



# Audit Report



OIG-19-037

FINANCIAL MANAGEMENT

Audit of Treasury's Compliance With the IPERA Requirements  
for Fiscal Year 2018

June 3, 2019

Office of  
Inspector General

Department of the Treasury

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## Abbreviations

ACTC	Additional Child Tax Credit
AFR	Agency Financial Report
AOTC	American Opportunity Tax Credit
BEP	Bureau of Engraving and Printing
CTC	Child Tax Credit
EITC	Earned Income Tax Credit
EO	Executive Order
IPERA	Improper Payments Elimination and Recovery Act of 2010
IPERIA	Improper Payments Elimination and Recovery Improvement Act of 2012
IPIA	Improper Payments Information Act of 2002
IRS	Internal Revenue Service
NRP	National Research Program
OIG	Office of Inspector General
OMB	Office of Management and Budget
PTC	Premium Tax Credit
RCG	Risk and Control Group
SSA	Social Security Administration
SSN	Social Security Number
TIGTA	Treasury Inspector General for Tax Administration
Treasury	Department of the Treasury

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*The Department of the Treasury  
Office of Inspector General*

June 3, 2019

David F. Eisner  
Assistant Secretary for Management

This report presents the results of our audit of the Department of the Treasury's (Treasury) compliance with improper payment reporting requirements for fiscal year 2018. The objective of our audit was to assess and report on Treasury's overall compliance with requirements contained in the Improper Payments Elimination and Recovery Act of 2010 (IPERA),<sup>1</sup> enacted to help Federal agencies strengthen the framework for reducing and reporting improper payments. As part of our audit, we also assessed Treasury's compliance with additional improper payment reporting requirements set forth in Executive Order (EO) 13520, *Reducing Improper Payments and Eliminating Waste in Federal Programs*, and the Improper Payments Elimination and Recovery Improvement Act of 2012 (IPERIA).<sup>2</sup> Appendix 1 provides more detail of the objective, scope, and methodology of our audit.

This report also summarizes the results of the Treasury Inspector General for Tax Administration's (TIGTA) assessment of the Internal Revenue Service's (IRS) compliance with improper payment reporting requirements in fiscal year 2018. This summarization includes the IRS management response to TIGTA's audit findings. TIGTA issued its report on May 13, 2019, which is included in its entirety as appendix 2 of this report.

## Results in Brief

Treasury met many IPERA requirements, but was not in compliance for fiscal year 2018 due to IRS not reducing the overall Earned

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<sup>1</sup> Pub. L. No. 111-204, 124 Stat. (July 22, 2010)

<sup>2</sup> Pub. L. No. 112-248, 126 Stat. (January 10, 2013)

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Income Tax Credit (EITC) improper payment rate to less than 10 percent of the program payments. IRS estimates that 25.06 percent (\$18.4 billion) of EITC payments were issued improperly in fiscal year 2018. This is the 8<sup>th</sup> consecutive year that we have determined that Treasury is noncompliant with IPERA due to IRS's EITC reporting deficiencies. We determined that Treasury was in compliance with all other IPERA, EO 13520, and IPERIA improper payment reporting requirements.

We also reviewed Treasury's risk assessment process and recapture audit programs to determine the accuracy and completeness of Treasury improper payments reporting. Our audit identified the need for Treasury to improve its IPERA implementation process.

Although we concluded Treasury conducted program specific risk assessments, we found that Treasury needs to improve its risk assessment process to ensure the risk rating determined for each program and activity is accurate and reasonable. We are recommending the Assistant Secretary for Management ensures that Treasury (1) updates its Qualitative Risk Assessment Questionnaire to provide a reasonable basis for its risk ratings; and (2) revises the agency's IPERA implementation guide to require components to submit appropriate and sufficient supporting documentation for their risk assessment results.

In addition, we noted that the Bureau of Engraving and Printing (BEP) can improve its payment recapture audit reporting. BEP's submission to Treasury for the payment recapture audits did not include certain required information. We recommend the Assistant Secretary for Management ensures that BEP and other Treasury components submit complete payment recapture audit information to the Risk and Control Group (RCG) as required by Treasury's IPERA guidance.

We determined that Treasury complied with the requirement to publish its Agency Financial Report (AFR) and any accompanying material required by the Office of Management and Budget (OMB) on its website for fiscal year 2018, and posted required improper payment information to the [paymentaccuracy.gov](http://paymentaccuracy.gov) website.

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In a written response, management concurred with our three recommendations to improve its risk assessment process and to address the payment recapture audit reporting deficiencies identified in our report. Management noted that it has updated its fiscal year 2019 Department-wide IPERA compliance guidance to include a revised Qualitative Risk Assessment Questionnaire that will provide a more reasonable basis for assessing if a program is susceptible to significant improper payments. Management also noted that Treasury components will be required to submit appropriate and sufficient justification in support of their risk assessment responses. Management noted that it will actively monitor BEP and other components to ensure they more accurately and timely complete their payment recapture audit reporting prior to submission.

Management's response to our report is provided in appendix 4.

We also summarized TIGTA's audit results in this report. TIGTA determined that IRS continues to incorrectly rate the improper payment risk associated with the Additional Child Tax Credit (ACTC), American Opportunity Tax Credit (AOTC), and Premium Tax Credit (PTC), which results in a significant understatement of improper payments. IRS's ACTC, AOTC, and PTC were also erroneously identified as medium risk programs instead of as high risk programs. The incorrect rating results in the exclusion of required reporting by IRS in the AFR.

TIGTA identified over 2.2 million tax returns, which were not selected for review by the IRS, with an income discrepancy of \$1,000 or greater between the amount reported on the tax returns and the amount reported on forms W-2. These taxpayers received over \$10.1 billion in credits, which included \$6.0 billion in EITCs and over \$1.9 billion in ACTC. However, due to limited resources, the IRS does not address the majority of potentially erroneous EITC claims despite having established processes that identify billions of dollars in potentially erroneous EITC payments.

Additionally, TIGTA identified that the IRS has initiated corrective actions in an effort to address prior deficiencies reported by TIGTA. These efforts are resulting in the improved identification and recovery of erroneous EITC payments. TIGTA recommended that IRS should, based on the results of the nonwork Social Security

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Number (SSN)<sup>3</sup> pilot conducted in processing years 2018 and 2019, implement a process to systemically identify and evaluate tax returns filed by individuals who have nonwork SSNs to prevent erroneous refunds of EITCs and ACTCs.

Moreover, TIGTA evaluated IRS compliance with various improper payment reporting requirements, including the reporting of supplemental measures. TIGTA determined that IRS reported on actions the IRS intends to take to prevent future EITC improper payments, and efforts taken or planned to recapture EITC improper payments in the Treasury's fiscal year 2018 AFR.

TIGTA's report and the IRS management response are provided in appendix 2.

## Background

### Improper Payments Compliance and Reporting Requirements

Under the Improper Payments Information Act of 2002 (IPIA),<sup>4</sup> Federal agencies were required to review and identify programs and activities susceptible to improper payments on an annual basis and report estimates of improper payments to Congress along with actions to reduce estimated improper payments that exceeded \$10 million.

In 2009, EO 13520 required Federal agencies to intensify their efforts to eliminate payment error, waste, fraud, and abuse in major Federal programs while continuing to ensure that these programs serve and provide access to their intended beneficiaries. It increased Federal agencies' accountability and required that Federal agencies provide their agency Inspector General with detailed information on efforts to identify and reduce the number of improper payments in Federal programs with the highest dollar value of improper payments.

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<sup>3</sup> A nonwork SSN is issued for obtaining Federal benefits (e.g., Medicaid or food stamps) and is not valid for work. The Social Security Administration has issued almost eight million "NOT VALID FOR EMPLOYMENT" SSNs since 1972 to individuals who do not have authorization to work in the United States.

<sup>4</sup> Pub. L. No. 107-300, 116 Stat. (November 26, 2002)



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Following EO 13520, on July 22, 2010, the President signed IPERA into law. IPERA amended IPIA, strengthening agencies' program reviews and reporting requirements. IPERA expanded the types of payments to be reviewed and established the requirement for agencies to conduct recovery audits if cost-effective. IPERA also required Inspectors General to report on their respective agencies' compliance with IPERA each fiscal year.

IPERIA further expanded agency improper payment requirements to foster greater agency accountability. IPERIA requires the OMB Director to identify a list of high priority Federal programs for greater levels of oversight and review. For those high priority programs, IPERIA requires OMB to coordinate with agencies to establish annual targets and semi-annual or quarterly actions for reducing improper payments. Agencies are required to submit an annual report to the Inspector General on actions (1) taken or planned to recover improper payments and (2) intended to prevent future improper payments. The report is also required to be available to the public on a central website.

For fiscal year 2018, EITC was Treasury's only OMB-identified high priority program.

In accordance with IPERIA and EO 13520, Offices of Inspector General (OIG) are required to review and report on their respective agencies' OMB-designated high priority programs, if any. Specifically, OIGs are to review management's assessment of the level of risk, the quality of the improper payment estimates and methodology, and the oversight and financial controls in place to identify and prevent improper payments. Recommendations, if any, are to be provided for modifying agency plans related to its high priority programs to include improvements for determining and estimating improper payments.

In Memorandum 15-02 dated October 20, 2014, OMB issued revisions to OMB Circular No. A-123, Appendix C, to provide agencies guidance on implementing all improper payment compliance and reporting requirements. In June 2018, OMB further revised the OMB guidance (OMB M-18-20) in an effort to transform the improper payment compliance framework to create a more unified, comprehensive, and less burdensome set of requirements. According to OMB M-18-20, all agencies should institute a

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systematic method of reviewing all programs once every three years to determine the programs' improper payment risk. Additionally, agencies are required to take into account the following seven risk factors that are likely to contribute to a susceptibility of significant improper payments:

- Whether the program or activity reviewed is new to the agency;
- The complexity of the program or activity reviewed, particularly with respect to determining correct payment amounts;
- The volume of payments made annually;
- Whether payment eligibility decisions are made outside of the agency;
- Recent major changes in program funding, authorities, practices, or procedures;
- The level, experience, and quality of training for personnel responsible for making program eligibility determination or certifying that payments are accurate; and
- Significant deficiencies in the audit reports of the agency or other relevant management findings that might hinder accurate payment certification.

### **Treasury's Improper Payment Risk Assessment**

Treasury issued *Fiscal Year 2018 Treasury Implementation Guide for OMB Circular A-123 Appendix C: Requirements for Payment Integrity Improvement* (Treasury's IPERA Guidance) to all components. Treasury also provided all components two tools—the Qualitative Risk Assessment Questionnaire and Quantitative Risk Assessment Summary—to assess the level of risk for each payment type, such as Federal employee payments including payroll, contract payments, claims and/or vouchers, grants, and travel cards. The Qualitative Risk Assessment Questionnaire, which consists of sixty-two questions, must be applied to each payment type within each Fund Group.<sup>5</sup> Using component responses, the Qualitative Risk Assessment Questionnaire computes a per-program risk score which determines the risk assessment rating of low, medium, or high.

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<sup>5</sup> A Fund Group is a set of activities recognized as a program within the component.

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After each component completes and reviews its risk assessment, the results are provided to the RCG. For programs at medium risk for incurring significant improper payments, the component is required to conduct an internal control review. For any program identified as having a high risk for improper payments, the responsible component is also required to provide the following information for inclusion in Treasury's AFR:

- estimates of improper payments,
- root causes of improper payments,
- corrective action plan to reduce improper payments,
- a summary of internal controls over the improper payment process, and
- an improper payments reduction outlook.

For fiscal year 2018, Treasury identified EITC as its only high risk program. The risks of improper payments for AOTC, ACTC, and PTC were rated as medium.

### **Payment Recapture Audits**

IPERA requires agencies to conduct recovery audits (also referred to as payment recapture audits) to prevent, detect, and recover overpayments, if conducting such audits would be cost-effective, for each program and activity that expends \$1 million or more annually. A payment recapture audit is a review and analysis of an agency's or program's accounting and financial records, and other pertinent information supporting its payments that is specifically designed to identify overpayments.

Treasury's IPERA Guidance requires each component to complete, certify, and submit a worksheet providing a consistent reporting format that includes information on the results of the component's payment recapture audits and treatment of recaptured improper payments. The worksheets are submitted to the RCG for review and the data are consolidated and reported in the AFR.

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### **Treasury's Improper Payment Reporting**

On November 15, 2018, Treasury published its fiscal year 2018 AFR and subsequently posted it to its website. Included in that report was the required improper payments information with the following accompanying information:

- risk assessment and results;
- improper payment estimates for the EITC program;
- statistical sampling methodology used to arrive at the estimated improper payments for fiscal year 2018;
- summary discussing the supplemental measures for the EITC program;
- IRS's strategy of identifying and reducing EITC refund claims in fiscal year 2018;
- description of the corrective action plans for the EITC program, including the root causes and projected result for fiscal year 2019;
- description of barriers, which limit the IRS's corrective actions in reducing overclaims in the EITC program;
- discussion of annual payment recapture audit efforts; and
- results of Treasury's Do Not Pay Initiative<sup>6</sup> operation.

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<sup>6</sup> IPERIA requires agencies to ensure that a thorough review of available databases occurs prior to the release of Federal funds to help verify eligibility and prevent certain improper payments. The Do Not Pay Initiative provides resources for agencies to review payment or award eligibility for purposes of identifying and preventing improper payments.

## Treasury OIG Audit Results

According to OMB Circular A-123, an agency is required to meet six specific requirements to be compliant with IPERA. The six requirements are (1) publishing an AFR; (2) conducting a risk assessment; (3) publishing an improper payment estimate; (4) publishing corrective action plans; (5) publishing and meeting reduction targets; and (6) reporting a gross improper payment rate of less than 10 percent. We found that Treasury did not comply with IPERA for fiscal year 2018 because the IRS has not reduced the overall improper payment rate to less than 10 percent for the EITC program. Specifically, the IRS reported an EITC improper payment rate of 25.06 percent (or \$18.4 billion). We discuss this further in our Finding 1 below. Treasury did comply with the other IPERA requirements as outlined in Table 1. In addition, appendix 3 provides a summary of Treasury programs' compliance with IPERA reporting criteria.

Table 1: Treasury's Compliance with IPERA Requirements

Improper Payment Criteria	Compliance
Publish an AFR or PAR	Yes
Conduct risk assessment	Yes
Publish an improper payment estimate	Yes
Publish corrective action plans	Yes
Publish and meet reduction targets	N/A*
Report a gross improper payment rate of less than 10 percent	No

Source: OIG's and TIGTA's review of the Department of the Treasury Agency Financial Report for Fiscal Year 2018.

\* Treasury and OMB developed a series of EITC supplemental measures for use in lieu of reduction targets.

We also reviewed Treasury's risk assessment process and recapture audit programs to determine the accuracy and completeness of Treasury improper payments reporting. We noted that Treasury included the required improper payment disclosures in the AFR, and complied with the requirement to post required improper payment information to the [paymentaccuracy.gov](http://paymentaccuracy.gov) website. However, we identified opportunities for Treasury to

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improve its risk assessment process and payment recapture audit reporting.

## Finding 1

### **Treasury Was Not in Compliance with IPERA for Fiscal Year 2018**

We determined that Treasury was not in compliance with IPERA for fiscal year 2018 due to IRS not reducing the overall improper payment rate for the EITC program to less than 10 percent. IRS estimates that 25.06 percent (or \$18.4 billion) in EITC payments were issued improperly in fiscal year 2018. IPERA requires a gross improper payment rate of less than 10 percent for each program and activity for which an improper payment estimate was obtained and published in the AFR. This is the 8<sup>th</sup> consecutive year we have determined that Treasury is not in compliance with IPERA due to IRS's EITC improper payments reporting deficiencies.

On June 15, 2015, Treasury notified Congress of several proposed statutory changes to reduce the improper payment rate of the EITC program. As part of its notification, Treasury informed Congress that the Administration's fiscal year 2016 budget included proposals that were intended to help improve EITC compliance by:

- Accelerating due dates for filing information returns, including Form *W-2, Wage and Tax Statement (W-2)*, to facilitate early detection of income misreporting and fraud, including identity theft. This would allow the IRS to identify erroneous EITC claims and stop the refunds before they are paid;
- Regulating tax return preparers, which would help reduce erroneous EITC claims by weeding out unscrupulous and incompetent preparers;
- Providing more flexible correctable error authority, which would help the IRS to deny certain erroneous claims, including erroneous EITC claims, before refunds are paid;
- Increasing civil and criminal penalties for tax-related identity theft, which would prevent some erroneous EITC claims; and
- Simplifying the rules for claiming the EITC for taxpayers who reside with a child that they do not claim as a dependent, which would reduce taxpayer burden and improve EITC compliance.

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Congress passed the Consolidated Appropriations Act of 2016, which became law on December 18, 2015.<sup>7</sup> The law provides the IRS with additional tools to reduce EITC improper payments. The provisions include:

- Effective for tax returns filed after December 18, 2015, individuals (primary, secondary, and dependent) must have a valid SSN issued on or before the due date of the tax return to be eligible to claim the EITC.
- Beginning in January 2017, employers and third-parties were required to file W-2s, and report on employee income by January 31 each year. These forms were previously due no later than March 31 (February 28 for paper filed forms) each year. The Act also prohibits the IRS from issuing tax refunds prior to February 15 when the tax return includes the EITC.

However, the Act did not expand the IRS's authority to systematically correct the erroneous claims that are identified when tax returns are processed. According to TIGTA, without expanded error correction authority, IRS will not be able to prevent the issuance of billions of dollars in improper EITC payments.

IRS has submitted a legislative proposal requesting correctable error authority as part of its fiscal year 2020 budget submission. According to TIGTA, IRS continues to request additional authority that would allow it to correct tax returns with identified erroneous refundable credit claims during processing. TIGTA made no recommendation related to this finding.

## **Finding 2**

### **Treasury Needs to Improve its Risk Assessment Process**

Treasury needs to improve its risk assessment process to ensure the risk rating determined for each program and activity is accurate and reasonable. The qualitative risk assessment program is not properly designed to demonstrate that the weight assigned to risk

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<sup>7</sup> Pub. L. No. 114-113, 129 Stat. 2242 (December 18, 2015)

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factors and the basis for its determination of level of improper payment risk are reasonable.

We determined that the Qualitative Risk Assessment Questionnaire utilized to assess programs for fiscal year 2018 incorporated the seven IPERA risk factors, however, the basis for the calculation of each program and activity risk rating was not reasonably supported. Specifically, we noted that the questionnaire calculates the risk rating by the summation of numerical values assigned to each question's response of either "Yes," "No," or "Not Applicable". However, no explanation was provided to support the basis for which the numerical values were assigned to each question or how each question specifically addressed the key IPERA risk factors. Additionally, although Treasury's fiscal year 2018 IPERA Guidance states that components must maintain support for each answer in the Qualitative Risk Assessment Questionnaire to enable year over year comparison to facilitate interaction with oversight bodies, the components were not required to submit the supporting documentation with the completed Qualitative Risk Assessment Questionnaire.

As a result, we could not determine if Treasury's process of utilizing the Qualitative Risk Assessment Questionnaire for determining its programs' susceptibility to significant improper payments was reasonable. According to RCG officials, the Qualitative Risk Assessment Questionnaire was developed to assess the effectiveness of internal controls relating to improper payments; however, Treasury did not put additional weight on the IPERA risk factors that are likely to contribute to a risk of significant improper payments.

### **Recommendations**

We recommend the Assistant Secretary for Management ensures that Treasury:

1. Updates its Qualitative Risk Assessment Questionnaire to provide a reasonable basis for its risk ratings.
2. Revises the agency's IPERA implementation guide to require components to submit appropriate and sufficient supporting documentation for their risk assessment results.



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## Management Response for Recommendations 1 and 2

Treasury management stated that it has updated its fiscal year 2019 Department-wide IPERA compliance guidance to include a revised Qualitative Risk Assessment Questionnaire that will provide a more reasonable basis for assessing if a program is susceptible to significant improper payments. Additionally, Treasury components will be required to submit appropriate and sufficient justification in support of their risk assessment responses.

The implementation date for management's proposed corrective action is November 15, 2019.

### OIG Comment

Management's response meets the intent of our recommendations.

## **Finding 3**

### **Treasury Needs to Ensure That BEP and Other Treasury Components Submit Complete Payment Recapture Audit Information**

We found that the documentation supporting BEP's payment recapture audit was not complete. Specifically, BEP's payment recapture audit results worksheet submitted to the RCG for inclusion in Treasury's fiscal year 2018 AFR did not contain the following required information:

- reviewer's certification,
- recapture audit program description, and
- supporting documentation for the amount subject to review and total contract payments reviewed.

According to BEP officials, the lack of documentation supporting BEP's payment recapture audit is attributed to the turnover of key personnel in the accounting division compounded by a lack of up-to-date written standard operating procedures for the process. Upon our request, BEP provided us supporting documentation for the amount subject to payment recapture audits; however, BEP was not able to provide support for the total contract payments reviewed. According to BEP, they could not locate the sample file

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that identified which of the payments in the population were reviewed.

Treasury's IPERA Guidance requires that each Treasury component submit a certified and completed Payment Recapture Audit Results spreadsheet, providing background on the component's payment recapture audit program and information about the results of the payment recapture audits. Components should submit supporting documentation for all amounts reported on the spreadsheet. Additionally, components must maintain documentation supporting the completed Payment Recapture Audit Results spreadsheet for 5 fiscal years.

Ultimately, Treasury's fiscal year 2018 AFR included all required payment recapture audit information. However, it should be noted that inclusion of recapture audit information in the AFR, without supporting documentation and review of that documentation, may lead to the reporting of erroneous and unreliable information.

### **Recommendation**

We recommend the Assistant Secretary for Management ensures that BEP and other Treasury components submit complete payment recapture audit information to the RCG as required by Treasury's IPERA guidance.

### **Management Response for Recommendation 3**

Treasury management stated that it will actively monitor BEP and other components to ensure they more accurately and timely complete their payment recapture audit reporting prior to submission.

The implementation date for management's proposed corrective action is November 15, 2019.

### **OIG Comment**

Management's response meets the intent of our recommendation.

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## Treasury Inspector General for Tax Administration Audit Results

The following are excerpts from TIGTA's fiscal year 2018 IPERA audit report. TIGTA made one recommendation in their report.

### **Finding 1                      The Internal Revenue Service Is Not in Compliance With Improper Payment Reporting Requirements**

TIGTA reported that IRS continues to incorrectly conclude improper payments associated with the Additional Child Tax Credit (ACTC), AOTC, and PTC credits do not have a high risk. The IRS once again erroneously rated the risk associated with ACTC and AOTC as medium which is contrary to the IRS's own National Research Program (NRP) and compliance data, which when analyzed shows a high risk of improper payments. As a result, the IRS is significantly understating its estimate of improper payments associated with refundable tax credits in its reports to the OMB and Congress. Furthermore, the inaccurate risk rating results in the exclusion of required reporting by the IRS in the AFR.

TIGTA also reported that the IRS compliance studies identified a high risk of improper payments associated with the ACTC and AOTC, yet the IRS erroneously classified these as a medium risk. TIGTA's review of the IRS's compliance studies found the results to be consistent with TIGTA's prior estimated improper payments for these two credits for which the dollar amount exceeds the IPERA criteria for a high risk rating. Based on the compliance studies conducted by the IRS, the potential estimated improper payment rate for ACTC during tax years 2009 through 2011 was 33 percent (\$8.7 billion) and 31 percent (\$5.3 billion) for AOTC during tax year 2012. Both continue to exceed the IPERA criteria for a significant risk of improper payments and, as such, should be identified as high risk programs. IRS reported in the Fiscal Year 2018 AFR that it will begin developing a methodology that will quantitatively analyze and estimate improper payments for the ACTC and AOTC. This methodology will use data from the NRP to calculate ACTC and AOTC error rates going forward.

In addition, the quantitative analysis identifies the risk of improper Net PTC payments as high, yet the IRS erroneously classifies it as a medium risk. In April 2016, TIGTA reported that the IRS's

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methodology to assess the PTC did not include a quantitative assessment and, as such, its assessment of an improper payment risk associated with the PTC is unreliable. In fiscal year 2018, the IRS continued to use a qualitative assessment and incorrectly rated the improper payment risk associated with the PTC as medium. However, in October 2018, the IRS completed a quantitative analysis of the Net PTC using the NRP data to calculate a Net PTC error rate for Tax Year 2014 tax returns (the first year for which the PTC was available) in response to a recommendation to an audit completed by the Government Accountability Office.<sup>8</sup> According to the IRS's own analysis of its compliance data, the estimated error rate was 41 percent (\$440 million) of Net PTC payments. The IRS's analysis confirmed that Net PTC improper payments, as defined by OMB definition, would likely exceed the improper payment reporting thresholds of a high risk.

IRS management cautioned that the Net PTC error rates may change as additional compliance data becomes available. Although the NRP sample provides unbiased estimates of compliance, the number of returns claiming Net PTC in the Tax Year 2014 sample used for the analysis was small and the margin of error for the Net PTC overclaim percentage is approximately  $\pm 18$  percentage points. TIGTA reported in December 2018, a total of \$3.7 billion claimed in Advance PTCs was in excess of the amount of PTCs to which taxpayers were entitled. Of this amount, a total of \$1 billion is not required to be repaid.

TIGTA's evaluation of IRS's improper payment risk assessment methodology has continually shown that the IRS's repeated use of qualitative evaluation does not provide an accurate assessment of the risk of improper payments. Furthermore, a quantitative evaluation is also needed to accurately assess the risk of the PTC.

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<sup>8</sup> GAO. Ref. No. GAO-17-467, *Improper Payments: Improvements Needed in CMS and IRS Controls over Health Insurance Premium Tax Credit* (July 2017).

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## **Finding 2**

### **Assessment of Fiscal Year 2018 Compliance With Earned Income Tax Credit (EITC) Improper Payment Reporting Requirements**

As TIGTA previously reported, the IRS has not reduced the overall EITC improper payment rate to less than 10 percent but it has been approved for this exception to the annual reduction target reporting requirement. As an alternative, the Department of the Treasury and the OMB collaborated on the development of a series of EITC supplemental measures for use in lieu of reduction targets, which OMB approved in 2014. The supplemental measures are:

- The Annual Error Rate – identifies the percentage of total EITC payments that were improper
- The Amount of Revenue Protected – shows the total value of erroneous payments prevented or recovered through compliance activities
- The Amount of Revenue Protected From Paid Preparer Treatments – shows dollars erroneously or fraudulently claimed by paid tax preparers but not paid out, or recovered by Treasury Department
- The Number of Preparer Due Diligence Penalties Proposed – reflects the effectiveness of the Treasury’s efforts to ensure that paid tax preparers are submitting accurate, non-fraudulent EITC claims on behalf of taxpayers

## **Finding 3**

### **Notwithstanding Earlier Income and Withholding Reporting, a Majority of Discrepancies Are Still Not Addressed Due to Limited Resources**

TIGTA’s analysis of Tax Year 2017 tax returns identified over 22.8 million Tax Year 2017 tax returns that claimed the EITC and/or ACTC. TIGTA matched Forms W-2, Wage and Tax Statement, received by the IRS as of December 27, 2018, to the wages reported on the 22 million tax returns to evaluate whether the income reported by the taxpayers on these tax returns was supported by third-party Forms W-2. TIGTA identified over 2.2 million tax returns with an income discrepancy of \$1,000 or greater from what was reported on the return to what was

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reported on Forms W-2 that were not selected for further review by the IRS. Refunds associated with these tax returns totaled over \$10.1 billion, which included \$6.0 billion in EITC and over \$1.9 billion in ACTC. For 278,174 of the returns, TIGTA identified that the IRS received no third party Forms W-2 supporting the wages reported on the returns (for which over \$1.0 billion in EITCs and/or ACTCs was paid).

The amount of EITC and ACTC a taxpayer receives is directly related to the amount of income reported on the tax return. As such, some taxpayers may be motivated to erroneously report more or less income to increase the amount of refundable credits they could receive. However, as TIGTA continues to report, IRS compliance resources are limited. Consequently, the IRS does not address the majority of potentially erroneous EITC claims despite having established processes that identify billions of dollars in potentially erroneous EITC payments

For example, TIGTA continues to report that the IRS's use of traditional compliance tools will not provide any significant reduction in refundable credit improper payments. Without additional tools and authorities, the IRS will continue to issue billions of dollars each year in improper refundable credit payments.

TIGTA also reported that the IRS has repeatedly requested additional authority that would allow it to correct tax returns during processing when:

- The information provided by the taxpayer does not match the information contained in Government databases.
- The taxpayer has exceeded the lifetime limit for claiming a deduction or credit.
- The taxpayer has failed to include documentation with his or her return that is required by statute.

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## **Finding 4**

### **Actions Are Being Taken to Address Our Prior Recommendations**

TIGTA reported that the IRS has initiated corrective actions in an effort to address prior deficiencies reported by TIGTA. In July 2017, TIGTA reported that the IRS still had not established processes to prevent individuals who have a nonwork SSN from receiving the EITC. In response, the IRS initiated a pilot program to identify 500 tax returns with EITC claims during processing in which claimants were issued a nonwork SSN and, as such, do not qualify for the EITC. For the 2018 Filing Season, IRS management indicated that they identified 341 tax returns for which taxpayers agreed that they were not entitled to the EITC or did not provide a valid response within the suspense time frame. As a result, the IRS protected approximately \$1.3 million in revenue. For the 2019 Filing Season, the IRS expanded the testing to 1,000 selections over a 10-week period.

Furthermore, IRS has taken steps to use Social Security Administration (SSA) self-employment income information to improve its audit selection process in response to TIGTA's prior audit recommendations. In calendar year 2017, the IRS developed methods to scan the SSA self-employment income adjustment records and convert the images to digital data as an interim solution. As of September 2018, the IRS has created 1,468 exam cases from 11,552 leads through the scanning process. TIGTA reported that although SSA started its development effort (development of the fully digital transfer from the SSA to the IRS), the programming will not be completed until after the memorandum of understanding has been signed between the agencies. IRS management expects the memorandum of understanding to be signed by the end of fiscal year 2019.

### **Recommendation**

In its report, TIGTA recommended that the IRS implement a process to systemically identify and evaluate all tax returns filed by individuals who have nonwork SSNs to prevent erroneous refunds of EITCs and ACTCs.

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TIGTA's report and the IRS management response are provided in appendix 2 of this report.

\* \* \* \* \*

We appreciate the courtesy and cooperation extended to our staff during this audit. Major contributors to this report are listed in appendix 5. A distribution list for this report is provided as appendix 6. If you have any questions, you may contact me at (202) 927-0009, or Catherine Yi, Audit Manager, at (202) 927-5591.

/s/  
James Hodge  
Director, Financial Audits



The overall objective of our audit was to determine whether the Department of the Treasury (Treasury) complied with the improper payment reporting requirements for fiscal year 2018. We assessed Treasury's compliance with the reporting requirements set forth in the Improper Payments Elimination and Recovery Act of 2010 (IPERA); Executive Order 13520, *Reducing Improper Payments and Eliminating Waste in Federal Programs*; and the Improper Payment Elimination and Recovery Improvement Act of 2012 (IPERIA). Our audit scope did not include the review of programs and activities administered by the Internal Revenue Service (IRS). The Treasury Inspector General for Tax Administration (TIGTA) is responsible for the audit of IRS's compliance with improper payment reporting requirements.

To accomplish our objective, we reviewed applicable laws, regulations, and guidance issued by the Office of Management and Budget (OMB), and *FY 2018 Treasury Implementation Guide for OMB Circular A-123 Appendix C: Requirements for Payment Integrity Improvement*; reviewed Treasury's fiscal year 2018 Annual Financial Report; interviewed Departmental Offices and component entities' personnel; and performed testing of Treasury's risk assessments and payment recapture audit programs.

To determine compliance with IPERA and OMB guidance, we reviewed the fiscal year 2018 Annual Financial Report and any accompanying information to assess whether Treasury had:

- published an Annual Financial Report for the most recent fiscal year and posted that report and any accompanying materials required by OMB on Treasury's website;
- conducted a program specific risk assessment for each program or activity that conforms with IPERIA, if required;
- published improper payment estimates for all programs and activities identified as susceptible to significant improper payments under its risk assessment, if required;
- published programmatic corrective action plans in the Annual Financial Report, if required;
- published, and is meeting, annual reduction targets for each program assessed to be at risk and estimated for improper payments, if required and applicable; and

- reported a gross improper payment rate of less than 10 percent for each program and activity for which an improper payment estimate was obtained and published in the Annual Financial Report.

To assess Treasury's risk assessment process, we randomly selected a statistical sample of 10 of 54 non-IRS programs identified by Treasury for risk assessment. To determine the completeness and accuracy of the information reported and compliance with the applicable guidance for the sample, we reviewed the program risk assessments and supporting documentation. We conducted interviews of Treasury personnel involved in the risk assessment and review process. We also provided the 10 selected components with an Office of Inspector General questionnaire and used their responses to evaluate their risk assessment methodologies.

To assess Treasury's payment recapture audit program, we selected a statistical sample of 8 of 20 reporting entities on Treasury's recapture audit. To determine the completeness and accuracy of the information reported, and compliance with the applicable guidance, we reviewed the components' submissions of the payment recapture audit results along with its supporting documentation and determined if the component (1) employed an internal control program to prevent, detect and recover overpayments; (2) considered all programs that expend \$1 million or more annually; (3) prepared and submitted justifications for those programs that did not complete a payment recapture audit; (4) completed and submitted Payment Recapture Audit Results worksheets to Treasury's Risk and Control Group; and (5) disposed of recovered funds in accordance with OMB guidance. In order to make this determination, we also obtained evidence through the components' responses to our questionnaires and our interviews with Treasury personnel.

For the sample design, a simple random number method was used to generate a representative sample. We did not project the sample results to the population. We used a 90 percent confidence level, a 1 percent expected error rate and a +/-5.0 percent sample precision to calculate the sample size.

We conducted our fieldwork in Washington, D.C., from March 2019 to May 2019.

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.

*TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION*



*Some Refundable Credits Are Still Not  
Classified and Reported Correctly as a High  
Risk for Improper Payment by  
the Internal Revenue Service*

**May 13, 2019**

**Reference Number: 2019-40-039**

This report remains the property of the Treasury Inspector General for Tax Administration (TIGTA) and may not be disseminated beyond the Internal Revenue Service without the permission of TIGTA.

This report may contain confidential return information protected from disclosure pursuant to I.R.C. § 6103(a). Such information may be disclosed only to Department of the Treasury employees who have a need to know this information in connection with their official tax administration duties.

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P.O. Box 589  
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Washington, D.C. 20044-0589

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## HIGHLIGHTS

### **SOME REFUNDABLE CREDITS ARE STILL NOT CLASSIFIED AND REPORTED CORRECTLY AS A HIGH RISK FOR IMPROPER PAYMENT BY THE INTERNAL REVENUE SERVICE**

## Highlights

### **Final Report issued on May 13, 2019**

Highlights of Reference Number: 2019-40-039 to the Commissioner of Internal Revenue.

#### **IMPACT ON TAXPAYERS**

The Improper Payments Elimination and Recovery Act of 2010 and subsequent legislation strengthened agency reporting requirements and redefined "significant improper payments" in Federal programs. The Office of Management and Budget has declared the Earned Income Tax Credit (EITC) Program a high-risk program that is subject to reporting in the Department of the Treasury Agency Financial Report. The IRS estimates that 25.06 percent (\$18.4 billion) of EITC payments were issued improperly in Fiscal Year 2018.

#### **WHY TIGTA DID THE AUDIT**

This audit was initiated because TIGTA is required to assess the IRS's compliance with the reporting requirements contained in the Improper Payments Elimination and Recovery Act of 2010; Executive Order 13520, *Reducing Improper Payments*; and the Improper Payment Elimination and Recovery Improvement Act of 2012. The objective of this review was to determine whether the IRS complied with annual improper payment reporting requirements for Fiscal Year 2018.

#### **WHAT TIGTA FOUND**

The IRS provided all required EITC improper payment information for inclusion in the *Department of the Treasury Agency Financial Report Fiscal Year 2018*. The IRS has not reduced the overall EITC improper payment rate to less than 10 percent, but it has been approved for this exception to the annual reduction target reporting requirement. As an

alternative, the Department of the Treasury and the Office of Management and Budget collaborated on the development of a series of EITC supplemental measures for use in lieu of reduction targets.

The IRS continues to incorrectly rate the improper payment risk associated with the Additional Child Tax Credit, the American Opportunity Tax Credit, and the Premium Tax Credit. The incorrect rating allows the IRS to circumvent the reporting of required information for these programs to the Department of the Treasury for inclusion in the Agency Financial Report.

TIGTA identified over 2.2 million tax returns with an income discrepancy of \$1,000 or greater from what was reported on the tax returns that were not selected for further review by the IRS. These taxpayers received over \$10.1 billion, which included \$6.0 billion in EITCs and over \$1.9 billion in Additional Child Tax Credits.

Finally, TIGTA identified that the IRS has initiated corrective actions in an effort to address prior deficiencies reported by TIGTA. These efforts are resulting in the improved identification and recovery of erroneous EITC payments.

#### **WHAT TIGTA RECOMMENDED**

TIGTA recommended that the IRS implement a process to systemically identify and evaluate tax returns filed by individuals who have nonwork Social Security Numbers to prevent erroneous refunds of EITCs and ACTCs.

IRS management agreed with this recommendation and plans to take appropriate corrective actions to identify and evaluate tax returns filed by individuals who use nonwork Social Security Numbers.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

May 13, 2019

**MEMORANDUM FOR COMMISSIONER OF INTERNAL REVENUE**

A handwritten signature in blue ink that reads "Michael E. McKenney".

**FROM:** Michael E. McKenney  
Deputy Inspector General for Audit

**SUBJECT:** Final Audit Report – Some Refundable Credits Are Still Not Classified  
and Reported Correctly as a High Risk for Improper Payment by the  
Internal Revenue Service (Audit # 201940006)

This report presents the results of our review to determine whether the Internal Revenue Service (IRS) complied with the annual improper payment reporting requirements for Fiscal Year 2018. This audit is included in our Fiscal Year 2019 Annual Audit Plan and addresses the major management challenge of Reducing Fraudulent Claims and Improper Payments.

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

Copies of this report are also being sent to the IRS managers affected by the report recommendation. If you have any questions, please contact me or Russell P. Martin, Assistant Inspector General for Audit (Returns Processing and Account Services).



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*Abbreviations*

Abbreviation	Description
ACTC	Additional Child Tax Credit
AOTC	American Opportunity Tax Credit
EITC	Earned Income Tax Credit
IPERA	Improper Payments Elimination and Recovery Act
IPERIA	Improper Payments Elimination and Recovery Improvement Act
IPIA	Improper Payments Information Act
IRS	Internal Revenue Service
NRP	National Research Program
OMB	Office of Management and Budget
PATH Act	Protecting Americans From Tax Hikes Act of 2015
PTC	Premium Tax Credit
SSA	Social Security Administration
SSN	Social Security Number
TIGTA	Treasury Inspector General for Tax Administration



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## *Background*

The Office of Management and Budget (OMB) defines an improper payment as any payment that should not have been made, was made in an incorrect amount, or was made to an ineligible recipient. Agency Inspectors General have responsibility for evaluating agency information related to improper payments. The Improper Payments Information Act (IPIA) of 2002<sup>1</sup> requires Federal agencies, including the Internal Revenue Service (IRS), to estimate the amount of improper payments and report to Congress annually on the causes of and the steps taken to reduce improper payments. The IPIA also requires agencies to address whether they have the information systems and other infrastructure needed to reduce improper payments. The annual report must also describe steps the agency has taken to ensure that agency managers are held accountable for reducing improper payments. The following legislation and Executive Order clarified and expanded the IPIA requirements:

- **Executive Order 13520, Reducing Improper Payments** – signed by the President on November 20, 2009, it increased Federal agencies' accountability for reducing improper payments while continuing to ensure that Federal programs serve and provide access to intended beneficiaries. It requires Federal agencies to provide agency Inspectors General with detailed information on efforts to identify and reduce the number of improper payments in Federal programs with the highest dollar value of improper payments.
- **Improper Payments Elimination and Recovery Act (IPERA) of 2010**<sup>2</sup> – enacted on July 22, 2010, it amended the IPIA by strengthening agency reporting requirements and redefining "significant improper payments" in Federal programs. For Fiscal Year<sup>3</sup> 2014 and beyond, significant improper payments are defined as gross annual improper payments (*i.e.*, the total amount of overpayments and underpayments). The gross annual improper payments is the total amount of overpayments plus underpayments made in the program during the fiscal year reported that (a) exceeded both 1.5 percent of program outlays and \$10 million of all program or activity payments or (b) exceeded \$100 million at any percent of program outlays.
- **Improper Payments Elimination and Recovery Improvement Act (IPERIA) of 2012**<sup>4</sup> – enacted on January 10, 2013, it further expanded agency improper payment requirements to foster greater agency accountability. Like Executive Order 13520, the IPERIA requires the OMB Director to identify a list of high-priority Federal programs.

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<sup>1</sup> Pub. L. No. 107-300, 116 Stat. 2350.

<sup>2</sup> Pub. L. No. 111-204, 124 Stat. 2224.

<sup>3</sup> Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.

<sup>4</sup> Pub. L. No. 112-248, 126 Stat. 2390.



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For those high-priority programs, the IPERIA requires agencies to develop additional or supplemental measures for tracking progress in reducing improper payments and submit an annual report to the Inspector General of the agency on the steps the agency has taken and plans to take to recover past and prevent future improper payments. The report is also required to be posted on a website accessible to the public.

On June 26, 2018, the OMB issued revisions to Circular A-123 Appendix C, *Requirements for Payment Integrity Improvement*. Circular A-123 Appendix C provides agencies and Inspectors General with guidance on the implementation of the IPIA as amended by the IPERA, IPERIA, and Executive Order 13520. According to the OMB, the goal of the revised Appendix C is to transform the improper payment compliance framework to create a more unified, comprehensive, and less burdensome set of requirements. For example, agencies are compliant with most improper payments reporting requirements through the Agency Financial Report.<sup>5</sup> The IPERA adds an important component of accountability to the entire spectrum of improper payment efforts. Every year, each agency Inspector General reviews its agency's improper payment reporting in the agency's Agency Financial Report and any accompanying material such as that provided on [paymentaccuracy.gov](http://paymentaccuracy.gov) to determine if the agency complies with IPERA and OMB guidance.

**Process to identify IRS programs for improper payment risk assessment**

The Department of the Treasury (Treasury Department) identifies the programs that the IRS must assess for the risk of improper payments. For Fiscal Year 2018, the Treasury Department selected 18 IRS program fund groups. These funds were selected for assessment based on each fund groups' materiality to the IRS financial statements. However, OMB's revised guidance allows agencies to conduct improper payment risk assessments at least once every three years for programs that are deemed to be a low risk for susceptibility to significant improper payments. The IRS received approval from the Treasury Department to conduct these risk assessments on a three-year rotational schedule starting in Fiscal Year 2018. Appendix IV provides a list of the nine IRS programs for which the IRS completed an improper payment risk assessment for Fiscal Year 2018. On March 20, 2014, the OMB issued additional supplemental improper payment guidance to the Treasury Department clarifying the requirement for annual risk assessments of all refundable tax credits. The OMB guidance clarified that *all refundable credits* are subject to IPERA requirements because they can represent an additional outlay of funds by the Government. Nonrefundable tax credits reduce an individual's tax liability and represent an

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<sup>5</sup> The Agency Financial Report presents the Treasury Department's financial and performance information for the fiscal year with comparative prior year data, where appropriate.



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offset of excess taxes that were already paid to the Government. Therefore, nonrefundable tax credits do not result in an additional budget outlay.

The IRS used the *Qualitative Risk Assessment Questionnaire* for Fiscal Year 2018 (hereafter referred to as the Risk Assessment Questionnaire) and related guidance provided by the Treasury Department to assess the level of risk for each identified program. In response to concerns raised in prior Treasury Inspector General for Tax Administration (TIGTA) reports,<sup>6</sup> the Risk Assessment Questionnaire was updated in Fiscal Year 2016 in an attempt to provide a more accurate assessment of the risk associated with the programs the Treasury Department identified. The Risk Assessment Questionnaire computes a risk score for each program based on the IRS's response to the questions it contains. The risk score determines whether there is a low, medium, or high risk of improper payments in a program. The Treasury Department establishes the level of risk for a program's improper payments. Based on the risk score, different actions are required by agencies:

- *Low-risk program* – A risk score of 0 to 28 requires agencies to monitor those programs annually through the risk assessment.
- *Medium-risk program* – A risk score of 29 to 44 requires agencies to review payment controls for improvement opportunities.
- *High-risk program* – A risk score of 45 or greater requires agencies to establish a corrective action plan.

The IRS is required to forward the results and documentation supporting the risk assessments performed to the Treasury Department. For any program identified as having a high risk for improper payments, the IRS must also provide the following information for inclusion in the Treasury Department's annual Agency Financial Report:

- The rate and amount of improper payments.
- The root causes of the improper payments.
- Actions taken to address the root causes.
- Annual improper payment reduction targets.

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<sup>6</sup> TIGTA, Ref. No. 2014-40-093, *Existing Compliance Processes Will Not Reduce the Billions of Dollars in Improper Earned Income Tax Credit and Additional Child Tax Credit Payments* (September 2014); TIGTA, Ref. No. 2015-40-044, *Assessment of Internal Revenue Service Compliance With the Improper Payment Reporting Requirements in Fiscal Year 2014* (April 2015); and TIGTA, Ref. No. 2016-40-036, *Without Expanded Error Correction Authority, Billions of Dollars in Identified Potentially Erroneous Earned Income Credit Claims Will Continue to Go Unaddressed Each Year* (April 2016).



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- Discussion of any limitations to the IRS's ability to reduce improper payments.

**The IRS updated the methodology used to identify and report the Earned Income Tax Credit (EITC)<sup>7</sup> improper payment rate for Fiscal Year 2018**

The OMB has previously identified the EITC as a high-risk program, and as such, an annual risk assessment is not required to be performed. The EITC is currently the only IRS high-risk program and the only program with information included in the Treasury Department's Agency Financial Report. The EITC continues to be the only IRS program that the OMB has identified as a high-priority program.

For Fiscal Year 2018, the IRS changed its improper payment rate calculations to conform to the revised guidance received from the OMB. Specifically, the IRS updated its estimation methodology to add back overclaims recovered through the IRS post-refund activities to the total overclaims amount in deriving the improper payment rate for Fiscal Year 2018. The IRS estimates that 25.06 percent (\$18.4 billion) of EITC payments made in Fiscal Year 2018 were improper payments.

This review was performed with information obtained from the Office of the Chief Financial Officer and the Office of Research, Applied Analytics, and Statistics located at the IRS Headquarters in Washington, D.C., and the Small Business/Self-Employed Division's Examination Operations in Philadelphia, Pennsylvania, during the period October 2018 through March 2019. In addition to assessing the IRS's compliance with the improper payment reporting requirements, we also evaluated the effectiveness of the IRS's use of select tools to prevent and recover erroneous refundable credit payments. 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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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<sup>7</sup> The EITC is used to offset the impact of Social Security taxes on low-income families and to encourage them to seek employment.



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*Results of Review*

***The Internal Revenue Service Is Not in Compliance With Improper  
Payment Reporting Requirements***

The IRS continues to incorrectly rate improper payments associated with the Additional Child Tax Credit (ACTC), American Opportunity Tax Credit (AOTC), and Premium Tax Credit (PTC) as a medium risk. This rating is contrary to the IRS's own National Research Program (NRP), compliance data, and compliance studies, which identify an estimated improper payment amount, as defined by OMB guidance that exceeds the amount that warrants a high-risk rating for each of these credits. As a result, the IRS continues to significantly understate its estimate of improper payments in its reports to the OMB and Congress. Further, the inaccurate risk rating continues to allow the IRS to circumvent the reporting of required information to the Treasury Department for inclusion in the Agency Financial Report. For example, the IRS does not report on:

- The rate and amount of improper payments.
- The causes of improper payments and the agency's plans to address them.
- Reduction targets.
- Limitations to the agency's ability to reduce improper payments, including legislative limitations.

***IRS compliance studies identify a high risk of improper payments associated with the ACTC and AOTC, yet the IRS erroneously classifies these as a medium risk***

In Fiscal Years 2017 and 2018, the IRS completed an in-depth analysis using the data from its NRP individual income tax reporting compliance studies to provide an overview of taxpayer compliance behavior regarding the ACTC and AOTC. Our review of the IRS's compliance studies found the results to be consistent with TIGTA's prior estimated improper payments for these two credits for which the dollar amount exceeds the IPERA criteria for a high risk of improper payments. Based on the compliance studies conducted by the IRS, the potential ACTC and AOTC improper payment rates<sup>8</sup> were computed as follows:

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<sup>8</sup> TIGTA estimated the potential ACTC and AOTC improper payment rates using the IRS's estimated overclaims and underclaimed amounts presented in its compliance study reports.





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- ACTC – The IRS estimates that nearly 33 percent (\$8.7 billion) of ACTC payments made during Tax Years 2009 through 2011 were likely improper.
- AOTC – The IRS estimates that over 31 percent (\$5.3 billion) of AOTC payments made during Tax Year 2012 were likely improper.

The potential estimated overclaims and underclaims reported by the IRS in its compliance studies for the ACTC and AOTC confirm that the improper payments, as defined by OMB guidance, meet the IPERA guidelines for rating as a high risk. Programs are to be rated as high risk when they are susceptible to significant improper payments under the IPIA. Per the OMB, significant improper payments are defined as gross annual improper payments in the program exceeding (a) both 1.5 percent of program outlays and \$10 million of all program or activity payments made during the fiscal year reported or (b) \$100 million regardless of the improper payment percentage of total program outlays. OMB Circular A-123 Appendix C, Part I Section C,<sup>9</sup> requires agencies to institute a systemic method to identify programs susceptible to significant improper payments once every three years. The guidance states:

*This systematic method could be a quantitative evaluation based on a statistical sample or a qualitative method (e.g., a risk-assessment questionnaire). Improper payment risk assessments conducted prior to Fiscal Year 2020 may use qualitative or quantitative methods. Beginning in Fiscal Year 2020, programs with outlays for a 12-month period exceeding \$5 billion should use a quantitative evaluation as the systematic method for review. If a program used a qualitative method prior to Fiscal Year 2020, the program may consider continuing to use the method unless the IPERA compliance review has identified that the previously used qualitative method did not reasonably support whether the program's improper payments were above or below the statutory threshold established under IPIA.*

OMB Circular A-123 does not direct agencies to use one method of assessment over another unless the risk of improper payment is significant. Rather, the guidance provides agencies an example of the methods that could be used to evaluate risk. Our evaluation of the IRS's improper payment risk assessment methodology has continually shown that the IRS's repeated use of a qualitative evaluation does not provide an accurate assessment of the risk of improper payments. However, the IRS reported in the Fiscal Year 2018 Agency Final Report that it will begin developing a methodology that will quantitatively analyze and estimate improper payments for the ACTC and AOTC. This methodology will use data from the NRP to calculate ACTC and AOTC error rates going forward.

<sup>9</sup> OMB Circular A-123 Appendix C, Part I Section C, Item 2.



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**Quantitative analysis identifies the risk of improper Net PTC payments as high,  
yet the IRS erroneously classifies it as a medium risk**

In Fiscal Year 2015, the OMB established an interagency working group that included representatives from the IRS, the Treasury Department, and the Department of Health and Human Services' Centers for Medicare and Medicaid Services to complete a comprehensive risk assessment for the PTC. The interagency working group agreed that the Centers for Medicare and Medicaid Services would be responsible for assessing risks and developing improper payment error rates for Advance PTC<sup>10</sup> payments, and the IRS would be responsible for assessing risk and, if necessary, developing improper payment error rates for PTC payments made in response to taxpayers reconciling the Advance PTC on their tax returns. Payments of the PTC made due to the reconciliation on the tax return are referred to as the Net Premium Tax Credit, or Net PTC.

In April 2016, we first reported that the IRS's methodology to assess the PTC does not include a quantitative assessment and, as such, its assessment of an improper payment risk associated with the PTC is unreliable. In Fiscal Year 2017 and now for Fiscal Year 2018, the IRS continues to use a qualitative assessment and incorrectly rates the improper payment risk associated with the Net PTC as medium. However, in October 2018, the IRS completed a quantitative analysis of the Net PTC using the NRP data to calculate a Net PTC error rate for Tax Year 2014 tax returns (the first year for which the PTC was available) in response to a recommendation to an audit completed by the Government Accountability Office.<sup>11</sup> According to the IRS's own analysis of its compliance data, the estimated error rate was 41 percent (\$440 million) of Net PTC payments. The IRS's analysis confirmed that Net PTC improper payments, as defined by OMB definition, would likely exceed the improper payment reporting thresholds of a high risk.

IRS management cautioned that the Net PTC error rates may change as additional compliance data become available. Although the NRP sample provides unbiased estimates of compliance, the number of returns claiming Net PTC in the Tax Year 2014 sample used for the analysis was small and the margin of error for the Net PTC overclaim percentage is approximately  $\pm 18$  percentage points. We reported in December 2018, a total of \$3.7 billion claimed in Advance PTCs was in excess of the amount of PTCs to which taxpayers were entitled. Of this amount, a total of \$1 billion is not required to be repaid.<sup>12</sup>

<sup>10</sup> Advance Premium Tax Credit is a tax credit that is paid in advance to a taxpayer's insurance company to help cover the cost of premiums.

<sup>11</sup> GAO. Ref. No. GAO-17-467, *Improper Payments: Improvements Needed in CMS and IRS Controls over Health Insurance Premium Tax Credit* (July 2017).

<sup>12</sup> The Affordable Care Act limits the amount of tax that individuals with income between 100 percent and 400 percent of the Federal Poverty Level will have to repay.





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**Assessment of Fiscal Year 2018 Compliance With Earned Income Tax  
Credit Improper Payment Reporting Requirements**

As previously noted, the OMB has identified the EITC as a high-risk program. As such, the IRS is required to report annually on its efforts to reduce EITC improper payments. Our review confirmed that the IRS provided all required EITC improper payment information to the Treasury Department for inclusion in the *Department of the Treasury Agency Financial Report Fiscal Year 2018*. The IRS has not reduced the overall EITC improper payment rate to less than 10 percent; however, it has been approved for this exception to the annual reduction target reporting requirement. As an alternative, the Treasury Department and the OMB collaborated on the development of a series of EITC supplemental measures for use in lieu of reduction targets. The OMB approved these supplemental measures on August 27, 2014, and the measures were published in the *Department of the Treasury Agency Financial Report Fiscal Year 2014* as required. The supplemental measures are:

- **The Annual Error Rate** – identifies the percentage of total EITC payments that were improper.
- **The Amount of Revenue Protected** – shows the total value of erroneous payments prevented or recovered through compliance activities.
- **The Amount of Revenue Protected From Paid Preparer Treatments** – shows dollars erroneously or fraudulently claimed by paid tax preparers but not paid out or recovered by the Treasury Department.
- **The Number of Preparer Due Diligence Penalties Proposed** – reflects the effectiveness of the Treasury Department efforts to ensure that paid tax preparers are submitting accurate, nonfraudulent EITC claims on behalf of taxpayers.

Figure 1 provides a summary of our evaluation of IRS compliance with the various improper payment reporting requirements, including the reporting of supplemental measures.

**Figure 1: IRS Compliance With Improper Payment  
Requirements for the EITC Program for Fiscal Year 2018**

Improper Payment Requirement	Source of Requirement	Provided by IRS
Conduct a program-specific risk assessment for each program or activity identified by the Treasury Department.	IPERA	Yes
Publish an improper payment estimate for the EITC.	IPERA	Yes
Report an improper payment rate of less than 10 percent for the EITC.	IPERA	No



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<b>Improper Payment Requirement</b>	<b>Source of Requirement</b>	<b>Provided by IRS</b>
Provide the methodology for identifying and measuring EITC improper payments.	Executive Order	Yes
Publish EITC improper payment supplemental measures in lieu of annual reduction targets for the EITC.	OMB/ Treasury Department	Yes
Provide plans and supporting analysis for meeting the reduction targets for EITC improper payments.	Executive Order	Yes
Publish a programmatic corrective action plan for the EITC.	IPERA	Yes
Report on actions the IRS intends to take to prevent future EITC improper payments.	IPERIA	Yes
Report on efforts taken or planned to recapture EITC improper payments.	IPERA / IPERIA	Yes
Provide plans and supporting analysis for ensuring that the initiatives undertaken do not unduly burden program access and participation by eligible beneficiaries.	Executive Order	Yes
Provide required EITC information for posting to the paymentaccuracy.gov website.	Executive Order / IPERIA	Yes
Submit quarterly reports to TIGTA and the Council of the Inspectors General on Integrity and Efficiency and make available to the public a report on EITC improper payments identified by the agency.	Executive Order	N/A <sup>13</sup>

*Source: TIGTA's review of IRS EITC information provided to the Treasury Department for inclusion in the Department of the Treasury Agency Financial Report Fiscal Year 2018.*

***Notwithstanding Earlier Income and Withholding Reporting, a Majority of Discrepancies Are Still Not Addressed Due to Limited Resources***

Our analysis of Tax Year 2017 tax returns identified over 22.8 million Tax Year 2017 tax returns that claimed the EITC and/or ACTC. We matched Forms W-2, *Wage and Tax Statement*, received by the IRS as of December 27, 2018, to the wages reported on the 22.8 million tax returns to evaluate whether the income reported by the taxpayers on these tax returns was supported by third-party Forms W-2. We identified over 2.2 million tax returns with an income

<sup>13</sup> Effective for Fiscal Year 2014 forward, the dollar threshold for which agencies are required to report quarterly high-dollar improper payments is \$25,000 per individual. Because the maximum EITC an individual can receive is well below the \$25,000 threshold, the IRS would not be required to report any quarterly high-dollar payments for Fiscal Year 2014 forward.



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discrepancy of \$1,000 or greater from what was reported on the returns to what was reported on Forms W-2 that were not selected for further review by the IRS. Refunds associated with these tax returns totaled over \$10.1 billion, which included \$6.0 billion in EITC and over \$1.9 billion in ACTC. For 278,174 of the returns, we identified that the IRS received no third-party Forms W-2 supporting the wages reported on the returns (for which over \$1.0 billion in EITCs and/or ACTCs was paid). Figure 2 shows the type of income discrepancy on the 2.2 million returns that the IRS did not select for review.

**Figure 2: Tax Year 2017 Tax Returns With a Wage Discrepancy  
That Were Not Selected for Either Fraud or Examination Review<sup>14</sup>**

Wage Discrepancy Type	Returns	Refunds Received	EITC Received	ACTC Received
Returns – No Form(s) W-2 Received Supporting Wages Reported	278,174	\$1,187,961,097	\$792,354,216	\$248,826,661
<b>Returns – Forms W-2 received:</b>				
More Income Reported on Return	563,916	\$2,748,108,753	\$1,649,361,223	\$563,446,176
Less Income Reported on Return	1,430,894	\$6,253,273,499	\$3,583,230,613	\$1,172,386,071
<b>Total</b>	<b>2,272,984<sup>15</sup></b>	<b>\$10,189,343,349</b>	<b>\$6,024,946,052</b>	<b>\$1,984,658,908</b>

Source: TIGTA analysis of Individual Master File,<sup>16</sup> Information Returns Master File,<sup>17</sup> and Form W-2 data for tax returns processed as of May 3, 2018, for which the wage discrepancy was \$1,000 or greater.

The amount of EITC and ACTC a taxpayer receives is directly related to the amount of income reported on the tax return. As such, some taxpayers may be motivated to erroneously report more or less income to increase the amount of refundable credits they could receive. However, as we continue to report, IRS compliance resources are limited. Consequently, the IRS does not address the majority of potentially erroneous EITC claims despite having established processes that identify billions of dollars in potentially erroneous EITC payments. TIGTA is conducting a

<sup>14</sup> Some of the discrepancies we identified could be the result of employers not submitting accurate Forms W-2 to the IRS and may not necessarily be erroneous. The actual amount of the refund will only be known if returns with income discrepancies are identified and reviewed to determine the validity of the income reported in support of refundable credits claimed.

<sup>15</sup> Total includes 170,516 tax returns where taxpayers entered “HSH,” which indicates they received wages as a household employee.

<sup>16</sup> The IRS database that maintains transactions or records of individual tax accounts.

<sup>17</sup> Creates a Master File of current tax year information returns and maintains access to nine prior years.



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separate audit of the IRS's NRP cases to identify and quantify the reasons taxpayers' claims are adjusted.

**The IRS continues to request additional authority (referred to as correctable error authority or math error authority) that would allow it to correct tax returns with identified erroneous refundable credit claims during processing**

The Protecting Americans From Tax Hikes Act of 2015 (PATH Act)<sup>18</sup> requires employers and third parties to file Form W-2 and report nonemployee income on Form 1099-MISC, *Miscellaneous Income*, by January 31 each year. The PATH Act also prohibits the IRS from issuing tax refunds prior to February 15 when the tax return includes the EITC or the ACTC. Although the PATH Act gives the IRS more time to verify these claims before refunds are issued, it did not expand the IRS's authority to systemically correct erroneous claims that are identified at the time tax returns are processed. The IRS must still audit each tax return to prevent or recover these unsupported refundable credits.

As we have continued to report in our annual assessment of IRS efforts to reduce improper refundable credit payments, the IRS's use of traditional compliance tools is not resulting in any significant reduction in refundable credit improper payments. Currently under the Internal Revenue Code, the IRS can use its math error authority<sup>19</sup> to address erroneous EITC claims by systemically correcting mathematical or clerical errors such as correcting entries made on the wrong line on the tax return or mathematical errors in computing income or the EITC. The IRS must conduct an audit to address potentially erroneous refundable credit claims for which it does not have math error authority. The IRS estimated that it costs \$1.67 to resolve an erroneous EITC claim using math error authority, compared to \$425.22 to conduct a pre-refund audit. However, the majority of potentially erroneous EITC claims the IRS identifies do not contain the types of errors for which it has math error authority.

The IRS has repeatedly requested additional authority that would allow it to correct tax returns during processing when:

- The information provided by the taxpayer does not match the information contained in Government databases (*e.g.*, income information reported on the tax return does not match Form W-2 information the IRS receives from the Social Security Administration (SSA)).

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<sup>18</sup> Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, 129 Stat. 2242 (2015).

<sup>19</sup> Correctable error authority and math error authority are synonymous. Both terms can be used to describe the IRS's authority to systemically correct erroneous claims at the time tax returns are processed.



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- The taxpayer has exceeded the lifetime limit for claiming a deduction or credit. For example, in January 2018, we reported that billions of dollars in potentially erroneous AOTCs continue to be issued. This included our identifying over 600,000 tax returns for which a student claimed had already been claimed for the AOTC for four years.<sup>20</sup> We estimate these taxpayers received more than \$1 billion in erroneous AOTCs. The number of potentially erroneous AOTC claims that the IRS can audit is dependent on available resources. According to IRS management, as of August 21, 2017, the IRS has completed audits of 7,047 returns associated with Tax Years 2015 and 2016 claims resulting in assessments totaling more than \$8.8 million.
- The taxpayer has failed to include documentation with his or her return that is required by statute.

***Actions Are Being Taken to Address Our Prior Recommendations***

Our review identified that the IRS has initiated corrective actions in an effort to address prior deficiencies reported by TIGTA. These efforts are resulting in the improved identification and recovery of erroneous EITC payments. For example:

- ***A pilot program was initiated to identify and address erroneous EITC claims by individuals issued a “nonwork” Social Security Number (SSN).***<sup>21</sup> In July 2017,<sup>22</sup> we reported that the IRS still had not established processes to prevent individuals who have a nonwork SSN from receiving the EITC. As a result, 49,310 individuals who are not authorized to work in the United States received almost \$117.7 million in potentially erroneous EITCs in Tax Year 2014. In response, the IRS initiated a pilot program to identify 500 tax returns with EITC claims during processing in which claimants were issued a nonwork SSN and, as such, do not qualify for the EITC.<sup>23</sup> The claimant is asked to provide documentation that he or she no longer has a nonwork SSN (now has one that

<sup>20</sup> The American Recovery and Reinvestment Act of 2009 (Pub. L. No. 111-5, § 1001, 123 Stat. 115, subsequently amended by the Tax Relief Unemployment Insurance Reauthorization and Job Creation Act of 2010, Pub. L. No. 111-312, 124 Stat. 3296) allows the AOTC for the first four years of postsecondary education.

<sup>21</sup> A nonwork SSN is issued for obtaining Federal benefits (e.g., Medicaid or food stamps) and is not valid for work. The SSA has issued almost eight million “NOT VALID FOR EMPLOYMENT” SSNs since 1972 to individuals who do not have authorization to work in the United States.

<sup>22</sup> TIGTA, Ref. No. 2017-40-042, *Processes Do Not Maximize the Use of Third-Party Income Documents to Identify Potentially Improper Refundable Credit Claims* (July 2017).

<sup>23</sup> The Personal Responsibility and Work Opportunity Reconciliation Act of 1996, enacted August 22, 1996, requires individuals claiming the EITC to have a valid-for-work SSN and authorizes the IRS to deny claims to those individuals who file using an invalid SSN. The taxpayer, spouse (if married filing jointly), and each qualifying child must have a valid SSN to be eligible to claim the EITC.



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is valid for work) and as such qualifies for the EITC claimed. If the claimant cannot provide the documentation or fails to respond to the notice, the IRS will disallow the credit. The Tax Cuts and Jobs Act, enacted in December 2017,<sup>24</sup> changed the requirements for the ACTC to now require a valid SSN for each qualifying dependent to claim the credit.<sup>25</sup>

For the 2018 Filing Season, IRS management indicated that they identified 341 tax returns for which taxpayers agreed that they were not entitled to the EITC or did not provide a valid response within the suspense time frame. As a result, the IRS protected approximately \$1.3 million in revenue. For the 2019 Filing Season, the IRS expanded the testing to 1,000 selections over a 10-week period.

- ***Interim processes are being developed in an effort to better use SSA transcript information to identify and recover erroneous refundable credit claims.*** In response to our prior audit recommendations, the IRS has taken steps to use SSA Self-Employment income information to improve its audit selection process. Since December 2016, all SSA Self-Employment transcripts meeting basic criteria (*i.e.*, questionable Schedule C, *Profit or Loss From Business (Sole Proprietorship)*), and refundable credits claimed) have been transcribed and included in the established processes of filtering and classifying returns for examinations. In Calendar Year 2017, the IRS developed methods to scan the SSA Self-Employment income adjustment records and convert the images to digital data as an interim solution. As of September 2018, the IRS has created 1,468 exam cases from 11,552 leads through the scanning process.

The development of the fully digital transfer from the SSA to the IRS has required steady cooperation between the agencies. The IRS originally anticipated that the new memorandum of understanding would be signed in February 2019. However, the implementation of the project has been delayed. According to the IRS, the SSA started its development efforts. However, programming will not be completed until after the memorandum of understanding has been signed. IRS management expects the memorandum of understanding to be signed by the end of Fiscal Year 2019.

<sup>24</sup> Pub. L. 115-97, 131 Stat. 2054.

<sup>25</sup> Individuals without a valid SSN may claim a credit of up to \$500.





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## ***Recommendation***

The Commissioner, Wage and Investment Division, should:

**Recommendation 1:** Based on the results of the nonwork SSN pilot conducted in Processing Years<sup>26</sup> 2018 and 2019, implement a process to systemically identify and evaluate tax returns filed by individuals who have nonwork SSNs to prevent erroneous refunds of EITCs and ACTCs.

**Management's Response:** The IRS agreed with this recommendation and plans to continue the pilot to identify and evaluate tax returns for potential inclusion in its annual compliance plan where nonwork SSNs are used.

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<sup>26</sup> The calendar year in which the tax return or document is processed by the IRS.



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**Appendix I**

*Detailed Objective, Scope, and Methodology*

The overall objective of this review was to determine whether the IRS complied with the annual improper payment reporting requirements for Fiscal Year<sup>1</sup> 2018. This review evaluated the IRS's compliance with the reporting requirements contained in the IPERA of 2010;<sup>2</sup> Executive Order 13520, *Reducing Improper Payments*;<sup>3</sup> and the IPERIA of 2012.<sup>4</sup> The scope of this review included an assessment of the information that the IRS provided for inclusion in the *Department of the Treasury Agency Financial Report Fiscal Year 2018*. To accomplish our objective, we:

- I. Reviewed the *Department of the Treasury Agency Financial Report Fiscal Year 2018*, published on November 15, 2018, to determine if the IRS was in compliance with the improper payment reporting requirements for Fiscal Year 2018. We compared the information contained in the Agency Financial Report to the improper payment reporting requirements outlined in Appendix C to OMB Circular A-123, *Requirements for Payment Integrity Improvement*,<sup>5</sup> guidance on improper payment reporting.
  - A. Determined if the IRS was in compliance with IPERA reporting requirements.
  - B. Determined if the IRS was in compliance with IPERIA reporting requirements.
  - C. Determined if the IRS was in compliance with Executive Order 13520 reporting requirements.
  - D. Reviewed information that the IRS provided to the Treasury Department for posting to the paymentaccuracy.gov website.
  - E. Determined if the information included in the *Department of the Treasury Agency Financial Report Fiscal Year 2018* relative to EITC improper payments accurately

<sup>1</sup> Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.

<sup>2</sup> Pub. L. No. 111-204, 124 Stat. 2224.

<sup>3</sup> Executive Order 13520, *Reducing Improper Payments* (November 20, 2009).

<sup>4</sup> Pub. L. No. 112-248, 126 Stat. 2390.

<sup>5</sup> June 2018.





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- reflects the underlying information from the IRS and was posted to [paymentaccuracy.gov](http://paymentaccuracy.gov) or other Internet locations as required.
- F. Evaluated the adequacy of the IRS's updated methodology to calculate the EITC improper payment rate and dollar amount. Specifically, we determined if the IRS revised the methodology used to compute the EITC improper payment rate and dollar amount since Fiscal Year 2017.
- II. Evaluated the adequacy of the IRS's Fiscal Year 2018 risk assessments for revenue program funds identified by the Treasury Department.
- A. Ensured that the required Risk Assessment Questionnaire was completed for each revenue program fund and identified the risk level for each.
  - B. Ensured that the IRS determination of improper payment risk is consistent with the potential ACTC improper payment rate (or noncompliance rate).
  - C. Ensured that the IRS determination of improper payment risk is consistent with the potential AOTC improper payment rate (or noncompliance rate).
  - D. Evaluated the IRS's efforts to evaluate the risk of PTC improper payments.
    - 1. Obtained information regarding the OMB interagency working group's progress on defining PTC improper payments and assessing their risk.
    - 2. Determined the steps the IRS took to assess the risk of PTC improper payments for Fiscal Year 2018. We determined if the process used provides a reasonable assessment of the risk of improper PTC payments for Fiscal Year 2018.
- III. Followed up on select prior audit findings to ensure that the IRS has taken the agreed-upon action to resolve the issues.
- A. Determined if the IRS is now receiving the SSA Self-Employment transcripts through electronic format and its plans for using the electronic transcripts.
  - B. Determined if the IRS has taken action to analyze the available nonwork SSN data and evaluate their usefulness in identifying potentially fraudulent EITC claims.
  - C. Determined if the IRS developed effective processes and procedures to identify and prevent the issuance of EITC and ACTC payments when the income reported on the tax return is not supported by Forms W-2, *Wage and Tax Statement*.



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1. Performed further data analysis on the 22 million Tax Year 2017 tax returns claiming the EITC and the ACTC identified in our December 2018 audit report.<sup>6</sup>
  - a. Identified tax returns for which the income claimed is more than that reported on Forms W-2. We quantified the impact of overclaiming income.
  - b. Identified tax returns for which the income claimed was less than reported on Forms W-2. We quantified the impact of underclaiming income.
2. Determined if the tax returns were selected for further review to confirm the legitimacy of the wage income reported on the return in support of the EITC or ACTC claimed.
3. Provided examples of the cases above to the IRS for its review and determination as to how the refund bypassed IRS controls.

**Data Validation Methodology**

During this review, we relied on data extracts obtained from the IRS's Individual Master File,<sup>7</sup> the Individual Return Transaction File<sup>8</sup> databases for Processing Year<sup>9</sup> 2018, and the Forms W-2 File<sup>10</sup> for Tax Year 2017 that were available on TIGTA's Data Center Warehouse.<sup>11</sup> Before relying on the data, we ensured that each file contained the specific data elements we requested. In addition, we selected random samples of each extract and verified that the data in the extracts were the same as the data captured in the IRS's Integrated Data Retrieval System.<sup>12</sup> We also performed an analysis to ensure the validity and reasonableness of our data such as ranges of dollar values, transaction dates, and tax periods. Based on the results of our testing, we believe that the data used in our review were reliable.

**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

<sup>6</sup> TIGTA, Ref. No. 2019-40-013, *Results of the 2018 Filing Season* (December 2018).

<sup>7</sup> The IRS database that maintains transactions or records of individual tax accounts.

<sup>8</sup> A database the IRS maintains that contains information on the individual tax returns it receives.

<sup>9</sup> The calendar year in which the tax return or document is processed by the IRS.

<sup>10</sup> The Form W-2 database is created by TIGTA using IRS information reported on Forms W-2 for each tax year.

<sup>11</sup> A TIGTA repository of IRS data.

<sup>12</sup> IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.



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for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: controls in place to ensure that the IRS met the annual improper payment reporting requirements established in the IPERA, Executive Order 13520, and the IPERIA. We tested these controls by reviewing and analyzing relevant documents, data, and calculations related to the preparation of EITC improper payment estimate information.



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**Appendix II**

*Major Contributors to This Report*

Russell P. Martin, Assistant Inspector General for Audit (Returns Processing and Account Services)  
Sharla J. Robinson, Acting Director  
Linna K. Hung, Audit Manager  
Jane G. Lee, Lead Auditor  
Michael J. Bibler, Auditor



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**Appendix III**

*Report Distribution List*

Chief Financial Officer  
Deputy Commissioner for Operations Support  
Deputy Commissioner for Services and Enforcement  
Commissioner, Wage and Investment Division  
Chief, Research, Applied Analytics, and Statistics  
Director, Office of Legislative Affairs  
Director, Office of Program Evaluation and Risk Analysis  
Director, Return Integrity and Compliance Services, Wage and Investment Division  
Director, Office of Audit Coordination



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**Appendix IV**

*Internal Revenue Service Programs Identified  
for Improper Payment Risk Assessments*

The following IRS programs were identified by the Treasury Department for improper payment risk assessments for Fiscal Year 2018.

<b>IRS Program</b>	<b>Type of Program</b>	<b>Level of Risk Identified</b>
Headquarters Disbursement Earned Income Credit <sup>1</sup>	Revenue	High
Additional Child Tax Credit	Revenue	Medium
American Opportunity Tax Credit	Revenue	Medium
Premium Tax Credit	Revenue	Medium
Informant Reimbursement	Revenue	Low
Taxpayer Services	Administrative	Low
Tax Law Enforcement	Administrative	Low
Operations Support	Administrative	Low
Business Systems Modernization	Administrative	Low

*Source: IRS Office of the Chief Financial Officer.*

<sup>1</sup> The EITC Program has been declared a high risk program for improper payments by the OMB; therefore, no formal risk assessment is required for this revenue fund. The Earned Income Credit and EITC are the same credit.



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**Appendix V**

*Management's Response to the Draft Report*




CHIEF FINANCIAL OFFICER

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

May 6, 2019

MEMORANDUM FOR MICHAEL E. MCKENNEY  
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Ursula S. Gillis   
Chief Financial Officer

SUBJECT: Response to Draft Audit Report – Some Refundable Credits Are  
Still Not Classified and Reported Correctly as a High-Risk for  
Improper Payment by the Internal Revenue Service  
(Audit #201940006)

Thank you for the opportunity to review and comment on your draft audit report entitled, *Some Refundable Credits Are Still Not Classified and Reported Correctly as a High-Risk for Improper Payment* by the Internal Revenue Service. We continue to administer the refundable tax credit (RTC) programs effectively – including the Earned Income Tax Credit (EITC), the American Opportunity Tax Credit (AOTC), the Additional Child Tax Credit (ACTC), and the Premium Tax Credit (PTC) component of the Affordable Care Act (ACA) – despite significant challenges resulting from the nature of tax credits and the lack of information needed to verify taxpayer eligibility and claims at the time a return is filed. The RTCs' complex and numerous rules make it difficult for taxpayers to sort through complicated family relationships and residency arrangements to determine eligibility. This complexity contributes to the relatively high overclaim rates for these credits. We also lack third-party information that we could use to verify eligibility for the RTCs since the information needed may not be available when returns are processed, may be unreliable, or may not exist. Further, our limited statutory authority prevents pre-refund changes or corrections to taxpayer returns while resource constraints preclude the expansion of existing compliance programs to reduce RTC overclaims significantly or to increase recoveries.

We appreciate your acknowledgement of these challenges and your discussion of potential statutory changes that could help us reduce erroneous claims in a pre-refund environment. We reach out to and educate taxpayers and tax practitioners to reduce fraud and errors and to protect revenue, and we pursue traditional compliance activities where incorrect payments are made. However, we could accomplish more with additional tools. The President's FY 2020 budget submission proposes several legislative changes that would facilitate tax administration. These proposals include: (1) increasing oversight of paid tax return preparers to help reduce the need for





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post-refund enforcement activity, (2) providing more flexible authority for the IRS to address correctable errors when taxpayers claim credits for which they are ineligible or for which they exceed their lifetime limit, or when they fail to submit required documentation, (3) improving clarity in worker classification and information reporting requirements, (4) expanding mandatory electronic filing of Forms W-2, and (5) requiring a Social Security Number (SSN) that is valid for employment to claim EITC, the child tax credit and credit for other dependents.

Each year we evaluate the RTCs and other programs to determine the risk of susceptibility to improper payments. The purpose of the risk assessment process is to evaluate the strength of program controls and to determine overall susceptibility. In FY 2018, our assessments once again indicated that RTC overclaims are not rooted in internal control weaknesses, financial management deficiencies or reporting failures, but instead, result from the eligibility rules and the statutory construction of the credits. We do not agree with your conclusion that Treasury's qualitative risk assessment approach is an attempt to circumvent the reporting requirements of the Improper Payments Elimination and Recovery Act (IPERA). The IRS has published RTC compliance studies that detail overclaim rates by dollar and percentage, including in the FY 2018 Treasury Agency Financial Report (AFR) in Section A: Tax Gap and Tax Burden, pages 147-148.

We have expressed past concerns about the identification of overclaims of refundable tax credits as improper payments based on the definition included in IPERA and related legislation. We reiterate that while we support the intent of IPERA, the nature of the RTCs means that the IRS cannot design and implement effective countermeasures to erroneous RTC payments without additional statutory authority. However, we acknowledge stakeholder concerns and public interest in this matter, so we have committed to analyzing and reporting quantitatively on improper payments for AOTC and ACTC (in addition to the EITC and PTC calculations we already perform), with the intention of having results available to report, as necessary, in the FY 2019 Treasury AFR.

We appreciate your attestation of the actions we have taken to address prior recommendations. These include deploying a pilot program to identify instances in which nonwork SSNs are used in EITC claims and initializing steps to establish a memorandum of understanding with the Social Security Administration to use their self-employment income information to improve the audit process. We plan to continue these efforts in the future, consistent with your recommendation and our ongoing efforts to improve voluntary compliance.

If you have any questions, please contact me at 202-317-6400, or a member of your staff may contact John Pekarik, Associate Chief Financial Officer for Internal Controls, at 202-803-9151.

Attachment





*The Internal Revenue Service Is Not in Compliance  
With Improper Payment Requirements*

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Attachment

**Recommendation**

The Commissioner, Wage and Investment Division, should:

Based on the results of the nonwork SSN pilot conducted in Processing Years 2018 and 2019, implement a process to systemically identify and evaluate tax returns filed by individuals who have nonwork SSNs to prevent erroneous refunds of EITCs and ACTCs.

**IRS Response**

The IRS agrees with the recommendation. We will continue the pilot to identify and evaluate tax returns for potential inclusion in our annual compliance plan where nonwork SSNs are used.

**Responsible Official**

Director, Refundable Credits Policy and Program Management  
Return Integrity and Compliance Services  
Wage and Investment Division

**Due Date**

April 30, 2020

The table below summarizes Treasury programs' compliance with the IPERA reporting requirements by program.

<b>Program Name</b>	<b>Published an AFR or PAR (1)</b>	<b>Conducted a Risk Assessment</b>	<b>Published an Improper Payment Estimate (2)</b>	<b>Published Corrective Action Plans (2)</b>	<b>Published and iMeeting Reduction Targets (2)</b>	<b>Reported an Improper Payment Rate of Less than 10 Percent (2)</b>
<b>Internal Revenue Service – Earned Income Tax Credit</b>	Yes	N/A	Yes	Yes	N/A	No
<b>Internal Revenue Service – Additional Child Tax Credit</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Internal Revenue Service – American Opportunity Tax Credit</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Internal Revenue Service - Refundable Premium Assistance Tax Credit</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Internal Revenue Service - Informant Reimbursement</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Internal Revenue Service - Taxpayer Services</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Internal Revenue Service - Tax Law Enforcement</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Internal Revenue Service - Operations Support</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Internal Revenue Service - Business Systems Modernization</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Fiscal Service - Salaries and Expenses, Fiscal Service</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Fiscal Service - Reimbursements to Federal Reserve Banks</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Fiscal Service - Financial Agent Services</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Fiscal Service - Federal Reserve Bank Reimbursement Fund</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Fiscal Service - Debt Collection</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Fiscal Service - Interest on the Public Debt (Indefinite)</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Fiscal Service - Corporation for Public Broadcasting</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Fiscal Service - Corporation for Public Broadcasting</b>	Yes	Yes	N/A	N/A	N/A	N/A

Appendix 3  
 Treasury Programs' Compliance With IPERA Criteria

<b>Program Name</b>	<b>Published an AFR or PAR (1)</b>	<b>Conducted a Risk Assessment</b>	<b>Published an Improper Payment Estimate (2)</b>	<b>Published Corrective Action Plans (2)</b>	<b>Published and Meeting Reduction Targets (2)</b>	<b>Reported an Improper Payment Rate of Less than 10 Percent (2)</b>
<b>Fiscal Service - Payment to Legal Services Corp</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Fiscal Service - Fed. Pay. Resident Tuition Sup</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Fiscal Service - Judgments, Court of Claims</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Fiscal Service - Judgments, US Courts</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Fiscal Service - Claims for Contract Disputes</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Fiscal Service - Fed. Pay- Emerg. PI &amp; Sec</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Fiscal Service - Fed. Pay-DC Water &amp; Sewer</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Fiscal Service - Refund Money Erroneously Rec'd</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Fiscal Service - Fed. Pay-School Improvement</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Fiscal Service - Paymt to Resolution Fd Corp</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Fiscal Service - Interest on Uninvested Fds</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Fiscal Service - Restitution of Foregone Interest, Financial Manage</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Fiscal Service - Amer. Indian &amp; Alaskan Native</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Fiscal Service - Check Forgery Insurance Fund</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Fiscal Service - D.C. Water &amp; Sewage</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Fiscal Service - Travel Promotion Fund, Corp for Travel Promotion</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Fiscal Service - Cheyenne River Sioux TWHRTF</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Community Development Financial Institutions Fund - CDFI Program</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Community Development Financial Institutions Fund - CDFI BGP Financing Fund</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Community Development Financial Institutions Fund - Capital Magnet Fund</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Office of D.C. Pensions - District of Columbia Federal Pension Fund</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Office of D.C. Pensions - DC Judicial Retirement and Survivor's Annuity Fund</b>	Yes	Yes	N/A	N/A	N/A	N/A

Appendix 3  
Treasury Programs' Compliance With IPERA Criteria

<b>Program Name</b>	<b>Published an AFR or PAR (1)</b>	<b>Conducted a Risk Assessment</b>	<b>Published an Improper Payment Estimate (2)</b>	<b>Published Corrective Action Plans (2)</b>	<b>Published and Meeting Reduction Targets (2)</b>	<b>Reported an Improper Payment Rate of Less than 10 Percent (2)</b>
<b>Departmental Offices - Salaries and Expenses, DO</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Departmental Offices - Grants for Specified Energy Property in Lieu of TC</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Departmental Offices - State Small Business Credit Initiative</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Departmental Offices - TFI</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Office of International Assistance - Global Environment Facility, Funds Appropriated</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Office of International Assistance - Contribution to the Asian Development Fund, Funds</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Office of International Assistance - Contribution to Inter-Amer Development</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Office of International Assistance - Contrib Int'l Develop Assoc</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Office of International Assistance - Contrib to Int'l Bk-Reconstrct</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Office of International Assistance - Contrib to African Develop Fd</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Office of International Assistance - Contrib to African Develop Bk</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Office of International Assistance - Int'l Fund for Agric. Develop.</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Office of International Assistance - Global Food Security Fund</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Office of Financial Stability - Salaries and Expenses</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Office of Financial Stability - Home Affordable Modification Program</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Office of the Inspector General - Salaries and Expenses, OIG</b>	Yes	Yes	N/A	N/A	N/A	N/A

Program Name	Published an AFR or PAR (1)	Conducted a Risk Assessment	Published an Improper Payment Estimate (2)	Published Corrective Action Plans (2)	Published and Meeting Reduction Targets (2)	Reported an Improper Payment Rate of Less than 10 Percent (2)
<b>Special Inspector General for Troubled Asset Relief Program - Office of Special Inspector General TARP</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Departmental Offices - IA Technical Assistance Prog.</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Departmental Offices - Treasury Forfeiture Fund</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Treasury Inspector General for Tax Administration - Treasury IG for Tax Admin.</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Bureau of Engraving and Printing - Bureau of Engraving and Printing Fund</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Treasury Franchise Fund - Treasury Franchise Fund</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Financial Crimes Enforcement Network - Salaries and Expenses, FinCEN</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Office of Financial Research - Financial Research Fund</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>The Mint - United States Mint Public Enterprise Fund</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Office of the Comptroller of the Currency - Assessment Funds, OCC</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Alcohol Tobacco and Trade Bureau - Salaries and Expenses, TTB</b>	Yes	Yes	N/A	N/A	N/A	N/A
<b>Alcohol Tobacco and Trade Bureau - Internal Revenue, Collections for Puerto Rico</b>	Yes	Yes	N/A	N/A	N/A	N/A


- (1) For the Published an AFR or PAR criteria which applies at an agency level, if the agency is compliant then the programs are all compliant.
- (2) The requirements apply only to the programs that are susceptible to significant improper payments.



DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C.

May 31, 2019

**MEMORANDUM FOR DIRECTOR JAMES HODGE  
FINANCIAL STATEMENT AND PROCUREMENT AUDITS,  
OFFICE OF INSPECTOR GENERAL**

**FROM:** David F. Eisner   
Assistant Secretary for Management

**SUBJECT:** Audit of Treasury's Compliance with the Improper Payment Reporting Requirements for Fiscal Year (FY) 2018

We have reviewed the draft audit report on Treasury's improper payment reporting for FY 2018 and appreciate the opportunity to respond. We recognize the importance of achieving full compliance with the Improper Payment Elimination and Recovery Act (IPERA), which includes complying with the Office of Management and Budget (OMB) Memorandum M-15-02, Executive Order 13520, *Reducing Improper Payments and Eliminating Waste in Federal Programs*, Appendix C to Circular A-123, *Requirements for Payment Integrity Improvement*, and OMB Circular A-136, *Financial Reporting Requirements*.

Your audit concluded that Treasury did not comply with the IPERA requirement for FY 2018 as the improper payment rate for the Earned Income Tax Credit (EITC) is greater than 10 percent, as reported by the Treasury Inspector General for Tax Administration (TIGTA). We appreciate your acknowledgement that Treasury was in compliance with all other IPERA requirements.

As we have reported in previous years, a number of factors contribute to the high over-claim rate for the EITC and prevent us from fully complying with the IPERA requirements. The numerous and complex rules of EITC make it difficult for taxpayers to sort through complicated family relationships and residency arrangements to determine eligibility. The IRS also lacks third-party information to verify eligibility for EITC, since the information may not be available when returns are processed, or may not exist or be reliable. Further, the limited statutory authority prevents the IRS from making pre-refund corrections to taxpayer returns, and resource constraints preclude the IRS from expanding existing compliance programs to reduce over-claims or increase recoveries. Despite these challenges, we will continue to collaborate with the IRS and OMB to identify a more effective process for reporting compliance information for refundable credit programs.

Risk assessments for EITC and other refundable tax credit programs show that improper payments from these programs are not rooted in internal weaknesses, financial management deficiencies, or financial reporting failures. Instead, they stem from inherent aspects of delivering these benefits through the tax system, as well as how Congress structured the program, and IRS' lack of available tools to verify data or correct identified issues.

Attached is our response to your recommendations. If you have any questions, please let me know, or you may contact Carole Banks, Deputy Chief Financial Officer, at (202) 622-0818.

**Attachment**

Attachment 1: ASM Response to IPERA Audit Recommendations



**Attachment 1**

**Management's Response to IPERA Audit Recommendations**

**Office of Inspector General (OIG) Recommendations:**

The OIG recommends the Assistant Secretary for Management ensure:

1. Treasury updates its Qualitative Risk Assessment Questionnaire to provide a reasonable basis for its risk ratings.
2. Treasury revises its Improper Payment Elimination and Recovery Act (IPERA) implementation guide to require components to submit appropriate and sufficient supporting documentation for their risk assessment results.
3. Bureau of Engraving and Printing (BEP) and other Treasury components submit complete payment recapture audit information to the Risk and Control Group (RCG) as required by Treasury's IPERA guidance.

**Management's Response:**

Treasury management concurs with the OIG's recommendations. Treasury has updated its FY 2019 Department-wide IPERA compliance guidance to include a revised Qualitative Risk Assessment Questionnaire that will provide a more reasonable basis for assessing if a program is susceptible to significant improper payments. In Treasury's updated IPERA guidance, Treasury components will be required to submit appropriate and sufficient justification in support of their risk assessment responses.

Treasury management will actively monitor BEP and other components to ensure they more accurately and timely complete their payment recapture audit reporting prior to submission.

Implementation Date: November 15, 2019

Responsible Official: Assistant Secretary for Management and Deputy Chief Financial Officer

Appendix 5  
Treasury OIG Major Contributors To This Report

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Catherine Yi, Audit Manager  
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Rebecca Berry, Auditor  
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**The Department of the Treasury**

Secretary of the Treasury  
Deputy Secretary  
Assistant Secretary for Management  
Deputy Chief Financial Officer  
Director, Risk and Control Group

**Office of Management and Budget**

Controller, Office of Federal Financial Management  
OIG Budget Examiner

**United States Senate**

Chairman and Ranking Member  
Committee on Homeland Security and Governmental Affairs

**U.S. House of Representative**

Chairman and Ranking Member  
Committee on Oversight and Reform

**U.S. Government Accountability Office**

Comptroller General of the United States



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