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Accountability \* Integrity \* Reliability

United States Government Accountability Office  
Washington, DC 20548

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September 27, 2005

The Honorable Charles E. Grassley  
Chairman  
The Honorable Max Baucus  
Ranking Minority Member  
Committee on Finance  
United States Senate

Subject: *Activities of the Treasury Inspector General for Tax Administration*

The Department of the Treasury Inspector General for Tax Administration (TIGTA) audits and investigates the Internal Revenue Service's (IRS) operations to (1) promote economy and efficiency and detect and prevent fraud and abuse and (2) recommend actions for improvement. TIGTA was established by the Internal Revenue Service Restructuring and Reform Act of 1998<sup>1</sup> (IRS Reform Act), which amended the Inspector General Act of 1978<sup>2</sup> (IG Act), to include an independent inspector general (IG) to provide oversight of IRS's activities, programs, and offices.

This report responds to your request that we review the activities of TIGTA. As discussed with your staff, we are providing information regarding (1) TIGTA's budget and staffing levels; (2) TIGTA's audit and investigative coverage of IRS, including oversight of IRS's offices and identified weaknesses in IRS's operations, and audit coverage of specific requirements of the IRS Reform Act; (3) TIGTA's audit and investigative accomplishments; (4) the quality assurance program, including the results of peer reviews; and (5) the audit follow-up process to track IRS's implementation of TIGTA's audit recommendations.

### **Results in Brief**

Over the 5-year period of fiscal years 2000 through 2004, TIGTA's budget authority increased by 14 percent while staff levels decreased by 6 percent. In fiscal year 2004, TIGTA had budget authority of about \$130 million and realized authorized full-time equivalent (FTE) staff of 877. In relation to IRS's total federal funds, the budget authority for TIGTA's oversight has steadily declined but is comparable to such ratios for other IG offices.

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<sup>1</sup>Pub. L. No. 105-206, 112 Stat. 685, 705 (July 22, 1998).

<sup>2</sup>Pub. L. No. 95-452, 92 Stat. 1101 (Oct. 12, 1978) (codified, as amended, at 5 U.S.C. App.).

During fiscal year 2004, TIGTA provided audit coverage of IRS through an organizational structure that mirrors IRS's organizational structure and through audit plans that include coverage of IRS's business units, management challenges, and congressionally mandated work. TIGTA's audits provided coverage of the IRS management challenges identified by TIGTA, the high-risk areas designated by us, and mandatory coverage required by the IRS Reform Act. Investigative coverage is provided through TIGTA's investigative mission of addressing employees' integrity, external attempts to corrupt tax administration, and employee and infrastructure security.

As a result of its audit and investigative coverage, TIGTA reported that it issued 942 audit reports, addressed 39,611 complaints and allegations, and closed 22,350 investigations over the 5-year period of fiscal years 2000 through 2004. TIGTA claimed financial accomplishments resulting from these audits and investigations of over \$16.3 billion, and identified additional potential financial impacts on tax administration of over \$50 billion.

TIGTA's external peer reviews and internal quality reviews have concluded that TIGTA's quality assurance program provides reasonable assurance that audit reports meet applicable standards. The program includes internal quality reviews of individual audits, internal quality inspections of the Office of Audit, and an external quality peer review of the Office of Audit every 3 years in compliance with government auditing standards.<sup>3</sup>

IRS tracks corrective actions on audit recommendations using the Department of the Treasury's Joint Audit Management Enterprise System (JAMES). The system includes audit recommendations from TIGTA, the Department of the Treasury Office of Inspector General, and us. IRS management is responsible for ensuring that corrective actions are taken on audit recommendations that address IRS. For fiscal years 2000 through 2004, JAMES reported that as of May 2005, about 83 percent of all audit recommendations were implemented.

## **Scope and Methodology**

We obtained the actual budget authority and the staffing levels at TIGTA,<sup>4</sup> and the total federal funds and FTEs at IRS,<sup>5</sup> for fiscal years 2000 through 2004, as reported in the *Budget of the United States Government*. We used this information to identify trends over this period and to compare TIGTA's resources with overall IRS resources. In addition, we compared the ratio of IG budget authority with agency budgetary resources<sup>6</sup> in fiscal year 2004 for all IG offices for which an IG is appointed by the President and confirmed by the Senate. For fiscal year 2004 agency budgetary

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<sup>3</sup>GAO, *Government Auditing Standards*, GAO-03-673G (Washington, D.C.: June 2003).

<sup>4</sup>Office of Management and Budget, *Budget of the United States Government*, Appendix (Washington, D.C.: Government Printing Office) Fiscal Years 2002-2006.

<sup>5</sup>Office of Management and Budget, *Budget of the United States Government*, Analytical Perspectives (Washington, D.C.: Government Printing Office) Fiscal Years 2002-2006.

<sup>6</sup>Agency budgetary resources are those amounts available to enter into new obligations and to liquidate them, and are made up of new budget authority (including direct spending authority provided in existing statute and obligation limitations) and unobligated balances of budget authority provided in previous years.

resources, we used information from the Statement of Budgetary Resources for each agency reported in the Fiscal Year 2006 *Budget of the United States Government*.<sup>7</sup> We did not audit or otherwise verify the budget amounts.

To analyze TIGTA's audit coverage of IRS, we compared the organizational structures of TIGTA and IRS to analyze coverage of IRS's offices and missions, obtained copies of completed audits, and reviewed all audit reports issued by TIGTA during fiscal year 2004. We compared the subjects and contents of these audit reports with weaknesses at IRS previously identified by TIGTA and us to determine the extent to which the known weaknesses were being covered through TIGTA's audits. In addition, we compared the audit reports with TIGTA's statutorily mandated coverage of IRS's administration of specific provisions of the IRS Reform Act. To illustrate the investigative coverage of IRS, we obtained the number of investigative cases that addressed the mission areas of TIGTA's Office of Investigations during fiscal year 2004.

We identified the audit and investigative accomplishments reported by TIGTA in semiannual reports to the Congress for fiscal years 2000 through 2004, and obtained examples of individual reports to illustrate. We did not audit or otherwise verify the dollar amount of financial accomplishments reported by TIGTA.

Regarding quality control, we interviewed TIGTA staff and obtained documentation of TIGTA's quality control process, including the reports on quality control, internal quality inspections, and external peer review reports of TIGTA's audit operations. We also interviewed TIGTA staff regarding the tracking of audit recommendations and obtained JAMES documentation for audit follow-up, including information about the percentage of recommendations implemented by IRS.

We performed our audit from March 2005 through August 2005, in accordance with U.S. generally accepted government auditing standards. We requested comments on a draft of this report from the Treasury Inspector General for Tax Administration or his designee. We received written comments from the Treasury Inspector General for Tax Administration, which we have reprinted in enclosure IV. We also received several oral comments offering technical suggestions, which we have incorporated as appropriate.

## **Background**

IRS administers America's tax laws and collects the revenues that fund most government operations and public services. Each year IRS employees make millions of contacts with American taxpayers and businesses. To accomplish its mission, IRS focuses its efforts on achieving three key goals: (1) improving taxpayer service; (2) enhancing enforcement of the tax law; and (3) modernizing IRS through people, processes, and technology. For the fiscal year 2004 filing season, IRS reported that it collected over \$2 trillion, processed over 131 million individual returns, and issued approximately 100 million refunds totaling about \$208 billion.

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<sup>7</sup>Office of Management and Budget, *Budget of the United States Government*, Supplemental Information (Washington, D.C.: Government Printing Office) Fiscal Year 2006.

TIGTA is responsible for the independent oversight of IRS at the Department of the Treasury. Formed in January 1999 as a result of the IRS Reform Act, TIGTA is an oversight organization within the Department of the Treasury in addition to, and independent of, the Department of the Treasury Office of Inspector General, which was established by the IG Act Amendments of 1988.<sup>8</sup> Both IGs report directly to the Secretary of the Treasury; however, TIGTA provides oversight of IRS, and the Treasury IG provides oversight of the remaining offices at the Department of the Treasury.

Prior to the IRS Reform Act, IRS oversight was provided by the Treasury IG and the IRS Office of Chief Inspector, also known as the Inspection Service. Established on October 1, 1951, the Inspection Service was responsible for carrying out internal audits and investigations to (1) promote the economic, efficient, and effective administration of the nation's tax laws; (2) detect and deter fraud and abuse in IRS's programs and operations; and (3) protect IRS from external attempts to corrupt or threaten its employees. The Chief Inspector reported to IRS's Commissioner and Deputy Commissioner and provided information to the Treasury IG, who included the results of Inspection Service activities in the Treasury IG's semiannual reports to the Congress.

In 1998 the Senate Committee on Finance concluded that the Office of Chief Inspector lacked sufficient autonomy from IRS to independently provide monitoring and oversight activities.<sup>9</sup> In addition, the committee believed that the relationship between the Treasury IG and the Inspection Service did not foster the appropriate oversight of IRS. Consequently, to improve the quality and the credibility of IRS's oversight, TIGTA was established within the Department of the Treasury to provide independent audits and investigations of IRS.

In addition to the authorities and responsibilities granted under the IG Act, the IRS Reform Act gives TIGTA the statutory authority to allow staff to carry firearms, execute and serve search and arrest warrants, serve subpoenas and summonses, make arrests, and seize property. The IRS Reform Act also makes taxpayer returns and return information available for inspection by TIGTA. TIGTA reports to and operates under the general supervision of the Secretary of the Treasury; however, neither the Secretary nor any other officer of the Treasury Department can prevent or prohibit TIGTA from initiating, carrying out, or completing any audit or investigation, or from issuing a subpoena during the course of any audit or investigation. In addition, TIGTA is required to report to the Attorney General whenever there are reasonable grounds to believe that there has been a violation of federal criminal law.

Consistent with the IG Act and the IRS Reform Act, TIGTA conducts audits and investigations of IRS's programs and operations to promote the economic, efficient, and effective administration of the nation's tax laws and to detect and deter fraud and abuse in IRS's programs and operations. TIGTA's primary functional offices are the Office of Audit, the Office of Investigations, the Office of Information Technology, the Office of Management Services, and the Office of the Chief Counsel. As required by the IG Act, TIGTA reports its activities and the results of audit and investigative

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<sup>8</sup>Pub. L. No. 100-504, 102 Stat. 2515 (Oct. 18, 1988).

<sup>9</sup>S. Rep. No. 105-174 (1998).

efforts in semiannual reports to the Congress for the periods ending March 31 and September 30 each year. Also, TIGTA presents specific information in these semiannual reports about IRS's compliance with provisions of the IRS Reform Act.

### **TIGTA Budgets and Staffing**

The IRS Reform Act provided that all but 300 of IRS's Inspection Service FTEs for fiscal year 1998 be transferred to TIGTA. The IRS Commissioner was allowed to retain up to 300 FTEs to staff an internal audit function. In addition, 21 FTEs previously transferred from the Inspection Service to the Treasury IG for oversight of IRS pursuant to a 1990 memorandum of understanding (MOU) were transferred to the newly formed TIGTA. As a result, TIGTA realized 932 FTEs and had budget authority of about \$114 million in fiscal year 2000, its first year of operations. In fiscal year 2004, TIGTA had budget authority of \$130 million and realized 877 authorized FTEs. As of September 30, 2004, TIGTA had 874 staff on board with 317 in the Office of Audit; 432 in the Office of Investigations; 81 in the Office of Information Technology; 23 in the Office of Management Services, including the IG; and 21 in the Office of Chief Counsel.

From fiscal year 2000 through fiscal year 2004, TIGTA's budget authority increased by 14 percent, from \$114 million to \$130 million, while TIGTA's FTEs decreased by 6 percent, from 932 to 877. TIGTA's increased budget authority occurred mostly in the second year of operations because of expenses related to establishing an independent office and the effects of full costing of federal retirements. Since fiscal year 2001, TIGTA has operated in a relatively unchanged budget environment while absorbing increases in costs that are largely beyond TIGTA's control, accompanied by a corresponding reduction in FTEs. For a comparison, during fiscal years 2000 through 2004, overall IRS's total federal funds increased by 52 percent and FTEs increased by 1 percent. Therefore, even though they have both increased in recent years, TIGTA's budget authority as a percentage of IRS's total federal funds decreased from 0.30 percent to 0.23 percent. (See table 1.)

**Table 1: TIGTA's and IRS's Budgets and FTEs for Fiscal Years 2000 through 2004**

Dollars in millions

<b>Fiscal year</b>	<b>TIGTA's budget authority</b>	<b>IRS's total federal funds</b>	<b>TIGTA's budget authority as a percentage of IRS's total federal funds</b>	<b>TIGTA's FTEs</b>	<b>IRS's FTEs</b>
2000	\$114	\$37,881	0.30	932	97,799
2001	127	39,370	0.32	937	98,574
2002	130	46,658	0.28	943	100,217
2003	128	51,631	0.25	926	99,862
2004	130	57,443	0.23	877	98,735

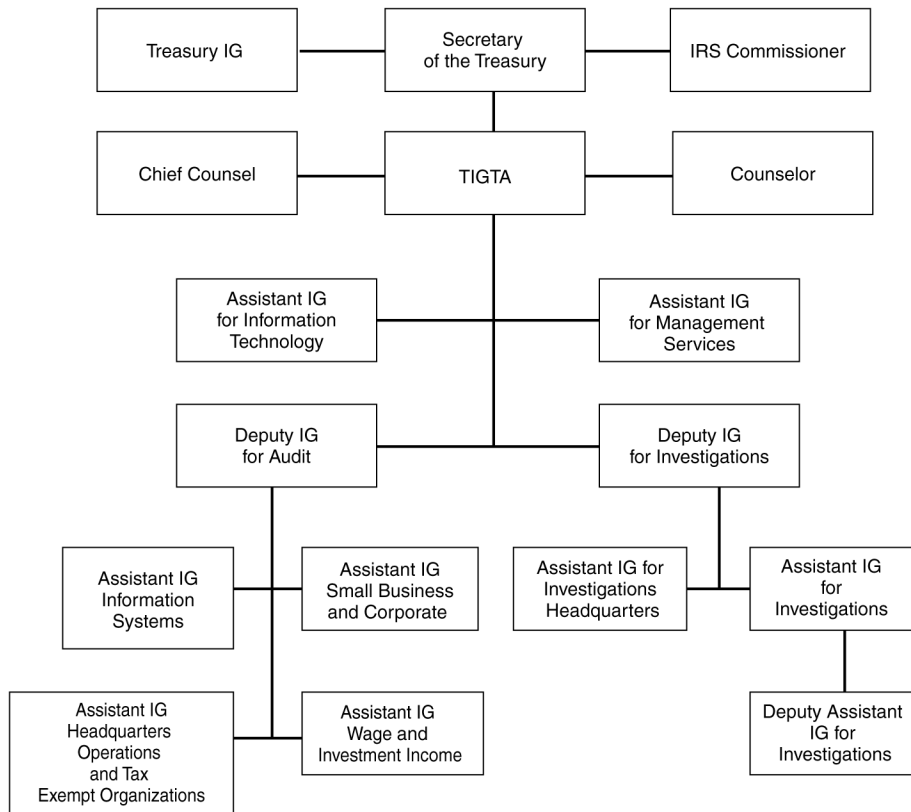
Source: Budget of the United States Government.

The comparison of TIGTA's budget authority with IRS's total federal funds represents the amount provided for IG oversight as it relates to the amount of budgetary resources received by the agency that it oversees. When this comparison is made for the other IG offices in which the IG is appointed by the President and confirmed by the Senate, the percentages vary depending on the size of the federal agencies, their missions, and the oversight issues emphasized by each IG office. Such a comparison for fiscal year 2004 budgets indicates that the ratio of TIGTA's budget authority to IRS's total federal funds was within the range of these percentages for other IGs and their agencies. (See enc. I.) The comparison of IGs' budget authorities and agencies' budgetary resources ranged from 0.004 percent to 1.03 percent, whereby TIGTA's percentage of IRS resources was at 0.23 percent, which ranks sixth of 28 agencies. This comparison at IRS does not include the implications of IRS's main role as the nation's tax collector and the amount of federal revenue collected by the IRS.

### Audit Coverage of IRS

In fiscal year 2004, TIGTA issued 189 audit reports, which provided audit coverage of IRS's operating divisions and other units (see enc. II), as well as the high-risk areas identified by us, management challenges identified by TIGTA, and audits of IRS's activities mandated by the IRS Reform Act. This is accomplished through TIGTA's organizational structure, which has four business units reporting to the Deputy IG for Audit that are aligned with IRS's operating divisions and other units, and provide audits of identified risks and congressionally mandated IRS requirements. (See fig. 1.)

Figure 1: TIGTA Organization Chart



Source: TIGTA.

For example, in fiscal year 2004, TIGTA's Wage and Investment Income business unit issued 40 audit reports that addressed the IRS Wage and Investment Division's mission to serve tax filers with wage and investment income and to help taxpayers understand the tax laws. The work of this division includes IRS's enforcement of the tax laws, the processing of taxpayers' returns, and the administration of the Earned Income Tax Credit and Advanced Earned Income Tax Credit while minimizing the burden on taxpayers and protecting their privacy.

Also, in fiscal year 2004, TIGTA's Small Business and Corporate Programs business unit issued 37 audit reports to cover IRS's Small Business and Self-Employed Division, which serves self-employed individuals; individual filers with income from rents, royalties, pensions, annuities, partnerships, estates, and trusts; and small businesses with assets of up to \$10 million. These audits also included coverage of IRS's Large and Mid-Size Business Division, which serves businesses with assets of more than \$10 million. During fiscal year 2004, TIGTA's audits concentrated on assessing IRS's efforts to provide quality service while helping taxpayers understand the tax laws, processing the tax returns, and enforcing compliance with the tax laws.

TIGTA's Headquarters Operations and Exempt Organizations business unit issued 82 audit reports in fiscal year 2004 to provide coverage of IRS's Tax-Exempt and Government Entities Division, which serves a wide range of customers, including small local community organizations, municipalities, major universities, pension funds, state governments, Indian tribal governments, and tax-exempt bond issuers. These audits also provide coverage of IRS's Financial Management and Operations, IRS's activities in compliance with the Government Performance and Results Act of 1993,<sup>10</sup> the Criminal Investigation function, and agencywide shared services.

TIGTA's Information Systems business unit issued 30 audit reports to cover IRS efforts to modernize its core business systems and to provide high-quality, efficient, and responsible information services for its operating divisions. In addition, through these audits, TIGTA oversees the security of information systems, the buildings that house the systems, and the people who operate them, and assesses IRS's efforts to manage risks and vulnerabilities throughout its technology modernization projects.

### **Audit Coverage of Risks and Mandates**

While TIGTA is organized to provide audits that address IRS's operating divisions and other units, emphasis is also placed on high-risk areas identified by us, IRS's management challenges identified by TIGTA, and mandatory coverage required by the IRS Reform Act. Since 1990, we have periodically reported on government operations that we have designated as high risk because of their greater vulnerabilities to fraud, waste, abuse, and mismanagement. We also identify high-risk areas to focus on the need for broad-based transformations to address major challenges to economy, efficiency, or effectiveness.

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<sup>10</sup>Pub. L. No. 103-62, 107 Stat. 285 (Aug. 3, 1993).

In January 2003 we identified 25 high-risk areas across government and added a 26<sup>th</sup> high-risk area in July 2003. These areas included IRS's multibillion-dollar Business Systems Modernization program, financial management, collection of unpaid taxes, and earned income tax credit noncompliance. In January 2005 we combined the financial management area with the systems modernization area into a category titled "Business Systems Modernization," and combined the earned income credit noncompliance with the collection of unpaid taxes into a category titled "Enforcement of Tax Laws."

The management challenges identified by TIGTA at the beginning of fiscal year 2004 include the high-risk areas identified by us; therefore, TIGTA's audits of management challenges provide coverage of our identified high-risk areas at IRS.<sup>11</sup> (See enc. III.) The identification of management challenges by the IGs began in 1997 when the IGs were asked by congressional leaders to identify the 10 most serious management problems in their respective agencies. This request began a yearly process that continues as a result of the Reports Consolidation Act of 2000.<sup>12</sup> This act called for executive agencies, including IRS, to include their IGs' lists of significant management challenges in their annual performance and accountability reports to the President, the Office of Management and Budget (OMB), and the Congress.

Efforts to modernize IRS's systems, mandated by the IRS Reform Act, began in fiscal year 1999. IRS expects that it will take 10 to 15 years at a cost of \$7 billion to \$10 billion. We have recognized the modernization of IRS's systems as a high-risk area, and TIGTA has identified this as a management challenge that will require attention for years to come. TIGTA has also recognized that the integration of IRS's financial management and performance are management challenges at IRS by citing the weaknesses we reported in our audits of IRS's financial statements. These challenges include serious deficiencies in financial systems, including control weaknesses and system deficiencies affecting financial reporting, unpaid tax assessments, tax revenue and refunds, and computer security. In fiscal year 2004, TIGTA completed 15 audits that addressed IRS's systems modernization and 13 audits that addressed IRS's financial management and performance.

IRS's administration of tax compliance initiatives and taxpayer protection and rights are also designated by TIGTA as management challenges. Both of these challenges include the collection of taxes, which is also a GAO high-risk area. In addition, TIGTA has recognized improper payments at IRS as a management challenge that includes taxpayers' noncompliance with the earned income tax credit. To provide audit coverage of these areas in fiscal year 2004, TIGTA completed 29 audits of tax compliance initiatives along with 17 audits of taxpayers' protection and rights, which included the collection of unpaid taxes, and 5 audits that addressed erroneous and improper payments, which included taxpayers' noncompliance with the earned income tax credit.

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<sup>11</sup>GAO and TIGTA maintain ongoing coordination of high-risk audit efforts.

<sup>12</sup>Pub. L. No. 106-531, 114 Stat. 2537 (Nov. 22, 2000).



TIGTA's fiscal year 2004 audits also covered the statutorily mandated audits specified in the IRS Reform Act, which requires TIGTA to review IRS's actions taken to improve service to taxpayers. TIGTA's audit reports covered the following areas:

- restrictions on the use of enforcement statistics to evaluate IRS employees,
- any termination or mitigation under section 1203 of the IRS Reform Act,<sup>13</sup>
- information regarding the improper denial of requests for information from IRS,
- restrictions on directly contacting taxpayers who have indicated they prefer their representatives be contacted,
- procedures on the filing of a notice of a lien,
- procedures for seizure of property,
- certification that the Treasury Secretary complied with certain disclosures,
- extensions of the statute of limitations for the assessment and collection of taxes,
- adequacy and security of IRS technology,
- restrictions on the designation of taxpayers as illegal tax protesters, and
- actions with respect to violations of the fair-debt-collection provisions.

To satisfy additional statutory provisions, TIGTA reported in each fiscal year 2004 semiannual report the number of taxpayer complaints during the period and the number of employee misconduct and taxpayer abuse allegations received by IRS or the IG during the period from taxpayers, IRS employees, and other sources. In addition, the semiannual reports included a required summary of the status of such complaints and allegations as well as their disposition, including any action by the Department of Justice and any moneys paid as a settlement.

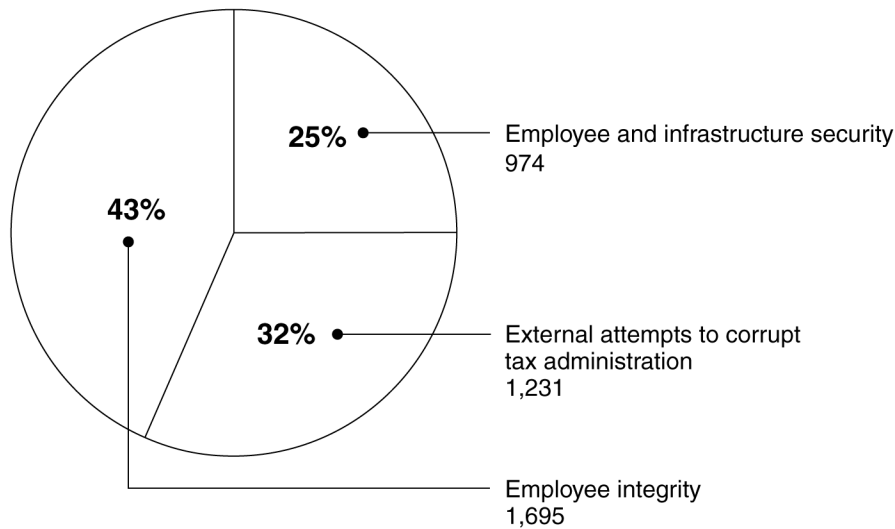
### **Investigative Coverage**

As was the case with the audit function, the IRS Reform Act also transferred the statutory law enforcement authority of the former IRS Inspection Service to TIGTA and its Office of Investigations. TIGTA has responsibility for enforcing criminal law related to internal revenue and focuses investigations on three main areas of concern: (1) allegations of criminal violations and serious administrative misconduct by IRS employees; (2) external attempts to corrupt tax administration; and (3) issues of employee infrastructure and security. (See fig. 2.) The Office of Investigations' authority includes executing and serving search and arrest warrants, serving subpoenas and summonses, making arrests without warrant for any offense against the United States related to internal revenue laws, and seizing property subject to foreclosure under IRS laws.

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<sup>13</sup>In general, the IRS Commissioner shall terminate the employment of any IRS employee if there is a final administrative or judicial determination that in the performance of official duties, such employee committed any misconduct violations outlined in the act.

**Figure 2: TIGTA's Office of Investigations Closed Investigations by Investigative Area Reported by TIGTA in Fiscal Year 2004**



Source: TIGTA.

The investigative responsibilities of TIGTA's Office of Investigations are coordinated with the IRS Criminal Investigation office through an MOU between TIGTA and the Chief of IRS Criminal Investigation signed in August 2000. The MOU specifies that IRS Criminal Investigation will investigate violations of the Internal Revenue Code's substantive criminal tax provisions, such as attempted evasion, failure to file or pay, the subscription of false documents, and corrupt endeavors to obstruct or impede the administration of the tax code. TIGTA has responsibility to protect IRS against external attempts to corrupt or threaten IRS employees, including investigations of allegations of IRS employee conduct violations and other allegations regarding employee integrity.

During fiscal year 2004, TIGTA reported that it closed 3,900 investigative cases.<sup>14</sup> Of these, 1,695 investigations, or 43 percent, addressed employee integrity cases, such as misconduct, extortion, theft, taxpayer abuses, false statements, and financial and contractor fraud. For example, because of these investigations, two IRS employees were indicted for diverting tax refunds to their own accounts, an employee pleaded guilty to filing fabricated income tax returns to obtain tax refund payments, and an employee pleaded guilty to stealing checks payable to IRS and altering them for personal use.

TIGTA reported that 32 percent of closed investigations during fiscal year 2004, or 1,231 investigations with final referrals, addressed external attempts to corrupt or interfere with the administration of internal revenue laws. These external attempts to corrupt or interfere include bribes offered by taxpayers to compromise IRS employees, the manipulation of IRS's systems and programs, the use of fraudulent IRS documentation, and impersonation of IRS officials. Specifically, TIGTA reported that the Office of Investigations conducted 56 investigations into bribery allegations

<sup>14</sup>TIGTA recognizes investigative cases as closed after they are referred for final action. This may include referrals to the Department of Justice, state or local jurisdictions, or IRS.

involving taxpayers, 280 investigations of attempts to manipulate IRS's systems and operations, and 895 investigations into nontax fraud and other related activities. To illustrate, as a result of TIGTA's investigations, an individual was sentenced for mail fraud because this individual directed clients to deposit funds for tax purposes into a fund used for the individual's personal purposes. In addition, individuals were sentenced for bribing IRS employees and for impersonating IRS employees.

The remaining 25 percent of closed investigations, or 974 investigative cases with final referrals reported by TIGTA, addressed employee and infrastructure security to ensure IRS's ability to collect taxes. Specifically, this includes activities by the Office of Investigations to identify threats against IRS personnel and facilities and to notify IRS management of the potential for harm. In addition, TIGTA also investigates threats and assaults directed at facilities and employees, which include arresting individuals who direct threatening letters and statements to IRS employees. Consequently, as reported, TIGTA issued 64 advisories notifying IRS management of potential threats and completed 910 investigations of threats and assaults directed at IRS facilities and employees.

### **TIGTA's Accomplishments**

Statutory IGs, including TIGTA, are required by the IG Act to report specific financial accomplishments in their semiannual reports provided for the Congress. As required, TIGTA's semiannual reports for fiscal years 2000 through 2004 included the number of audit reports issued and the questioned costs, unsupported costs, and funds to be put to better use identified by the audits. As defined by the IG Act, questioned costs include either alleged violations of laws, regulations, contracts, grants, or agreements; costs not supported by adequate documentation; or the expenditure of funds for an intended purpose that was unnecessary or unreasonable. In addition, unsupported costs are defined as costs that do not have adequate documentation, and funds to be put to better use are inefficiencies identified by the IG in the use of agency funds. For the 5-year period, TIGTA issued 942 audit reports and reported \$16.1 million in questioned costs, \$3.1 million in unsupported costs, and \$16.2 billion in funds to be put to better use.

In an example of questioned costs, TIGTA's follow-up audit of controls over IRS's telecommunications costs found that about \$2.2 million of questioned costs had been identified by IRS based on TIGTA's prior findings of ineffective controls. In an example of unsupported costs, TIGTA audited four invoices from the IRS business systems modernization contract and found approximately \$9.5 million of these costs unsupported by documentation from the contractor. After TIGTA's audit report draft was issued, the contractor provided documentation to support all but approximately \$52,000 of the \$9.5 million originally questioned. In an example of funds to be put to better use, TIGTA recommended that IRS reduce the amount of underused office space, which could save about \$84 million per year.

In addition to the audit accomplishments, during the same 5-year period, TIGTA reported that 39,611 complaints and allegations were addressed and that 22,350 investigative cases were closed. This activity resulted in the reported recovery of about \$17.5 million of embezzled or stolen funds and almost \$80 million in court-ordered fines, penalties, and restitutions. In addition, reported nonmonetary

investigative accomplishments included almost 10,000 criminal referrals—of which about 1,700 were accepted for prosecution by the Department of Justice or state or local authorities—and administrative dispositions on 3,805 investigations, which included removal, termination of employment or suspension, reduction in grade, written or oral reprimand, or resignation of the employee. The combined financial accomplishments from audits and investigations reported by TIGTA over the 5-year period totaled about \$16.3 billion.

In addition to the audit information required by the IG Act, TIGTA's Office of Audit has identified measures that demonstrate additional potential financial impact on tax administration. These accomplishments are intended to provide further insights into the value and potential impact of TIGTA's audits and include increases in the collection of additional taxes, improvements to revenue protection and taxpayer privacy, correction of inefficient uses of resources, needed protections of human and capital assets, and correction of problems with the reliability of management information. To illustrate, TIGTA estimated that by improving the controls to ensure that tax returns with potential transfer pricing<sup>15</sup> issues are referred to international examiners for consideration, federal revenue could increase by approximately \$32.3 million annually, provided that IRS has the additional resources to examine the returns. For the 5-year period we reviewed, TIGTA reported over \$50 billion of these additional potential financial impacts.

### **TIGTA Quality Assurance Program**

TIGTA's quality assurance program includes a quality review of individual audit reports, internal quality inspections to monitor the quality of audits, and external quality peer reviews. Specifically, the IG Act requires federal IGs to follow *Government Auditing Standards*, which requires an appropriate internal quality control system and an external peer review every 3 years. These standards specify that quality control systems should include procedures for monitoring, on an ongoing basis, whether the policies and procedures related to the standards are suitably designed and are being effectively applied.

To comply with the quality assurance standard, TIGTA's Office of Management and Policy uses a standardized checklist to review all draft audit reports prior to issuance. This review addresses audit scope, finding attributes, the sufficiency and relevancy of findings in comparison to the audit objectives, the adequacy of recommendations to address identified causes, audit sampling methodology, and quantifiable outcome measures. In addition, the review provides assurance of general compliance with professional auditing standards; conformance with TIGTA report format; clarity of information; and conformance with rules for grammar, punctuation, and style.

TIGTA also performs quality assurance through internal quality inspections of each of its four business units once every 3 years. In these inspections, each business unit is assigned responsibility for conducting the inspection of another business unit and reporting to the Deputy IG for Audit on the results. The checklist used in this review

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<sup>15</sup>Transfer pricing is a term commonly used to describe pricing arrangements for exchanging goods, services, and other property between related entities or affiliates of multinational businesses with operations in the United States and other countries.

includes steps derived from the quality assurance process of the President's Council on Integrity and Efficiency (PCIE)<sup>16</sup> and guidance from *Government Auditing Standards*. The checklist has questions that address staff qualifications, independence, professional judgment, independent referencing, audit planning, sampling plans, supervision, evidence, work papers, internal controls, illegal acts, noncompliance, abuse, and reporting.

Two internal inspections of TIGTA's business units have been completed, and two are planned for the audit activities covering fiscal years 2004 and 2005. The reviews of the Headquarters Operations and Exempt Organizations unit and the Wage and Investment Income unit found that the audits conducted by these business units were completed in compliance with U.S. generally accepted government auditing standards. In addition, the reports concluded that audit staff generally complied with Office of Audit policies and procedures. The review did find instances in which the audit teams could more closely follow policies and procedures and reported TIGTA's planned actions to address the review's conclusions.

TIGTA has obtained two external peer reviews from other IG offices since fiscal year 2000 and obtained an unqualified opinion in each review. These external quality control reviews provide TIGTA with an independent opinion on the quality control system, whether the system is in place and operating effectively, and whether the policies and applicable audit standards are being followed. The Transportation IG performed the most recent external peer review of TIGTA. The peer review report, dated January 22, 2004, concluded that the quality control system for the audit function had been designed in accordance with quality standards established by PCIE. The peer review report further states that TIGTA's quality control system provides reasonable assurance of material compliance with professional auditing standards in conducting its audits. The report also identifies opportunities for TIGTA to strengthen compliance with its quality control system for the conduct of audits. The peer review observations include aspects of continuing professional education, quality control, audit planning, evidence and work papers, the assessment of management controls, and audit reporting.

### **Audit Follow-up**

The Department of the Treasury tracks audit recommendations through the JAMES. JAMES includes all audit recommendations from TIGTA, the Treasury IG, and us on the basis of information provided by the auditors, and tracks the status of management's response and implementation. Treasury's process for tracking audit recommendations is consistent with OMB Circular No. A-50, *Audit Follow Up*, which states that audit follow-up on recommendations contained in audit reports is an integral part of good management and is a shared responsibility of agency management officials and auditors. In addition, each agency is required to establish a system to ensure the prompt and proper resolution and implementation of audit recommendations.

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<sup>16</sup>PCIE is an interagency council composed principally of the presidentially appointed and Senate-confirmed IGs, which is governed by Executive Order No. 12805 of May 11, 1992, to coordinate and enhance the work of the IGs.

The IG Act also requires that semiannual reports prepared by the IGs, including those of TIGTA, provide an identification of each significant recommendation described in previous semiannual reports for which corrective action has not been completed. In addition, *Government Auditing Standards* requires that audit plans include a consideration of the results of previous audits that could affect the current audit objectives and follow-up on known significant findings and recommendations.

Under OMB Circular No. A-50, IRS management is responsible for completing plans for corrective actions to address audit recommendations and for ensuring that corrective action is taken in response to each audit report. Each TIGTA business unit has a staff member who is a JAMES user with the ability to query the system and provide feedback on the status of individual open or closed audit report recommendations. TIGTA's semiannual reports include the status of prior audit recommendations as required by the IG Act. Moreover, in compliance with government auditing standards, TIGTA officials stated that subsequent audits follow up on prior audit recommendations. During fiscal years 2000 through 2004, JAMES reported that of 2,912 corrective actions planned by IRS management to address TIGTA's audit recommendations, 2,625, or approximately 90 percent, were closed because IRS agreed to adopt the recommendations. Of these closed recommendations, JAMES reported that about 83 percent have been fully implemented.

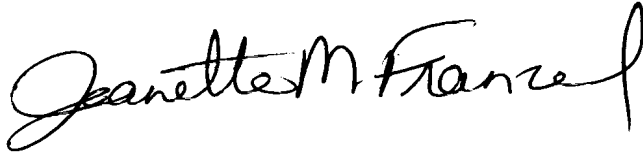
### **Agency Comments**

In written comments on a draft of this report, the Treasury Inspector General for Tax Administration generally concurred with the report contents. TIGTA staff separately offered several oral comments for clarification purposes. We considered each of the suggestions and incorporated changes as appropriate.

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As agreed with your offices, unless you announce its contents earlier, we plan no further distribution of this report until 30 days after its date. At that time, we will send copies to the Secretary of the Treasury, the Commissioner of Internal Revenue, the Treasury Inspector General for Tax Administration, the Deputy Director for Management of the Office of Management and Budget, other congressional committees, and interested parties. In addition, this report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

If you have any questions or would like to discuss this report, please contact me at (202) 512-9471 or franzelj@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report were Jackson W. Hufnagle, Assistant Director, and Clarence Whitt.

A handwritten signature in black ink that reads "Jeanette M. Franzel". The signature is written in a cursive style with a large, looped initial "J".

Jeanette M. Franzel  
Director  
Financial Management and Assurance

Enclosures – 4

**A Comparison of Inspectors General's Budget Authority and  
Agencies' Budgetary Resources,  
Fiscal Year 2004**

Dollars in millions

No.	Federal agency	IG budget authority	Agency total budgetary resources	IG budget authority as a percentage of agency budgetary resources
1	Nuclear Regulatory Commission	\$7	\$682	1.03
2	Federal Deposit Insurance Corporation	26	2,728	0.95
3	Corporation for National and Community Service	6	935 <sup>a</sup>	0.64
4	Environmental Protection Agency	51	13,152	0.39
5	Agency for International Development	37	14,633	0.25
6	Treasury Inspector General for Tax Administration	130	57,443 <sup>b</sup>	0.23
7	Department of Commerce	21	9,823	0.21
8	Department of Justice	74	37,415	0.20
9	Department of Homeland Security	93	53,879	0.17
10	Department of the Interior	42	25,109	0.17
11	Department of State	32	21,332	0.15
12	National Aeronautics and Space Administration	27	19,187	0.14
13	General Services Administration	40	28,732	0.14
14	Tennessee Valley Authority (TVA)	9 <sup>c</sup>	7,341 <sup>d</sup>	0.12
15	Department of Energy	39	36,523	0.11
16	Small Business Administration	14	14,025	0.10
17	Department of Labor	66	67,890 <sup>e</sup>	0.10
18	Department of Housing and Urban Development	101	111,556	0.09
19	Department of Veterans Affairs	65	94,564	0.07
20	Railroad Retirement Board	7	10,461 <sup>f</sup>	0.07
21	Department of Transportation	63	106,442	0.06
22	Department of Agriculture	81	142,890	0.06
23	Department of Education	46	131,766	0.03
24	Department of Health and Human Services	223 <sup>g</sup>	721,084	0.03
25	Department of Defense	179	1,014,878	0.02
26	Social Security Administration	88	562,912	0.02
27	Office of Personnel Management	16	126,269	0.01
28	Department of the Treasury	14	373,254 <sup>h</sup>	0.004
29	Central Intelligence Agency	na <sup>i</sup>	na <sup>i</sup>	na <sup>i</sup>

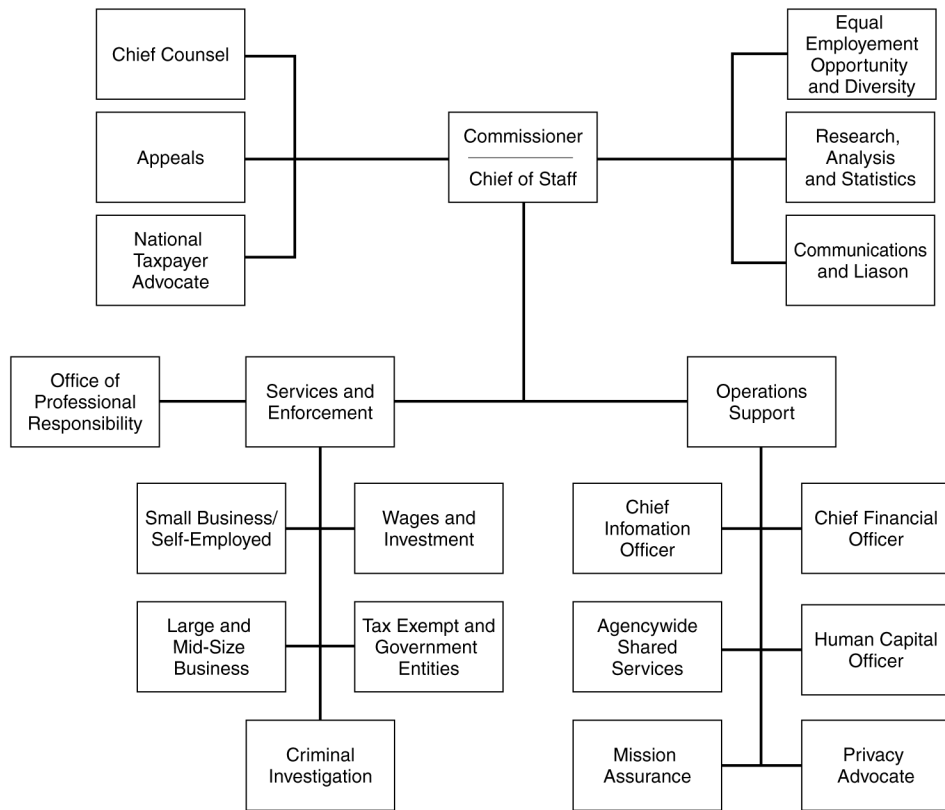
Source: *Budget of the United States Government, Fiscal Year 2006.*<sup>a</sup>Corporation for National and Community Service's fiscal year 2006 congressional budget justification.<sup>b</sup>IRS's total federal funds.<sup>c</sup>Amounts for the TVA Inspector General are fiscal year 2005 estimates.<sup>d</sup>Gross Fund Authority.<sup>e</sup>Department of Labor totals exclude Pension Benefit Guaranty Corporation.<sup>f</sup>Railroad Retirement Board fiscal year 2004 Performance and Accountability Report.<sup>g</sup>Includes budget authority to combat Medicare fraud.<sup>h</sup>Treasury's agency budgetary resources exclude IRS and include interest on Treasury debt securities.<sup>i</sup>Central Intelligence Agency and IG budgets are not available.



**Internal Revenue Service Organization**

The Internal Revenue Service’s (IRS) four business divisions have missions directed at groups of taxpayers. (See fig. 3.) The Wage and Investment Division serves filers with wage and investment income; (2) the Small Business and Self-Employed Division serves self-employed individuals, individual filers with income from rents, royalties, pensions, annuities, partnerships, estates, and trusts, and small businesses with assets up to \$10 million; (3) the Large and Mid-Size Business Division serves businesses with assets of more than \$10 million; and (4) the Tax-Exempt and Government Entities Division serves small local community organizations, municipalities, major universities, pension funds, state governments, Indian tribal governments, and tax-exempt bond issuers. Along with the Criminal Investigation unit, these divisions report to the Deputy Commissioner for Services and Enforcement.

**Figure 3: IRS Organization**



Source: IRS.

Additional IRS offices report to the IRS Commissioner, including the Office of Appeals, which resolves tax controversies between taxpayers and IRS without litigation; the Taxpayer Advocate Service, headed by the National Taxpayer Advocate, which helps taxpayers resolve problems that have not been resolved through normal IRS channels and recommends changes to the Congress to improve the tax system; and Operations Support and other offices that support IRS activities.

**Coverage of High-Risk Areas and Management Challenges in  
Fiscal Year 2004 TIGTA Audit Reports**

	<b>GAO 2005<sup>a</sup> high-risk areas</b>	<b>GAO 2003<sup>b</sup> high-risk areas</b>	<b>Management challenges identified by TIGTA in 2004<sup>c</sup></b>	<b>Fiscal year 2004 TIGTA audit reports</b>
<b>Areas addressed by TIGTA<sup>d</sup> audits</b>	Systems modernization	Systems modernization	Systems modernization	15
		Financial management	Integrating performance and financial management	13
	Enforcement of tax laws	Collection of unpaid taxes	Tax compliance initiatives	29
			Taxpayer protection and rights	17
		Earned income tax credit noncompliance	Erroneous and improper payments	5
			Quality customer service operations	26
			Security of IRS	18
			Processing returns and implementing tax law changes	10
			Complexity of the tax law	2
			Human capital	1
<b>Audits of management challenges</b>				<b>136</b>
<b>Other audits</b>				3
<b>Total TIGTA audits</b>				<b>139</b>
<b>Contract audits<sup>e</sup></b>				50
<b>Total audits</b>				<b>189</b>

Sources: GAO's 2003 and 2005 High Risk Series, and TIGTA's fiscal year 2004 audit reports.

<sup>a</sup>GAO, *High-Risk Series: An Update*, GAO-05-207 (Washington, D.C.: January 2005).

<sup>b</sup>GAO, *High-Risk Series: An Update*, GAO-03-119 (Washington, D.C.: January 2003).

<sup>c</sup>Department of the Treasury, *Performance and Accountability Report FY 2004*.

<sup>d</sup>The Department of the Treasury Inspector General for Tax Administration.

<sup>e</sup>Contract audits performed for TIGTA by the Defense Contract Audit Agency.

Comments from the Department of the Treasury



INSPECTOR GENERAL  
for TAX  
ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20005

September 14, 2005

Ms. Jeanette M. Franzel  
Director  
Financial Management and Assurance  
U.S. Government Accountability Office  
441 G Street, NW  
Washington, DC 20548

Dear Ms. Franzel:

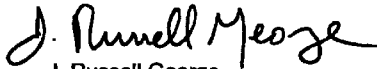
This is the Treasury Inspector General for Tax Administration (TIGTA) response to the Government Accountability Office (GAO) draft report, "Activities of the Treasury IG for Tax Administration," Report Number GAO-06-18R.

I appreciate your conducting a thorough and comprehensive review of many of TIGTA's activities. We are proud of our accomplishments and are pleased that the GAO report documents several of the successes we have achieved.

According to my staff, the GAO staff assigned to this review were professional and fair, which resulted in a balanced and accurate draft report. We generally concur with the contents of the draft report. Ms. Patricia Greiner of my staff has contacted Mr. Jack Hufnagle of GAO to discuss some of our comments and suggestions to correct some technical inaccuracies in the report.

If you have any questions or need additional information, please contact me or Ms. Greiner at (202) 622-8482. Once again, thank you for reviewing TIGTA, and I look forward to continuing to work with GAO to achieve our mutual goal of improving performance and accountability in the Federal Government.

Sincerely,

  
J. Russell George  
Inspector General

(194504)

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