The Internal Revenue Service's Implementation of the Improper Payments Information Act Is Progressing

April 2005

Reference Number: 2005-40-062

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

April 15, 2005

MEMORANDUM FOR CHIEF FINANCIAL OFFICER

FROM: Pamela J. Gardiner
Deputy Inspector General for Audit

SUBJECT: Final Audit Report - The Internal Revenue Service's Implementation of the Improper Payments Information Act Is Progressing (Audit # 200440042)

This report presents the results of our review to evaluate the process the Internal Revenue Service (IRS) established to complete the Department of the Treasury's (the Treasury) implementation plan to comply with the Improper Payments Information Act of 2002 (IPIA).[1]

The IPIA requires agencies to report annually on the extent of improper payments, and the actions being taken to reduce them, for all potentially high-risk programs and activities meeting specific criteria. According to the Government Accountability Office (GAO), improper payments have been recognized as a longstanding, widespread, and significant problem in the Federal Government. The Office of Management and Budget (OMB) estimated these payments to be about $35 billion annually for major Federal Government benefit programs.[2]

In May 2003 and September 2004, the OMB issued its implementing and alternative guidelines for the development of a formal implementation plan for the IPIA, the performance of risk assessments and annual statistical assessments for high-risk programs, and reporting requirements.[3] Under the OMB guidelines and the Treasury IPIA implementation plan, the various Treasury agencies, including the IRS, were

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[1] Pub. L. No. 107-300, 116 Stat. 2350 (2002).
[2] *Financial Management: Status of the Governmentwide Efforts to Address Improper Payment Problems* (GAO-04-99, dated October 2003).
[3] OMB memorandum entitled, Improper Payments Information Act of 2002 (Public Law No: 107-300) (M-03-13, dated May 2003) and Alternative for Estimating Improper Payment Amounts, Chief Financial Officer Council Working Group on Improper Payments.

required to conduct annual risk assessments of programs not already identified as high risk that had program funding greater than or equal to $10 million. Treasury agencies were to report the results of those assessments to the President and the Congress. The only program the IRS deemed to be at high risk for improper payments was the Earned Income Tax Credit Program, which was previously recognized as a high-risk program and reported under OMB *Preparation, Submission, and Execution of the Budget* (Circular A-11) requirements.

The IRS performed risk assessments for 13 of the 14 programs identified by the Treasury as requiring a risk assessment under OMB guidelines. The one program for which the IRS did not assess risk was the Unapplied Collections Program. The Associate Chief Financial Officer (CFO) for Revenue Financial Management, with verbal concurrence from Treasury personnel, believed the Unapplied Collections Program was not covered under the IPIA because funding for the Program was not derived from Federal Government funds. The Treasury's annual Performance and Accountability Report must be in compliance with OMB guidelines. As such, we believe that, if the IRS wanted to exclude a specific program, such as the Unapplied Collections Program, from coverage under the IPIA, it should have sought formal concurrence from the Treasury. In any event, the amount of disbursements in the Unapplied Collections Program makes it unlikely the Unapplied Collections Program would be a high-risk program.

When performing two of the required risk assessments, the IRS did not use program assistance when evaluating the internal controls in the programs. While the Treasury IPIA guidelines did not provide specific direction on who should perform annual risk assessments, it would have been prudent on the part of the Associate CFO for Revenue Financial Management to solicit the opinions of those having firsthand program knowledge. If the risk assessments had been performed with assistance from program area employees, the risk assessments may have identified additional risks.

We recommended the CFO work with the Treasury to obtain formal exemptions from the Treasury for IRS programs meeting the IPIA risk assessment criteria for which the CFO has determined that a risk assessment will not be performed. In addition, the CFO should include IRS operating function employees on the assessment teams when conducting future annual risk assessments.

<u>Management's Response</u>: Management partially agreed to both recommendations. They believe they took the appropriate steps to notify the Treasury CFO's office that they would not be performing the Unapplied Collections Program risk assessment and concurred with formal notification to the Treasury only in the event they have to remove any future risk assessments from the Treasury list.

In addition, while management did not agree to assign functional employees to the risk assessment teams, they pointed out they involved the functional employees in the risk assessments and obtained agreement from functional staff to assist during the Fiscal Year 2005 risk assessments. Management's complete response to the draft report is included as Appendix V.

Office of Audit Comment: Although IRS management agreed to obtain formal exemptions in the future when risk assessments listed in the Treasury IPIA implementation plan are not conducted, they disagreed that they should have obtained a formal exception this year for not conducting the risk assessment for the Unapplied Collection Program. Formally notifying the Treasury would have ensured the Treasury's information provided to the Congress would have included the affected IRS revenue programs and activities. Not doing so could expose the IRS to criticism and cause unnecessary concern over its IPIA implementation methods.

In addition, the Associate CFO for Revenue Financial Management agreed to have IRS functional staff assist on some future risk assessments by obtaining and analyzing data but did not agree to have IRS functional staff assigned to the assessment teams. We believe assigning IRS functional staff to future risk assessments may enhance the identification of risks. This would allow the risk assessment teams to solicit the opinions of those having firsthand program knowledge. Officials we contacted from other agencies believed program area involvement was critical to identifying potential problems and weaknesses that may cause improper payments and could make a program high risk.

While we still believe our recommendations are worthwhile in full, we do not intend to elevate our disagreement concerning these matters to the Department of the Treasury for resolution.

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 and Investment Income Programs), at (202) 927-0597.

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Background

One component of the Fiscal Year (FY) 2002 President's Management Agenda (PMA)[1] was the initiative for agencies to reduce the amount of improper payments. An improper payment is any payment that should not have been made or that was made in an incorrect amount under a statutory, contractual, administrative, or other legally applicable requirement.

Agency programs listed in the Office of Management and Budget's (OMB) guidance entitled, *Preparation, Submission, and Execution of the Budget* (Circular A-11), were required to report annually on the extent of improper payments and the actions being taken to reduce the improper payments. Circular A-11 required the Internal Revenue Service (IRS) to estimate and report the amount of improper payments resulting from the Earned Income Tax Credit (EITC) Program, long recognized as having significant payment issues.

According to the Government Accountability Office (GAO), improper payments have been recognized as a longstanding, widespread, and significant problem in the Federal Government. The OMB estimated these payments to be about $35 billion annually for major Federal Government benefit programs.[2] The Improper Payments Information Act of 2002 (IPIA)[3] was enacted to address these concerns.

The Chairman of the Senate Committee on Finance[4] expressed concerns over improper payments, stating, "Because of the magnitude and implications of improper payments Government-wide . . . it is critical that agencies [including the IRS] take their responsibilities under the [Improper Payments Information] Act seriously." The Chairman also stated that agency reports are expected to be accurate, with complete disclosure of improper payment amounts, and that the Senate Committee on Finance should "consider the reports required by the [Improper Payments

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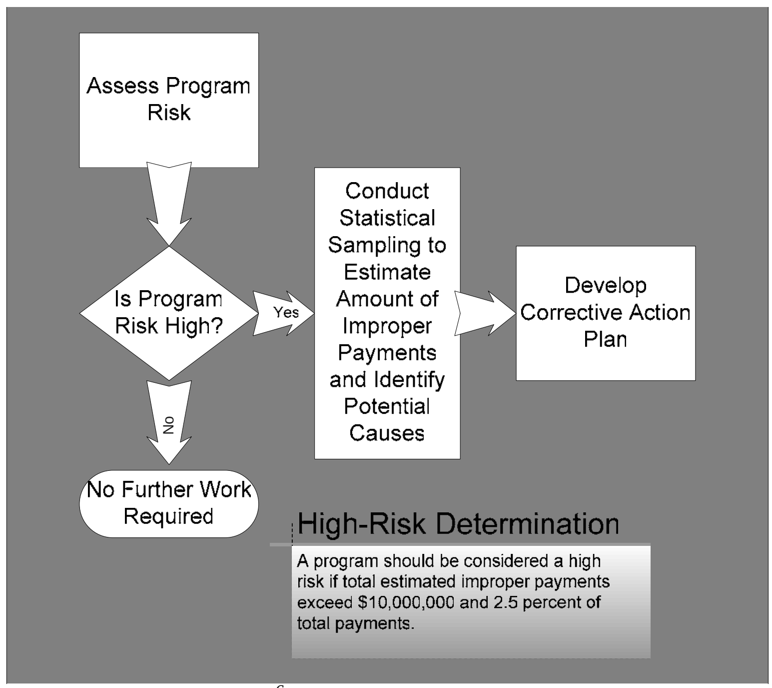
[1] The PMA is a strategy for improving the management of the Federal Government and focuses on 14 areas for improvement.
[2] *Financial Management: Status of the Governmentwide Efforts to Address Improper Payment Problems* (GAO-04-99, dated October 2003).
[3] Pub. L. No. 107-300, 116 Stat. 2350 (2002).
[4] Senator Charles Grassley (R-Iowa).

Information] Act to provide critical information that will assist in the Committee's oversight and monitoring of Federal [Government] programs and activities, as well as the Congress' evaluation of agency management and control over Federal [Government] funds."[5]

The IPIA extended the PMA reporting requirement for improper payments to include other potentially high-risk programs and activities meeting specific criteria. As a result, all Federal Government agencies, including the IRS, must now evaluate the potential for improper payments in all high-risk program areas on an annual basis.

Figure 1: High-Risk Determination



Source: OMB guidelines.[6]

For those program areas determined to be at high risk, the agencies must estimate the amount of the existing improper payments and develop plans to improve controls in the

[5] Letter from Senator Charles Grassley to the Honorable Joshua B. Bolten, Director, OMB, dated January 9, 2004.
[6] OMB memorandum entitled, Improper Payments Information Act of 2002 (Public Law No: 107-300) (M-03-13, dated May 2003) and Alternative for Estimating Improper Payment Amounts, Chief Financial Officer Council Working Group on Improper Payments.

high-risk program areas to improve payment accuracy. Under the IPIA, the OMB was charged with the responsibility of developing the implementation guidelines for all Federal Government agencies.

In May 2003, the OMB issued its implementing guidelines requiring all Departments, including the Department of the Treasury (the Treasury), to develop a formal implementation plan for the IPIA. The Treasury developed its plan using OMB guidance, internal control standards contained in the Treasury Management Control Program, and GAO recommendations contained in several reports that addressed improper payments. Under the Treasury's IPIA implementation plan, the various Treasury agencies, including the IRS, were required to conduct annual risk assessments of programs not already identified as high risk under OMB Circular A-11 and having program funding greater than or equal to $10 million.

For any program determined to be at high risk of improper payments, the agencies, including the IRS, were then required to determine if the improper payment amounts could be greater than or equal to $10 million. For programs meeting these criteria, the agencies were to statistically sample the programs' disbursements to obtain a valid estimate of the total dollar value (absolute value) of improper payments. This analysis would serve as the benchmark for future improper payment assessments. If the improper payments for a program were statistically estimated to equal or exceed $10 million and 2.5 percent of total payments, the IRS was to develop and implement a corrective action plan to improve payment accuracy. The action plan and progress in meeting the action plan goals would be reported to the Congress in each year's Performance and Accountability Report (PAR) due near the end of each calendar year.[7]

During the course of implementation, some Federal Government agencies expressed concerns over the resources needed to conduct annual statistical assessments in complex programs. According to the Congressional Record, one

[7] The most recent Department of the Treasury PAR was issued in November 2004.

Congresswoman stated, "The GAO proposed [to the Congress] that agencies could avoid reporting on improper payments if the agency concluded that the cost of estimating the level of improper payments was not 'cost beneficial' . . . I was concerned that the provision simply created another loophole for agencies to avoid addressing this problem, and I am pleased that the Senate chose not to include this provision."[8]

The OMB subsequently issued revised guidelines on statistically sampling certain high-risk programs in September 2004.[9] Under the new guidelines, once approved by the OMB, agencies could choose an alternative to the annual studies, but statistical assessments would still be required. The guidance allowed for agencies to perform trend analyses using previously available baselines, if less than 5 years old, to estimate the existing improper payment rates. However, each baseline rate must be updated at least every 5 years through statistical analysis. In addition, agencies should annually perform a statistically valid sample on a component of the program that may be susceptible to significant improper payments.

The IRS Chief Financial Officer (CFO) and the Director, EITC, had the responsibility for ensuring compliance with the IPIA and implementing the Treasury IPIA guidelines. This included performing risk assessments on the programs meeting the IPIA criteria. The Associate CFO for Revenue Financial Management (revenue programs) and the Associate CFO for Internal Financial Management (administrative programs) performed risk assessments in their respective areas. The Director, EITC, took responsibility for the EITC Program.

This review was performed in the Office of the CFO at the IRS National Headquarters in Washington, D.C.; the Beckley Finance Center in Beckley, West Virginia; and the EITC Program office in Atlanta, Georgia, during the period February through December 2004. The audit was conducted

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[8] Congresswoman Jan Schakowsky (D-Illinois) during Congressional Testimony to the United States House of Representatives on November 12, 2002.
[9] Alternative for Estimating Improper Payment Amounts, Chief Financial Officer Council Working Group on Improper Payments.

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

The Risk Assessments Were Timely Completed, but the Process Could Be Improved

The IRS established a process to complete the Treasury implementation plan to comply with the IPIA. The Treasury identified the programs that required a risk assessment based on total funding greater than or equal to $10 million. The purpose of the risk assessment was to identify programs which may be susceptible to significant erroneous payments. The Treasury guidelines supplemented OMB guidelines by requiring the IRS to document the risk assessments performed for the programs subject to the IPIA.

The Associate CFO for Revenue Financial Management and the Associate CFO for Internal Financial Management timely evaluated the risk of improper payments for 13 of the 14 required programs.[10] They documented the process by using the Treasury risk assessment questionnaire, which asked 54 questions designed to assess the risk of improper payments.

Performing risk assessments ensures the Treasury can identify high-risk programs and, with subsequent statistical analysis, provide both the Congress and taxpayers with an accurate accounting of improper payment rates. The 13 programs evaluated accounted for approximately $646 billion in total funding and $252 billion in total payments (see Appendix IV).

According to the Chairman of the Senate Committee on Finance, information on the extent of improper payments ". . . is critical to the Congress' understanding of existing problems and its ability to legislate to reduce improper payment levels. Only with careful analysis of this information can [the Congress] ensure the most effective,

[10] The Treasury identified a total of 16 programs, including 2 EITC programs, accounting for $680 billion in total funding and $283 billion in total payments. The 2 programs, Headquarters Disbursements Earned Income Credit and EITC Compliance, have funding over $10 million but did not require a risk assessment because the EITC Program was already deemed to be high risk under OMB Circular A-11 and was previously recognized as high risk in the Treasury's annual PAR.

efficient, and economical operation of Federal [Government] programs."

We did identify two areas in which the IRS was not in compliance with the Treasury implementation plan or could have improved the process.

The IRS did not evaluate the risk of making improper payments for the Unapplied Collections Program

The Associate CFO for Revenue Financial Management believed the Unapplied Collections Program was not covered under the IPIA because the $57 million in Program funding was not derived from Federal Government funds. The Associate CFO stated that, since the Program was just a clearing account for deposits from seizure proceeds, it should not be part of the IPIA. In addition, the Associate CFO stated and we confirmed that Treasury personnel verbally agreed with the IRS' reasoning for not performing the Unapplied Collections Program risk assessment.

However, since funds in the clearing account are transferred to taxpayers' accounts to offset outstanding tax liabilities and the remaining balances are refunded to taxpayers, there is a chance for misapplied payments. In addition, the Associate CFO for Revenue Financial Management had elected to perform a risk assessment for the $608 billion of revenue in the Refund Collection Program, for which the funding was also not derived from Federal Government funds.

The Treasury included revenue account programs, including the Unapplied Collections Program, in the IPIA implementation plan it submitted to the OMB. We believe that, if the IRS wanted to exclude a program from the Treasury's report to the Congress, it should have formally informed the Treasury, since the Unapplied Collections Program was included in the IPIA implementation plan. If the Treasury had concurred, the Treasury's information provided to the Congress would not have included the affected IRS revenue programs and activities. If the Congress was not satisfied that the Treasury complied with the Act, the Congress would have so advised.

While the decision not to perform a risk assessment for the Unapplied Collections Programs should have been better documented and formalized through the Treasury, the effect of not performing the risk assessment was minimal. Since the Unapplied Collections Program had total disbursements of only $6,635,360, the Program would not likely have met the $10 million improper payment threshold requiring further statistical analysis, as required in the Treasury implementation plan.

The IRS did not always conduct risk assessments with the aid of individuals working within the program, which could have helped identify areas of risk

The 10 administrative program risk assessments performed by the Associate CFO for Internal Financial Management were completed with the aid of individuals working within each IRS functional program. However, the Associate CFO for Revenue Financial Management's IPIA team conducted risk assessments by obtaining and analyzing data from IRS functional programs but did not always include IRS functional staff on the assessment teams. The Associate CFO for Revenue Financial Management did include a policy analyst on the team to complete the risk assessment on the internal controls for the Payment – Child Credit Exceeds Liability Program but did not do so for the Refund Collection and Refund Collection – Interest Programs. The IRS submitted the risk assessments for these two Programs and rated each as a low or medium risk for improper payments.

Although the Treasury IPIA guidelines did not provide specific direction on who should perform annual risk assessments, it would have been prudent on the part of the Associate CFO for Revenue Financial Management to solicit the opinions of those having firsthand program knowledge. Officials we contacted from other agencies involved in implementing the IPIA believed program area involvement was critical to identifying potential problems and weaknesses that may cause improper payments and could make a program high risk.

Performing future risk assessments with assistance from program area employees may enhance the identification of risks. For example, the risk assessment for the Refund Collection Program was conducted by staff from the CFO's office and showed the Program to be a low risk. However, the GAO, in its report on the IRS' FY 2004 Financial Statements,[11] stated that the " . . . GAO continues to consider issues related to IRS's [sic] controls over financial reporting, management of unpaid assessments, and collection of revenue and issuance of tax refunds to be material weaknesses." The report stated this material weakness results in " . . . lost revenue to the Federal government and potentially billions of dollars in improper payments . . . " and the "IRS's [sic] taxpayer compliance programs identified billions of potentially underreported taxes and erroneous EITC claims each year." The report also stated the " . . . IRS relies extensively on detective controls, such as automated matching of tax returns with third-party data such as W-2s [wage and tax statements], to identify for collection underreported taxes and improper refunds. However, these programs are not run until months after the returns have been filed and, as a result, cannot be used to prevent improper refunds from being disbursed." The GAO also stated that " . . . due in large part to perceived resource constraints, [the] IRS selects only a portion of the questionable cases it identifies for follow-up investigation and action."

The Associate CFO for Revenue Financial Management informed us that, as a result of concerns from OMB officials, meetings were held with the OMB to provide details and additional information to support the IRS' Revenue Collections Program risk assessment determination. After submitting the risk assessments to the Treasury, the Associate CFO for Revenue Financial Management requested a computer extract to identify and analyze refund accounts to help confirm that improper payments would not exceed 2.5 percent of total disbursements even if it was determined to be at high risk. To approximate the percentage of improper refunds, the computer extract identified accounts with tax assessments after a refund was issued. This data analysis was obtained to respond to OMB concerns on the basis of the assessments. The CFO and staff held discussions with and provided briefing materials to Treasury and OMB officials.

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[11] *Financial Audit: IRS's Fiscal Years 2004 and 2003 Financial Statements* (GAO-05-103, dated November 2004).

The Associate CFO for Revenue Financial Management informed us he believed the office staff's background was sufficient to conduct the risk assessments. However, we believe the Associate CFO for Revenue Financial Management and staff would benefit by involving IRS operating functions in the risk assessment process.

Recommendations

For future annual IPIA assessments, we recommend the CFO:

1. Submit a request to the Treasury to obtain a formal exemption for not conducting any risk assessment identified in the Treasury IPIA implementation plan.

   Management's Response: IRS management believes they took the appropriate steps to notify the Treasury CFO's office that they would not be performing the Unapplied Collections Program risk assessment and concurred with this recommendation only in the event they have to remove any future risk assessments from the Treasury list.

   Office of Audit Comment: Although IRS management agreed to obtain formal written exemptions in the future when risk assessments listed in the Treasury IPIA implementation plan are not conducted, they disagreed that they should have obtained a formal exception this year for not conducting the risk assessment for the Unapplied Collection Program. Formally notifying the Treasury would have ensured the Treasury's information provided to the Congress would have included the affected IRS revenue programs and activities. Not doing so could expose the IRS to criticism and cause unnecessary concern over its IPIA implementation methods.

2. Include IRS operating function employees on the assessment teams when conducting future annual risk assessments.

Management's Response: IRS management partially concurred with this recommendation. They pointed out they involved the functional employees in conversations regarding the risk assessments and obtained their agreement to assist during the FY 2005 risk assessments.

Office of Audit Comment: The Associate CFO for Revenue Financial Management agreed to have IRS functional staff assist on some future risk assessments by obtaining and analyzing data but did not agree to have IRS functional staff assigned to the assessment teams. We believe assigning IRS functional staff to future risk assessments may enhance the identification of risks. This would allow the risk assessment teams to solicit the opinions of those having firsthand program knowledge. Officials we contacted from other agencies believed program area involvement was critical to identifying potential problems and weaknesses that may cause improper payments and could make a program high risk.

The Earned Income Tax Credit Program Is Attempting to Comply With the Office of Management and Budget's Guidelines for Estimating Improper Payment Amounts

The only program the IRS deemed to be at high risk for improper payments was the EITC Program, which was previously covered under OMB Circular A-11.

The initial OMB guidelines instructed agencies that, once a program was identified as being at high risk, the agency should statistically estimate the annual amount of improper payments and report the estimates to the President and the Congress with an action plan to reduce improper payments. The OMB later determined that, for a small number of large and complex high-risk programs like the EITC Program, an annual statistical sample may not be achievable given program realities and resource constraints. Therefore, in September 2004, the OMB issued alternative guidelines for estimating improper payment amounts.[12]

The Director, EITC, in conjunction with the Director, Research, created a plan to comply with the alternative OMB guidelines for estimating improper payment amounts and is seeking OMB approval. The plan includes methodologies for estimating error rates for FY 2004 by using 1999 baseline error rates resulting from a 2001 EITC compliance study. In addition, the plan proposed periodic future EITC compliance studies. These periodic studies will be supplemented with interim studies

[12] Alternative for Estimating Improper Payment Amounts, CFO Council Working Group on Improper Payments

that measure selected, high-risk components of the EITC Program. Working with the OMB, the EITC Program will follow these alternative initiatives to comply with the IPIA.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this audit was to evaluate the process the Internal Revenue Service (IRS) established to complete the Department of the Treasury's (the Treasury) implementation plan to comply with the Improper Payments Information Act of 2002 (IPIA).[1] To accomplish our objective, we:

I. Evaluated the IRS' implementation of a controlled process to evaluate its programs for improper payments.

   A. Interviewed IRS executives to identify the process the IRS used to assign IPIA responsibilities.

   B. Obtained the risk assessment documents and compared them to the required payment types under the Treasury Fund Symbols identified in the Treasury's Inventory of Programs to determine whether the required risk assessments were conducted.

   C. Interviewed managers to identify individuals assigned to complete the risk assessments and determined whether the individuals had the knowledge and qualifying experience to make the risk assessments.

   D. Reviewed program types for which risk assessments and statistical sampling were not conducted to determine whether they were susceptible to significant erroneous payments.

II. Identified legal and procedural requirements and guidelines that applied to the IPIA.

   A. Kept informed of the Treasury IPIA working group meetings for changes in the Treasury IPIA plan and Office of Management and Budget (OMB) guidance.

   B. Conducted research to obtain outside stakeholders' current perspective on implementation of the IPIA (e.g., committee hearings, Congressional concerns).

   C. Interviewed Treasury IPIA contacts to identify the reporting requirements for the IRS.

III. Determined the cause of any problems or issues identified.

   A. Interviewed OMB officials to identify agencies recognized as having best practices in implementing the IPIA and met with the executives/managers responsible for implementing the IPIA in those agencies to learn about best practices that may aid the IRS in its implementation efforts.

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[1] Pub. L. No. 107-300, 116 Stat. 2350 (2002).

B. Determined the reason the required risk assessment was not completed through interviews with responsible management.

IV. Determined the effect of any issues identified on the IRS and stakeholders by analyzing the data the IRS provided to the Treasury and determining whether the data fulfilled the annual reporting requirements.

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 O'Hara, Audit Manager
Kenneth L. Carlson, Jr., Lead Auditor
Julia Tai, Senior Auditor
David Lowe, Auditor
Stephanie McFadden, Auditor

Appendix III

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Appendix IV

Internal Revenue Service Inventory of Programs Meeting Office of Management and Budget Criteria

Under the Department of the Treasury (the Treasury) Improper Payments Information Act of 2002[1] implementation plan, the Internal Revenue Service (IRS) was required to conduct annual risk assessments of programs, not already identified as high risk under Office of Management and Budget (OMB) guidance entitled, *Preparation, Submission, and Execution of the Budget* (Circular A-11), and having program funding greater than or equal to $10 million. The Treasury identified 16 programs that, according to its financial accounting records, accounted for more than $680 billion in total funding and more than $283 billion in total disbursements.[2]

Figure 1: Total Funding and Disbursements for IRS Programs Meeting OMB Criteria

Program Name	Total Funding	Total Disbursements
Business Systems Modernization	$ 715,305,805.69	$ 305,468,419.27
Earned Income Tax Credit Compliance*	$ 180,534,331.38	$ 113,896,552.72
Federal Tax Lien Revolving Fund	$ 11,536,205.13	$ 5,749,784.14
Health Insurance Tax Credit Administration	$ 69,545,000.00	$ 9,851,792.87
Headquarters Disbursement Earned Income Credit*	$ 34,606,000,000.00	$ 31,660,692,339.72
Information Systems (20#/#0919)	$ 2,077,800,462.93	$ 1,340,349,683.59
Information Systems (20X0919)	$ 12,586,591.97	$ 6,827,305.40
Payment - Child Credit Exceeds Liability	$ 22,770,000,000.00	$ 6,290,630,118.96
Process Assistance and Management (20#0912)	$ 4,560,163,269.54	$ 3,249,396,634.57
Process Assistance and Management (20#/#0912)	$ 11,330,526.62	$ 7,558,077.75
Process Assistance and Management (20X0912)	$ 29,722,481.62	$ 7,485,835.62
Refund Collection	$ 608,273,809,100.39	$ 235,025,605,209.01
Refund Collection - Interest	$ 3,219,000,000.00	$ 2,525,358,556.93
Tax Law Enforcement	$ 4,008,770,014.49	$ 3,015,871,209.92
Unapplied Collections - IRS**	$ 56,903,769.03	$ 6,635,360.39
Undistributed Inter-Agency Receipt	$ (17,684,231.40)	$ 57,936,258.97
Totals for 13 with Risk Assessments	**$ 645,741,885,226.98**	**$ 251,848,088,887.00**
Grand Totals	**$ 680,585,323,327.39**	**$ 283,629,313,139.83**

* No Risk Assessment Required

** The IRS Did Not Perform Risk Assessment

Source: Department of the Treasury Inventory of Programs (Erroneous Payments).

[1] Pub. L. No. 107-300, 116 Stat. 2350 (2002).

[2] We did not perform any validation testing of the Treasury's financial accounting records.

Appendix V

Management's Response to the Draft Report

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

CHIEF FINANCIAL OFFICER

RECEIVED
MAR 14 2005

March 14, 2005

MEMORANDUM FOR GORDON C. MILBOURN III
ASSISTANT INSPECTOR GENERAL FOR AUDIT

FROM: Janice Lambert
Chief Financial Officer

SUBJECT: Draft Audit Report # 200440042, "The Internal Revenue Service's Implementation of the Improper Payment Information Act Is Progressing"

Thank you for the opportunity to comment on your recent review of Internal Revenue Service's (IRS) Implementation of the Improper Payment Information Act (IPIA). FY 2004 was the first year these extensive reviews were implemented at Treasury and the IRS. We were pleased to be able to conclude that the IRS did not have any risk programs, except for the Earned Income Tax Credit (EITC) Program. The Government Accountability Office (GAO) concurred with this assessment during the FY 2004 financial statement audit.

As previously discussed, the Department of Treasury's implementing guidance did not require formal written notification of the joint decision to remove the Unapplied Collection Program from the assessment. I appreciate your recognition and confirmation of the verbal agreement between the IRS and Treasury regarding the decisions about this program. I would also like to reaffirm GAO's concurrence with our position that this account should not have been included in the risk assessments. Additionally, Treasury's CFO has deleted this account from our list of programs requiring assessment for FY 2005. We do, however, understand your concerns regarding the documentation of decisions regarding IPIA assessments and will formalize any future assessment decisions with Treasury via written memorandum.

Your report recommends that IRS operating function employees be part of the team for future annual risk assessments. While operating employees were not a formal part of the assessment team for FY 2004, the assessment team did extensively coordinate with the business owners and used their reports as part of the risk assessments. The assessment team also coordinated with employees from the Business Systems Division (BSD) and the Office of the Commissioner, Research, Analysis and Statistics. We agree that future risk assessments would be improved through closer coordination

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among the operating employees and are taking steps to incorporate them more fully into the FY 2005 assessment process. For example, on January 13, 2005, we met with the Automated Underreporter (AUR) analysts from the Wage & Investment (W&I) and Small Business and Self Employed (SB/SE) divisions. They helped explain the detailed data used during the FY 2004 risk assessments to the GAO auditors and have also agreed to assist us during the FY 2005 risk assessments.

I have attached a detailed response to each recommendation along with management corrective actions, proposed implementation dates, and responsible officials as applicable.

If you have any questions, please contact me at 202.622.6400, or have a member of your staff contact Gregory E. Kane, Associate CFO, Revenue Financial Management at 202.435.5346.

Attachment

ATTACHMENT 1

RECOMMENDATION 1

Submit a request to the Treasury to obtain a formal exemption for not conducting any risk assessment identified in the Treasury IPIA implementation plan.

CORRECTIVE ACTION

Management concurs with this recommendation only in the event we have to remove any future risk assessments from the Treasury list.

We believe we took the appropriate steps to notify the Treasury CFO's office that we would not be performing the Unapplied Collections Program Risk assessment. The Associate CFO, Revenue Financial Management determined that this clearing account did not require a risk assessment under IPIA, and obtained an agreement with our GAO auditors. Your staff confirmed with Treasury personnel that we contacted them, and the Treasury CFO did not accurately remove it from the list of risk assessments. Your report further acknowledges that the total disbursements were $6 million and, therefore, would not likely have met the $10 million criteria. We have confirmed with Treasury personnel that the Unapplied Collections Program has been deleted from the list of programs they want the IRS to assess during FY 2005, and there are no further actions required.

IMPLEMENTATION DATE

Not Applicable

RESPONSIBLE OFFICIAL

Not Applicable

CORRECTIVE ACTION MONITORING PLAN

Not Applicable

RECOMMENDATION 2

Include IRS operating function employees on the assessment teams when conducting future annual risk assessments.

CORRECTIVE ACTION

Management partially concurs with this recommendation. As we discussed with the auditors, the Associate CFO, Revenue Financial Management took significant steps to assess the risk in the refund program. We had ongoing discussions with the Treasury

CFO office, the GAO auditors, and the OMB staff. We contacted and secured information from the Automated Underreporter Program offices in W&I and SB/SE. We had special extracts run by our BSD programmers and from the Enforcement Revenue Information System staff. In responding to the follow-up questions asked by OMB, we coordinated with the Director, EITC and the Director Research, Analysis and Statistics.

On January 13, 2005, the Associate CFO, Revenue Financial Management met with the program leads for the Automated Underreporter Program from W&I and SB/SE to obtain additional information related to the under reporter program related to the risk assessments, and to have them assist us in explaining this data to the GAO auditors. They have also agreed to assist the Associate CFO, Revenue Financial Management during the FY 2005 risk assessments.

IMPLEMENTATION DATE

January 13, 2005

RESPONSIBLE OFFICIAL

Gregory Kane, Associate CFO, Revenue Financial Management

CORRECTIVE ACTION MONITORING PLAN

Not Applicable