
- Specific job series considered enforcement positions: 110, 301, 340, 343, 501, 503, 512, 526, 592, 598, 905, 920, 930, 950, 962, 986, 987, 1101, 1169, 1171, 1510, 1801, 1802, and 1811.

After selection based on the above criteria, locations with fewer than seven employees were removed from the population because we needed locations that would likely have managers onsite.

This information was used to estimate the number of potential enforcement employees within each business unit and functions within each city. Our review was conducted in the Large and Mid-Size Business (LMSB), Small Business/Self-Employed (SB/SE), Tax Exempt and Government Entities (TE/GE), and Wage and Investment (W&I) Divisions; the Criminal Investigation (CI) and Appeals (AP) functions; and the National Taxpayer Advocate office (NTA).

[1] The TIMIS is a system that supports payroll and personnel processing and reporting requirements.
[2] The Discovery Directory is a system that allows users to locate and view personal contact information for IRS employees.
[3] Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

Because of the improved compliance over the last two audit periods, we determined that a judgmental sample would be adequate in selecting sites and employees for review. The potential enforcement employee population disbursement, geographic coverage, and prior audit coverage were all factors considered in selecting the five audit sites of Birmingham, Alabama; Phoenix, Arizona; Miami, Florida; and Ogden and Salt Lake City, Utah.

Once the audit sites were determined, the TIMIS data and IRS Discovery Directory were used to determine the number of managers as well as the number of different addresses of the managers located within the audit sites. This information was considered when selecting the business units and functions to be reviewed at each site.

Unannounced visits were made to each of the five audit sites. The listing of potential enforcement employee managers compiled using the Discovery Directory allowed us to identify initial contacts to begin our sampling. The initial contact points for some sites also identified other enforcement employee managers located on site. This information was used, as well as the managers we had previously identified, to judgmentally select 5 managers per site and 3 employees per manager, for a total of 75 employees. We reviewed the selected employees' performance documentation prepared during October 1, 2002, through August 31, 2003, for compliance with the requirements of RRA 98 §§ 1204 (a) and (b).

The sample distribution follows:

Business Unit (BU)	BU Reviewed at	Number of Managers Selected	Number of Employees Selected	Business Unit as Percentage of Population[4]
AP	1 site	1	3	3%
CI	2 sites	2	6	8%
LMSB	2 sites	2	6	10%
NTA	1 site	1	3	4%
SB/SE	5 sites	16	48	64%
TE/GE	1 sites	1	3	4%
W&I	2 sites	2	6	7%
TOTALS		**25**	**75**	**100%**

[4] These percentages were calculated on the total number of employees we identified in each of the business units. These percentages were then used to determine how many employees in each business unit should be included in our sample.

Statistical sample of appropriate supervisors

A statistical sample of appropriate supervisors was selected for review to determine the IRS' compliance with the self-certification requirement of RRA 98 § 1204 (c).

The IRS Organizational Performance Division, Data Analysis, Standards, and Reporting function identified the population of 111 appropriate supervisors for the first 3 quarters of FY 2003. The audit period did not allow for the fourth quarter certifications to be included in the sample. We used attribute sampling and the following formula to calculate the minimum sample size (n) of 43:

n = [N* p(1-p)] / [N* (A/Z) ˆ2 +p(1-p)].

n = Sample size.

N = Population (111 appropriate supervisors for the first 3 quarters of FY 2003).

Z = Desired Confidence Level (90 percent).

p = Expected Error Rate (4.2 percent).

A = Precision Level (± 4 percent).

The appropriate supervisors were numbered 1 through 111. We used a Microsoft Excel random number program to randomly select 43 numbers. The randomly selected numbers corresponded to a specific appropriate supervisor for a specific quarter.

We reviewed the supporting documentation for the 43 appropriate supervisor consolidated office certifications sampled. This included reviewing the Consolidated Office Certification Memorandum and the supporting managers' quarterly self-certification documents.

Appendix V

Management's Response to the Draft Report

CHIEF FINANCIAL OFFICER

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

RECEIVED
MAR 09 2004

March 4, 2004

MEMORANDUM FOR GORDON C. MILBOURN III
ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Eileen T. Powell
Chief Financial Officer

SUBJECT: Fiscal Year 2004 Statutory Audit of Compliance With Legal Guidelines Restricting the Use of Records of Tax Enforcement Results

Your report reviews our compliance with the IRS Restructuring and Reform Act of 1998 (RRA 98) Section (§) 1204 requirements that restrict the use of enforcement statistics to evaluate IRS employees or to impose or suggest production quotas or goals. Section 1204 also requires us to evaluate employees using the fair and equitable treatment of taxpayers as a performance standard and to certify quarterly on the use of tax enforcement results.

I am pleased your review found that the IRS is in compliance with RRA 98 §1204 (a) and found no potential violations of the use of Record of Tax Enforcement Results (ROTER), with §1204 (b), employees were evaluated on the fair and equitable treatment of taxpayers, and with §1204 (c), appropriate supervisors completed consolidated office certification memorandum to the Commissioner certifying that ROTERs were not used in a prohibited manner.

To continue improving the §1204 Program, we maintain current information on our Web page, and are revising our reporting documents to increase their accuracy and improve the timeliness of reports. Our goal is to improve the identification process of §1204 managers and enhance the accessibility and retrieval of §1204 documentation. These improvements will allow us to more accurately assess the effectiveness of the §1204 quarterly certification process and quickly identify and address any emerging concerns.

If you have any questions, please contact me at 202.622.6400, or John W. Roberts, Acting Associate Chief Financial Officer, Corporate Planning and Performance Unit at 202.622.4909.