Audit Report

OIG-14-032

The Department of the Treasury Was Not in Compliance With the Improper Payments Elimination and Recovery Act for Fiscal Year 2013

April 15, 2014

Office of Inspector General

Department of the Treasury

Contents

Abbreviations

AFR	Agency Financial Report
DO	Departmental Offices
EITC	Earned Income Tax Credit
FY	Fiscal Year
IPERA	Improper Payments Elimination and Recovery Act of 2010
IPIA	Improper Payments Information Act of 2002
IRS	Internal Revenue Service
OIG	Office of Inspector General
OMB	Office of Management and Budget
RCG	Risk and Control Group
TIGTA	Treasury Inspector General for Tax Administration

OIG

Audit Report

The Department of the Treasury
Office of Inspector General

April 15, 2014

Nani A. Coloretti
Assistant Secretary for Management

This report presents the results of our audit of the Department of the Treasury's (Treasury) compliance with the Improper Payments Elimination and Recovery Act of 2010 (IPERA)[1] for fiscal year (FY) 2013. IPERA was enacted to help Federal agencies strengthen the framework for reducing and reporting improper payments. The objective of our audit was to assess and report on Treasury's compliance with improper payment requirements set forth in IPERA. Appendix 1 provides more detail of the objective, scope, and methodology of our audit.

This report also incorporates the results of the Treasury Inspector General for Tax Administration's (TIGTA) assessment of the Internal Revenue Service's (IRS) compliance with IPERA. TIGTA issued its report on March 31, 2014, which is included as appendix 2 of this report. The results of our audit, insofar as they relate to IRS, are based solely on TIGTA's report.

Results in Brief

We determined that Treasury was not in compliance with IPERA for FY 2013 due to IRS's Earned Income Tax Credit (EITC) deficiencies reported by TIGTA. Specifically, IRS did not publish annual EITC improper payment reduction targets and has not reported an improper payment rate of less than 10 percent.

TIGTA also reported that (1) improper payment risk assessments may not provide a reliable assessment of the risk of improper payments in tax administration, and (2) Federal courts have ruled that IRS does not have regulation authority over paid tax return

[1] Pub. L. No. 111-204, 124 Stat. (July 22, 2010)

preparers, which was previously cited as IRS's most promising initiative to reduce EITC improper payments.

This is the third consecutive year we have determined that Treasury is not in compliance with IPERA due to EITC deficiencies.

In this report, we are reaffirming our prior year recommendation that the Assistant Secretary for Management ensure that Treasury submit a comprehensive plan to Congress that includes a description of the corrective actions Treasury will take to remediate non-compliance with IPERA due to IRS's EITC deficiencies. We are also recommending that the Secretary of the Treasury or designee, in no later than 30 days, submit to Congress either reauthorization proposals or proposed statutory changes necessary to bring the EITC program into compliance with IPERA.

In a written response, management agreed with our recommendation to ensure that a comprehensive plan is submitted to Congress which includes a description of the corrective actions Treasury will take to remediate its IPERA non-compliance. The response noted that management has been working with the Office of Management and Budget (OMB) with respect to developing supplemental measures to address the EITC deficiencies. Management also expressed agreement with our second recommendation regarding the submission to Congress either reauthorization proposals or proposed statutory changes to bring the EITC program into compliance with IPERA but noted that IRS will not be ready to submit a complete corrective action plan within the required 30 days. Management provided an implementation date of May 15, 2015, to address this recommendation which exceeds IPERA's 30-day statutory deadline. We have summarized and evaluated management's response in the recommendations section of this report. Management's complete response is provided in appendix 3.

Background

Improper Payments Elimination and Recovery Act of 2010

Under the Improper Payments Information Act of 2002 (IPIA),[2] 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. IPERA amended IPIA by strengthening agencies' program reviews and reporting requirements. IPERA expands the types of payments that should be reviewed and establishes the requirement for agencies to conduct recovery audits if cost-effective.

IPERA also requires the Inspectors General to report on respective agencies' compliance with IPERA each fiscal year.

OMB's "Requirements for Effective Measurement and Remediation of Improper Payments," of OMB Circular No. A-123, *Management's Responsibility for Internal Control,* (OMB Circular No. A-123, Appendix C) was revised to provide agencies guidance on implementing the requirements of IPERA.[3] This guidance provides for (1) identifying and reporting on improper payments and (2) performing and reporting on payment recapture audits.

To determine compliance with IPERA and OMB guidance, we are required to review the Agency Financial Report (AFR) and any accompanying information to assess whether Treasury has:

- published an AFR 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 31 U.S.C. §3321,[2] if required;

[2] Pub. L. No. 107-300, 116 Stat. (Nov. 26, 2002)

[3] OMB M-11-16, *Issuance of Revised Parts I and II to Appendix C of OMB Circular A-123*, (April 14, 2011)

* 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 AFR, if required;
* published, and met, annual reduction targets for each program assessed to be at risk and measured for improper payments;
* 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 AFR; and
* reported information on its efforts to recapture improper payments.

Treasury's Improper Payment Risk Assessment

Treasury's Risk and Control Group (RCG), under the Deputy Chief Financial Officer, issued *Treasury-Wide Guidance for the FY 2013 Implementation of Circular A-123, Appendix C, Requirements for the Effective Measurement and Remediation of Improper Payments* (Treasury's IPERA Guidance) to all Treasury bureaus and Departmental Offices (DO) subcomponents (hereafter we refer to bureaus and DO subcomponents collectively as "components"). RCG identified the programs for which components were required to assess the risk of improper payment. Treasury components used the "Improper Payments Elimination and Recovery Risk Assessment Questionnaire for FY 2013" developed by RCG to assess the level of risk for each program identified. Each component was to provide the results and documentation for all risk assessments to RCG. For any program identified as having a high risk for improper payment, the responsible component was also required to provide the following information for inclusion in the AFR:

* The rate and amount of improper payment;
* The root causes of improper payments;
* Actions taken to address the root causes;
* Annual improper payment reduction targets; and
* A discussion of any limitations to the component's ability to reduce improper payments.

For FY 2013, Treasury identified the EITC as its only high risk program. IRS estimated that 22 to 26 percent of EITC payments were issued improperly and estimated the value of these improper payments to be between $13.3 and $15.6 billion.

Payment Recapture Audits

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

Treasury's IPERA Guidance requires each component to complete a worksheet providing a consistent reporting format that includes information on the component's payment recapture audits. The worksheets are to be submitted to RCG for review and the results are then consolidated and reported in the AFR.

Audit Results

Treasury Was Not in Compliance with IPERA for FY 2013

We determined that Treasury was not in compliance with IPERA for FY 2013 due to IRS's EITC deficiencies reported by TIGTA. Specifically, IRS did not publish annual EITC improper payment reduction targets and has not reported an improper payment rate of less than 10 percent. This is the third consecutive year we have determined that Treasury is not in compliance with IPERA due to EITC deficiencies.

As a result of our determination of Treasury's noncompliance with IPERA for FY 2011, Treasury submitted a plan to Congress describing the actions that it intended to take to come into compliance, as required by IPERA and OMB Circular No. A-123,

Appendix C. However, the plan did not address the non-compliance with IPERA due to EITC deficiencies. The plan only addressed deficiencies associated with its reporting on payment recapture audits (which were also identified in the FY 2011 IPERA report[4]). Treasury officials believed that by reporting corrective actions related to EITC deficiencies in the AFR, they satisfied the reporting requirements of IPERA and OMB Circular No. A-123, Appendix C. Based on discussions with OMB staff, we determined that this did not satisfy Treasury's IPERA reporting requirement.

Treasury has not yet submitted to Congress a complete corrective action plan addressing EITC deficiencies. Treasury and IRS management are in discussions with OMB to develop supplemental reporting measures that would be appropriate to gauge the impact of EITC compliance and outreach efforts in lieu of developing error reduction targets.

Since Treasury has not been in compliance with IPERA for 3 consecutive fiscal years for the same program, IPERA requires that, not later than 30 days of the determination of non-compliance, the Secretary of the Treasury must submit to Congress (1) reauthorization proposals for the EITC program; or (2) proposed statutory changes necessary to bring the EITC program into compliance.

Recommendations

1. We reaffirm our prior year recommendation that the Assistant Secretary for Management ensure that Treasury submit a comprehensive plan to Congress that includes a description of the corrective actions Treasury will take to remediate non-compliance with IPERA due to IRS's EITC deficiencies.

Management Response

Management agreed with our recommendation and stated that Treasury has been working with OMB with regard to the EITC. Management noted it received OMB's formal letter 1) approving that developing supplemental measures is appropriate to gauge the

[4] *The Department of the Treasury Was Not in Compliance With the Improper Payments Elimination and Recovery Act for Fiscal Year 2011* (OIG-12-044; issued March 15, 2012)

impact of EITC compliance and outreach efforts in lieu of developing error reduction targets, and 2) agreeing on what non-EITC refunds are required under IPERA versus what IRS will continue to report as tax gap reduction efforts. Management pointed out that the OMB letter states that by establishing supplemental measures and reporting them along with the annual reported improper payment estimates, Treasury will fulfill specific requirements found in Executive Order 13520 and the Improper Payments Elimination and Recovery Improvement Act of 2012. According to management, IRS is continuing to develop these measures, and will be meeting with OMB to obtain their concurrence and provide the measures to Treasury, along with the annual EITC error estimates for reporting in the FY 2014 AFR. Beyond these measures, corrective actions are currently in place to reduce the improper payment rate. However, numerous barriers – including authentication errors, verification errors, the complexity of the tax law, and the structure of the EITC – continue to provide challenges with respect to the reduction of improper payments. Management's response is provided in appendix 3.

OIG Comment

Management's response meets the intent of our recommendation.

2. We recommend that the Secretary of the Treasury or designee, in no later than 30 days, submit to Congress either reauthorization proposals or proposed statutory changes necessary to bring the EITC program into compliance with IPERA.

   Management Response
   Management responded that it agreed with the spirit of our recommendation but that IRS will not be ready to submit a complete corrective action plan within 30 days. Management noted that due to the complexity of the EITC and its impact on a significant segment of the taxpaying public, it believes that any proposals put forward must be comprehensive, well thought out, and focused on achieving the dual goals of maximizing participation in the program and reducing, to the greatest extent possible, improper payments associated with the credit. Management indicated an implementation date of May 15, 2015 for its

submission of any reauthorization proposals or statutory changes to bring the EITC program into compliance with IPERA.

Management also stated that it has proposed in the General Explanations of the Administration's Fiscal Year 2015 Revenue Proposals correctible error authority. According to management, this authority will permit IRS to correct errors in certain narrow circumstances providing an appropriate balance between using IRS resources efficiently and effectively and maintaining the procedural protections available to taxpayers. Management noted that IRS is exploring new approaches such as the simplification of EITC eligibility criteria and the identification of more efficient means to distinguish valid claims from over claims. Management's response is provided in appendix 3.

<u>OIG Comment</u>

We acknowledge management's agreement with our recommendation. However, the submission of either reauthorization proposals or proposed statutory changes by management's planned corrective action date of May 15, 2015, exceeds IPERA's 30 day statutory deadline. While we recognize and appreciate the challenges involved in this process, we reaffirm our recommendation and will continue to monitor management's actions going forward.

* * * * * *

We appreciate the courtesies and cooperation extended to our staff during this audit. Should you have any questions, you may contact me at (202) 927-5400, or Donna F. Joseph, Deputy Assistant Inspector General for Financial Management and Information Technology Audit at (202) 927-5784. Major contributors to this report are listed in appendix 4.

/s/

Marla A. Freedman
Assistant Inspector General for Audit

The Improper Payments Elimination and Recovery Act of 2010 (IPERA) requires that we conduct an audit of the Department of the Treasury's (Treasury) compliance with requirements set forth in IPERA for identifying and reducing improper payments in its programs and activities. The objective of this audit was to determine Treasury's compliance with IPERA for fiscal year 2013. 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 IPERA. TIGTA's scope included an assessment of the Earned Income Credit (EITC) information that IRS provided for inclusion in Treasury's Agency Financial Report (AFR) and a review of IRS's progress on previous recommendations. EITC was the only program identified by the IRS for improper payment reporting.

To accomplish our objective, we reviewed applicable laws, guidance issued by the Office of Management and Budget, and Treasury-wide guidance related to IPERA; reviewed the fiscal year 2013 AFR to determine if Treasury complied with the reporting requirements of IPERA; interviewed key Departmental Offices and component entities' personnel; and performed testing of Treasury's risk assessment and payment recapture audit program.

To review Treasury's risk assessment process, we randomly selected a sample of 21 of 40 non-IRS programs identified by Treasury for risk assessment. To determine the reasonableness and accuracy of the information reported and compliance with the applicable guidance for the sample, we reviewed the program risk assessments and conducted interviews of personnel involved in their preparation and review.

To review the payment recapture audit program, we randomly selected a sample of 11 of 14 non-IRS components. To determine the reasonableness and accuracy of the information reported, and compliance with the applicable guidance for the sample, we reviewed the components' submissions and conducted interviews with component personnel, as well as reviewed supporting documentation.

We conducted our fieldwork in Washington, DC, from September 2013 to March 2014.

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

The Internal Revenue Service Fiscal Year 2013 Improper Payment Reporting Continues to Not Comply With the Improper Payments Elimination and Recovery Act

March 31, 2014

Reference Number: 2014-40-027

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HIGHLIGHTS

THE INTERNAL REVENUE SERVICE FISCAL YEAR 2013 IMPROPER PAYMENT REPORTING CONTINUES TO NOT COMPLY WITH THE IMPROPER PAYMENTS ELIMINATION AND RECOVERY ACT

Highlights

Final Report issued on March 31, 2014

Highlights of Reference Number: 2014-40-027 to the Internal Revenue Service Chief Financial Officer.

IMPACT ON TAXPAYERS

The Improper Payments Elimination and Recovery Act (IPERA) of 2010 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 22 to 26 percent of EITC payments were issued improperly in Fiscal Year 2013. The dollar value of these improper payments was estimated to be between $13.3 billion and $15.6 billion.

WHY TIGTA DID THE AUDIT

This audit was initiated because the IPERA requires TIGTA to assess the IRS's compliance with improper payment requirements. The objective of this review was to assess the IRS's compliance with the IPERA. The scope of this review included an assessment of EITC information the IRS provided for inclusion in the *Department of the Treasury Agency Financial Report Fiscal Year 2013* and a review of the IRS's progress on previous recommendations.

WHAT TIGTA FOUND

The IRS continues to not provide all required IPERA information to the Department of the Treasury for inclusion in the *Department of the Treasury Agency Financial Report Fiscal Year 2013*. For the third consecutive year, the IRS did not publish annual reduction targets or report an improper payment rate of less than 10 percent for the EITC.

IRS management has indicated that the IRS and the Department of the Treasury are in continued discussions with the Office of Management and Budget to obtain its approval to develop supplemental measures that are appropriate to gauge the impact of EITC compliance and outreach efforts in lieu of developing error reduction targets.

Finally, although risk assessments were performed for each of the programs that the Department of the Treasury required the IRS to assess, the risk assessment process still may not provide a valid assessment of improper payments in tax administration. As such, the EITC remains the only revenue program fund to be considered at high risk for improper payments.

WHAT TIGTA RECOMMENDED

TIGTA made no recommendations in this report.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

March 31, 2014

MEMORANDUM FOR CHIEF FINANCIAL OFFICER

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

SUBJECT: Final Audit Report – The Internal Revenue Service Fiscal Year 2013 Improper Payment Reporting Continues to Not Comply With the Improper Payments Elimination and Recovery Act
(Audit # 201440018)

This report presents the results of our annual review of the Internal Revenue Service's (IRS) compliance with the requirements of the Improper Payments Elimination and Recovery Act (IPERA) of 2010[1] for Fiscal Year 2013. The IPERA requires the Treasury Inspector General for Tax Administration (TIGTA) to review annually the IRS's compliance with these requirements. This audit is included in our Fiscal Year 2014 Annual Audit Plan and addresses the major management challenge of Fraudulent Claims and Improper Payments.

Management's complete response to the draft report is included as Appendix V. Subsequent to our audit testing, the IRS received and provided to TIGTA official guidance from the Office of Management and Budget approving the establishment of supplemental measures for use in evaluating the incremental reduction in Earned Income Tax Credit improper payments. As noted in the IRS management response, the development of these supplemental measures is ongoing. As such, the guidance does not affect the IRS's compliance with Fiscal Year 2013 IPERA reporting requirements. We plan to evaluate the establishment and use of these supplemental measures in subsequent annual reviews of improper payments.

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

[1] Pub. L. No. 111-204, 124 Stat. 2224

The Internal Revenue Service Fiscal Year 2013 Improper Payment Reporting Continues to Not Comply With the Improper Payments Elimination and Recovery Act

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The Internal Revenue Service Fiscal Year 2013 Improper Payment Reporting Continues to Not Comply With the Improper Payments Elimination and Recovery Act

Abbreviations

EITC	Earned Income Tax Credit
IPERA	Improper Payments Elimination and Recovery Act of 2010
IRS	Internal Revenue Service
NRP	National Research Program
TIGTA	Treasury Inspector General for Tax Administration

The Internal Revenue Service Fiscal Year 2013 Improper Payment Reporting Continues to Not Comply With the Improper Payments Elimination and Recovery Act

Background

Generally, an improper payment is defined as a payment that should not have been made or that was made in an incorrect amount or to an ineligible recipient. Improper payments by Federal Government agencies have been an issue for many years. Various ways have been put forth to identify, measure, and reduce them, including laws specifically addressing improper payments, an executive order, and guidance by certain oversight agencies such as the Office of Management and Budget. In addition, agency Inspectors General serve a role by evaluating agency information related to improper payments.

The Improper Payments Information Act of 2002[1] 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 the agency is taking to reduce improper payments. It 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 Improper Payments Elimination and Recovery Act of 2010 amended the Improper Payments Information Act of 2002

The President signed the Improper Payments Elimination and Recovery Act (IPERA) of 2010[2] into law on July 22, 2010. The IPERA amends the Improper Payments Information Act of 2002 by strengthening agency reporting requirements and redefining "significant improper payments." Significant is defined as gross annual improper payments (*i.e.*, the total amount of overpayments plus underpayments) made in the program during the fiscal year[3] reported that exceeded (a) both 2.5 percent of program outlays and $10 million of all program or activity payments or (b) $100 million. The IPERA requires the Treasury Inspector General for Tax Administration (TIGTA) to annually review the IRS's compliance with the IPERA reporting requirements.

Our evaluation of the IRS's compliance with the IPERA is incorporated into the Department of the Treasury Office of Inspector General's annual assessment of the Department of the Treasury's compliance with the IPERA. Fiscal Year 2013 was the third year Inspectors General were required to assess agencies' compliance with the IPERA. The Treasury Inspector General

[1] Pub. L. No. 107-300, 116 Stat. 2350.
[2] Pub. L. No. 111-204, 124 Stat. 2224.
[3] A 12-consecutive-month period ending on the last day of any month. The Federal Government's fiscal year begins on October 1 and ends on September 30.

The Internal Revenue Service Fiscal Year 2013 Improper Payment Reporting Continues to Not Comply With the Improper Payments Elimination and Recovery Act

is required to issue a report on the annual assessment of the Department of the Treasury's compliance with the IPERA by April 15, 2014.

In addition, Executive Order 13520, *Reducing Improper Payments and Eliminating Waste in Federal Programs*, signed by the President on November 20, 2009, further increases Federal agencies' accountability for reducing improper payments while continuing to ensure that Federal programs serve and provide access to their intended beneficiaries. It requires Federal agencies to 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. TIGTA's evaluation of this information is published in a separate report, the most recent being in Calendar Year 2013.[4]

IPERA process to identify IRS programs for improper payment risk assessment

The Department of the Treasury identifies the programs that the IRS must assess for the risk of improper payments. The IRS used the Improper Payments Elimination and Recovery Risk Assessment Questionnaire for Fiscal Year 2013 (the Questionnaire) and related guidance provided by the Department of the Treasury to assess the level of risk for each identified program. The Questionnaire computes a risk score for each program based on the IRS's response to the questions contained in the Questionnaire. The risk score determines whether there is a low, medium, or high risk of improper payments in a program. The Department of the Treasury establishes the level of risk for a program's improper payments based on the risk score ranges and considers programs with a risk score of 0 to 11 as low risk, 12 to 28 as medium risk, and 29 and greater as high risk.

The IRS is required to forward the results and documentation for all risk assessments to the Department of the Treasury. Appendix IV provides a list of the IRS programs the Department of the Treasury identified for an improper payment risk assessment for Fiscal Year 2013. For any program identified as having a high risk for improper payments, the IRS must provide the following information to the Department of the Treasury for inclusion in the 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.
- A discussion of any limitations to the IRS's ability to reduce improper payments.

[4] TIGTA, Ref. No. 2013-40-084, *The Internal Revenue Service Is Not in Compliance With Executive Order 13520 to Reduce Improper Payments* (Aug. 2013).

The Internal Revenue Service Fiscal Year 2013 Improper Payment Reporting Continues to Not Comply With the Improper Payments Elimination and Recovery Act

The Earned Income Tax Credit (EITC) has previously been declared a high-risk program by the Office of Management and Budget; therefore, no risk assessment is required to be prepared for it. The EITC is currently the only IRS high-risk program and the only one with information included in the agency financial report.

The IRS uses a statistically valid method to estimate EITC improper payments based on compliance information

The IRS uses the National Research Program (NRP) as the primary source of data to estimate the annual EITC improper payment rate. The NRP provides the IRS with compliance information that is statistically representative of the taxpayer population. Updated estimates of taxpayer compliance are computed for each tax year.[5] The IRS uses each tax year's NRP results to update the EITC improper payment rate.

Although the NRP process results in a more current estimate of the accuracy of EITC claims than previous methods, the estimated improper payment rate for a given fiscal year is not based on current year data. Because of the time it takes to complete the annual NRP, the IRS's annual estimate of the improper payment rate is based on data that are approximately three years old. For example, EITC improper payment rates for Fiscal Year 2013 are based on information from Tax Year 2009 tax returns that were processed in Calendar Year 2010.

This review was performed with information obtained from the Office of the Chief Financial Officer and the Office of Research, Analysis, and Statistics, both located at the IRS National Headquarters in Washington, D.C., during the period November 2013 through March 2014. The scope of this review included verifying that required risk assessment Questionnaires were completed, verifying that the EITC information the IRS provided for inclusion in the *Department of the Treasury Agency Financial Report Fiscal Year 2013* was accurate, and reviewing the IRS's progress on previous recommendations. 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.

[5] A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.

The Internal Revenue Service Fiscal Year 2013 Improper Payment Reporting Continues to Not Comply With the Improper Payments Elimination and Recovery Act

Results of Review

The Internal Revenue Service Continues to Not Comply With Improper Payments Elimination and Recovery Act Requirements

The IRS continues to not provide all required IPERA information to the Department of the Treasury for inclusion in the *Department of the Treasury Agency Financial Report Fiscal Year 2013*. For the third consecutive year, the IRS did not publish annual reduction targets or report an improper payment rate of less than 10 percent for the EITC. According to the IPERA, continued noncompliance will result in additional reporting requirements as well as a review of Department of the Treasury, and potentially IRS, funding by the Office of Management and Budget. Figure 1 provides a summary of our evaluation of IRS compliance with the IPERA.

Figure 1: IRS Compliance With Improper Payment Requirements for the EITC Program for Fiscal Years 2011 Through 2013

IPERA Requirement	Provided by the IRS		
	Fiscal Year 2011	Fiscal Year 2012	Fiscal Year 2013
Conduct a program-specific risk assessment for each program or activity that conforms with Section 3321 of Title 31 U.S.C.	Yes	Yes	Yes
Publish a programmatic corrective action plan for the EITC.	Yes	Yes	Yes
Publish an improper payment estimate for the EITC.	Yes	Yes	Yes
Publish annual reduction targets for the EITC and discuss progress toward meeting those targets.	No	No	No
Report an improper payment rate of less than 10 percent for the EITC.	No	No	No
Report on efforts to recapture EITC improper payments.	Yes	Yes	Yes

Source: TIGTA's review of IRS EITC information provided to the Department of the Treasury for inclusion in the Department of the Treasury Agency Financial Reports for Fiscal Years 2011 through 2013.

As Figure 2 illustrates, the IRS has made little improvement in reducing EITC improper payments since being required by the Improper Payments Information Act of 2002 to report estimates of these payments to Congress.

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With the Improper Payments Elimination and Recovery Act

Figure 2: Estimated EITC Improper Payments for Fiscal Years 2003 Through 2013

Fiscal Year	Minimum Improper Payments[6] Percentage	Maximum Improper Payments Percentage	Minimum Improper Payments Dollars (Billions)	Maximum Improper Payments Dollars (Billions)
2003	25%	30%	$9.5	$11.5
2004	22%	27%	$8.6	$10.7
2005	23%	28%	$9.6	$11.4
2006	23%	28%	$9.8	$11.6
2007	23%	28%	$10.4	$12.3
2008	23%	28%	$11.1	$13.1
2009	23%	28%	$11.2	$13.3
2010	24%	29%	$15.3	$18.4
2011	21%	26%	$13.7	$16.7
2012[7]	21%	25%	$11.6	$13.6
2013	22%	26%	$13.3	$15.6
Total			$124.1	$148.2

Source: Department of the Treasury Performance and Accountability Reports for Fiscal Years 2003 through 2010 and Department of Treasury Agency Financial Reports for Fiscal Years 2011 through 2013.

As we reported in August 2013,[8] the IRS's estimates of Fiscal Year 2012 improper EITC payments were understated. They were based on the assumption that a provision in the American Recovery and Reinvestment Act of 2009 (Recovery Act)[9] that increased the EITC for certain taxpayers would expire at the end of 2010. However, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010[10] extended the provision through December 2012. It was later extended through December 2017 by the American Taxpayer

[6] For Fiscal Year 2005 through Fiscal Year 2009, the IRS computed the minimum and maximum improper payment rates (referred to as the upper and lower bounds) using different sets of assumptions concerning the compliance of EITC claimants who fail to show up for the NRP audit.
[7] The Fiscal Year 2012 improper payment estimates were understated. The estimates do not reflect the extension of the additional EITC for families with three or more children.
[8] TIGTA, Ref. No. 2013-40-084, *The Internal Revenue Service Is Not in Compliance With Executive Order 13520 to Reduce Improper Payments* (Aug. 2013).
[9] Pub. L. No. 111-5, 123 Stat. 115 (2009).
[10] Pub. L. No. 111-312,124 Stat. 3299 (2010).

The Internal Revenue Service Fiscal Year 2013 Improper Payment Reporting Continues to Not Comply With the Improper Payments Elimination and Recovery Act

Relief Act of 2012.[11] The IRS's estimates did not take into account the extension of the additional EITC for families with three or more children. As a result, the Fiscal Year 2012 improper payment estimates were understated. The extended EITC provision was correctly included in the IRS's Fiscal Year 2013 estimates of EITC improper payments.

The Fiscal Year 2013 estimates also include EITC underpayments, which have not been included in IRS's estimates in the past. The *Department of the Treasury Agency Financial Report Fiscal Year 2013* states that underpayments increased the overall improper payment rate by less than 0.05 percent. The IRS estimate of $60.3 billion total EITC claims in Fiscal Year 2013 was used to calculate the estimated minimum and maximum EITC improper payment amounts. The estimated improper payment rate and resulting dollar estimates will increase or decrease as the number and/or amount of EITC claims received in a given tax year increases or decreases.

Improper payment risk assessments may not provide a reliable assessment of the risk of improper payments in tax administration

In January 2013, TIGTA reported[12] that the IPERA risk assessment process did not provide a reliable assessment of improper payment risk for IRS revenue program funds.[13] We found that the definition of an IRS program affects the reliability of the risk assessment. The IRS administers the tax law by establishing broad programs focused on helping taxpayers meet their tax responsibilities, *i.e.*, processing tax returns and enforcing the law, to ensure that everyone meets their obligation to pay taxes. Limiting the assessment of the risk of improper payments to fund groups (e.g., the verification of one tax credit) may significantly underestimate the risk of improper payments to tax administration.

In addition, we reported that risk assessments were not performed in compliance with Department of the Treasury guidelines. Department of the Treasury guidance states that the risk assessments should be conducted by a team of reviewers knowledgeable in the types of payments for each of the program fund groups. However, the IRS assigned completion of some of the risk assessments to individual employees who were not always knowledgeable about the program fund being assessed. In addition, the IRS did not maintain adequate documentation to support its assessment.

Finally, we reported that the Questionnaire did not effectively address risks associated with tax refund payments. We found that the Questionnaire contained questions that did not apply to the IRS's revenue program funds, yet an answer to these questions was required. Specifically, for those questions that applied to tax administration, the Questionnaire required a yes or no

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[11] Pub. L. No. 112-240,126 Stat. 2319 (2013).
[12] TIGTA, Ref. No. 2013-40-015, *Improper Payments Elimination and Recovery Act Risk Assessments of Revenue Programs Are Unreliable* (Jan. 2013).
[13] The IRS's custodial activity includes revenues collected and refunds disbursed. However, in this report the general term "revenue" is used in place of "custodial." The revenue program funds for which the IRS performed risk assessments generally represent specific individual tax credits or refund payments.

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response to these questions. Depending on the response to these questions, the program's risk score could be affected. We recommended that the IRS work with the Department of the Treasury to better identify the IRS programs to be included in the risk assessments for improper payments and refine the Questionnaire to ensure that all questions are applicable to tax administration and more accurately reflect the risks associated with tax refund payments, develop a formal process for assigning responsibility for the completion of the risk assessments, and develop a process to ensure that the Department of the Treasury guidance is being followed.

In response to our audit recommendations, the IRS met with the Department of the Treasury to revise the risk assessment Questionnaire for revenue funds. In addition, the Office of the Chief Financial Officer provided the business units with Fiscal Year 2013 IPERA guidance from the Department of the Treasury that included a required documentation retention period of five years. The Office of the Chief Financial Officer worked with the business unit executives to ensure that the appropriate subject matter experts were identified and participated in the review process. Following Department of the Treasury guidance, the business units developed risk assessment teams with the knowledge and experience to ensure the accuracy of the risk assessment of the revenue programs. However, no changes were made to how IRS programs were identified to be assessed for improper payment risk pending the result of ongoing discussions among the IRS, Department of the Treasury, and the Office of Management and Budget regarding which IRS programs are to be evaluated under improper payment legislation. As such, the Department of the Treasury still selects the fund groups for evaluation based on each fund groups' materiality to the IRS financial statements rather than by significant broad-based IRS program activities.

Documentation was provided to support IRS 2013 risk assessments; however, the risk assessment process still may not provide a valid assessment of improper payments in tax administration.

During the course of this review, we were provided with documentation showing that risk assessments were performed for each of the programs that the Department of the Treasury required the IRS to assess. For Fiscal Year 2013, the Department of the Treasury selected 25 program fund groups for review—six administrative program funds and 19 revenue program funds.[14] However, the process still may not provide a valid assessment of improper payments in tax administration. The EITC remains the only revenue program fund to be considered at high risk for improper payments; there is no effective process to address the continued risks associated with improper tax refund payments resulting from other refundable tax credits[15] and tax refund fraud. According to IRS management, the IRS and the Department of the Treasury are continuing to meet with the Office of Management and Budget to determine the best way to

[14] See Appendix IV. Note: The EITC Program has been declared a high-risk program for improper payments by the Office of Management and Budget; therefore, no formal risk assessment is required for it.
[15] A refundable credit is not limited to the amount of an individual's tax liability and can result in a Federal tax refund that is larger than the amount of a person's Federal income tax withholding for that year.

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address improper tax refunds, including which revenue refund accounts to include in the annual risk assessment process. Currently, improper EITC payments are addressed under the IPERA, with improper tax refunds addressed as part of the IRS's efforts to reduce the Tax Gap.[16] This is despite the Office of Management and Budget guidance on the IPERA that defines an improper payment as:

> *"…any payment that should not have been made or that was made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirements."*

As such, tax refunds resulting from refundable tax credits and tax refund fraud paid by the IRS in error are an improper payment and the programs that resulted in the erroneous refund should be evaluated under the IPERA. While the IRS has developed a number of initiatives for reducing the Tax Gap, the IPERA is the only mechanism that requires the IRS to evaluate the causes of improper payments, assess whether the IRS has the tools it needs to effectively reduce improper payments, and report to TIGTA and the Office of Management and Budget on the processes and programs it uses or plans to use to reduce improper payments.

The regulation of paid tax return preparers was previously cited as the IRS's most promising initiative to reduce EITC improper payments; however, Federal courts have ruled that the IRS does not have this regulation authority

The IRS announced a plan in January 2010 to register, license, and create enforcement tools that would impact the paid return preparer community more broadly. IRS management expected the new return preparer program (consisting of registration, testing, education, and enforcement) to have a positive impact on overall paid preparer compliance. These activities were to be implemented over a three-year period. In a February 2011 TIGTA report,[17] the IRS noted that its efforts to regulate tax return preparers would drive increased EITC compliance, decrease fraud, and reduce the improper payment rate. IRS management stated that the tax return preparer initiative was the IRS's most promising avenue to substantially reduce erroneous EITC payments. The IRS further indicated that evidence suggests that unscrupulous preparers contribute to overall improper EITC claims. Paid return preparers assisted in the preparation of approximately 66 percent of all EITC claims in Tax Year 2008.

However, on January 18, 2013, a Federal Court enjoined the IRS from enforcing the regulatory requirements for registered tax return preparers. The IRS appealed the Federal Court's decision. On February 11, 2014, the Federal Appeals Court ruled that the IRS does not have the authority to regulate tax preparers by requiring them to pay an annual fee, pass a qualifying exam, and take

[16] The Tax Gap is the estimated difference between the amount of tax that taxpayers should pay and the amount that is paid voluntarily and on time
[17] TIGTA, Ref. No. 2011-40-023, *Reduction Targets and Strategies Have Not Been Established to Reduce the Billions of Dollars in Improper Earned Income Tax Credit Payments Each Year* (Feb. 2011).

annual continuing education. Although the IRS has a number of programs to monitor and address tax return preparer EITC compliance, these programs require IRS resources to investigate and assist tax return preparers in becoming compliant. As a result, the effectiveness of these programs is limited to the availability of resources. The February 2014 Federal Appeals Court ruling means that the IRS can no longer prevent tax return preparers who do not meet minimum proficiency requirements from filing tax returns on behalf of taxpayers, including those claiming the EITC.

The Court ruling materially affects the basis on which the IRS planned to establish a baseline for meaningful reduction targets as previously indicated. The IRS indicated in its response to our 2012 report[18] that Fiscal Year 2011 was the first year of a three-year ramp-up of this initiative. IRS management indicated that after the program is fully established, the IRS will have a baseline against which it can set meaningful reduction targets. However, the IRS can no longer implement the most beneficial aspects of the tax return preparer initiative.

The IRS did not provide the Department of the Treasury or TIGTA with quantifiable improper payment reduction targets for the EITC as required by the IPERA for a third consecutive year. IRS management has indicated that the IRS and the Department of the Treasury are in continued discussions with the Office of Management and Budget to obtain its approval to develop supplemental measures that are appropriate to gauge the impact of EITC compliance and outreach efforts in lieu of developing error reduction targets. As part of these discussions, the IRS and the Department of the Treasury should also obtain input from the Office of Management and Budget as to an acceptable baseline against which improvement can be measured. The IRS has not provided us with documentation detailing the content of the discussions of those meetings or with a time frame for the development of the supplemental measures.

[18] TIGTA, Ref. No. 2012-40-028, *The Internal Revenue Service Is Not in Compliance With All Improper Payments Elimination and Recovery Act Requirements* (Mar. 2012).

**The Internal Revenue Service Fiscal Year 2013
Improper Payment Reporting Continues to Not Comply
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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to assess the Internal Revenue Service's (IRS) compliance with the requirements of the Improper Payments Elimination and Recovery Act (IPERA) of 2010[1] for Fiscal Year 2013. The IPERA requires TIGTA to review annually the IRS's compliance with the IPERA reporting requirements. 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 2013* and a review of the IRS's progress on previous recommendations. To accomplish our objective, we:

I. Determined if certain conditions identified in prior TIGTA audits still exist. We reviewed the Department of the Treasury's Joint Audit Manager Enterprise System reports, discussed the IRS's corrective actions with management, and determined if the previous recommendations and goals had been implemented.

II. Determined if the information the IRS provided for inclusion in the *Department of the Treasury Agency Financial Report Fiscal Year 2013* complied with the IPERA reporting requirements. We compared the information contained in the agency financial report to the IPERA reporting requirements outlined in the Office of Management and Budget Circular A-123, *Management's Responsibility for Internal Control*, guidance on improper payment reporting. We also compared the information provided by the IRS to the Department of the Treasury with the information contained in the agency financial report to ensure that the information was accurately reflected in the report. We evaluated the accuracy of the IRS's estimate of the EITC improper payment rate and the associated dollar projections.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: controls in place to ensure that the IRS met the reporting requirements established in the IPERA. We tested these controls by reviewing and analyzing relevant documents, data, and calculations related to preparation of IPERA improper payment estimate information.

[1] Pub. L. No. 111-204, 124 Stat. 2224

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Appendix II

Major Contributors to This Report

Russell P. Martin, Acting Assistant Inspector General for Audit (Returns Processing and Account Services)
Deann L. Baiza, Director
Roy E. Thompson, Audit Manager
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Karen C. Fulte, Senior Auditor

The Internal Revenue Service Fiscal Year 2013 Improper Payment Reporting Continues to Not Comply With the Improper Payments Elimination and Recovery Act

Appendix III

Report Distribution List

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Appendix IV

Internal Revenue Service Programs Identified for Improper Payment Risk Assessments

The following IRS programs were identified by the Department of the Treasury for improper payment risk assessments for Fiscal Year 2013.

IRS Program	Type of Program	Level of Risk Identified
Affordable Health Care Program	Administrative	Low
Business Systems Modernization	Administrative	Low
Federal Highway Administration (FHWA) Allocation Account	Administrative	Low
Information Systems	Administrative	Low
Tax Law Enforcement	Administrative	Low
Taxpayer Services	Administrative	Low
Adoption Credit	Revenue	Low
Alternative Minimum Tax Credit Refunds	Revenue	Low
American Opportunity Credit	Revenue	Low
Build America Bonds	Revenue	Low
Child (Tax) Credit Payments	Revenue	Low
Consolidated Omnibus Budget Reconciliation Act (COBRA) Credit	Revenue	Low
Corporation Tax Credit Refunds	Revenue	Low
EITC Disbursements[1]	Revenue	High
Health Care Credit Payments	Revenue	Low
Home Buyers Credit Refunds	Revenue	Low
Informant Reimbursement	Revenue	Low
Making Work Pay Credit	Revenue	Low

[1] The EITC Program has been declared a high-risk program for improper payments by the Office of Management and Budget; therefore, no formal risk assessment is required for it.

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The Internal Revenue Service Fiscal Year 2013 Improper Payment Reporting Continues to Not Comply With the Improper Payments Elimination and Recovery Act

IRS Program	Type of Program	Level of Risk Identified
New Clean Renewable Energy Bonds	Revenue	Low
Qualified Energy Conservation Bond	Revenue	Low
Qualified Zone Academy Bonds	Revenue	Low
Qualified School Construction Bonds	Revenue	Low
Refund Collection	Revenue	Low
Refund Collection – Interest	Revenue	Low
Small Business Health Insurance Tax Credit	Revenue	Low

Source: IRS Office of the Chief Financial Officer.

The Internal Revenue Service Fiscal Year 2013 Improper Payment Reporting Continues to Not Comply With the Improper Payments Elimination and Recovery Act

Appendix V

Management's Response to the Draft Report

CHIEF FINANCIAL OFFICER

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

March 27, 2014

MEMORANDUM FOR MICHAEL E. MCKENNEY
ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Robin L. Canady
Chief Financial Officer

Robin L. Canady

SUBJECT: Draft Audit Report –The Internal Revenue Service Fiscal Year 2013 Improper Payment Reporting Continues to Not Comply With the Improper Payments Elimination and Recovery Act (Audit # 201440018)

We have reviewed the draft report titled, *"The Internal Revenue Service Fiscal Year 2013 Improper Payment Reporting Continues to Not Comply With the Improper Payments Elimination and Recovery Act"* (IPERA). Our response is provided below.

As you correctly stated in your report, the IRS and the Department of the Treasury (Treasury) were in continued discussions with the Office of Management and Budget (OMB) during your audit testing period to obtain a formal letter from OMB: (1) approving the use of supplemental measures to gauge the impact of Earned Income Tax Credit (EITC) compliance and outreach efforts in lieu of error reduction targets; and (2) determining which non-EITC refunds are required to be reported under IPERA and which will continue to be reported as part of the tax gap. We appreciate TIGTA's collaboration and willingness to give us the opportunity to obtain this letter from OMB prior to the issuance of your report, and we understand that because the letter was received on March 20, 2014, TIGTA was not able to review and determine how OMB's decisions affected the IRS' compliance with IPERA in Fiscal Year (FY) 2013.

We appreciate your acknowledgement that the IRS revised the risk assessment questionnaire for revenue funds, provided the business units with FY 2013 IPERA guidance that included a required documentation retention period of five years, and worked with the business unit executives to ensure that the appropriate subject matter experts were identified and participated in this year's review process, all in response to your audit recommendations. We are also pleased to report that the guidance we received in the OMB letter will resolve the reported non-compliance areas in your report. The OMB letter formally states

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that by IRS establishing supplemental measures and reporting them along with the annual reported improper payment estimates, Treasury and the IRS will fulfill specific requirements found in Executive Order 13520 and IPERA. The IRS is continuing to develop these measures and anticipates meeting with OMB to obtain their concurrence and provide the measures to Treasury, along with our annual EITC error estimates for reporting in the FY 2014 Annual Financial Report.

The OMB letter also states it is reasonable for the IRS to exempt reporting refunds made without relation to any refundable tax credit program (i.e., those payments made for tax withholdings) from improper payments requirements. For the non-EITC refundable credits, OMB states the IRS should continue to perform risk assessments on all IPERA-implicated refundable tax credit programs, but OMB agrees that in cases of returns filed with multiple refundable credits, it is reasonable that non-compliance related to those non-EITC credits will continue to be estimated as part of the tax gap estimation program. OMB suggests that Treasury describe this determination in their Annual Financial Report, including identification of any statutory barriers to meeting requirements.

If you have any questions, please contact me at (202) 317-6400, or a member of your staff may contact John Pekarik, Acting Associate Chief Financial Officer, Corporate Planning and Internal Control, at (202) 317-4038.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20020

APR 14 2014

MEMORANDUM FOR MARLA A. FREEMAN
ASSISTANT INSPECTOR GENERAL FOR AUDIT

FROM: Nani A. Coloretti Shaun Kerr for NAC
Assistant Secretary for Management

Dorrice Roth Dorrice C. Roth
Deputy Chief Financial Officer

SUBJECT: Management Response to Draft Report – The Department of the Treasury Was Not in Compliance With the Improper Payments Elimination and Recovery Act (IPERA) for Fiscal Year (FY) 2013

We have reviewed the subject draft report and appreciate the opportunity to respond. Treasury recognizes the importance of achieving full compliance with IPERA, which includes complying with the government-wide implementing guidance issued by the Office of Management and Budget (OMB) in Memorandum M-11-16, *Issuance of Revised Parts I and II to Appendix C of OMB Circular A-123*, and OMB Circular A-136, *Financial Reporting Requirements*. Last year, Treasury worked diligently to implement the Office of the Inspector General (OIG) FY 2012 recommendations. IRS has corrective actions in place to reduce the improper payment rate, but there are numerous barriers, including authentication errors, verification errors, the complexity of the tax law, and the structure of the EITC.

The IRS is also developing supplemental measures that are appropriate for gauging the impact of EITC compliance and outreach efforts in lieu of developing error reduction targets. The IRS anticipates meeting with OMB to obtain their concurrence and provide measures to Treasury, along with the EITC error estimates for reporting in the FY 2014 Agency Financial Report.

Treasury will continue to ensure that bureaus and offices are submitting the necessary improper payments information that Treasury will then report in the Agency Financial Report (AFR) in accordance with OMB requirements.

Attached are our planned corrective actions in response to your recommendations. If you have any questions, please let us know, or your staff may contact Harold Barnshaw, Director, Risk and Control Group (RCG), at (202) 622-9331.

Attachment

Recommendation 1:

We reaffirm our prior year recommendation that the Assistant Secretary for Management ensure that Treasury submit a comprehensive plan to Congress that includes a description of the corrective actions Treasury will take to remediate non-compliance with IPERA due to IRS's EITC deficiencies.

Corrective Action 1-1: We agree with this recommendation. Treasury has been working with OMB, with respect to the EITC, and received OMB's formal letter 1) approving that developing supplemental measures is appropriate to gauge the impact of EITC compliance and outreach efforts in lieu of developing error reduction targets, and 2) agreeing on what non-EITC refunds are required under IPERA versus those that IRS will continue to report as part of its efforts to reduce the tax gap. The OMB letter formally states that by establishing supplemental measures and reporting them along with the annual reported improper payment estimates, Treasury will fulfill specific requirements found in Executive Order 13520 and the Improper Payments Elimination and Recovery Improvement Act of 2012 (IPERIA). The IRS is continuing to develop these measures, and will be meeting with OMB to obtain their concurrence and provide the measures to Treasury, along with the annual EITC error estimates, for reporting in the FY 2014 AFR.

Beyond the measures, corrective actions are currently in place to reduce the improper payment rate. However, numerous barriers – including authentication errors, verification errors, the complexity of the tax law, and the structure of the EITC – continue to provide challenges with respect to the reduction of improper payments. Nevertheless Treasury remains committed to developing a well-informed approach to resolving improper payments while ensuring the program continues to serve taxpayers.

Implementation Date: September 30, 2014

Responsible Official: Assistant Secretary for Management

Recommendation 2:

We recommend that the Secretary of the Treasury or designee, in no later than 30 days, submit to Congress either reauthorization proposals or proposed statutory changes necessary to bring the EITC program into compliance with IPERA.

Corrective Action 2-1: While we agree with the spirit of this recommendation, the IRS will not be ready to put forward a complete corrective action plan in 30 days. Due to the complexity of this refundable tax credit program and the impact this program has on a significant segment of the taxpaying public, Treasury believes that any proposals put forward by the Department must be comprehensive, well thought out, and focused on achieving the dual goals of maximizing

Attachment

participation in the program and reducing, to the greatest extent possible, improper payments associated with the credit.

The Department of the Treasury has proposed in the General Explanations of the Administration's Fiscal Year 2015 Revenue Proposals correctible error authority. This change will grant Treasury the regulatory authority to permit the IRS to correct errors in certain narrow circumstances providing an appropriate balance between using IRS resources efficiently and effectively and maintaining the procedural protections available to taxpayers. While this authority is not the complete solution, it is a step in the right direction to ensure taxpayers receive the full benefit of this credit. The IRS has begun re-evaluating past and present efforts to meet these goals, and the IRS is exploring new approaches such as the simplification of EITC eligibility criteria and the identification of more efficient means to distinguish valid claims from over claims. In the future, Treasury will ensure that internal and external stakeholders and subject matter experts work together diligently and closely to identify more potential solutions to the challenge of improper payments. Treasury will continue to work closely with the IRS to accelerate the implementation date of reauthorization proposals or proposed statutory changes to bring the EITC program in compliance with IPERA.

Implementation Date: May 15, 2015

Responsible Official: Assistant Secretary for Management

Donna F. Joseph, Deputy Assistant Inspector General for Financial Management and Information Technology Audit
Michael Fitzgerald, Director, Financial Audit
Catherine Yi, Audit Manager
Myung Han, Audit Manager
Kenneth Harness, Auditor-in-Charge
Rufus Etienne, Senior Auditor
Robert Hong, Auditor
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