



*Tax-Exempt User Fee Processing
Improved for Dishonored Checks and
Refund of Overpayments*

July 13, 2010

Reference Number: 2010-10-085

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.

Redaction Legend

1 = Tax Return/Return Information



HIGHLIGHTS

TAX-EXEMPT USER FEE PROCESSING IMPROVED FOR DISHONORED CHECKS AND REFUND OF OVERPAYMENTS

Highlights

Final Report issued on July 13, 2010

Highlights of Reference Number: 2010-10-085 to the Internal Revenue Service Commissioner for the Tax Exempt and Government Entities Division.

IMPACT ON TAXPAYERS

Charitable organizations and retirement plan administrators submit determination requests and pay user fees for the Internal Revenue Service (IRS) to determine whether they meet the requirements for tax-exempt status. After review of the determination request, the IRS issues a determination letter advising the applicant of the results of the review. The IRS has made improvements since our prior audit; however, a few determination letters were issued when dishonored checks were received, and customer overpayments of user fees totaling \$1,730 were not refunded to applicants. The IRS must ensure the Federal Government is reimbursed for the services it performs and that organizations that may need their refunds to perform charitable activities are not burdened.

WHY TIGTA DID THE AUDIT

This audit was initiated at the request of Tax Exempt and Government Entities Division management. A Fiscal Year 2001 TIGTA audit concluded that the Tax Exempt and Government Entities Division issued determination letters without receiving full payment of user fees and did not always refund overpayments of user fees to customers. Although they were unable to complete all planned corrective actions, Tax Exempt and Government Entities Division management requested that TIGTA perform a followup audit to determine whether conditions noted in our prior report still exist.

The overall objectives of this review were to determine whether controls were strengthened to identify and prevent issuance of determination letters when customer user fee checks are dishonored; and whether controls were strengthened to identify, control, and timely resolve user fee overpayment conditions.

WHAT TIGTA FOUND

Since our previous audit, Tax Exempt and Government Entities Division management has focused on employee training and alternative manual process changes to improve their handling of user fee payments. As a result, the vast majority of determination letters are issued only when the user fee has been paid, and the vast majority of user fee refunds are being identified and processed for timely issuance. However, determination letters were issued for 7 determination letter applications when customer checks were dishonored, and 13 customers submitting determination letter applications overpaid their required user fees and did not receive refunds as required.

WHAT TIGTA RECOMMENDED

TIGTA recommended the Commissioner, Tax Exempt and Government Entities Division, refund 13 overpayments that were identified by the audit team and improve controls to ensure all User Fee Refund Request forms are signed by field specialists and managers and input to computer systems for timely issuance of refunds.

In their response to the report, IRS management agreed with the recommendations and has already taken appropriate corrective actions.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

July 13, 2010

MEMORANDUM FOR COMMISSIONER, TAX EXEMPT AND GOVERNMENT ENTITIES
DIVISION

Michael R. Phillips

FROM:

Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – Tax-Exempt User Fee Processing Improved for
Dishonored Checks and Refund of Overpayments (Audit # 200910030)

This report presents the results of our review of the effectiveness of the Tax Exempt and Government Entities Division's effort to process user fee payment information. The overall objectives of this review were to determine whether controls were strengthened to identify and prevent issuance of determination letters when customer user fee checks are dishonored; and whether controls were strengthened to identify, control, and timely resolve user fee overpayment conditions. This audit was requested by Tax Exempt and Government Entities Division management and was conducted as part of the Treasury Inspector General for Tax Administration Office of Audit Fiscal Year 2010 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives.

Management's complete response to the draft report is included as Appendix VI.

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 Nakamura, Assistant Inspector General for Audit (Management Services and Exempt Organizations), at (202) 622-8500.



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*Tax-Exempt User Fee Processing Improved for Dishonored
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Abbreviations

EDS	Employee Plans/Exempt Organizations Determination System
EO	Exempt Organizations
EP	Employee Plans
IRS	Internal Revenue Service
LINUS	Letter and Information Network User-fee System



Tax-Exempt User Fee Processing Improved for Dishonored Checks and Refund of Overpayments

Background

Charitable organizations and retirement plan administrators submit determination requests and pay user fees¹ for the Internal Revenue Service (IRS) to determine whether they meet requirements for tax-exempt status. After review of the determination request, the IRS issues a determination letter advising the applicant of the results of the review.

User fees are not charged for simple determination requests, but can range up to \$15,000 for complex retirement plans and must be submitted with the application for service.² The IRS remits part of the user fee to the Department of the Treasury General Fund and retains the remainder to offset the expense of providing determination letters.³

A Fiscal Year 2001 Treasury Inspector General for Tax Administration audit⁴ identified risks associated with user fee processing, such as the Tax Exempt and Government Entities Division issuing determination letters without receiving full payment of user fees and not always refunding overpayments of user fees to customers. Based on our recommendations, Tax Exempt and Government Entities Division management stated that through employee training and Internal Revenue Manual and alternative manual process changes, they had decreased risks associated with processing user fees. Although they were unable to complete all planned corrective actions, Tax Exempt and Government Entities Division management requested in June 2009 that we perform a followup audit to determine whether the following conditions noted in our prior report still exist:

- Determination letters were issued even though personal checks that were submitted for the associated user fees were dishonored.
- User fee overpayments associated with determination applications were not always refunded.

Based on the request from IRS management, we limited our scope to follow up on only the dishonored check and overpayment issues associated with determination letter requests.⁵

¹ Internal Revenue Code Section 7528 requires the payment of user fees for tax-exempt determination requests.

² See Appendix V for a detailed overview of the tax-exempt user fee process.

³ The IRS is allowed to retain a portion of the user fees it collects, based on criteria established in the Treasury, Postal Service, and General Government Appropriations Act of 1995 (Pub. L. No. 103-329, 108 Stat. 2382, 2388, September 30, 1994) (reprinted in 26 United States Code Section 7801).

⁴ *Additional Management Actions Are Needed to Better Process and Safeguard Tax Exempt and Government Entities Division User Fee Payments* (Reference Number 2001-10-136, dated August 22, 2001).

⁵ The Tax Exempt and Government Entities Division also processes user fees for private letter rulings and opinions. However, processing of these types of user fee payments was not addressed in this audit.



Tax-Exempt User Fee Processing Improved for Dishonored Checks and Refund of Overpayments

During the period May 2008 through June 2009, the Tax Exempt and Government Entities Division received 64,736 initial Exempt Organizations (EO) function determination applications⁶ and 83,027 Employee Plans (EP) and EO function user fee payments totaling \$49.7 million. Of the total user fees received, 432 checks totaling \$224,000 were subsequently dishonored for nonsufficient funds and 1,925 refunds totaling \$1.2 million were issued to customers for overpayment or return of user fees.

This review was performed at the Tax Exempt and Government Entities Division National Headquarters in Washington, D.C., and the EP and EO functions offices in Cincinnati, Ohio, during the period October 2009 through April 2010. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Detailed information on our audit objectives, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

⁶ The 64,736 EO function determination applications do not include applications for group exemption letters. Also, we did not identify the total number of Employee Plans function determination applications received because this information was not readily available.



Tax-Exempt User Fee Processing Improved for Dishonored Checks and Refund of Overpayments

Results of Review

Improvements Were Identified, but Determination Letters Were Issued Without Payment of User Fees and Refunds Were Delayed

Since our previous audit, Tax Exempt and Government Entities Division management has focused on employee training and alternative manual process changes to improve their handling of user fee payments. As a result, the vast majority of determination letters are correctly issued when the user fees are paid, and the vast majority of user fee refunds are identified and processed for timely issuance. However, use of these manual processes continues to incorrectly allow issuance of some determination letters when customer checks are dishonored, and some overpayments are delayed or not refunded to applicants. While the number of occurrences is few, manual processes are subject to human error. IRS management must continue monitoring these manual processes to ensure the Federal Government is reimbursed for the services it performs and that organizations that may need their refunds to perform charitable activities are not burdened.

The number of determination letters incorrectly issued when user fee checks were dishonored decreased

As shown in Figure 1, the IRS is issuing fewer determination letters when user fee checks are dishonored than we noted in our prior audit.



Tax-Exempt User Fee Processing Improved for Dishonored Checks and Refund of Overpayments

Figure 1: Comparison of Determination Letters Issued When Checks Are Dishonored

Time Period	Average Number of Determination Letters Issued Without Payment per Month ⁷
Fiscal Year 2001 Audit	3
Fiscal Year 2010 Audit	1/2

Source: Fiscal Year 2001 audit and analysis of EO function Adjustments Unit Dishonored Check Logs, Letter and Information Network User-fee System (LINUS),⁸ and EP/EO Determination System (EDS)⁹ information.

To evaluate the issuance of determination letters when customer user fee checks were dishonored, we reviewed all 277 determination requests (270 tax-exempt organization and 7 retirement plan determination requests) with dishonored check conditions for the period April 2008 through March 2009.¹⁰ Determination letters were issued for 7 (2.5 percent) of 277 applications with dishonored checks totaling \$4,375.

- 6 of the 7 determination letters were issued before the Wage and Investment Division Cincinnati Submission Processing Center Accounting Branch notified the Tax Exempt and Government Entities Division EO function Adjustments Unit that the customer checks totaling \$4,000 were dishonored. As a result, the EO function Adjustments Unit did not know the checks were dishonored when it issued the determination letters. The 6 determination letters were issued on average of 37 calendar days (a range of between 15 and 58 calendar days) after determination applications and user fee checks were received by the Cincinnati Submission Processing Center. However, the Cincinnati Submission Processing Center Accounting Branch notified the EO function Adjustments Unit about the dishonored checks an average of 11 calendar days (a range of between 2 and 28 calendar days) after the determination letters were issued. EO function

⁷ The Fiscal Year 2001 audit reported that nine (average of three per month) determination letters were issued when customer user fee checks were dishonored during the 3-month period January through March 2000. The current audit identified 7 (approximately 1 every 2 months) determination letters were issued when customer user fee checks were dishonored during the 12-month period April 2008 through March 2009.

⁸ The LINUS is the system of record for all determination application user fee payments, including any subsequent payments submitted by the customer, dishonored checks, and refunds.

⁹ The EDS is the system of record for all determination letter applications processed by the Cincinnati Submission Processing Center.

¹⁰ Most of the 277 determination requests were already closed on the EDS and the dishonored check indicator had been removed by the time of our review. To evaluate the use of the dishonored check indicator, we reviewed 29 determination requests for January 2010 and determined the dishonored check indicators were timely input to the EDS and the LINUS, and customers were timely notified of the dishonored checks for all 29 cases.



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management stated the Cincinnati Submission Processing Center Accounting Branch processes dishonored checks through the bank twice, which accounts for much of the delay in notifying the EO function Adjustments Unit. In the past, EO function Adjustments Unit guidelines required that determination letters be held until checks cleared the bank. The guidelines were changed to release the determination letters sooner and provide better customer service to the 99 percent of customers whose checks are not dishonored. Because of this change, the IRS will likely be unable to completely assure that determination letters are only issued when the user fee is paid in full.

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After discovering that determination letters were issued when seven user fee checks were dishonored, EO function Adjustments Unit management contacted the customers to obtain payment for the dishonored checks. Full payment was received for four dishonored checks and ***** 1 *****

***** . However, they input a dishonored check indicator to the 3 accounts with unpaid balances totaling \$1,325 so that additional services are not performed for the tax-exempt entities until outstanding balances are paid in full. Therefore, there is still the potential that the IRS will receive the correct user fee if the tax-exempt entities need additional services from the IRS.

The reason the IRS is unable to completely eliminate instances where determination letters are issued when user fee checks have been dishonored is due in part to the current system of manual processes. Prior to the conclusion of this review, Tax Exempt and Government Entities Division management began taking steps to strengthen controls to decrease the risk that determination letters will be issued without full payment of the user fee. However, as long as the processes are manual and subject to human error, IRS management must continue monitoring these manual processes to ensure the overall number of determination letters issued without payment remains low. This oversight will help ensure the Federal Government does not lose revenue and EO



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function Adjustments Unit personnel do not spend time trying to collect money for determination letters that have already been issued.

The Cincinnati Submission Processing Center processed more than \$49.7 million in user fees during the same 13-month period that we conducted our analysis of dishonored checks. Because we identified only \$4,375 in user fee payments dishonored by the bank even though determination letter services were provided, we are not making any recommendations at this time.

EO function customers are not always refunded overpayments

As shown in Figure 2, there were fewer instances when the IRS did not refund overpayments as required than we noted in our prior audit.

Figure 2: Comparison of Overpayments That Were Not Refunded

Time Period	Average Number of Overpayments Not Refunded per Month¹¹
Fiscal Year 2001 Audit	2.6
Fiscal Year 2010 Audit	1

Source: Fiscal Year 2001 audit and analysis of LINUS and EDS data.

For the 14-month period May 2008 through June 2009, 13 of the approximately 65,000 EO function customers submitting determination letter applications overpaid their required user fee and did not receive refunds totaling \$1,730 as required.¹² Review of determination letter case information identified the following reasons why the refunds were not processed:

- 10 of 13 cases did not contain User Fee Refund Request forms, indicating the overpayments were overlooked by the EO function field specialists and reviewing managers.
 - In 3 of the 10 cases, EO function Adjustments Unit screeners identified the overpayment condition and advised the EO function field specialists at the time of

¹¹ The total number of determination letter user fee overpayments that were not properly refunded decreased from 31 for the 12-month period October 1999 through September 2000 to 13 for the 14-month period May 2008 through June 2009.

¹² See Appendix IV.



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case assignment that refunds were due. However, refunds were not subsequently issued and the closed cases did not contain User Fee Refund Request forms that should have been prepared by the EO function field specialists.

- In 7 of the 10 cases, the EO function Adjustments Unit screeners, EO function field specialists, and EO function group managers did not identify the overpayment conditions.¹³

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IRS procedures require field specialists to ensure that the correct user fee is paid by reviewing the financial information submitted by the applicant along with the description of the activities to determine the appropriate user fee. The field specialists’ secretaries verify the user fee amount received on the LINUS. If the final payment amount cannot be verified on the LINUS, the specialist or secretary should contact the EO function Adjustments Unit for proof of payment. Tax Exempt and Government Entities Division management stated that the LINUS was not designed to maintain account balance information that would allow for identifying customers that have overpaid user fees. In the cases previously listed, manual processes failed to identify and ensure refunds were initiated when customers overpaid user fees. These manual processes are effective at decreasing risk only when each employee and manager is on the alert and attentively performs their assigned tasks.

Prior to the conclusion of this review, the EO Adjustments Unit initiated steps to refund all 13 overpayments identified by the TIGTA and strengthen controls to ensure refunds are issued prior to cases closing on the EDS. While the number of overpayments not refunded was relatively small, IRS management must continue monitoring these manual processes to ensure organizations that may need their refunds to perform charitable activities are not burdened.

Recommendation

Recommendation 1: The Commissioner, Tax Exempt and Government Entities Division, should refund the 13 overpayments that were identified by the audit team.

¹³ In 1 of these cases, the customer’s initial payment check was dishonored by the bank and the subsequent check included an overpayment of \$30.



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Management's Response: Tax Exempt and Government Entities Division management agreed with this recommendation and refunded the 13 overpayments on June 2, 2010.

Refund of overpayments for EO and EP functions customers were sometimes delayed

Our review of 66 user fee overpayments (39 EO function and 27 EP function) for the period June 2008 through May 2009 showed that it took an average of 11 and 19 calendar days respectively, from the time the field specialist prepared the User Fee Refund Request form until the refund information was input to the LINUS. However, refunds of overpayments for some customers were sometimes delayed.

Our prior report stated the Tax Exempt and Government Entities Division had not established specific processing standards to ensure overpayments of user fees are timely refunded and had not developed an effective process to expedite the refund actions. Our current audit determined that time standards have not been established for processing user fee refunds and that User Fee Refund Request forms are not always expedited. We concluded that internal control weaknesses allowed some forms to be significantly delayed between 40 and 130 calendar days.

To identify the timeliness of processing User Fee Refund Request forms, a judgmental sample of 90 (6 percent) of 1,518 refund records (762 EO function and 756 EP function) for the period June 2008 through May 2009 were selected for review. We performed analysis to identify delays in processing User Fee Refund Request forms from the time the field specialists prepared the form¹⁴ through the time refund information was input to the LINUS.¹⁵ We were unable to conduct a complete analysis of all 90 sampled cases because some User Fee Refund Request forms were incomplete or could not be located. Forms that contained partial information were used to the extent possible. For example, a form that did not include a manager's signature was still used to measure the amount of time from the date it was prepared by the field specialist through the date it was input to the LINUS for refund.

We determined that 66 of 90 User Fee Refund Request forms were input to the LINUS an average of 15 calendar days (range from 0 to 130 calendar days) after they were signed by field specialists. As stated previously, time standards have not been established for processing user fee refunds, but we believe the average of 15 calendar days is reasonable. Figure 3 shows the number of days to process the 66 User Fee Refund Request forms.

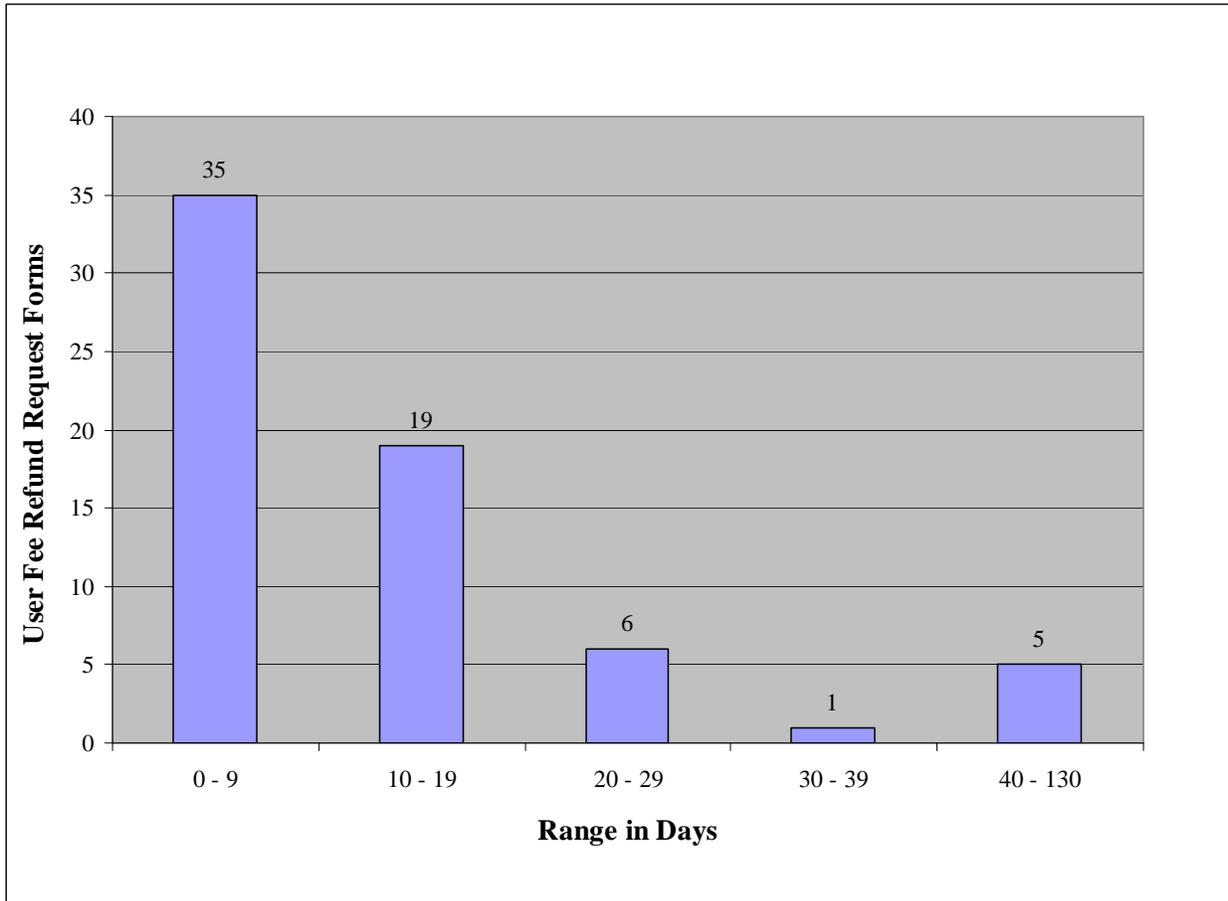
¹⁴ EP and EO function field specialists generally prepare User Fee Refund Request forms to refund overpayments when the determination is made that an organization or retirement plan qualifies for tax-exempt status and that a refundable condition exists.

¹⁵ Testing did not include issuance of the refund because another office has that responsibility. We tested processes under the control of only the Tax Exempt and Government Entities Division.



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Figure 3: Analysis of Time to Process Refund Requests



Source: Analysis of User Fee Refund Request forms and LINUS data.

Although most of the forms we reviewed were processed within a reasonable amount of time, 5 (8 percent) of the 66 took from 40 to 130 calendar days from the time the field specialist prepared the User Fee Refund Request forms until the refund information was entered to the LINUS. The five most significant delays occurred while waiting for approval by the manager, or while waiting for input to the LINUS. Because we reviewed only a sample of User Fee Refund Request forms, the total population may contain additional forms that incurred significant delays.

For the 5 refunds that took from 40 to 130 calendar days, manual processes failed to identify and ensure that all User Fee Refund Request forms were prepared, approved, and properly input to the LINUS so refunds could be processed and issued within a reasonable time period. Prior to the conclusion of this review, Tax Exempt and Government Entities Division management began initiating steps to strengthen controls to ensure managers cannot close refund cases off the EDS until User Fee Refund Request forms are forwarded to the EO function Adjustments Unit for processing the refund. However, IRS management must continue monitoring these manual



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processes to ensure organizations that may need their refunds to perform charitable activities are not burdened and retirement plans receive refunds timely.

Recommendation

Recommendation 2: The Commissioner, Tax Exempt and Government Entities Division, should improve controls to ensure all User Fee Refund Request forms are signed by field specialists and managers and input to computer systems for issuance of refunds without delay.

Management's Response: Tax Exempt and Government Entities Division management agreed with this recommendation and has issued new written procedures for the issuance of refunds. Among other things, the new procedures require all User Fee Refund Request forms to be signed by field specialists and managers. Further, the Tax Exempt and Government Entities Division has established new business rules in the EDS that prohibit managers from closing most cases in which a refund is due until the refund is issued. This change, combined with the existing requirement that managers close completed cases within 5 days, will help ensure that all refunds are promptly issued.



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Appendix I

Detailed Objectives, Scope, and Methodology

The overall objectives of this audit were to determine whether controls were strengthened to identify and prevent issuance of determination letters when customer user fee checks are dishonored; and whether controls were strengthened to identify, control, and timely resolve user fee overpayment conditions. To accomplish our objective, we:

- I. Obtained an extract of LINUS data for May 2008 through June 2009 and an extract of EDS data for May 2008 through June 2009.

Data validation tests were performed for both the LINUS and the EDS extracts. Data from both extracts were found to be accurate, but incomplete. Testing was performed to ensure that all fields were complete and correct data such as dates were input to date fields, and data were compared from the LINUS to the EDS during audit testing. During comparison testing from the EDS to the LINUS, we found that not all case information was included for the EDS extract. Since the EDS data were used to verify only processing actions, additional information was pulled from the EDS when the extract did not provide complete data. Based on our testing of the LINUS data, we determined the extract population was sufficiently complete, but complete information was not included in the extract for individual cases. Individual case information was pulled from the LINUS as needed to supplement the extract.

- II. Determined whether controls ensured the correct user fees were obtained by EP and EO functions before issuing determination letters, when customer checks were dishonored.
 - A. Obtained the log and copies of all dishonored checks maintained by the EO function Adjustments Unit for April 2008 through March 2009.
 - B. Reviewed LINUS data and determined whether the dishonored check code was input for all dishonored checks accounted for by the EO function Adjustments Unit and determined whether a subsequent repayment of the dishonored check was received.
 - C. Analyzed EDS data and determined whether controls prevented issuance of determination letters for customers with dishonored checks.
 - D. Obtained the EP/EO function case files for all exceptions and resolved any discrepancies.



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- III. Determined whether cases were closed and determination letters issued without resolving user fee overpayments from EO function customers.
 - A. Performed analysis of the LINUS extract and identified potential customer overpayments received from May 2008 through June 2009.
 - B. Reviewed all LINUS final exception cases and determined whether EO function specialists identified customer overpayment conditions and whether customers were refunded the appropriate amount.
 - C. Discussed potential overpayment cases with EO function management, resolved discrepancies, and determined the cause of not refunding the overpayment timely.
- IV. Determined whether user fee overpayments were appropriately controlled and requests for refunds were timely processed once initiated by EP and EO functions field specialists.
 - A. Determined through research and discussion with EP and EO functions management whether specific processing standards were established for the issuance of refunds for overpayments.
 - B. Obtained the refund request logs from the EO function Adjustments Unit for June 2008 through May 2009.
 - C. Selected a judgmental sample¹ of 90 closed refund cases from the population of 1,518 records (762 EO function and 756 EP function) for the period June 2008 through May 2009 for review. We obtained the related case files and documentation such as LINUS prints, and the User Fee Refund Request form signed by the specialist and group manager and performed analysis to determine the number of days to process refunds.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objective: the Internal Revenue Code and Tax Exempt and Government Entities Division policies and procedures for processing determination applications, letters, and refunds. We evaluated these controls by interviewing management, reviewing determination cases, and reviewing LINUS and EDS data.

¹ We chose a judgmental sample because we did not plan to project our results.



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Appendix II

Major Contributors to This Report

Nancy A. Nakamura, Assistant Inspector General for Audit (Management Services and Exempt Organizations)
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Michael A. McGovern, Auditor
Carol A. Rowland, Auditor



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Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Commissioner, Wage and Investment Division SE:W
Deputy Commissioner, Tax Exempt and Government Entities Division SE:T
Director, Employee Plans, Tax Exempt and Government Entities Division SE:T:EP
Director, Exempt Organizations, Tax Exempt and Government Entities Division SE:T:EO
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 Liaisons:
 Director, Communications and Liaison, Tax Exempt and Government Entities
 Division SE:T:CL
 Senior Operations Advisor, Wage and Investment Division SE:W:S



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Appendix IV

Outcome Measure

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

Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Actual; \$1,730 for 13 customers (see page 3).

Methodology Used to Measure the Reported Benefit:

Computer analysis of LINUS data for approximately 65,000 EO function determination applications with user fee payments for the 14-month period May 2008 through June 2009 identified 13 customers who overpaid the correct user fee amount and did not receive refunds as required. The total amount of refunds due to customers that had overpaid user fees was \$1,730.



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Appendix V

Tax-Exempt User Fee Process

Tax Exempt and Government Entities Division EP and EO functions customers submit determination applications to the Wage and Investment Division Cincinnati Submission Processing Center in Covington, Kentucky. The Cincinnati Submission Processing Center is responsible for front-end processing of determination letter applications and enters information to the following computer systems:

- The LINUS - the system of record for all determination application user fee payments, including any subsequent payments submitted by the customer, dishonored checks, and refunds.
- The EDS - the system of record for all determination letter applications processed by the Cincinnati Submission Processing Center. All user fee payment information received initially, or at a later date by the Cincinnati Submission Processing Center is entered to the LINUS and uploaded to the EDS.

If the determination application is complete and the user fee is submitted in full,¹ the Wage and Investment Division Cincinnati Submission Processing Center forwards the determination application to the Tax Exempt and Government Entities Division EP/EO function Processing Unit in Cincinnati, Ohio. The EO Adjustments Unit is part of the EP/EO function Processing Unit and is responsible for processing both EP and EO function determination applications, updating the status on the EDS, updating information such as dishonored checks and refunds on the LINUS, and closing cases on the EDS. However, none of the user fee payment information entered to the LINUS by the EO Adjustments Unit is uploaded to the EDS. EP and EO function field specialists are responsible for reviewing financial information submitted by the applicant along with the description of activities to determine whether the correct fee has been paid. If sufficient information is received and the user fee is paid in full, the field specialist will issue a determination letter informing the organization or retirement plan whether it qualifies for tax-exempt status.

Special procedures apply when a user fee payment is dishonored or when the IRS determines a user fee has been overpaid.

¹ A preliminary determination is made by the Wage and Investment Division Cincinnati Submission Processing Center whether or not the user fee was paid in full. Only Tax Exempt and Government Entities Division field specialists upon review of the determination application can make the final decision on the amount of user fee that should be paid.



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Dishonored Check Process

The Cincinnati Submission Processing Center Accounting Branch notifies the EO function Adjustments Unit when user fees paid by checks are subsequently dishonored for nonsufficient funds. When dishonored checks are received, the EO function Adjustments Unit enters the dishonored check to the Dishonored Check Inventory Log and inputs a dishonored check indicator on the EDS. This indicator is intended to flag the account as having a dishonored check and stop processing of the determination letter until the user fee is fully paid. Upon notification of a dishonored check, the EO function Adjustments Unit, or if the case is assigned to a field office, the field specialist, sends a letter to notify the applicant that the check did not clear the bank and that the applicant must pay the user fee either by certified check or money order within 2 weeks. If the payment is not received, the Tax Exempt and Government Entities Division will notify the applicant that their determination application is being closed for failure to pay the required user fee.

Overpayment Process

EP and EO function specialists prepare User Fee Refund Request forms when they identify that applicants have overpaid the user fee, or when a fee is paid, but not required. The User Fee Refund Request form must be approved by the field specialist's group manager and forwarded to the EO function Adjustments Unit where the refund is input to the LINUS and recorded on a spreadsheet. A copy of the spreadsheet, LINUS data, and the User Fee Refund Request form is forwarded to the Beckley Finance Center in Beckley, West Virginia, where funds are disbursed for issuance of the refund.



Tax-Exempt User Fee Processing Improved for Dishonored Checks and Refund of Overpayments

Appendix VI

Management's Response to the Draft Report



COMMISSIONER
TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

JUN 29 2010

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Sarah Hall Ingram *Sarah Hall Ingram*
Commissioner, Tax Exempt and Government Entities

SUBJECT: Draft Audit Report – Tax-Exempt User Fee
Processing Improved for Dishonored Checks and
Refund of Overpayments (Audit # 200910030)

The Tax Exempt and Government Entities Division (TE/GE) appreciates your work in conducting this audit, which we requested you to add to your audit schedule for TE/GE for this fiscal year. Thank you for working it in.

We requested the audit to ensure that process changes we implemented following your previous audit of our user fee operation had successfully addressed the issues you identified at that time. As you know, we were unable to undertake two corrective actions we previously agreed to because they relied on IT solutions which proved to be impracticable. We therefore took alternative corrective actions, and we requested your evaluation of the effectiveness of these alternate solutions.

We appreciate your observation that our processes have improved, as well as your reminder that we must continue to monitor these manual processes, since such processes are inherently subject to human error.

Our specific responses to your recommendations are included in the attachment

We concur with the outcome measure you identify in Appendix IV of your report.

If you have any questions, please contact me, or a member of your staff may contact Cindy Thomas at (513) 263-3519.

Attachment



Tax-Exempt User Fee Processing Improved for Dishonored Checks and Refund of Overpayments

Attachment

Recommendation 1

The Commissioner, Tax Exempt and Government Entities Division, should refund the 13 overpayments that were identified by the audit team.

Corrective Action

Completed. All overpayments have been refunded.

Implementation Date

The refunds were issued June 2, 2010.

Responsible Official

Director, Exempt Organizations

Recommendation 2

The Commissioner, Tax Exempt and Government Entities Division, should improve controls to ensure all User Fee Refund Request forms are signed by field specialists and managers and input to computer systems for issuance of refunds without delay.

Corrective Action

Completed. TE/GE has issued new written procedures for the issuance of refunds. Among other things, the new procedures require all User Fee Refund Request forms to be signed by field specialists and managers. Further, TE/GE has established new business rules in EDS, the automated system used to control determination applications, that prohibit managers from closing most cases in which a refund is due until the refund is issued. This change, combined with the existing requirement that managers close completed cases within five days, will help ensure that all refunds are promptly issued.

Implementation Date

June 14, 2010.

Responsible Official

Director, Exempt Organizations