Systemic Weaknesses Need to Be Addressed Before the On-Line E-File Application Is Released to the Public

June 2004

Reference Number: 2004-40-110

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

June 9, 2004

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION
CHIEF INFORMATION OFFICER

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

SUBJECT: Final Audit Report - Systemic Weaknesses Need to Be
                            Addressed Before the On-Line E-File Application Is Released
                            to the Public (Audit # 200340058)

This report presents the results of our review of the Internal Revenue Service's (IRS) On-Line Electronic Filing (*e-file)* Application. The overall objective of this review was to determine whether the On-Line *e-file* Application functioned as intended, including providing third-party users with the ability to easily navigate through the application.

In the IRS Restructuring and Reform Act of 1998,[1] the Congress challenged the IRS to promote its *e-file* programs to the point at which 80 percent of all tax returns would be filed electronically by the 2007 Filing Season.[2] To help meet the Congressional mandate, the IRS created the e-Services project that, when completed, will provide a set of web-based business products as incentives to third parties to increase *e-file*. One of the initial e-Services products planned for release is the On-Line *e-file* Application, which will provide third parties with a faster, more accurate way to apply to become *e-file* providers[3] and make revisions to existing application information via the Internet.

The planned release of the On-Line *e-file* Application prior to the start of the 2004 Filing Season did not occur. As a result, neither the IRS nor third parties received the key benefits expected from the On-Line *e-file* Application. Third parties were not provided with the ability to prepare and submit Applications to Participate in the IRS *e-file*

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[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 filing season is the period from January through mid-April when most individual income tax returns are filed.
[3] An *e-file* provider can be either an Electronic Return Originator, a transmitter who transmits the electronic return to the IRS, an Intermediate Service Provider, a software developer of electronic filing software, or a reporting agent.

Program (Form 8633) or to make revisions to existing application information via the Internet.

Although the On-Line *e-file* Application was not released for public use as planned, the IRS was successful in combining individual and business *e-file* applications into one *e-file* application. This allows third parties to submit one application to *e-file* both individual and business tax returns. The IRS also combined six separate databases that previously housed applicant information into a single database, allowing IRS employees easier access to *e-file* applicant information.

However, systemic weaknesses need to be addressed before the On-Line *e-file* Application is released for public use. The current On-Line *e-file* Application does not have sufficient procedures and controls to ensure all information is protected and applications are processed effectively and timely. In addition, the IRS has not ensured the system has sufficient capacity for future growth or developed procedures to address those third parties that choose to submit their applications on paper. Finally, the system might not be sufficiently user-friendly to ensure third parties use the new On-Line *e-file* Application.

To address these issues, we recommended the Commissioner, Wage and Investment Division, ensure issues are effectively addressed before the On-Line *e-file* Application is made available for public use. The Commissioner should also ensure guidelines are updated to include procedures for the new application process, including applications *e-filed* and submitted on paper, and obtain feedback from internal users to identify issues that may affect the ease with which third parties can use the Application once it is released to the public.

Management's Response: IRS management agreed with our recommendations and has already initiated or completed corrective actions. Specifically, a set of work lists were designed to assist employees in determining the status of *e-file* applications, and management reports are being developed. Further, a draft Desk Guide was developed, which provides hands-on tutorials for using the system and guidance on how to use the work lists and other available reports to assist in ensuring the effective and timely processing of all *e-file* applications.

A risk assessment was conducted on the e-Services Project to assure that the *e-file* application information is adequately protected; the IRS will communicate the importance of providers updating their account information to ensure sensitive information is not subject to unauthorized access; and an analysis was conducted of capacity requirements and monitoring is in place to provide a warning in the event the system gets to 90 percent capacity. In addition, the IRS is currently revising the Internal Revenue Manual to outline the policy and procedures related to the application process for electronic and paper returns, while the previously mentioned Desk Guide will provide employees with procedures for using the *e-file* application online via the Internet.

Also, employee insights and suggestions were encouraged during project development and throughout the startup. Whenever technically feasible, these suggestions were adopted. The IRS also received and reacted to input from external users during the

initial testing phase prior to the release. 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 R. Phillips, Assistant Inspector General for Audit (Wage & Investment Income Programs), at (202) 927-0597.

Table of Contents

| **Background** | In the Internal Revenue Service (IRS) Restructuring and Reform Act of 1998,[1] the Congress challenged the IRS to promote its electronic filing (*e-file)* programs to the point at which 80 percent of all tax returns would be filed electronically by the 2007 Filing Season.[2] Unfortunately, if the IRS' current systems are not updated and refined, this goal will not be met. Therefore, to help meet the Congressional mandate, the IRS created the e-Services project. |

The e-Services project will provide a set of web-based business products, accessed through the IRS web site, as incentives to third parties to increase electronic filing. The project focuses on fostering easy-to-use electronic products and services, targeted at specific practitioner segments that inform, educate, and provide service to the taxpaying public.

E-Services products include agency-wide registration, authorization, authentication, and application procedures for tax practitioners. In addition, select Electronic Return Originators (ERO)[3] will be provided with On-Line Power of Attorney Application, verification of Taxpayer Identification Numbers, transcript delivery, and electronic account resolution. Releases of the e-Services project were initially scheduled to begin in June 2002 but were delayed until August 2003.

One of the initial e-Services products planned for release is the On-Line *e-file* Application, which will provide third parties with the ability to prepare, submit, and revise the Application to Participate in the IRS *e-file* Program (Form 8633) via the Internet. Form 8633 is the form third

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[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 filing season is the period from January through mid-April when most individual income tax returns are filed.
[3] EROs originate the electronic submission of income tax returns to the IRS. An ERO may originate the electronic submission of income tax returns that are either prepared by the ERO firm or collected from taxpayers.

parties use to apply to the IRS to become *e-file* providers.[4]
Providing third parties the ability to apply electronically is
part of the IRS' effort to make the entire *e-file* process
electronic. The On-Line *e-file* Application was originally
scheduled for release in 2002. However, as of the end of
our testing, it had not been released for third party use.

For third parties, the new On-Line *e-file* Application will
provide a faster, more accurate way to apply to become
e-file providers and make revisions to existing application
information via the Internet. For the IRS, it will provide
resource savings since IRS employees will no longer have to
manually input the information from paper applications into
the system. Instead, third parties will be entering
application information via the Internet.

Once the IRS receives an application or updated
information, it performs a series of checks to ensure the
applicant meets the qualifications to participate in the
e-file Program. If the applicant successfully passes these
checks, a unique identification number is assigned to the
applicant. This unique number identifies the entity and
location of the *e-file* provider and is required on all *e-file* tax
returns sent to the IRS.

This review was performed in the Electronic Tax
Administration and Business Systems Modernization offices
in the Modernization and Information Technology Services
organization at IRS National Headquarters in Washington,
D.C., and at the Electronic Filing Unit in the Andover
Submission Processing Site during the period October 2003
through February 2004. The audit was conducted in
accordance with *Government Auditing Standards*. We were
unable to complete our audit tests to determine whether the
On-Line *e-file* Application was functioning as intended,
including providing third-party users with the ability to
easily navigate through the application, because the On-Line
e-file Application was not released for public use before the
completion of our testing. Detailed information on our audit

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[4] An *e-file* provider can be either an ERO, a transmitter who transmits
the electronic return to the IRS, an Intermediate Service Provider who
processes tax return information and sends to a transmitter, a software
developer of electronic filing software, or a reporting agent who
electronically prepares Federal tax forms for employers.

objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

The On-Line E-File Application Was Not Released to the Public in Time for the 2004 Filing Season

Neither the IRS nor third parties received the key benefits expected from the On-Line *e-file* Application since it was not released as planned at the start of the 2004 Filing Season. Third parties were not provided with the ability to prepare and electronically submit Forms 8633 or make revisions to existing application information via the Internet. In addition, the IRS was unable to save resources resulting from third parties rather than IRS employees entering application information. Instead, as of December 30, 2003, the IRS had spent an additional 23,825 hours in labor, at a cost of approximately $377,000, because the On-Line *e-file* Application was only released for use internally.

Although the On-Line *e-file* Application was not released to the public as planned, the IRS was successful in:

- *Combining the individual and business e-file applications into one application.* Previously, if third parties wanted to *e-file* both individual and business tax returns, they would have to submit separate *e-file* applications. Third parties now have to submit only one application to *e-file* both individual and business tax returns.

- *Combining six separate databases that previously housed applicant information into a single database referred to as the Third Party Data Store (TPDS).* This allows IRS employees easier access to *e-file* applicant information. The TPDS is an electronic database that houses all pertinent information on third parties that interact with the IRS through e-Services. For example, this database contains information on all registered users[5] and *e-file* providers, along with information on their *e-file* activity.

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[5] A registered user is an entity, individual, or business that has completed the authentication process and has become a user of e-Services.

During the 2003 IRS Tax Forums,[6] the IRS Commissioner made a commitment to tax professionals that the On-Line *e-file* Application would be in operation for the 2004 Filing Season. This required the IRS to release the On-Line *e-file* Application for third-party use by August 2003 to allow sufficient time to process Forms 8633 before the start of the 2004 Filing Season. The IRS recommends applicants submit Forms 8633 at least 45 days before they wish to participate in the *e-file* Program.

The On-Line *e-file* Application was released for IRS employee use but did not work as expected

The IRS first implemented the On-Line *e-file* Application internally, shutting down the previous application process on September 12, 2003, and deploying the new On-Line *e-file* Application 12 days later. However, IRS management immediately determined that the On-Line *e-file* Application was not working as expected.

The IRS tracked and documented 263 problems that surfaced from September to December 2003. As of December 31, 2003, the IRS had been unable to resolve 22 of the 263 identified issues. Unresolved problems included the:

- Issuance of unique identification numbers to more than one *e-file* provider.

- Inability to change or add certain fields in the TPDS. For example, IRS employees were unable to update certain company names in the database.

- Inability to access the system, at times, due to connection problems.

Because the system did not work as expected, the IRS experienced a backlog of paper applications that at one time totaled approximately 10,000 new or revised applications. To process these applications, the IRS spent approximately $377,000 in extra labor costs. Applicants in the backlog

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[6] The IRS Nationwide Tax Forums offer the tax professional community an opportunity to attend seminars, workshops, and focus groups that discuss new IRS initiatives, such as e-Services, along with other issues that affect their profession.

were burdened when their applications were not timely processed. Some of the backlogged applications took from 10 to 12 weeks to process, whereas applications processed using the prior system were completed within 7 weeks. In addition, applicants did not know the status of their applications because the IRS was unable to issue letters confirming their receipt. Some applicants submitted duplicate applications fearing the original ones had been lost in the mail, while others contacted the *e-file* help desk.

The increased costs and taxpayer burden caused by the backlog were a one-time occurrence caused by a number of factors. For example:

- The IRS did not ensure the On-Line *e-file* Application was adequately tested prior to releasing it for use. Although management followed the test plan, their plans did not include a "shakedown" period to allow them to identify and resolve problems once the system was in place.

- IRS employees did not have the required 30-day period in which to learn the new process. Plans required a 30-day period for IRS employees that process *e-file* applications to become familiar with the On-Line *e-file* Application prior to using the system to process live data. This familiarity period never occurred. Instead, IRS employees were instructed to immediately begin using the On-Line *e-file* Application.

In spite of the numerous problems associated with the deployment of the On-Line *e-file* Application, IRS employees from various offices and functions worked diligently to ensure *e-file* applications were input and processed in time for the 2004 Filing Season. Because of their exemplary efforts, approximately 30,700 *e-file* applications were processed, ensuring that applicants were able to *e-file* tax returns for the 2004 Filing Season. We commend these employees on their dedication and hard work. The processing of these applications before the 2004 Filing Season was critical to the success of the IRS *e-file* Program.

Specific recommendations are not being made as we have previously reported on testing deficiencies for e-Services and other projects.[7]

Systemic Weaknesses Need to Be Addressed Before Full Implementation

The current On-Line *e-file* Application process does not have sufficient procedures and controls to ensure all *e-file* provider information is protected and applications are processed effectively and timely. In addition, the IRS has not ensured the system has sufficient capacity for future growth and has not developed procedures to address those third parties that choose to submit their applications on paper. Finally, the system might not be sufficiently user-friendly to ensure third parties can easily use the new On-Line *e-file* Application.

These systemic weaknesses were not identified because the IRS did not ensure the On-Line *e-file* Application was adequately tested prior to releasing the Application for internal use. IRS management advised us that IRS protocol did not provide for this specific testing. Plans required a 30-day period for IRS employees that process applications to become familiar with the On-Line *e-file* Application prior to using the Application to process live data. However, as stated, this familiarity period never occurred.

Management controls should provide reasonable assurance that management's objectives are being achieved and resources protected. This includes effective management information system reports that ensure controls are working and provide information with which to gauge the success of the program. System controls also include restrictions on users to allow access only to necessary system functions.

There are no effective management information system reports to ensure all applications are processed effectively and timely

The On-Line *e-file* Application process was designed to produce work lists[8] and notify employees when manual

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[7] *Testing Practices for Business Systems Modernization Projects Need Improvement* (Reference Number 2003-20-178, dated September 2003); and *Requirements Changes and Testing Delays Have Further Increased the Costs and Delayed the Benefits of the E-Services Project* (Reference Number 2004-20-036, dated February 2004).

intervention is needed to complete the application process. Although the work lists were required to be available at the time the system was released for internal use, the function did not operate as intended. Work lists were not automatically generated, so employees did not know there were *e-file* applications needing manual intervention to complete the application process.

In addition, the new system provided other management information reporting capabilities, but IRS management was not aware of these capabilities. Documentation explaining the reporting capabilities of the new system had not been provided to management when the system was released. At the beginning of January 2004, the developer of the system generated the first ad hoc report. This was an aged report that identified all applications that had been in the system for 30 or more days without being completed. This listing was 176 pages long and listed over 8,500 applicants. To ensure these applicants would be able to *e-file,* IRS employees manually worked this listing and issued the required unique identification numbers to the qualified applicants.

Once the work list feature is available, the IRS will need to develop procedures on how to use the work lists and other available reports to assist in ensuring the effective and timely processing of all *e-file* applications.

There is a risk of unauthorized access to *e-file* providers' information

IRS procedures state that if an *e-file* provider's application information (such as the provider's address or telephone number or the individuals listed on the provider's application) changes, the *e-file* provider must notify the IRS within 30 days of the change. In the prior system, only IRS employees had access to the system, creating a minimal risk of unauthorized accesses to system information, including sensitive information such as Social Security Numbers. When the new system is released for third-party use, third parties will be able to access their *e-file* provider

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[8] A work list is an electronic work assignment vehicle that alerts employees when applications need manual intervention to complete processing.

information via the Internet. If the application information is not timely updated, the system will not prevent an *e-file* provider who changes firms from accessing his or her former firm's *e-file* application information. Access to the former firm's information would allow the *e-file* provider to access sensitive information and potentially make unauthorized changes to other application information.

IRS management did not ensure all *e-file* provider information used in the new system was accurate and complete. Although it is the firm's responsibility to keep its *e-file* application information current, this will be even more important when third parties are able to access this system.

There is no assurance that the capacity of the TPDS will meet future expected growth of the system

The original capacity requirement for the TPDS, when planned in 2001, was to support 200,000 third-party organizations (such as EROs.) This capacity level was a performance requirement in the system specifications. However, management was unable to provide documentation confirming that this initial capacity requirement was met.

Because the original capacity specifications were developed several years earlier, management was not aware of whether subsequent revisions had been made to the system's original requirements. Ensuring the TPDS can adequately support the volume of third-party organizations will be of utmost importance as the growth in *e-file* continues and other factors, such as states mandating *e-filing,* result in more individuals becoming *e-file* providers.

There are no procedures for processing *e-file* applications submitted on paper

Although the IRS prefers that third parties apply to become *e-file* providers on-line, once the On-Line *e-file* Application is released, the IRS will still allow *e-file* applications (Form 8633) to be submitted on paper. However, procedures have not been developed to address third parties that choose to submit their *e-file* applications on paper. For example, the prior system issued interim letters to the applicants to advise them that their applications had been received and were being processed. The IRS has not

developed procedures for the new system to issue interim letters to *e-file* applicants because its primary focus has been on the On-Line *e-file* Application process and making third parties aware of the advantages of *e-filing* Form 8633.

The On-Line *e-file* Application might not be sufficiently user-friendly to ensure third parties can easily use it

Although we were unable to completely test the application process to assess its usability, we observed employees using the system and conducted an anonymous survey of employees that used both the prior system and the new system. Employee comments on the new system include:

- It takes two to four times longer to input an *e-file* application with the new system than it did using the prior system.

- It requires more screens, clicks, and input than the prior system.

- It is not user-friendly and requires multiple re-inputs of the same information.

- The screens on the new system should be only two pages and look just like the Form 8633. *(Note: The new system has 12-13 screens.)*

If the system is not user-friendly or is cumbersome to use, third parties might choose not to use the system or revert to submitting Forms 8633 and updates on paper.

Recommendations

The Commissioner, Wage and Investment Division, should work with the Chief Information Officer to:

1. Ensure that, before the On-Line *e-file* Application is released to the public:

   a. The system has sufficient management information reports to process applications timely and the reports are being generated as intended, including developing procedures for generating and using work lists and management information reports.

Management's Response: On March 10, 2004, the PRIME[9] released a set of work lists designed to assist the employees in determining the status of *e-file* applications. In addition, the PRIME is currently developing management reports based on the criterion submitted by the IRS. Lastly, in an effort to ensure that the employees are familiar with the various work lists and management information reports, a draft Desk Guide was developed. This Guide provides hands-on tutorials for using the system, as well as guidance on how to use the work lists and other available reports to assist in ensuring the effective and timely processing of all *e-file* applications.

b. A risk assessment is conducted to evaluate the access controls and determine what actions, if any, are necessary to ensure *e-file* application information is adequately protected. At a minimum, actions taken should include educating *e-file* providers on the importance of updating their account information.

Management's Response: A risk assessment was conducted on the e-Services Project to assure that the *e-file* application information is adequately protected. In addition, the Electronic Tax Administration Office will communicate the importance of providers updating their account information upon changes within their business to ensure sensitive information is not subject to unauthorized access. This information will be disseminated through various channels, such as Quick Alerts, an *e-file* Article, and tax forums.

c. An analysis is completed to ensure the system meets minimum capacity requirements and has the capability to meet future capacity demands resulting from the expansion of the *e-file* Program.

Management's Response: An analysis was conducted as part of the System Integration Testing and Performance testing. The system is currently operating at 25 percent

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[9] The IRS is working with a PRIME contractor, the Computer Sciences Corporation, to develop and deploy modernized systems.

of its total capacity. The IRS and PRIME monitor the disk allocation. The team will provide a warning in the event the system gets to 90 percent disk space.

2. Ensure guidelines are updated to include procedures for the new application process, including applications *e-filed* and submitted on paper.

Management's Response: The Chief Information Officer and the Commissioner, Wage and Investment Division, are currently revising the Internal Revenue Manual (IRM) and developing the previously mentioned Desk Guide for use by the employees working IRS *e-File* Applications. The updated IRM will outline the policy and procedures related to the application process for electronic and paper returns. The Desk Guide will provide employees with procedures for using the *e-File* application online via the Internet.

3. Identify and address employee concerns that may affect the ease with which third parties can use the application once it is released to the public.

Management's Response: Employee insights and suggestions were encouraged during project development and throughout the startup. Whenever technically feasible, these suggestions were adopted. The IRS also received and reacted to input from external users during the initial testing phase prior to the release. Since the release of the product, the level of acceptance has been positive. At this point in the life cycle of this software, it is not necessary to make a special effort to seek additional input from employees since external users will become the primary users. This was completed April 26, 2004.

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine whether the Internal Revenue Service's (IRS) On-Line Electronic Filing (*e-file)* Application was functioning as intended, including providing third-party users with the ability to easily navigate through the application. To accomplish this objective, we:

I. Determined the goals and objectives of the On-Line *e-file* Application.

   A. Determined the goals and expectations the Office of Electronic Tax Administration has for the On-Line *e-file* Application.

   B. Reviewed and analyzed the documentation on the Functional Specification Package, project documentation, and implementation testing to determine what and how the program was designed, implemented, and expected to operate.

   C. Determined the impact to the IRS if expectations for the On-Line *e-file* Application are not met.

II. Determined if the On-Line *e-file* Application system was adequately tested prior to implementation and if results of testing were used to make changes/modifications prior to release.

   A. Determined if usability testing was performed and if results were used to improve the ability of third parties to use the application.

   B. Determined if acceptance testing was done and if all reported defects were corrected and/or explained.

III. Determined if key issues were adequately addressed during the implementation process to ensure the application is functioning as intended.

   A. Determined if internal users were provided access to the system (familiarity venue) before the system was used for production.

   B. Determined if parallel processing of the old and new systems was used until the new system was functioning as intended.

Major Contributors to This Report

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Outcome Measures

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

Type and Value of Outcome Measure:

- Inefficient Use of Resources – Actual; approximately $377,000 extra labor costs (see page 3).

- Taxpayer Burden – Potential; approximately 30,700 Electronic Filing (*e-file*) applicants affected (see page 3).

Methodology Used to Measure the Reported Benefit:

Based on the Internal Revenue Service (IRS) Work Planning & Control Program Analysis Report (PCC 6240), the Andover Submission Processing Site expended an additional unscheduled 17,635 staff hours (including detailed employees) from September 13 through December 27, 2003, to process Applications to Participate in the IRS *e-file* Program (Form 8633).

- General Schedule (GS)-7 tax examiners[1] – Calendar Year (CY) 2003 Boston pay rate for GS-7 Step 5 = $18.13 per staff hour x 3,991 hours over schedule = $72,356.83.

- GS-5 clerks[2] – CY 2003 Boston pay rate for GS-5 Step 5 = $14.64 x 1 hour under schedule = ($14.64).

- Detailed GS-5 clerks[3] – CY 2003 Boston pay rate for GS-5 Step 5 = $14.64 per staff hour x 13,645 hours over schedule = $199,762.80.

17,635 hours over schedule at a net cost of $272,104.99 ($72,356.83 - $14.64 + $199,762.80).

Based on the PCC 6240 for October 14 through December 27, 2003, the Austin Submission Processing Site expended an additional unscheduled 8,574 staff hours for technical support.

- GS-7 tax examiners[4] – CY 2003 Austin pay rate for GS-7 Step 5 = $17.29 per staff hour x 8,574 hours over schedule = $148,244.46.

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[1] Organization Code 38, Program Code 42710, Function Code 750.
[2] Organization Code 38, Program Code 42710, Function Code 760.
[3] Organization Code 38, Program Code 42711, Function Code 750.
[4] Organization Code 38, Program Code 42730, Function Code 750.

Based on the PCC 6240 for September 13 through December 27, 2003, the Andover Submission Processing Site expended 2,384 fewer staff hours than scheduled for technical support.

- GS-7 tax examiners[5] – 2003 Boston pay rate for GS-7 Step 5 = $18.13 per staff hours x 2,384 hours under schedule = - $43,221.92.

6,190 hours over-scheduled hours at a net cost of $105,022.54 ($148,244.46 - $43,221.92).

Overall 23,825 hours at a net cost of $377,127.53 ($272,104.99 + $105,022.54).

There were approximately 30,700 *e-file* applications processed using the new system that did not have an interim letter issued to acknowledge receipt of the application. The applicants did not know the status of their applications, and processing took 10 to 12 weeks.

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[5] Organization Code 38, Program code 42730, Function Code 750.

Management's Response to the Draft Report

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

May 28, 2004

RECEIVED

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MEMORANDUM FOR TREASURY INSPECTOR GENERAL FOR TAX
ADMINISTRATION

FROM: John M. Dalrymple
                  Deputy Commissioner for Operations Support

SUBJECT: Draft Audit Report – Systemic Weaknesses Need to Be
                  Addressed Before the On-Line *e-File* Application Is Released
                  to the Public (Audit # 200340058 – ECMS # 0404-
                  5Y8MRBBL)

We have reviewed your audit report regarding the On-Line *e-File* Application.
Your report references several systemic weaknesses that needed to be
addressed before the application was released to the public. As outlined in the
attached, we have already completed or initiated corrective actions on many of
your recommendations.

Based on our corrective actions, we deployed the On-Line *e-File* Application on
March 28, 2004. This application, the second portion of a suite of web-based
business products designed to provide incentives to third parties to increase
electronic filing, allows firms to complete on-line, a new integrated application for
participation in the IRS *e-File* Program. It also offers a delegation of authority
feature that allows principals and responsible officials of the firm/organization to
delegate e-service incentive products access to their employees and allows one
set of *e-File* identification numbers.

Since its launch, over 24,000 third parties have registered as *e-File* providers,
with an increase of over 13 percent within the first month. Third parties have
realized many of the improvements associated with the release. For example,
the decrease in the number of errors in applications due to the transition from
paper to electronic submissions not only speeds up the process, but reduces the
amount of time IRS employees must spend on exception handling. Similarly, the
centralization of data stores enhances usability, encourages increased
participation in the program, and allows for faster and better access to critical
data. Finally, the addition of on-line help utilities and other critical resources
ensures higher levels of service on the part of the IRS and greater availability of
information.

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While this is the beginning in a web-based environment, it will promote the use of electronic filing, thereby moving us closer to the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA98) goal that paperless filing should be the preferred and most convenient means of filing Federal tax and information returns.

We concur with TIGTA's measurable benefits of electronic tax administration. Attached is our response to your specific recommendations.

If you have any questions, please contact me at (202) 622-6860, or have a member of your staff contact Bert DuMars, Director, Electronic Tax Administration Division at (202) 622-7990.

Attachment

Management Response to Draft Audit Report – Systemic Weaknesses Need
to be Addressed Before the On-Line *e-File* Application Is Released to the Public
(Audit # 200340058)

IDENTITY OF RECOMMENDATION #1a:
The Commissioner, Wage and Investment Division, should work with the Chief
Information Officer to:

    1.   Ensure that, before the On-Line *e-File* Application is released to
        the public:

            a. The system has sufficient management information
            reports to process applications timely and the reports are
            being generated as intended, including developing
            procedures for generating and using work lists and
            management information reports.

CORRECTIVE ACTION #1a:
We agree with the recommendation and have developed the following
documents/reports:

- Work Lists – On March 10, 2004, the PRIME released a set of work lists
  designed to assist the employees in determining the status of *e-File*
  applications. Procedures for generating work lists have been developed
  and work list items are being utilized by Andover personnel.

- Management Reports – Management reports are currently being
  developed by the PRIME based on the criterion submitted by the IRS. In
  March 2004, the IRS provided the PRIME with all known management
  reports. As the PRIME develops reports, they are submitted to the IRS for
  approval. After approval, the management reports are placed into the
  production environment. Once the management reports are placed into
  production, the IRS must determine if the reports are being generated as
  intended and develop procedures for obtaining management reports.

- Desk Guide - In an effort to ensure that the employees are familiar with
  the various work lists and management information reports, the Chief
  Information Officer, in conjunction with the PRIME and the Commissioner
  of Wage and Investment, developed a draft Desk Guide. This Guide
  provides hands on tutorials for utilizing the system as well as guidance on
  how to use the work lists and other available reports to assist in ensuring
  the effective and timely processing of all e-File applications.

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IMPLEMENTATION DATE:
February 1, 2005

RESPONSIBLE OFFICIAL(S):
Director, Strategic Services Division OS:CIO:I:ET:S

CORRECTIVE ACTION MONITORING PLAN: We enter accepted corrective actions into the Joint Audit Management Enterprise System (JAMES). These corrective actions are monitored on a monthly basis until completion.

IDENTITY OF RECOMMENDATION #1b:
The Commissioner, Wage and Investment Division, should work with the Chief Information Officer to:

> 1. Ensure that, before the On-Line *e-File* Application is released to the public:

>> b. A risk assessment is conducted to evaluate the access controls and determine what actions, if any, are necessary to ensure *e-File* application information is adequately protected. At a minimum, actions taken should include educating *e-File* providers on the importance of updating their account information.

CORRECTIVE ACTION #1b:
We agree with these recommendations and have already taken the following actions.

A risk assessment was conducted on the e-Services Project for the purpose of certification under the Internal Revenue Manual (IRM) 2.1.10, Information Systems Security Manual. This assessment ensures that the *e-File* application information is adequately protected.

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In addition, the Electronic Tax Administration (ETA) Office will communicate the importance of providers updating their account information upon changes within their business to ensure sensitive information is not subject to unauthorized access. This information will be disseminated through various channels, such as:

- Quick Alerts – a free, on-line service that disseminates mass e-File messages, within seconds, to all "subscribed" individual and business *e-File* Software Developers, Transmitters, and Authorized IRS *e-File* Providers.

- *e-File* Article – an article designed for the electronic return originators that is posted on the IRS.gov website.

- Tax Forums – a series of seminars designed to offer the latest word on tax law, compliance, and tax practice and procedures.

- *e-File* Letter – a letter issued to electronic return originators providing information relevant for processing tax returns electronically.

IMPLEMENTATION DATES:
Completed – March 1, 2004 – Risk Assessment
February 1, 2005 - Communications

RESPONSIBLE OFFICIAL(S):
Director, Strategic Services Division OS:CIO:I:ET:S

CORRECTIVE ACTION MONITORING PLAN: We enter accepted corrective actions into the Joint Audit Management Enterprise System (JAMES). These corrective actions are monitored on a monthly basis until completion.

IDENTITY OF RECOMMENDATION #1c:
The Commissioner, Wage and Investment Division, should work with the Chief Information Officer to:

1. Ensure that, before the On-Line *e-File* Application is released to the public:

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c. An analysis is completed to ensure the system meets minimum capacity requirements and has the capability to meet future capacity demands resulting from the expansion of the *e-File* Program.

CORRECTIVE ACTION #1c:
An analysis was conducted as part of SIT and Performance testing. The system is currently operating at 25% of its total capacity. The IRS and PRIME monitor the disk allocation. The team will provide a warning in the event the system gets to 90% disk space.

IMPLEMENTATION DATE:
Completed – April 30, 2004

RESPONSIBLE OFFICIAL(S):
Director, Business System Modernization OS:CIO:B

CORRECTIVE ACTION MONITORING PLAN: N/A

IDENTITY OF RECOMMENDATION #2:
The Commissioner, Wage and Investment Division, should work with the Chief Information Officer to:

2. Ensure guidelines are updated to include procedures for the new application process, including applications e-Filed and submitted on paper.

CORRECTIVE ACTION #2:
We agreed with the recommendation. The Chief Information Officer and the Commissioner, Wage and Investment Division, are currently revising IRM 3.42.10, Authorized IRS *e-File* Provider, as well as developing a Desk Guide for use by the employees working IRS *e-File* Applications. IRM 3.42.10 will outline the policy and procedures related to the application process for electronic and paper returns. The Desk Guide will provide employees with procedures for using the *e-File* application on-line via the internet.

IMPLEMENTATION DATE:
February 1, 2005

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RESPONSIBLE OFFICIAL(S):
Director, Strategic Services Division OS:CIO:I:ET:S

CORRECTIVE ACTION MONITORING PLAN: We enter accepted corrective
actions into the Joint Audit Management Enterprise System (JAMES). These
corrective actions are monitored on a monthly basis until completion.

IDENTITY OF RECOMMENDATION #3:
The Commissioner, Wage and Investment Division, should work with the Chief
Information Officer to:

> 3. Identify and address employee concerns that may affect the ease
> with which third parties can use the application once it is released to
> the public.

CORRECTIVE ACTION #3:
During the product development and throughout the start-up, we encouraged
employee input. During the extended test phase of the product, our employees
provided valuable insights and suggestions for improvements and enhancements.
Whenever technically feasible, these changes and modifications were adopted.
We also received and reacted to input from our external users during the initial
testing phase prior to the release. Since the release of the product, the level of
acceptance has been positive. At this point in the life cycle of this software, it is
not necessary to make a special effort to seek additional input from our internal
users since external users will become the primary users.

IMPLEMENTATION DATE:
Completed – April 26, 2004

RESPONSIBLE OFFICIAL(S):
Commissioner, Wage and Investment SE:W

CORRECTIVE ACTION MONITORING PLAN: N/A