



*Progress Has Been Made in Improving
the Accuracy of Trust Fund Recovery
Penalty Transactions; However,
Significant Work Remains*

September 21, 2007

Reference Number: 2007-10-183

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

Phone Number | 202-927-7037

Email Address | Bonnie.Heald@tigta.treas.gov

Web Site | <http://www.tigta.gov>



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

September 21, 2007

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION
CHIEF FINANCIAL OFFICER

Michael R. Phillips

FROM:

Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – Progress Has Been Made in Improving the
Accuracy of Trust Fund Recovery Penalty Transactions; However,
Significant Work Remains (Audit # 200610033)

This report presents the results of our review to determine whether the Internal Revenue Service (IRS) has developed an effective methodology to improve its ability to readily and accurately account for Trust Fund Recovery Penalty (TFRP) transactions.¹ This audit was requested by the Chief Financial Officer.

Impact on the Taxpayer

The Government Accountability Office has repeatedly reported that the IRS' accounting for trust fund recovery transactions needs to be improved. We identified two areas management should address to help assure the accuracy of these types of transactions in the future: reconsider the projected completion date for the data cleanup effort and evaluate the accuracy of transactions posted during the data cleanup. The accurate posting of transactions to taxpayer accounts with TFRP assessments is critical to ensuring IRS records regarding taxpayer balance-due amounts are correct. Inaccurate account balances could result in incorrect information being provided to taxpayers attempting to resolve their delinquencies.

¹ When a company does not pay the taxes it withholds from employee wages, such as Social Security or individual income tax, the IRS has the authority to assess all responsible corporate officers individually for the taxes withheld via the TFRP.



*Progress Has Been Made in Improving the Accuracy of
Trust Fund Recovery Penalty Transactions;
However, Significant Work Remains*

Synopsis

Progress is being made in addressing the reliability of TFRP transaction information recorded in taxpayer accounts. However, despite a number of recent upgrades to the functionality of the Automated Trust Fund Recovery system,² the postings of many TFRP-related transactions still require at least some manual processing. As part of its efforts to address the long-term material weaknesses associated with the processing of these transactions, the IRS plans to begin implementing systemic posting of payments on TFRP assessments to all related accounts beginning in March 2008.

In preparation for implementation of the systemic cross-posting of payment transactions, the IRS initiated a large-scale cleanup of taxpayer accounts with TFRP assessments. The purpose of the data cleanup is to ensure taxpayer accounts contain the required links to related accounts and to correct any missing or misapplied payments prior to conversion to the systemic posting of payments. Planning for the cleanup of taxpayer accounts was begun in September 2006.

While the ongoing cleanup should significantly improve the reliability of existing information in taxpayer accounts, we identified two areas that Small Business/Self-Employed (SB/SE) Division management should address to help assure the cleanup and conversion are successful. First, the projected timetable for completion of the data cleanup needs to be reconsidered. The data cleanup is scheduled to be completed in January 2008. The most intensive phase, initiated on May 4, 2007, involves a manual review of selected cases identified as containing one or more potential account errors. However, completion of the manual phase of the cleanup will extend significantly beyond the current projected date. As of July 14, 2007, 83,746 cases still required initial review for potential errors and, based on present staffing and prior production rates, the estimated remaining cases will take approximately 1 year to complete, which is significantly beyond the current estimated completion date of January 2008.

Also, the action plan guiding the cleanup does not include any steps or dates relating to confirming the impact of the cleanup on the overall accuracy of taxpayer accounts. For example, the Chief Financial Officer routinely evaluates errors in taxpayer accounts with unpaid assessments relating to TFRP assessments. The Chief Financial Officer's most recent analysis indicated that TFRP-related errors in taxpayer accounts totaled 49,545 as of May 2007. Chief Financial Officer staff informed us the error reports on which this analysis was based can be readily generated, as needed, to assist in tracking the progress made from the data cleanup.

Second, additional consideration should be given to evaluating the accuracy of transactions posted during the data cleanup. The IRS informed us that accounts will be reviewed only once as part of the manual cleanup. While this decision is understandable in light of the amount of resources assigned to the cleanup effort, it puts the IRS at risk of not identifying all material

² This system is used to help support the preparation and input of TFRP assessments and related transactions.



*Progress Has Been Made in Improving the Accuracy of
Trust Fund Recovery Penalty Transactions;
However, Significant Work Remains*

errors in taxpayer accounts prior to conversion to systemic processing. Any new transactions posting during the period July 2007 through January 2008 to either existing or new accounts previously reviewed by a tax examiner during May or June 2007 will not be subject to evaluation for errors prior to the conversion. The number of new transactions could be substantial and presents a high risk of new account errors.

Recommendations

We recommended the Director, Campus Compliance Services, SB/SE Division, reevaluate the estimated completion date for the data cleanup and the timing of subsequent planned events and amend the TFRP action plan to include an evaluation of the impact of the cleanup on the overall accuracy of taxpayer accounts using the error reports developed by the Chief Financial Officer. The Director, Campus Compliance Services, SB/SE Division, in coordination with the Director, Collection Policy, SB/SE Division, should also evaluate the feasibility of conducting a final review of all taxpayer accounts with TFRP assessments for errors after the manual cleanup is completed, to identify and correct any errors in transactions that posted during the cleanup.

Response

IRS management agreed with our recommendations and noted that they have already implemented the substance of both recommendations. Specifically, management stated they have reevaluated the estimated completion date for the cleanup. Based on additional staff being trained and the continued rise in production rates, management anticipates meeting the target completion date of January 31, 2008. In addition, the SB/SE Division is currently receiving weekly error reports from the Chief Financial Officer and expects to receive them throughout the cleanup initiative. The TFRP action plan has been updated to reflect this process. Finally, management stated they will evaluate the feasibility of conducting a final review of the TFRP accounts. Specifically, SB/SE Division management will perform a final assessment of the results at project completion to evaluate the feasibility of conducting another review of all the TFRP accounts prior to converting to a systemic payment posting process. Management's complete response to the draft report is included as Appendix IV.

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



*Progress Has Been Made in Improving the Accuracy of
Trust Fund Recovery Penalty Transactions;
However, Significant Work Remains*

Table of Contents

Background	Page 1
Results of Review	Page 3
Progress Has Been Made in Addressing the Reliability of Trust Fund Recovery Penalty Transaction Information Recorded in Taxpayer Accounts	Page 3
The Projected Timetable for Completion of the Data Cleanup Should Be Reconsidered	Page 4
<u>Recommendation 1:</u>	Page 5
Additional Consideration Should Be Given to Evaluating the Accuracy of Transactions Processed During the Data Cleanup	Page 5
<u>Recommendation 2:</u>	Page 6
Appendices	
Appendix I – Detailed Objective, Scope, and Methodology	Page 8
Appendix II – Major Contributors to This Report	Page 10
Appendix III – Report Distribution List	Page 11
Appendix IV – Management’s Response to the Draft Report	Page 12



*Progress Has Been Made in Improving the Accuracy of
Trust Fund Recovery Penalty Transactions;
However, Significant Work Remains*

Abbreviations

IRS	Internal Revenue Service
SB/SE	Small Business/Self-Employed
TFRP	Trust Fund Recovery Penalty



*Progress Has Been Made in Improving the Accuracy of
Trust Fund Recovery Penalty Transactions;
However, Significant Work Remains*

Background

When a company does not pay the taxes it withholds from employee wages, such as Social Security or individual income tax, the Internal Revenue Service (IRS) has the authority to assess all responsible corporate officers¹ individually for the taxes withheld via the Trust Fund Recovery Penalty (TFRP).² Although the TFRP may be assessed against multiple individuals, the total penalty amount may be collected only once. To accomplish this, IRS procedures require that payments be cross-posted to all related individual and business accounts. Payments should be cross-posted to the TFRP liability first until it is paid in full; any remaining payments should next be applied toward lien fees and collection costs, such as installment agreement fees. Payments applied to lien fees and collection costs should not be cross-posted to related taxpayer accounts. Proper cross-posting of payments on TFRP assessments is dependent on the presence of information in taxpayer records linking all related individual and business accounts.

The Small Business/Self-Employed (SB/SE) Division has overall responsibility for posting TFRP assessments and related transactions to taxpayer accounts. It uses the Automated Trust Fund Recovery system to help support the preparation and input of TFRP assessments and related transactions. The Office of the Chief Financial Officer has overall responsibility for the financial reporting of the IRS. In connection with this responsibility, the Chief Financial Officer routinely evaluates taxpayer accounts with unpaid assessments relating to TFRP assessments to properly report on these types of transactions.

The Government Accountability Office has repeatedly reported that the IRS' accounting for trust fund recovery transactions needs to be improved. For example, in its audit of the IRS' 2006 and 2005 Financial Statements,³ the Government Accountability Office estimated that 11 percent of all taxpayer accounts with trust fund recovery transactions contained inaccuracies. The inaccuracies identified were primarily the result of the IRS' failure to properly record payments to all related taxpayer accounts associated with unpaid payroll taxes. Overall, the Government Accountability Office found that, if the business or any officer of that business paid some or all of the outstanding taxes, the IRS' systems are unable to automatically reflect the payment as a reduction in the amounts owed on any related accounts.

This review was performed at the Headquarters Office of the Chief Financial Officer and SB/SE Division National Headquarters in Washington, D.C.; in the Ogden, Utah, and

¹ Any person required to collect, account for, and pay over taxes held in trust who willfully fails to perform any of these activities.

² 26 U.S.C. § 6672 (2006).

³ *IRS' Fiscal Year 2006 and 2005 Financial Statements* (GAO-07-136, dated November 2006).



*Progress Has Been Made in Improving the Accuracy of
Trust Fund Recovery Penalty Transactions;
However, Significant Work Remains*

Brookhaven, New York, Campuses;⁴ and the Springfield, New Jersey, and Annapolis, Maryland, SB/SE Division Collection Field function⁵ offices during the period November 2006 through June 2007. The audit was conducted 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.

⁴ The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.

⁵ The unit in the Area Offices consisting of revenue officers who handle personal contacts with taxpayers to collect delinquent accounts or secure unfiled returns.



*Progress Has Been Made in Improving the Accuracy of
Trust Fund Recovery Penalty Transactions;
However, Significant Work Remains*

Results of Review

Progress Has Been Made in Addressing the Reliability of Trust Fund Recovery Penalty Transaction Information Recorded in Taxpayer Accounts

Overall, the IRS continues to make progress in its efforts to develop and implement an effective methodology for readily and accurately accounting for TFRP transactions. However, despite a number of recent upgrades to the functionality of the Automated Trust Fund Recovery system, the postings of many TFRP-related transactions still require at least some manual processing. For example, the cross-posting of all payments related to TFRP assessments requires manual processing, which significantly increases the risk of errors occurring.

As part of its efforts to address the long-term material weaknesses associated with the processing of TFRP-related transactions, the IRS plans to begin implementing systemic posting of payments for these assessments to all related accounts beginning in March 2008. It has already begun the systemic processing of TFRP assessments to taxpayer accounts, although manual processing of these transactions is still required in many cases.

In preparation for implementation of the systemic cross-posting of payment transactions, the IRS initiated a large-scale cleanup of taxpayer accounts with TFRP assessments. The purpose of the data cleanup is to ensure taxpayer accounts contain the required links to related accounts and to correct any missing or misapplied payments prior to conversion to the systemic posting of payments. Planning for the cleanup of taxpayer accounts was begun in September 2006.

While the ongoing cleanup should significantly improve the reliability of existing information in taxpayer accounts, we identified two areas SB/SE Division management should address to help assure the cleanup and conversion are successful:

- The projected timetable for completion of the data cleanup should be reconsidered.
- Additional consideration should be given to evaluating the accuracy of transactions posted during the data cleanup.

In addition, until the IRS completes implementation of the conversion to systemic processing of TFRP-related transactions, we will be unable to reliably appraise the impact of any processing enhancements on the accuracy of information posted to taxpayer accounts.



*Progress Has Been Made in Improving the Accuracy of
Trust Fund Recovery Penalty Transactions;
However, Significant Work Remains*

***The Projected Timetable for Completion of the Data Cleanup Should
Be Reconsidered***

The purpose of the data cleanup is to ensure taxpayer accounts contain the required links to related accounts and to correct any missing or misapplied payments prior to conversion to the systemic posting of payments. The cleanup is scheduled to be completed in January 2008. The most intensive phase, initiated on May 4, 2007, involves a manual review, by a team of 14 tax examiners, of selected cases identified as containing 1 or more potential account errors. The IRS' efforts to address TFRP-related inaccuracies are guided by a detailed action plan that describes the critical steps planned and estimated completion dates.

Completion of the manual phase of the cleanup will extend significantly beyond the current projected date, based on the present staffing and expected number of cases still requiring manual review. Specifically, cleanup inventory records indicate that between May 4 and July 14, 2007, 6,628 (66 percent) of 9,986 cases initially evaluated were identified as containing potential errors and assigned for manual review. The IRS informed us that as of July 14, 2007, 83,746 cases still required initial review for potential errors.

If the same percentage of these 83,746 cases requires manual review, which is likely given the cases are evaluated based on randomly selected blocks of inventory, the remaining inventory of work requiring tax examiner review will be approximately 55,000 cases. Based on present staffing and prior production rates, the estimated remaining cases will take approximately 1 year to complete, which is significantly beyond the current estimated completion date of January 2008.

Also, the action plan guiding the cleanup does not include any steps or dates relating to confirming the impact of the cleanup on the overall accuracy of taxpayer accounts. For example, the Chief Financial Officer, in connection with financial reporting responsibilities, routinely evaluates errors in taxpayer accounts with unpaid assessments relating to TFRP assessments. The account errors identified by the Chief Financial Officer all relate to missing or incorrect account-linking information. The Chief Financial Officer's most recent analysis indicated that TFRP-related errors in taxpayer accounts totaled 49,545 as of May 2007. While this represents a notable improvement over the 60,290 errors the Chief Financial Officer identified in September 2006, it also highlights the significant volume of work remaining for the SB/SE Division cleanup team. Chief Financial Officer staff informed us that the error reports on which this analysis was based can be readily generated, as needed, to assist in tracking the progress made from the cleanup.

Current and accurate information regarding project progress and results achieved is critical to management's ability to make sound, informed decisions regarding project resource needs and accomplishments. For example, identifying whether account-linking errors still exist after the cleanup would allow management to quickly gauge the success of this effort.



*Progress Has Been Made in Improving the Accuracy of
Trust Fund Recovery Penalty Transactions;
However, Significant Work Remains*

Recommendation

Recommendation 1: The Director, Campus Compliance Services, SB/SE Division, should a) reevaluate the estimated completion date for the data cleanup and the timing of subsequent planned events and b) amend the TFRP action plan to include an evaluation of the impact of the cleanup on the overall accuracy of taxpayer accounts using the error reports developed by the Chief Financial Officer.

Management's Response: IRS management agreed with this recommendation. They have reevaluated the estimated completion date for the cleanup and, based on additional staff being trained and the continued rise in production rates, are confident about their projection. The IRS anticipates meeting the target completion date of January 31, 2008. In addition, management is currently receiving weekly error reports from the Chief Financial Officer and expects to receive them throughout the cleanup initiative. These reports are being used to monitor the impact of the cleanup on the overall accuracy of taxpayer accounts; the TFRP action plan has been updated to reflect this process.

Additional Consideration Should Be Given to Evaluating the Accuracy of Transactions Processed During the Data Cleanup

For the cleanup efforts, taxpayer accounts are scheduled for evaluation based on the last two digits of the associated business taxpayer's Employer Identification Number. For example, during May and June 2007, businesses with Employer Identification Numbers ending in 00 through 06 were evaluated and assigned to tax examiners for review. The tax examiners reviewed the accounts selected and all related accounts for errors, such as missing account links and missing or misapplied payments.

The IRS informed us that accounts will be reviewed only once as part of the manual cleanup. While this decision is understandable in light of the amount of resources assigned to the cleanup effort, it puts the IRS at risk of not identifying all material errors in taxpayer accounts prior to conversion to systemic processing. Using the prior example, any new transactions posting to either existing or new accounts with Employer Identification Numbers ending in 00 through 06 during the period July 2007 through January 2008 will not be subject to evaluation for errors prior to the conversion. The number of new transactions could be substantial and presents a high risk of new account errors. During the period April through November 2006, for example, over 84,000 payment transactions requiring cross-posting to 1 or more related accounts were processed. In addition, as discussed previously, completion of the manual cleanup will likely extend significantly beyond January 2008 based on the progress we noted by the end of our fieldwork.



*Progress Has Been Made in Improving the Accuracy of
Trust Fund Recovery Penalty Transactions;
However, Significant Work Remains*

Further, based on our review of a sample of recent payments posted to taxpayer accounts with TFRP assessments, these types of transactions continue to contain errors that will need to be corrected. Specifically, our review of 63 recent payments identified that these payments were either not accurately posted to all related accounts (2 cases) or were posted to all related accounts only after a significant delay (2 cases). While the IRS informed us that these types of errors will be addressed as part of the ongoing cleanup, this is only true in cases involving transactions that are considered during the one-time review based on Employer Identification Numbers.

In evaluating the errors we identified, it is important to note that TFRP assessments are frequently not fully paid in one payment and that repayment may be made through a multiyear installment agreement requiring monthly payments. As a result, even a relatively low error rate in the accuracy of posting individual payments to a related account can result in a significant percentage of taxpayer accounts with incorrect account balances. This occurs because an error in posting any single payment to a taxpayer's account will result in the taxpayer's account balance always being incorrect regardless of how many prior or subsequent transactions were or are posted accurately to the same account.

Incorrect or untimely posting of payments on TFRP assessments to related taxpayer accounts results in inaccurate account balance-due amounts, impedes the IRS' ability to readily calculate the balance of its unpaid assessments, and could result in inaccurate information being provided to taxpayers attempting to resolve their delinquencies. In addition, the correction of existing account errors, including missing or misapplied payments and incorrect or missing account links, is critical to the successful implementation of the systemic TFRP payment posting process. For example, without complete and correct account links, the systemic payment posting process will be unable to accurately post taxpayer payments to all related accounts. In addition, any missing or misapplied payments not corrected before the conversion will result in incorrect taxpayer account balances being carried forward. *Standards for Internal Control in the Federal Government* specify that focused evaluations are a useful tool for evaluating the effectiveness of controls over the accuracy of transactions at a specific time.

Recommendation

Recommendation 2: The Director, Campus Compliance Services, SB/SE Division, in coordination with the Director, Collection Policy, SB/SE Division, should evaluate the feasibility of conducting a final review of all taxpayer accounts with TFRP assessments for errors after the manual cleanup is completed, to identify and correct any errors in transactions that posted during the cleanup. This evaluation should also weigh the risks and benefits of implementing the conversion to systemic payment posting while a potentially significant number of errors still exists in the database.

Management's Response: IRS management agreed with this recommendation. The IRS will evaluate the feasibility of conducting a final review of the TFRP accounts.



*Progress Has Been Made in Improving the Accuracy of
Trust Fund Recovery Penalty Transactions;
However, Significant Work Remains*

Specifically, a final assessment of the cleanup results at project completion will be performed to evaluate the feasibility of conducting another review of all the TFRP accounts prior to converting to a systemic payment posting process.



*Progress Has Been Made in Improving the Accuracy of
Trust Fund Recovery Penalty Transactions;
However, Significant Work Remains*

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine whether the IRS has developed an effective methodology to improve its ability to readily and accurately account for TFRP transactions.¹ To accomplish this objective, we:

- I. Determined whether effective controls have been established by the IRS to ensure TFRP transactions are timely and accurately recorded.
 - A. Interviewed selected SB/SE Division Compliance function personnel responsible for the processing and recording of TFRP assessments and related payments.
 - B. Prepared a flowchart of the method used to record TFRP assessments and related payments to taxpayer accounts and identified key controls.
 - C. Reviewed management information used to monitor TFRP-related payment transaction volume, timeliness, and accuracy.
 - D. Performed an onsite walkthrough of the TFRP assessment process at the Annapolis, Maryland, and Springfield, New Jersey, SB/SE Division Collection Field function² offices and at the Ogden, Utah, Campus³ to evaluate the operation of the controls identified in Steps 1.A. through 1.C.
 - E. Reviewed a randomly selected sample of 63 TFRP-related payment transactions.
 1. In December 2006, prepared a Master File⁴ data request to identify all TFRP taxpayer accounts containing a payment transaction posted during the period April through November 2006. A total of 84,685 payment transactions were identified. We selected a sample of 63 cases using a random number sampling program. We used random sampling to ensure all transactions would have an equal chance of being selected.

¹ When a company does not pay the taxes it withholds from employee wages, such as Social Security or individual income tax, the IRS has the authority to assess all responsible corporate officers individually for the taxes withheld via the TFRP.

² The unit in the Area Offices consisting of revenue officers who handle personal contacts with taxpayers to collect delinquent accounts or secure unfiled returns.

³ The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.

⁴ The IRS database that stores various types of taxpayer account information. The database includes individual, business, and employee plans and exempt organizations data.



*Progress Has Been Made in Improving the Accuracy of
Trust Fund Recovery Penalty Transactions;
However, Significant Work Remains*

2. To assess the reliability of the extracted data, compared it to IRS Master File data and source documentation including Request for Trust Fund Recovery Penalty Assessment(s) (Form 2749). We determined the reliability of the electronic data was adequate and valid for use in making our analytical conclusions.
 3. Obtained and reviewed supporting documentation for each sampled taxpayer case, including the Form 2749 and the applicable revenue officer⁵ case history.
 4. Compared supporting documentation for the selected sample cases to the information posted to the taxpayer records and determined whether:
 - a) The assessment amount was accurately input and all related business and individual accounts were identified.
 - b) The 63 recent payments were timely and accurately credited to all related accounts as required.
- F. Performed an onsite walkthrough of the TFRP payment posting process.
- II. Ascertained the status of IRS efforts to enhance accountability over TFRP-related receivables and collections.
- A. Interviewed Office of the Associate Chief Financial Officer for Revenue Financial Management personnel regarding the overall process used to review TFRP transaction data.
 - B. Evaluated the methodology and exception parameters they used to identify inconsistencies in these data.
 - C. Analyzed the TFRP action plan developed by the SB/SE Division to guide improvements to the method used to process these data.
 - D. Reviewed the status of SB/SE Division efforts to identify and correct existing TFRP transaction errors in taxpayer accounts.

⁵ An employee in the Collection Field function who attempts to contact taxpayers and resolve collection matters that have not been resolved through notices sent by the IRS campuses or Automated Collection Services.



*Progress Has Been Made in Improving the Accuracy of
Trust Fund Recovery Penalty Transactions;
However, Significant Work Remains*

Appendix II

Major Contributors to This Report

Nancy A. Nakamura, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs)
John R. Wright, Director
Anthony J. Choma, Audit Manager
Mildred Rita Woody, Lead Auditor
Richard E. Loudon, Senior Auditor
James S. Mills, Jr., Senior Auditor
Angela Garner, Auditor



*Progress Has Been Made in Improving the Accuracy of
Trust Fund Recovery Penalty Transactions;
However, Significant Work Remains*

Appendix III

Report Distribution List

Acting Commissioner C
Office of the Commissioner-Attn: Acting Chief of Staff C
Deputy Commissioner for Operations Support OS
Deputy Commissioner for Services and Enforcement SE
Deputy Commissioner, Small Business/Self-Employed Division SE:S
Director, Campus Compliance Services, Small Business/Self-Employed Division SE:S:CCS
Director, Collection, Small Business/Self-Employed Division SE:S:C
Director, Collection Policy, Small Business/Self-Employed Division SE:S:C:CP
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Internal Control OS:CFO:CPIC:IC
Audit Liaison: Commissioner, Small Business/Self-Employed Division SE:S
Chief Financial Officer OS:CFO



*Progress Has Been Made in Improving the Accuracy of
Trust Fund Recovery Penalty Transactions;
However, Significant Work Remains*

Appendix IV

Management's Response to the Draft Report



COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

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

RECEIVED
SEP - 6 2007

September 4, 2007

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Kathy K. Petronchak *Kathy K. Petronchak*
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – Progress Has Been Made In Improving the
Accuracy of Trust Fund Recovery Penalty Transactions;
However, Significant Work Remains (Audit # 200610033)

We have reviewed your report "Progress Has Been Made In Improving the Accuracy of Trust Fund Recovery Penalty Transactions; However, Significant Work Remains" and agree with your recommendations. We are pleased to report we have already implemented the substance of both recommendations.

We began planning the current Trust Fund Recovery Penalty (TFRP) Database Cleanup Initiative in September 2006. The report confirms that progress has been made in addressing the reliability of TFRP transaction information recorded in taxpayer accounts. We anticipate that the completion of the cleanup initiative will result in further improvement.

We had previously reevaluated the project's completion date based on additional staff being trained and the continued rise in production rates as these employees become more experienced on the Automated Trust Fund Recovery (ATFR) system. Current projections indicate we will meet the target date for completion of the cleanup.

Consistent with your recommendation, we have been monitoring the impact of the cleanup using reports provided by the Chief Financial Officer (CFO). The reports measure the overall accuracy of the TFRP accounts by using a comparative period of FY06. The latest CFO report indicated an 18.85 percent accuracy improvement between September 30, 2006 and July 28, 2007.

We will evaluate the feasibility of conducting a final review of the TFRP accounts prior to the transition to a systemic payment posting environment.

We respectfully disagree with the report's assumption that a potentially significant number of errors still exists in the database and that there is a high risk of new account errors. We also disagree with the report's statements that any error in posting of prior



*Progress Has Been Made in Improving the Accuracy of
Trust Fund Recovery Penalty Transactions;
However, Significant Work Remains*

2

transactions not corrected before the conversion to systemic payment processing will result in incorrect taxpayer account balances being carried forward. The ATFR application systemically executes a full review of all transactions on a TFRP account every time a new transaction occurs. As a result, any prior errors in linkage of the accounts or cross-referencing of payments/credits are identified and addressed, thus minimizing the potential for incorrect taxpayer account balances being carried forward.

Our comments on your recommendations are attached. If you have questions or concerns, please contact me or Fred Schindler, Director, Collection Policy, at (202) 283-7650, or Jeffrey Basalla, Director, Filing & Payment Compliance, Campus Compliance Services, at (202) 283-7399.

Attachment



*Progress Has Been Made in Improving the Accuracy of
Trust Fund Recovery Penalty Transactions;
However, Significant Work Remains*

Attachment

RECOMMENDATION 1:

The Director, Campus Compliance Services, SB/SE Division, should
a) reevaluate the estimated completion date for the data cleanup and the timing of subsequent planned events and b) amend the Trust Fund Recovery Penalty (TFRP) action plan to include an evaluation of the impact of the cleanup on the overall accuracy of taxpayer accounts using the error reports developed by the Chief Financial Officer.

CORRECTIVE ACTIONS:

We agree with Recommendation 1a. We previously reevaluated the estimated completion date for the data cleanup and are confident with our projection. We anticipate meeting the target completion date of January 31, 2008; therefore, the IRS concludes that no further corrective actions are needed for Recommendation 1a.

We also agree with Recommendation 1b. The action plan was updated prior to the issuance of this report. We are currently receiving CFO error reports weekly and expect to receive them throughout the cleanup initiative. We are using these reports to monitor the impact of the cleanup on the overall accuracy of taxpayer accounts. This evaluation process is already in place, but we will add specificity to the action plan as a corrective action to Recommendation 1b.

IMPLEMENTATION DATE:

The action plan was revised on August 13, 2007.

RESPONSIBLE OFFICIAL:

The Director, Campus Compliance Services, SB/SE Division, in coordination with the Director, Collection Policy, SB/SE Division.

CORRECTIVE ACTION(S) MONITORING PLAN:

Corrective action completed. No monitoring required.

RECOMMENDATION 2:

The Director, Campus Compliance Services, SB/SE Division, in coordination with the Director, Collection Policy, SB/SE Division, should evaluate the feasibility of conducting a final review of all taxpayer accounts with TFRP assessments for errors after the manual cleanup is completed, to identify and correct any errors in transactions that posted during the cleanup. This evaluation should also weigh the risks and benefits of implementing the conversion to systemic payment posting while a potentially significant number of errors still exist in the database.



*Progress Has Been Made in Improving the Accuracy of
Trust Fund Recovery Penalty Transactions;
However, Significant Work Remains*

2

CORRECTIVE ACTIONS:

We agree with Recommendation 2. The IRS will evaluate the feasibility of conducting a final review of the TFRP accounts. We continually assess the cleanup initiative to identify any additional case actions or program upgrades/enhancements that might be needed.

We will perform a final assessment of the cleanup results at project completion to evaluate the feasibility of conducting another review of all the TFRP accounts prior to conversion to a systemic payment posting process.

IMPLEMENTATION DATE:

February 28, 2008

RESPONSIBLE OFFICIAL:

The Director, Campus Compliance Services, SB/SE Division, in coordination with the Director, Collection Policy, SB/SE Division.

CORRECTIVE ACTION(S) MONITORING PLAN:

The Director, Campus Compliance Services, SB/SE Division, in coordination with the Director, Collection Policy, SB/SE Division will advise the SB/SE Commissioner of any delays in implementing this corrective action.