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United States Government Accountability Office
Washington, DC 20548

June 21, 2011

The Honorable Douglas H. Shulman
Commissioner of Internal Revenue

Subject: *Management Report: Improvements Are Needed to Enhance the Internal Revenue Service's Internal Controls and Operating Effectiveness*

Dear Mr. Shulman:

In November 2010, we issued our report on the results of our audit of the financial statements of the Internal Revenue Service (IRS) as of, and for the fiscal years ending, September 30, 2010, and 2009, and on the effectiveness of its internal control over financial reporting as of September 30, 2010.¹ We also reported our conclusions on IRS's compliance with selected provisions of laws and regulations and on whether IRS's financial management systems substantially comply with the requirements of the Federal Financial Management Improvement Act of 1996. In March 2011, we issued a report on information security issues identified during our fiscal year 2010 audit, along with associated recommendations for corrective actions.²

The purpose of this report is to present internal control issues identified during our audit of IRS's fiscal year 2010 financial statements for which we do not already have any recommendations outstanding. While two of these issues contributed to a significant deficiency in internal control discussed in our report on the results of our fiscal year 2010 financial statement audit, they all warrant IRS management's attention.³ This report provides 29 recommendations to address the internal control issues we identified. We will issue a separate report on the status of IRS's

¹GAO, *Financial Audit: IRS's Fiscal Years 2010 and 2009 Financial Statements*, [GAO-11-142](#) (Washington, D.C.: Nov. 10, 2010).

²GAO, *Information Security: IRS Needs to Enhance Internal Control over Financial Reporting and Taxpayer Data*, [GAO-11-308](#) (Washington, D.C.: Mar. 15, 2011).

³A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

implementation of the recommendations from our prior IRS financial audits and related financial management reports, as well as this one.

Results in Brief

During our audit of IRS's fiscal year 2010 financial statements, we identified several internal control issues for which we do not already have recommendations outstanding. These issues involved the following:

- **First-Time Homebuyer Tax Credits.** IRS's internal controls were not fully effective in identifying instances where taxpayers improperly made duplicate First-Time Homebuyer Credit (FTHBC) claims during fiscal year 2010. This occurred because IRS's related internal controls were not timely updated to effectively detect instances where taxpayers claimed the same FTHBC on both an amended 2008 tax return and a 2009 tax return. Consequently, erroneous refunds were disbursed.
- **Authorization of manual refunds.** Manual refund units at two IRS service center campuses (SCC) did not have current lists of officials authorized to approve manual refunds.⁴ This occurred because the appropriate managers did not always communicate staffing changes to the manual refund unit as required by IRS policy, and consequently, the lists became outdated.
- **Authorization of goods and services.** IRS did not always obtain approval before requesting and receiving services from vendors as required by IRS policy. This occurred because of an absence of sufficient procedures to help ensure compliance, as well as a lack of adherence to existing procedures.
- **Approval of personnel actions.** IRS did not always timely approve personnel actions for promotions prior to their effective dates as required by Office of Personnel Management guidelines. According to IRS, this occurred because of a lack of understanding of the requirements and because of the workload volume. In addition, IRS did not have specific procedures requiring central review and monitoring of the timeliness of personnel action requests and approvals to help ensure compliance with the requirements.
- **Recording time and attendance.** IRS did not always record Office of Chief Counsel employees' approved time card changes into IRS's electronic time and attendance system. This occurred because IRS did not have procedures in place to independently compare the time charges on approved manual time

⁴The preponderance of refunds are disbursed to taxpayers automatically by IRS's automated systems once a tax return is posted to the taxpayer's account and an overpayment to IRS is identified and calculated. However, refunds meeting certain defined criteria, such as those exceeding \$10 million, are subject to manual review and approval before disbursement and are known as manual refunds.

cards to those entered into IRS's time and attendance system to help ensure the accuracy of the system entries.

- **Verification of National Finance Center payroll changes.** IRS did not timely detect payroll errors made by the National Finance Center (NFC), which processes IRS's payroll. Although IRS was aware that NFC would be making a system programming change, IRS did not perform any testing after NFC implemented the change to help ensure that affected employees' pay and contributions were calculated correctly. Consequently, IRS was not aware that errors were made to some employees' pay calculations until we identified the problem in August 2010.
- **Cash receipts at the Beckley Finance Center.** IRS did not have internal controls in place to appropriately safeguard and account for cash receipts at the Beckley Finance Center (BFC). BFC receives various payments in the form of cash or checks daily; however, we found that BFC staff did not (1) immediately record these receipts in a control log when first received in the mail room, (2) maintain dual control over these receipts prior to logging them, and (3) reconcile the amount of receipts initially received to the amount deposited and recorded. This occurred because IRS had not established procedures at BFC requiring that these control activities be performed when handling cash receipts.
- **Contract employee background investigations.** IRS did not ensure that background investigations were performed for certain SCC mail couriers who were transporting mail that included taxpayer information from the SCC to the post office. Because IRS's policies and procedures do not require assigning a contracting officer's technical representative to contracts under \$100,000, IRS had not assigned anyone to oversee this particular courier contract. Consequently, background investigations for these mail couriers were not performed.
- **Deposit courier trip times.** Allowable time limits IRS established for some of its deposit courier routes greatly exceeded the average trip time and thus were not effective in identifying potential instances of SCC and lockbox bank deposit couriers making unauthorized stops during transit. This occurred because IRS lacked a consistent methodology for developing meaningful trip time limits, and thus the SCC and lockbox bank officials we spoke with were generally unable to explain or support how they arrived at each location's trip time limits.
- **Transfer of taxpayer information between processing facilities.** A courier vehicle's cargo door was not locked after it was loaded with taxpayer returns and other information, contrary to a requirement in the courier's contract. This occurred because neither the courier nor the business unit shipping or receiving the information verified that the cargo door was locked,

and because IRS lacked sufficient guidance for staff to properly monitor and enforce the provision requiring that cargo contents be locked during transport.

- **Document transmittal forms.** IRS's Small Business/Self-Employed Division managers were not adequately performing or documenting required reviews of internal control procedures over tracking and monitoring taxpayer receipts and information transmitted between IRS locations. This occurred because the *Internal Revenue Manual* (IRM) did not provide (1) a comprehensive process for managers to follow in assessing the existence of key controls and (2) clear guidance for how the reviews should be documented to help ensure that the controls were operating as designed.⁵
- **Compliance reviews of off-site processing facilities.** IRS did not complete compliance reviews for its off-site processing facilities every 2 years as required by the IRM. Although the IRM requires such reviews at processing facilities, IRS officials stated that the requirement was intended to apply only to the main SCC facility, and thus IRS only conducted compliance reviews at its off-site processing facilities once every 3 years. However, the IRM did not limit the requirement to the main SCC facilities, nor did it provide a separate requirement for off-site processing facilities, which, like the main SCC facilities, process revenue receipts and taxpayer information.
- **After dark security controls.** IRS's physical security controls intended to help prevent and detect unauthorized access to its processing facilities were not always effective. Specifically, we found that four exterior security lights were not functioning at one SCC we visited, thus hindering a full view of the exterior perimeter from the security cameras at night. However, the SCC's guards had not communicated this problem to management for correction because IRS's written procedures did not provide guidance to the security guards for reporting exterior light outages. In addition, SCC management was not aware of the outages because IRS did not require any of its periodic physical security reviews to occur after dark.
- **Property and equipment records.** IRS incorrectly recorded the asset purchase price for some assets in its property management system. This occurred because IRS did not have procedures to verify that the asset purchase price recorded in its property management system was accurate and consistent with the accounting records.
- **Disposal process for copiers.** IRS disposed of copiers without ensuring that the copiers did not contain confidential taxpayer information or sensitive information on IRS employees or operations on the hard drives. This occurred

⁵The IRM outlines business rules and administrative procedures and guidelines IRS uses to conduct its operations, and contains policy, direction, and delegations of authority necessary to carry out IRS's responsibilities to administer tax law and other legal provisions.

because IRS had not established policies or procedures that required wiping or removing the hard drives before disposing of the copiers.

These issues increase the risk that IRS may not prevent or promptly detect and correct (1) unauthorized or improper refunds, purchases, or promotions; (2) errors in the hours credited or amounts paid to staff; (3) loss or theft of cash receipts or taxpayer information; (4) security and control deficiencies at its SCCs and processing facilities; (5) data errors in its property records; and (6) improper disclosure of taxpayer and other sensitive data.

We are making 29 recommendations that if effectively implemented, should address the internal control issues we identified. These recommendations are intended to bring IRS into conformance with its own policies, the *Standards for Internal Control in the Federal Government*, or both.⁶

We provided IRS with a draft of this report and obtained its written comments. In its comments, IRS agreed with all of our recommendations and described actions it had taken, had under way, or planned to take to address the control weaknesses described in this report. In addition to its written comments, IRS provided technical comments on a draft of this report, which we incorporated as appropriate. Specifically, in most instances where we recommended changes in policy or procedures, we recommended that these be incorporated into the IRM. IRS explained that while it agreed with the policies and procedures we recommended, in a few instances the IRM was not the appropriate policy vehicle for the affected business units because they use different policy vehicles in those areas. Consequently, we modified three recommendations to remove references to the IRM and eliminated one recommendation because, as stated in the body of the report, the business unit established a written procedure after we brought the issue to its attention. At the end of our discussion of each of the issues in this report, we provide the related recommendations and have summarized IRS's related comments and our evaluation. IRS's comments are reprinted in enclosure II.

Scope and Methodology

This report addresses issues we identified during our audit of IRS's fiscal years 2010 and 2009 financial statements. As part of our audit, we tested IRS's internal control

⁶GAO, *Standards for Internal Control in the Federal Government*, [GAO/AIMD-00-21.3.1](#) (Washington, D.C.: November 1999), contains the internal control standards to be followed by executive agencies in establishing and maintaining systems of internal control as required by 31 U.S.C. § 3512 (c), (d) (commonly referred to as the Federal Managers' Financial Integrity Act of 1982).

over financial reporting.⁷ We designed our audit procedures to test relevant controls, including those for proper authorization, execution, accounting, and reporting of transactions. To assess internal controls related to safeguarding taxpayer receipts and information, we visited three SCCs,⁸ four lockbox banks,⁹ one off-site processing facility, eight Small Business/Self-Employed Division units,¹⁰ and eight taxpayer assistance centers.¹¹ We performed our audit of IRS's fiscal years 2010 and 2009 financial statements in accordance with U.S. generally accepted government auditing standards. We believe that our audit provided a reasonable basis for our findings and conclusions in this report. Further details on our audit scope and methodology are provided in our November 2010 report on the results of our audit of IRS's fiscal year 2010 and 2009 financial statement audit and are summarized in enclosure I.

First-Time Homebuyer Tax Credits

During our fiscal year 2010 financial audit, we found that IRS's internal controls were not fully effective in identifying instances where taxpayers made duplicate FTHBC claims related to the same home purchase,¹² resulting in payment of erroneous refunds. This internal control deficiency contributed to a significant deficiency in

⁷An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, the objectives of which are to provide reasonable assurance that (1) transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with U.S. generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition and (2) transactions are executed in accordance with the laws governing the use of budget authority and other laws and regulations that could have a direct and material effect on the financial statements.

⁸SCCs process tax returns and payments submitted by taxpayers.

⁹Lockbox banks are financial institutions designated as depositories and financial agents of the U.S. government under contract with the Department of the Treasury's Financial Management Service to perform certain financial services, including processing tax documents, depositing the receipts, and then forwarding the documents and data to IRS SCCs, which update taxpayers' accounts. During fiscal year 2010, there were seven lockbox banks processing taxpayer receipts on behalf of IRS.

¹⁰Small Business/Self-Employed Division units are field offices that serve partially or fully self-employed individuals, individual filers with certain types of nonsalary income, and small businesses.

¹¹Taxpayer assistance centers are field assistance units, located within IRS's Wage and Investment Division, designed to serve taxpayers who choose to seek help from IRS in person. Services provided include interpreting tax laws and regulations, preparing tax returns, resolving inquiries on taxpayer accounts, receiving payments, forwarding those payments to appropriate SCCs for deposit and further processing, and performing other services designed to minimize the burden on taxpayers in satisfying their tax obligations. These offices are much smaller facilities than SCCs or lockbox banks, with staffing ranging from 1 to about 35 employees.

¹²Making multiple FTHBC claims to receive multiple credits (e.g., two separate claims for \$8,000 each) is different from making one FTHBC claim, which is subsequently amended one or more times, to receive a single credit (e.g., a first claim for \$4,000 and a related amended claim for another \$4,000). In the first situation, the taxpayer is claiming more than the statutory limit for his or her circumstances. In the second situation, the taxpayer is correcting an earlier error in which he or she did not claim the entire amount of the credit to which he or she was entitled.

IRS's internal control over tax refund disbursements discussed in our report on the results of our fiscal year 2010 financial audit.¹³

The FTHBC is a refundable tax credit of up to the statutory limit of \$8,000 that an eligible first-time homebuyer could claim on a principal residence purchased from January 1, 2009, to April 30, 2010.¹⁴ For purposes of the credit, a first-time homebuyer is a taxpayer who (1) did not own a principal residence during the 3 years ending on the purchase date of his/her home or (2) meets the requirements for the long-time resident special rule.¹⁵ Eligible taxpayers who purchased a home during this period have the choice of making the FTHBC claim on the tax return of the year they purchased the home or amending their return of the year prior to the purchase of their home to make the credit claim.

In analyzing activity recorded in IRS's database of taxpayer accounts from October 1, 2009, through May 31, 2010, we identified 201 taxpayers who appeared to have each been allowed two FTHBCs, which collectively exceeded the maximum \$8,000 statutory limit. From these 201 cases,¹⁶ we statistically selected a random sample of 20 FTHBCs, reviewed the supporting documentation, and found that in 18 of these cases the taxpayers had submitted a claim on a 2008 amended return followed by a second claim on the 2009 return. In each case, IRS allowed both claims and consequently paid an erroneous refund.

¹³See [GAO-11-142](#).

¹⁴See the FTHBC, which is codified, as amended, at 26 U.S.C. § 36. The FTHBC was enacted in the Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, 122 Stat. 2654 (July 30, 2008), which provided taxpayers with a refundable tax credit up to \$7,500, which taxpayers must repay over 15 years, beginning in the 2011 filing season. It was subsequently amended three times with different versions of the FTHBC. The American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115 (Feb. 17, 2009), increased the maximum credit to \$8,000, and waived the repayment requirement for home purchases in 2009, so long as the home remains the taxpayer's primary residence for 3 years; the Worker, Homeownership, and Business Assistance Act of 2009, Pub. L. No. 111-92, 123 Stat. 2984 (Nov. 6, 2009), extended the time frame in which homebuyers could claim the FTHBC and included several other modifications; and the Homebuyer Assistance and Improvement Act of 2010, Pub. L. No. 111-198, 124 Stat. 1356 (July 2, 2010), included further credit modifications, such as extending the time frame for taxpayers to close on a house if they have entered into a written binding contract. While Congress did not renew the credit for tax year 2011, members of the military and certain other federal employees, who met certain requirements, had until April 30, 2011, to purchase a home or enter into a written binding contract in order to qualify for the credit. These taxpayers who entered into a binding contract prior to May 1, 2011, may also claim an FTHBC for a purchase made after April 30, 2011, and before July 1, 2011. See 26 U.S.C. § 36(h)(3).

¹⁵For FTHBC purposes, a long-time resident is defined as a taxpayer who has owned and used the same residence as a principal residence for any 5 consecutive years during the 8-year period ending on the date of the purchase of a subsequent principal residence. See 26 U.S.C. § 36(c)(6)

¹⁶We are 90 percent confident that 99 percent of the 201 FTHBC claims we identified as potential duplicate FTHBC claims resulted in the payment of erroneous tax refunds.

We expanded our analysis to encompass activity recorded in IRS's database of taxpayer accounts from April 2009 through mid-July 2010, and found an additional 201 taxpayers who also appeared to have been allowed multiple FTHBCs that collectively exceeded the \$8,000 statutory limit. However, the procedures we used to identify these 402 total suspicious cases were only able to detect instances where IRS allowed FTHBCs totaling more than \$8,000, which is the maximum dollar limit under the law. Our procedures were not able to detect instances where IRS allowed multiple FTHBCs totaling less than \$8,000 and to determine whether each one was allowable. Consequently, the actual number of taxpayers who were erroneously allowed multiple FTHBCs may be larger.

Internal control standards provide that internal control should be designed to provide reasonable assurance regarding the prevention of or prompt detection of unauthorized use or disposition of agency assets.¹⁷ This includes providing reasonable assurance that improper refund disbursements will be prevented or detected. However, when the specific filing requirements related to FTHBC were initiated, IRS's related internal controls were not revised to provide for effective detection of instances where taxpayers claimed the same FTHBC on both an amended 2008 tax return and an original 2009 tax return and thereby prevent erroneous refunds. For example, IRS uses numerous validity checks imbedded in its automated systems to detect a variety of erroneous or otherwise improper tax returns during processing. IRS informed us that at the time these erroneous refunds were disbursed, it had validity checks in place to prevent the acceptance of duplicate FTHBC claims filed on original tax returns. However, the validity checks were not designed to detect duplicate FTHBC claims that appeared on amended tax returns.

Subsequent to our testing, IRS informed us that it had implemented new validity checks in its automated systems. According to IRS, the new validity checks prevent the acceptance of duplicate FTHBC claims where one was filed on an amended tax return and the combined dollar amount exceeds the maximum statutory limit. Per IRS, its automated systems will reject the FTHBC claim if it does not pass its new validity checks.¹⁸ For example, the automated systems will reject the FTHBC claim if a taxpayer submits a second FTHBC claim and the sum of the two claims submitted by the taxpayer exceed the maximum statutory limit of \$8,000. However, IRS has not implemented procedures to monitor and verify the effectiveness of the new validity checks. If the effectiveness of these validity checks is not routinely monitored, IRS

¹⁷[GAO/AIMD-00-21.3.1.](#)

¹⁸The validity checks are not designed to reject instances where the sum of two claims filed by a taxpayer is less than or equal to the maximum statutory limit. A taxpayer can legitimately file multiple amended FTHBC claims related to a single home purchase, so long as the sum of the claims does not exceed the statutory limit. For example, an eligible taxpayer who (1) miscalculated the price of the home and filed a claim for an incorrect amount can file a related amended claim for the difference; (2) filed a \$7,500 FTHBC claim for a 2009 purchase can file for a related amended claim equal to \$500; and (3) purchased a home for \$80,000 and claimed a \$4,000 credit when filing as married filing separate can amend his/her return to file married filing jointly and claim an additional \$4,000 for the couple, provided the spouse had not previously filed an FTHBC claim for the home.

lacks assurance that they are functioning properly. This increases the risk that IRS may continue to disburse erroneous FTHBC-related refunds for amended returns.

Recommendation

We recommend that you direct the appropriate IRS officials to put procedures in place to periodically monitor the effectiveness of the new FTHBC validity checks for the duration of the filing of FTHBC claims to verify that they are working as intended.

IRS Comments and Our Evaluation

IRS agreed with our recommendation and stated that it has established procedures to monitor the effectiveness of its validity checks and controls via daily reports. IRS's proposed actions, if successfully carried out, should address the intent of our recommendation. We will evaluate the effectiveness of IRS's efforts during our audit of IRS's fiscal year 2011 financial statements.

Authorization of Manual Refunds

During our fiscal year 2010 financial audit, we found an internal control deficiency in the processing of manual refunds, which ultimately contributed to a significant deficiency in IRS's internal control over tax refund disbursements that we discussed in our report on the results of our fiscal year 2010 financial audit.¹⁹ Specifically, we found that the manual refund units at two SCCs were relying on outdated lists of approving officials to verify that manual refunds were properly authorized. To ensure proper segregation of duties, management authorizes specific individuals to approve manual refunds for processing and other specific individuals to actually process the refunds. In each IRS SCC, the manual refund unit maintains a list of officials currently authorized to approve manual refunds. When processing manual refunds, the manual refund unit is required to verify each signed manual refund against the list of authorized approving officials to help ensure that only authorized individuals approve manual refunds. For this control to be effective, the list needs to reflect accurate, up-to-date information. However, at the two SCCs we visited, we identified instances where the list contained outdated information. Specifically, we found the following.

- At one SCC, the list of authorized approving officials contained names of three IRS employees from the Criminal Investigation Unit whose authority to approve manual refunds ceased when their manual refund unit dissolved in January 2010. This occurred because the Criminal Investigation Unit, because of an oversight, did not notify the manual refund unit of the personnel changes so the list could be updated.
- At the same SCC, we found that an employee's role changed, resulting in the termination of the employee's authority to approve manual refunds. However,

¹⁹See [GAO-11-142](#).

the employee's business unit's manager did not notify the manual refund unit of the change. Consequently, at the time of our visit, this employee's name erroneously remained on the manual refund unit's list of authorized manual refund approving officials.

- At another SCC, we found that an employee who had retired in January 2010 was still included on the list of officials authorized to approve manual refunds at the time of our testing in June 2010. The manual refund unit at this SCC had not received notification of the personnel change because the secretary of the delegating manager forgot to inform the unit of the employee's retirement.

Internal control standards state that information should be recorded and communicated to management and others within the entity who need it and in a form and within a time frame that enables them to carry out their internal control and other responsibilities.²⁰ Additionally, the IRM states that while the manual refund unit maintains the list of employees authorized to approve manual refunds, it is the responsibility of the appropriate managers to immediately notify the manual refund unit of personnel changes so it can timely update the lists of employees authorized to approve refund requests. The IRM also states that the manual refund unit will annually solicit an update of officials authorized to approve manual refunds from the directors and heads of offices.²¹ Delays in timely communicating personnel changes to the manual refund unit increase the risk that unauthorized individuals can approve manual refunds and that erroneous or fraudulent refunds will be issued, thereby exposing the federal government to unnecessary losses.

Recommendation

We recommend that you direct the appropriate IRS officials to establish a mechanism to enforce the existing requirement for appropriate managers to immediately notify the manual refund units of any personnel changes affecting the approval or processing of manual refunds. This may be accomplished through mechanisms such as issuing periodic alerts, providing training, having the manual refund unit perform quarterly validations of the list of manual refund approving officials, or a combination of these.

IRS Comments and Our Evaluation

IRS agreed with our recommendation and stated that it would require all SCC accounting functions to provide a list of manual refund authorizers to the head of each business operating division quarterly to validate the individuals who are still authorized to sign manual refunds, starting at the end of June 2011. IRS stated that it will incorporate this change into the IRM by August 2011. However, it is not clear how this approach will ensure that the manual refund units are timely made aware of

²⁰GAO/AIMD-00-21.3.1.

²¹IRM § 3.17.79.3.5, *Employee Authorized to Sign Requests for Manual Refunds* (Jan. 1, 2010).

personnel changes affecting the approval or processing of manual refunds as intended by this recommendation. We will follow up during our audit of IRS's fiscal year 2011 financial statements to determine if this approach achieves the objective of this recommendation.

Authorization of Goods and Services

During our fiscal year 2010 financial audit, we found that IRS did not always obtain the requisite approval before entering into an agreement with, and receiving services from, vendors. IRS requires its employees to obtain various approvals before procuring goods and services in order to ensure that IRS has a legitimate business need for the goods and services and that sufficient funding is set aside to pay for them. Specifically, once an individual identifies the need for a good or service, the individual is required to forward the request to an approving official, who determines whether IRS has a legitimate business need for the good or service. If the approving official agrees with the need and approves the purchase, the request is then to be forwarded to a financial plan manager who must also approve the requisition, thereby indicating that sufficient funding exists to pay for it. Once these approvals have been obtained, IRS can begin the process of procuring the good or service. If IRS procures the good or service using the Office of Procurement, a contracting officer (CO) is assigned to process the request.²² The CO may delegate certain administrative tasks, such as issuing orders against an awarded contract, monitoring contract performance, and performing receipt and acceptance functions, but the CO is still the only individual authorized to modify the contract in any way.

During our fiscal year 2010 testing of a statistical sample of 115 nonpayroll expenses, we identified two cases in which IRS personnel did not request and obtain the proper approvals before acquiring services from vendors.²³ Specifically, we found the following.

- In one case, an IRS employee requested that a contractor conduct a training course for IRS staff that began on March 22, 2010, but did not receive approval from the financial plan manager indicating that funding was available until March 23, 2010, a day after the class had already started. The IRM states that the Standard Form 182, which is used to procure a training course conducted by an outside instructor, must be approved and funding obtained prior to the

²²The majority of IRS's purchases go through the Office of Procurement; however, nonprocurement transactions, such as advances, rent, travel, postage, training, printing, reimbursable items, and micropurchases up to \$3,000, are processed by business units rather than the Office of Procurement.

²³We identified these two instances during our testing of a statistical sample of 115 transactions covering expenses other than payroll and travel recorded from October 1, 2009, through May 31, 2010. Based on our testing, we estimated that the value of such expenses that could have the same control error could be as high as \$98.9 million (i.e., the net upper error limit at a 95 percent confidence level) out of a population of \$2.1 billion.

training event, which includes obtaining a signature from the financial plan manager.²⁴

- In the other case, an IRS employee requested services outside the scope of a contract without first seeking approval from the CO. Specifically, under a contract for document-shredding services, an employee—who was not the CO—requested that the vendor make an 11th trip to pick up documents for shredding when the contract only allowed for 10 pickups. By requesting and receiving the additional trip without proper authority to modify the contract terms, the employee established an unauthorized commitment.²⁵ In addition, funds had not previously been set aside and approved for an 11th pickup. The Federal Acquisition Regulation states that only a CO is authorized to modify contracts and bind the agency to a modified contract.²⁶

In both cases, we found that these staff did not follow IRS's policy to obtain the requisite approvals before procuring goods or services. In the first case, an IRS official stated that the individual who procured the training course focused only on the need for the class and anticipated that the financial plan manager's approval would be obtained before the class concluded. In the second case, an IRS official stated that the individual who requested additional services from the vendor did not recognize that the services authorized under the contract had already been exhausted because IRS did not require the individual to compare the services received to date against the contract terms prior to ordering additional services.

Internal control standards state that transactions and other significant events should be authorized and executed only by persons acting within the scope of their authority. This is the principal means of ensuring that only valid transactions to exchange, transfer, use, or commit resources and other events are initiated or entered into. By procuring goods/services without obtaining required approvals from the proper officials, employees risk binding IRS to a service that the agency does not want or for which it does not have sufficient funding or, in certain circumstances, creating unauthorized commitments that require IRS to incur unplanned costs if it chooses to ratify the commitment. It also further increases IRS's risk of fraudulent and unauthorized purchases and noncompliance with relevant laws, regulations, and IRS policies.

²⁴IRM § 6.410.1.1.14.1, *Acquiring Outservice Training*, and § 6.410.1.1.14.2, *Standard Form 182 Process* (Mar. 12, 2009).

²⁵An unauthorized commitment does not create a valid obligation and constitutes a nonbinding agreement that a CO may later ratify. IRS must have adequate funds available to cover the cost of ratifying an unauthorized commitment. *See* Federal Acquisition Regulation, 48 C.F.R. § 1.602-3 (Ratification of Unauthorized Commitments by Contracting Officers).

²⁶Federal Acquisition Regulation, 48 C.F.R. §§ 1.602 (Contracting Officers) and 43.102 (Contract Modifications Policy).

Recommendations

We recommend that you direct the appropriate IRS officials to take the following actions:

- Send out a reminder to all staff to follow policies and procedures for obtaining approval and funding of proposed purchases prior to entering into an agreement with vendors.
- Establish formal written procedures requiring staff to review purchase contract terms against the goods and services received to date before requesting additional goods or services.

IRS Comments and Our Evaluation

IRS agreed with our recommendations and plans to develop formal written instructions by the end of June 2011 to address the requirement to review contract terms and status of deliverables, and ensure that all related ordering activity is in compliance with the terms and conditions of the contract. IRS also stated that it plans to disseminate these instructions to all of its requisition tracking system users and business units, and send a reminder by the end of July 2011 to all employees to follow policies and procedures for obtaining approval and funding of proposed purchases prior to entering into agreements with vendors. IRS's proposed actions, if successfully carried out, should address the intent of our recommendations. We will evaluate the effectiveness of IRS's efforts during our audit of IRS's fiscal year 2011 financial statements.

Approval of Personnel Actions

During our fiscal year 2010 financial audit, we found that IRS did not always approve personnel actions for promotions prior to their effective dates. Timely approval of promotions prior to effective dates is essential in order to help ensure that employees are properly qualified for their new duties and to minimize the risk that employees may be compensated at a higher rate than that to which they are entitled.

IRS follows the Office of Personnel Management's (OPM) *Guide to Processing Personnel Actions* on preparing personnel actions. Accordingly, IRS uses the OPM Request for Personnel Action, Standard Form 52 (SF-52), which states that the approver certifies that the information entered on the form is accurate and that the processed action is in compliance with statutory and regulatory requirements.²⁷ IRS's business operations divisions, referred to as business units, initiate SF-52s in HR Connect—IRS's personnel system—and forward them through HR Connect to human

²⁷Per 5 U.S.C. § 2951, OPM has issued implementing regulations (5 C.F.R. § 9.2) that prescribe requirements for executive agencies on submitting information related to civilian employees, including reporting on appointments and other personnel actions.

resource (HR) specialists in IRS's Human Capital Office for approval and processing. All HR specialists are instructed to follow OPM guidelines and to process actions within established time frames.²⁸ For SF-52s approved with a promotion action, the HR specialists are to review the merit promotion rules and verify each employee's eligibility for the requested promotion prior to the effective date of the promotion.²⁹ However, during our testing of a statistical sample of 80 employees who were paid from October 1, 2009, through June 30, 2010, we found that IRS did not approve 2 of the 80 employees' SF-52s—both of which were associated with promotion actions—until after the effective dates of the actions.³⁰ In the first instance, an employee was selected for a competitive temporary promotion on July 24, 2009, with an effective date of August 2, 2009.³¹ IRS did not approve the promotion until August 19, 2009, 17 days after the effective date of the promotion. In the second instance, an employee received a career ladder promotion effective June 21, 2009. The employee's manager initiated and submitted the personnel action stating that the employee was eligible for promotion on May 29, 2009. The HR specialists received the personnel action request on June 2, 2009, but didn't approve the promotion until July 2, 2009, 30 days after receipt.

The IRM requires that IRS's human resource policies and procedures conform with existing legal requirements, including applicable OPM regulations.³² In addition, the IRM incorporates by reference the OPM guide for IRS to use for processing accession actions and conversions to other appointments in the competitive and excepted service.³³ The OPM guide requires that (1) no personnel action can be made effective prior to the date on which the appointing officer approved the action and (2) approval of a personnel action certifies that the action meets all legal and regulatory requirements. According to IRS officials, several factors contributed to the delays in approving personnel actions. In the first case, IRS officials informed us that although IRS provided its HR specialists training for approving personnel actions, the

²⁸According to IRS Human Capital Office officials, business units are generally required to submit SF-52s to the HR specialists one full pay period prior to the effective date of the personnel action. There may be exceptions, such as requests for employee separations.

²⁹All candidates for promotion must meet all minimum eligibility and qualification requirements before they may be promoted.

³⁰We performed dual purpose testing from a statistical sample of 80 payroll transactions, and the results of this type of testing must be expressed in dollar values. However, because the errors we found relate to the number of employees with unapproved personnel actions rather than to payroll dollars, we are unable to project the number of personnel actions related to promotions that contain errors.

³¹For each employee in our payroll transaction sample, we reviewed the most recent personnel action affecting his/her authorized pay rate that was in effect at the time of our testing in August 2010. Consequently, some of the personnel actions reviewed were effective prior to fiscal year 2010.

³²IRM § 6.250.1.3, *Issuing and Revising HRM Policies, Procedures, and Programs* (June 1, 2002).

³³IRM § 6.300.1.2, *Employment Procedures, Policies, and Delegations* (Nov. 6, 2009).

HR specialist in this case misunderstood the process and erroneously waited for paperwork that was not required for the approval process. In the second case, IRS officials said the HR specialist's workload volume caused the delay in approving the promotion. IRS officials also informed us that delays may also occur in approving personnel actions when the business units submit personnel action requests close to the effective dates of the actions. Because IRS did not centrally review and monitor the timeliness of personnel action requests and approvals to ensure compliance with applicable requirements, IRS was not aware that the promotions we identified were approved after their effective dates. Had IRS established and implemented procedures for monitoring the timeliness of these actions, it might have also recognized actions needed to provide additional instruction or adjust the workload levels of staff to help ensure that approvals occurred on time. Promoting employees prior to an HR specialist's approval increases the risk that employees may (1) be paid at higher rates than they are entitled and (2) not meet minimum qualification requirements to effectively perform their new duties.

Recommendation

We recommend that you direct the appropriate IRS officials to establish procedures to centrally review and monitor the timeliness of personnel action requests and approvals to help ensure compliance with the IRM and applicable OPM regulations and guidance.

IRS Comments and Our Evaluation

IRS agreed with our recommendation and stated that it developed a report and a process in April 2011 to centrally review and monitor the timeliness of noncompetitive personnel actions, and plans to establish a similar system to track the timeliness of competitive personnel actions by the end of August 2011. In addition, IRS said that it plans to establish a centralized quality review program to further support the ongoing evaluation of results and identify opportunities for improvement by the end of July 2011. IRS's proposed actions, if successfully carried out, should address the intent of our recommendation. We will evaluate the effectiveness of IRS's efforts during our audit of IRS's fiscal year 2011 financial statements and future audits.

Recording Time and Attendance

During our fiscal year 2010 financial audit, we found that IRS's controls were not fully effective in ensuring that all approved changes to time cards were appropriately entered into IRS's electronic time and attendance system. IRS employees record their time and attendance information either directly into IRS's Single Entry Time Reporting System (SETR), which is IRS's electronic time and attendance system, or by use of other forms or formats for subsequent input into SETR.³⁴ IRS's Office of

³⁴IRS allows its units to use alternative methods of timekeeping as long as all documents are controlled and retained.

Chief Counsel uses a manual time and attendance recordkeeping process whereby employees prepare manual hard-copy time cards that are signed by approving officials and then forwarded to an office manager—designated in SETR as a “proxy”—for electronic entry into SETR. However, during our testing of a statistical sample of 80 payroll transactions, we found that one employee’s manual time card was approved for 6 credit hours earned, but the electronic time card from SETR showed only 5 credit hours earned.³⁵ IRS officials informed us that the employee decided to work an additional hour on the last day of the pay period, which was after the employee’s initial time card had been approved and entered electronically into SETR. The employee prepared an amended time card, which the approving official signed and provided to the designated proxy. However, the proxy did not enter the subsequent change in the time and attendance system. IRS did not have procedures in place requiring an independent review of the approved manual time cards to the time and attendance information entered into SETR. Consequently, IRS was unaware of the discrepancy until we identified the problem. IRS subsequently corrected the electronic time card in SETR, about 9 months after the initial manual time card had been approved.

Internal control standards state that transactions should be accurately and timely recorded to maintain their relevance and value to management in controlling operations and making decisions. This applies to the entire process or life cycle of a transaction or event from initiation and authorization through its final classification in summary records.³⁶ If IRS does not properly record its employees’ time and attendance, employees may not be properly paid or credited for hours they worked, or may be overpaid or overcredited for hours they did not work.

Subsequent to our apprising IRS of this issue, IRS officials informed us that the Office of Chief Counsel field office where the error occurred had established and implemented new procedures in February 2011 for that field office to help ensure that manual time cards were accurately entered into SETR. Specifically, the new procedures require one timekeeper to enter the time cards into SETR for his or her assigned staff, and a second timekeeper to verify each manual time card against the hours recorded. Both timekeepers are required to sign each time card signifying entry and verification. After the time is entered and verified in SETR, the office manager or other designated supervisory staff member will sign the approval in SETR. Under the new procedures, the office manager will also regularly audit the time cards to help ensure that all required signatures (i.e., approving official, timekeeper, and verifying timekeeper) are present, and send quarterly reminders to all staff reminding them to compare their manual time card leave and credit hour balances with the balances shown on either their earnings and leave statements or in SETR. We have reviewed

³⁵ During our audit, we did not specifically test manual time cards against time entered into SETR. This exception was identified in conjunction with a test of the grade levels of approving officials who entered data into SETR. Therefore, we cannot project the results because we selected our sample from IRS’s entire payroll and not just from employees who used manual time cards.

³⁶ [GAO/AIMD-00-21.3.1](#).

these new procedures and believe that if fully and effectively implemented, they should help prevent or detect future errors. However, these new procedures are currently only applicable to the specific field office where the error occurred. As such, they do not preclude similar errors from occurring in other locations that also use hard-copy or other alternative time and attendance forms for subsequent input into SETR.

Recommendation

We recommend that you direct the appropriate IRS officials to adopt the local field office's timekeeping procedures or similar procedures for entering and verifying the accuracy of time and attendance information entered into SETR throughout IRS for use by all units in which employees do not enter their own time charges directly to SETR.

IRS Comments and Our Evaluation

IRS agreed with our recommendation and said that it plans to modify its procedures for reporting and approving time and attendance by the end of August 2011 to include the recommended requirements. IRS stated that it would also disseminate the procedures to all of its SETR business unit points of contact who are currently able to approve time cards in SETR. IRS's proposed actions, if successfully carried out, should address the intent of our recommendation. We will evaluate the effectiveness of IRS's efforts during our audit of IRS's fiscal year 2011 financial statements and future audits.

Verification of NFC Payroll Changes

During our fiscal year 2010 financial audit, we found that IRS did not always timely detect errors made by the National Finance Center (NFC) in processing IRS's payroll.³⁷ Specifically, we found that NFC made a programming change to its systems that caused incorrect computations of the Thrift Savings Plan (TSP) mandatory agency contribution for some IRS employees, and gave these employees 2 percent of their base pay instead of the statutorily required 1 percent for several months in 2009. IRS was not aware of these errors until we identified the problem during our testing in August 2010.

In June 2009, the President signed into law the Thrift Savings Plan Enhancement Act that eliminated the waiting period of up to a year that previously prevented newly hired federal employees covered under the Federal Employees Retirement System from becoming immediately eligible to receive the TSP agency automatic 1 percent of

³⁷NFC is a component of the Department of Agriculture that provides administrative and financial services to many federal agencies, including IRS. IRS forwards personnel and payroll data to NFC to process its payroll.

base pay contribution and the agency matching contribution.³⁸ To implement this legislation, NFC informed IRS that it would perform an automated system sweep to identify and update the payroll/personnel system database records for employees who were in the waiting period with the appropriate eligibility codes so that the employees could begin receiving their TSP agency contributions as appropriate. However, errors made in NFC's sweep process resulted in NFC crediting excess TSP agency contributions for 67 IRS employees totaling over \$7,700 from June until November 2009.³⁹ IRS was unaware of these errors until we identified the problem during our testing in August 2010. NFC corrected the errors in December 2010 and January 2011 but was unable to correct errors or recover overpayments that were beyond the 1-year time limit allowed for recovery or were associated with employees who had since left IRS.⁴⁰

Internal control standards state that transactions should be accurately and timely recorded. Managers also need to compare actual performance to planned or expected results and analyze significant differences.⁴¹ In addition, the Department of Agriculture's Office of Inspector General (IG) conducts an annual audit of NFC's internal control structure in accordance with the American Institute of Certified Public Accountant's Statement on Auditing Standards (SAS) No. 70 and issues a report (SAS 70 report).⁴² In its 2010 SAS 70 report on NFC, the IG issued an unqualified opinion and reported no material weaknesses in internal control.⁴³ However, the IG noted that it is not feasible for NFC's service-related control objectives to be solely achieved by NFC's control activities and procedures.

³⁸See Pub. L. No. 111-31, div. B, tit. I, 123 Stat. 1853 (June 22, 2009); see also Thrift Savings Plan Bulletin for Agency TSP Representatives No. 09-9, *Participation in the Thrift Savings Plan* (Sept. 9, 2009), pp. 3-4.

³⁹According to IRS officials, NFC was unable to explain how the errors occurred or why they stopped in November 2009.

⁴⁰See TSP regulation, 5 C.F.R. § 1605.12 (Removal of Erroneous Contributions), which provides that after 1 year the erroneous amount removed from the participant's account will not be returned to the participant's employing agency and will instead be used to offset TSP administrative expenses.

⁴¹[GAO/AIMD-00-21.3.1](#).

⁴²SAS No. 70, *Service Organizations*, provides guidance (1) on the factors an independent auditor should consider when auditing the financial statements of an entity that uses a service organization to process certain transactions and (2) for independent auditors who issue reports on the processing of transactions by a service organization for use by other auditors. NFC is considered a "service organization" as defined by SAS No. 70. SAS No. 70 will be replaced by Statement on Standards for Attestation Engagements No. 16, *Reporting on Controls at a Service Organization*, effective June 15, 2011, and by Clarified Statement on Auditing Standards, *Audit Considerations Relating to an Entity Using a Service Organization*, effective December 15, 2012.

⁴³Department of Agriculture, Office of Inspector General, *Audit Report: Statement on Auditing Standards No. 70 Report on National Finance Center Controls*, Report No. 11401-33-FM (Washington, D.C., Sept. 24, 2010).

Accordingly, the IG reported that user agencies should establish controls or procedures to complement those at NFC.

However, IRS did not have procedures to detect errors that may result from NFC's system programming changes, and thus it did not identify the errors we identified. According to IRS officials, IRS participated in NFC's tests of planned programming changes prior to implementation, but did not perform any tests of the results after such programming changes were made to help ensure that they were made correctly. Because running simulations on test data may yield different results than actual programming changes on live production data, it is essential that postimplementation tests be performed to ensure that such changes yield expected results.

We previously reported on a similar issue identified during our audit of IRS's fiscal year 2003 financial statements.⁴⁴ At that time, we found that 131 IRS employees erroneously received excess mandatory contributions to their TSP accounts, equaling 2 percent of their base pay rather than the 1 percent required by law. However, in those instances NFC was unable to determine the cause of the errors. Based on our recommendation at the time, IRS expanded its existing quarterly random sample review of payroll activities to include the recalculation of agency TSP contributions. While this is still a valid control that IRS should continue, this test did not identify the TSP errors we found in fiscal year 2010 because it was not designed to test a specific population, such as only those employees affected by a specific system programming change. Because IRS did not have controls in place to verify that NFC's system programming changes were properly made, IRS did not detect the payroll errors made by NFC and lost the ability to recover all of the excess TSP contributions. Such recoveries could have been used to help pay for its operations.

Subsequent to our bringing this issue to its attention, IRS updated its procedures to require review of a separate random sample of employees after NFC makes system changes that affect a large volume of employees to help ensure that the NFC system changes worked properly and to identify and remediate any problems identified. However, IRS's procedures do not specify that this random sample be drawn from a population that consists only of those employees likely to be affected by the NFC programming changes, and thus the sample results may not be an accurate indicator of the effectiveness of NFC's changes. As we noted earlier, IRS's normal quarterly random sample review of payroll activities did not identify the TSP errors we identified because IRS sampled from the entire population of IRS employees while the programming change only affected individuals covered under the Federal Employees Retirement System who were in the TSP waiting period. In addition, these new procedures did not provide the criteria for determining what programming changes will be subject to validation or establish responsibility for making and documenting this determination.

⁴⁴GAO, *Management Report: Improvements Needed in IRS's Internal Controls and Accounting Procedures*, [GAO-04-553R](#) (Washington, D.C.: Apr. 26, 2004).

Recommendation

We recommend that you further revise your detailed procedures for implementing the requirement to validate the appropriateness of NFC programming changes after such changes are made. These revisions should (1) clarify the criteria for determining what programming changes will be subject to validation, (2) identify officials responsible for making and documenting these determinations, and (3) require postimplementation statistical sampling from a targeted population that consists of employees who are most likely to be affected by the NFC programming change.

IRS Comments and Our Evaluation

IRS agreed with our recommendation and stated that it would develop a detailed standard operating procedure by the end of September 2011 that would address the elements cited in our recommendation. IRS's proposed actions, if successfully carried out, should address the intent of our recommendation. We will evaluate the effectiveness of IRS's efforts during our audit of IRS's fiscal year 2012 financial statements.

Cash Receipts at the Beckley Finance Center

During our fiscal year 2010 financial audit, we found that IRS did not have internal controls in place to appropriately safeguard and establish accountability for cash receipts received at its Finance Center in Beckley, West Virginia (BFC). BFC receives nontax payments in the form of cash or checks from customers, vendors, and employees daily.⁴⁵ BFC is responsible for handling all aspects of the processing of these receipts, from opening the mail, logging the payments received, and depositing the funds, to recording the transactions into IRS's financial system.

During our review of IRS's controls over such receipts at BFC, we found the following.

- Receipts were not immediately logged when first discovered in the mail room and were not under dual control at all times before they were recorded on a control log. Three BFC contract employees were responsible for handling receipts in the mailroom prior to the receipts being logged.⁴⁶ Upon discovery of receipts, the employee responsible for opening the mail transferred the receipts to a second employee who was responsible for reconciling the receipts to any documentation that accompanied the receipts. The second employee then transferred the receipts to a third employee, who was solely

⁴⁵IRS enters into agreements with other entities, including federal agencies, state governments, and private organizations, to provide services on a reimbursable basis. IRS refers to these entities as customers.

⁴⁶BFC's mail room staff consists entirely of contract employees who are required to pass a background check.

responsible for logging the receipts onto a control log. Each employee performed his or her assigned processing steps without the participation or intervention of another employee or a supervisor.

- BFC did not perform a reconciliation or other procedures to ensure that the amount of cash receipts initially received in the mail room matched the amount deposited and recorded, thus ensuring accountability for all cash receipts. After receipts were logged, the BFC mail room staff provided the receipts and the control log to an IRS accounting technician under single control to prepare the deposit. Once the deposit was prepared, the technician returned a photocopy of the log to the mail room; however, mail room staff did not verify that the log had not been changed. Additionally, while IRS staff reconciled the deposit amount to the amount recorded in IRS's general ledger, no one reconciled or compared the amount deposited and recorded back to the original log of receipts received in the mail room.

Internal control standards require that agencies establish physical controls to secure and safeguard vulnerable assets, such as cash.⁴⁷ Such assets should be periodically counted and compared to control records. The standards further state that key duties and responsibilities need to be divided or segregated among different individuals to reduce the risk of error or fraud. However, we found that IRS had not established procedures at BFC consistent with these requirements. The lack of adequate internal controls and accountability over cash receipts increased the risk that loss or theft would not be prevented or detected by BFC in a timely manner.

IRS made notable progress in the past in addressing internal control weaknesses related to safeguarding taxpayer receipts processed at its primary submission processing locations, such as SCCs and lockbox banks. IRS's efforts to address these weaknesses resulted in our closing a significant deficiency in internal control over hard-copy taxpayer receipts in fiscal year 2008. However, it is important that the basic safeguarding controls established in these locations be extended to other locations that receive and process nontax cash receipts. After we identified the issues at BFC, IRS revised its BFC desk procedures in September 2010 to require (1) cash receipts to be immediately logged under dual control when first discovered in the mail room, (2) mail room staff to maintain a copy of the log at all times, and (3) the amount of cash receipts initially discovered in the mail room to be independently reconciled to the amount deposited and recorded. These actions should help address this issue. However, to further reduce the risks we identified during our audit, it is important that IRS appropriately implement these requirements.

Recommendations

We recommend that you direct the appropriate IRS officials to take steps to effectively implement procedures at BFC requiring

⁴⁷[GAO/AIMD-00-21.3.1.](#)

- cash receipts to be immediately logged under dual control when first discovered in the mail room,
- mail room staff to maintain custody of the control log at all times, and
- the amount of cash receipts initially discovered in the mail room to be independently reconciled to the amount deposited and recorded in the general ledger.

IRS Comments and Our Evaluation

IRS agreed with our recommendations and indicated that it revised its check deposit process, updated its desk procedures, and trained employees on the new process to address these recommendations in late fiscal year 2010. IRS's proposed actions, if successfully carried out, should address the intent of our recommendations. We will evaluate the effectiveness of IRS's efforts during our audit of IRS's fiscal year 2011 financial statements.

Contract Employee Background Investigations

During our fiscal year 2010 financial audit, we found that IRS's controls were not fully effective in ensuring that all individuals responsible for handling sensitive taxpayer data had received favorable background investigation results before being granted access to that information. Specifically, at one of the SCCs we visited, background investigations had not been performed for three contract employees responsible for picking up outgoing mail, sorting it at a non-IRS facility, and then delivering it to a U.S. post office for mailing. These contract mail couriers had physical possession of first-class mail, which contained information relating to taxpayers. In previous years' audits, we found that IRS allowed contract employees at its SCCs, lockbox banks, taxpayer assistance centers, field offices, and off-site contractor facilities access to cash, checks, and other taxpayer information before management had received satisfactory results of each individual's background investigations, thereby subjecting IRS to an increased risk of theft or misuse of taxpayer receipts and data.⁴⁸ As a result, we recommended that IRS (1) clarify its requirements for which contract employees are subject to background investigations, (2) maintain appropriate documentation of background investigation results, and (3) enforce the requirement that appropriate background investigations be completed before contractors are granted routine, unescorted, unsupervised access to IRS facilities and to taxpayer data and receipts.

⁴⁸GAO, *Management Report: Improvements Needed in IRS's Accounting Procedures and Internal Controls*, [GAO-02-746R](#) (Washington, D.C.: July 18, 2002); *Management Report: Improvements Needed in IRS's Internal Controls*, [GAO-03-562R](#) (Washington, D.C.: May 20, 2003); *Management Report: Improvements Needed in IRS's Internal Controls and Accounting Procedures*, [GAO-04-553R](#) (Washington, D.C.: Apr. 26, 2004); *Management Report: Improvements Needed in IRS's Internal Controls*, [GAO-05-247R](#) (Washington, D.C.: Apr. 27, 2005); and *Management Report: Improvements Needed in IRS's Internal Controls*, [GAO-08-368R](#) (Washington, D.C.: June 4, 2008).

In response to our recommendations, IRS implemented several corrective actions to strengthen controls over contract employee background investigations, but deficiencies in such controls continue to exist.

Internal control standards require that agencies establish physical controls to secure and safeguard vulnerable assets, which include sensitive taxpayer information.⁴⁹ The IRM requires that when work is performed outside an IRS facility, contract employees may not have access to taxpayer information or data unless IRS has received favorable background investigation results.⁵⁰ Furthermore, the IRM requires that individuals engaged in procurement-related activities should ensure that all IRS contracts contain appropriate language holding contractors and other service providers accountable for complying with federal and IRS privacy, information protection, and data security policies and procedures.⁵¹ Consequently, the IRM states that a contracting officer's technical representative (COTR) is responsible for designating and documenting the risk level of each position within the contract, and initiating the process for obtaining background investigations as required.⁵² However, in this case no COTR was assigned to the contract, and thus no responsibility had been assigned to ensure that the background investigations were required and performed.

In establishing the contract for mail courier services at this SCC, IRS procurement staff followed IRS Policy and Procedures Memorandum No. 1.6 (C), which only requires appointing a COTR for contracts exceeding \$100,000. In this case, the mail courier services contract was actually paid for by the U.S. Postal Service, and thus because the contract cost to IRS was less than \$100,000, IRS did not appoint a COTR. In the absence of an assigned COTR, IRS procurement officials stated that the business unit requesting the contract service (the requesting business unit) was expected to assume responsibility for ensuring that required background investigations were performed for the contract employees. However, this expectation was not documented in any written policy. Consequently, the requesting business unit representatives responded that they were unaware of any policy or procedure requiring them to assess the need and initiate the provisions for a background investigation in these types of contracts.

⁴⁹[GAO/AIMD-00-21.3.1](#).

⁵⁰IRM § 10.23.2.2, *General Investigative Requirements* (Oct. 16, 2008), and IRM § 10.23.2.8, *Staff-Like Access* (Apr. 4, 2008).

⁵¹IRM § 10.5.1.5.5, *Personnel Engaged in Procurement Activities* (May 5, 2010).

⁵²IRM § 10.23.2.6, *Position Sensitivity Risk Designation Levels* (Oct. 16, 2008). A COTR is an authorized representative of the contracting officer (CO) acting within the limits of his or her authority as delegated by the CO. The COTR is generally responsible for monitoring contract performance and furnishing technical direction to the contractor after award, evaluating whether contractors are meeting their duties and the requirements of the contract and reporting back to the CO, performing receipt and acceptance functions, and facilitating and administering administrative aspects of contracts.

Lacking such a policy, no representatives of the procurement office or the requesting business unit with whom we spoke claimed responsibility for ensuring that background investigations were performed for this contract. Procurement officials stated that had the requesting business unit clearly communicated to them that background investigations were necessary and that contractors would be taking the mail to a non-IRS facility before delivering it to the post office, they would have included the provision for obtaining background investigations in the contract. The requesting business unit officials said that they were unaware of the requirement and that officials in the Personnel Security unit of IRS's Human Capital Office had the requisite technical expertise to determine which contract services warranted contract employee background investigations. Without a clear, documented policy establishing responsibility for assessing disclosure risk and ensuring that all contracts involving routine, unescorted, unsupervised physical access to taxpayer information require background investigations, regardless of contract award amount, IRS cannot ensure that necessary background investigations have been performed. This, in turn, increases the risk that contract employees with unsuitable backgrounds may be granted access to taxpayer information.

Recommendations

We recommend that you direct the appropriate IRS officials to do the following:

- Perform a review of all existing contracts under \$100,000 that (1) do not have an appointed COTR and (2) do not require that contract employees obtain background investigations to assess whether the services performed under each contract warrant a requirement that contract employees obtain background investigations.
- Based on a review of all existing contracts under \$100,000 without an appointed COTR that should require contract employees to obtain favorable background investigation results, amend those contracts to require that favorable background investigations be obtained for all relevant contract employees before routine, unescorted, unsupervised physical access to taxpayer information is granted.
- Establish a policy requiring collaborative oversight between IRS's key offices in determining whether potential service contracts involve routine, unescorted, unsupervised physical access to taxpayer information, thus requiring background investigations, regardless of contract award amount. This policy should include a process for the requiring business unit to communicate to the Office of Procurement and the Human Capital Office the services to be provided under the contract and any potential exposure of taxpayer information to contract employees providing the services, and for all three units to (1) evaluate the risk of exposure of taxpayer information prior to finalizing and awarding the contract and (2) ensure that the final contract

requires favorable background investigations as applicable, commensurate with the assessed risk.

IRS Comments and Our Evaluation

IRS agreed with our recommendations and stated that by June 2013 it would review all existing service contracts under \$100,000 to determine whether the services performed under these contracts warrant obtaining background investigations, and ensure that all of the contracts identified contain the necessary security requirements by September 2013. In addition, IRS stated that its Contractor Security Lifecycle Program Office, in conjunction with IRS's Agency-Wide Shared Services, Procurement, and Human Capital offices, will establish a policy and procedures by December 2012 requiring business units to (1) identify service contracts where contractors will have routine, unescorted, unsupervised physical access to taxpayer information; (2) document the risk of exposure for taxpayer data; and (3) ensure that security requirements are included in the contract as applicable. IRS's proposed actions, if successfully carried out, should address the intent of our recommendations. We will evaluate IRS's progress and the effectiveness of its actions during future audits.

Deposit Courier Trip Times

During our fiscal year 2010 financial audit, we found that IRS's allowable time limits for some of its courier routes were not effective in identifying potential instances of SCC and lockbox bank deposit couriers making unauthorized stops during transit. IRS contracts with courier companies to transfer taxpayer receipts from its SCCs and lockbox banks to financial institutions for deposit. We previously identified instances where couriers did not follow IRS policies for handling taxpayer receipts and information.⁵³ These instances included couriers (1) making unauthorized stops, (2) leaving vehicles containing deposits unattended, and (3) transferring taxpayer receipts and information from the vehicle used to pick up the deposits to another vehicle. We reported these issues to IRS along with recommendations to improve related controls. IRS responded to our recommendations by establishing policies for SCC and lockbox bank management to monitor deposit courier trip times to detect and prevent issues such as couriers making unauthorized stops. These policies required SCC and lockbox bank officials to establish deposit courier trip time limits in the courier contracts that if exceeded would initiate management discussions with couriers to determine if corrective actions are needed. These time limits were not intended to be maximums that take into account all possible contingencies, but were intended to help keep couriers accountable for their trip times and to help SCC and lockbox bank management in monitoring couriers.

However, we found that implementation of the requirements was not effective in improving the monitoring and oversight of deposit couriers. During our audit, we

⁵³See [GAO-05-247R](#).

found at all three SCCs and at three of the four lockbox banks we visited that the controls were not effective in identifying potential instances of deposit couriers making unauthorized stops. At each site visited, we selected a nonstatistical sample of deposit courier trip times for a 1-month period and calculated the average time to make a deposit run. We then compared these calculated average times to the allowable time limits outlined in the various courier contracts. In each case, the allowable time limit for deposit courier trips was in excess of the calculated average trip time by wide margins. As shown below, most of the established time limits we reviewed included unexplained cushions that limited the effectiveness of these monitoring controls in helping to ensure that receipts were transported as required to the depository institution. Specifically, we found the following.

- At the three SCCs, the allowable deposit trip time outlined in the courier contracts ranged from 12 minutes to 27 minutes greater than the average trip times, which were approximately 17 minutes for each SCC.
- At one lockbox bank, the allowable deposit trip time was almost twice as long as the average trip time of approximately 66 minutes.
- One lockbox bank used four different allowable trip times, ranging from 30 minutes to 60 minutes, to monitor a deposit trip that took on average 24 minutes to complete.
- At another lockbox bank, IRS and bank management officials established the allowable trip time at 128 minutes, despite the fact that actual trip times ranged from 46 minutes to 113 minutes during the 10-day period they analyzed prior to establishing the limit.
- Additionally, one SCC changed depository bank locations to a site closer to the IRS facility approximately 6 months prior to our site visit. However, IRS had not updated the time limits accordingly after the change.

Internal control standards require that agencies establish physical controls to secure and safeguard vulnerable assets, such as taxpayer receipts and related information, and that access be limited to authorized individuals to reduce the risk of unauthorized use or loss to the government.⁵⁴ Additionally, the IRM requires couriers to provide dedicated service for transportation of a deposit between the IRS facility and the depository institution with a transportation time that is not in excess of the time allowed in the courier contract. The IRM and *Lockbox Security Guidelines* (LSG)⁵⁵ further require that SCC and lockbox bank officials, respectively, follow up

⁵⁴[GAO/AIMD-00-21.3.1.](#)

⁵⁵The LSG outlines security guidelines for lockbox bank managers to use so that they adhere to IRS's physical, personnel, and data protection requirements to ensure protection of taxpayer receipts and information.

with deposit couriers for any trip in excess of the established time limit.⁵⁶ However, we found that there was no consistent methodology for calculating acceptable deposit courier trip time limits that would allow for the identification of potential unauthorized stops. The SCC and lockbox officials we spoke with could not clearly explain or support how they arrived at their established trip limits. In addition, they were not required to and did not periodically reassess or revise the limits when conditions changed, such as when the depository location changed. By not establishing meaningful trip limits that would allow for effective monitoring of the transfer of deposits or periodically reassessing and updating these limits when conditions change, IRS is at increased risk of taxpayer receipts and information being lost or diverted while in the custody of contract couriers, and that any losses that occur may not be timely detected.

Recommendations

We recommend that you direct the appropriate IRS officials to take the following actions:

- Establish procedures to provide a consistent methodology for calculating and establishing allowable deposit courier trip time limits to be used by both SCCs and lockbox banks that would assist in detecting potential unauthorized stops or other contractual violations for deposit couriers. Such procedures should include instructions for documenting and supporting how the trip limits were determined and require justification and approval for all established time limits that exceed the average trip time.
- Establish procedures to require periodic reassessments of, and updates to, deposit courier allowable trip time limits to account for changes in courier routes or other conditions that may affect trip times.

IRS Comments and Our Evaluation

IRS agreed with our recommendations and stated that it updated the LSG in January 2011 to include a consistent methodology for calculating and establishing allowable deposit courier trip time limits for lockbox banks. IRS also said it updated each SCC's courier contract statement of work to reflect new delivery time frames based on courier surveillance. IRS stated that by December 2011 it will establish procedures to require periodic reassessments of, and updates to, deposit courier allowable trip time limits to account for changes in courier routes or other conditions that may affect trip times, and will explore the use of Global Positioning System technology to track the deposit courier trip for each delivery, the use of lockbox bank staff to transport paper deposits in lieu of a dedicated courier, or both. IRS's proposed actions, if successfully carried out, should address the intent of our recommendations. We will evaluate the

⁵⁶IRM § 3.8.45.19.3, *Submission Processing Campus Receipt & Control Requirements and Responsibilities* (Jan. 1, 2011), and LSG 2.15(5), *Official Receipt for Transport of IRS Lockbox Deposit Form* (Jan. 1, 2011).

progress and effectiveness of IRS's efforts during our audit of IRS's fiscal year 2011 financial statements and future audits.

Transfer of Taxpayer Information between Processing Facilities

During our fiscal year 2010 financial audit, we found deficiencies in IRS's controls over contract couriers' transportation and safeguarding of taxpayer information between processing facilities. Four of IRS's SCCs use contract couriers to transport taxpayer information between the main campus facilities and their off-site facilities for further processing. These off-site processing facilities can range from 2 to 80 miles away from the starting destination. We reviewed the internal controls at one of the four SCCs with an off-site processing facility and found that (1) a courier vehicle's cargo door was not locked after it was loaded with taxpayer returns and other taxpayer-related information and (2) no procedures were in place to assure the sender or the recipient of the information that contract courier vehicles' cargo doors had not been opened or the contents had not been tampered with during transit.

The courier contract states that taxpayer information must be secured in a locked vehicle during transit. However, neither the courier nor the business unit shipping the information verified that the courier vehicle's cargo door was locked before the courier proceeded to its destination, and the business unit receiving the information did not verify that the vehicle's cargo door remained locked during transit. We also found that IRS's control intended to monitor and enforce the contract provision requiring that cargo contents be secured during transit was not effective. Specifically, IRS's Agency-Wide Shared Services performs monthly reviews of the contract couriers to assess and enforce compliance with contractual agreements, including whether cargo doors on contract courier vehicles are locked after the vehicles are loaded with taxpayer information and remain locked during transit. However, the guidance provided to the reviewers did not contain detailed instructions for assessing whether the cargo doors were locked during transit. We analyzed the Agency-Wide Shared Services' monthly reviews of the couriers covering a 9-month period at this SCC. In each case, we were unable to determine how the reviewer assessed that the cargo doors were locked during transit because the reviewer did not document how the assessment results were obtained. Additionally, the business units responsible for the shipment and receipt of the taxpayer returns and other information confirmed that there were no controls in place to verify that the information transmitted was properly safeguarded during transit, for example, with a tamper-resistant security seal attached to the latch of the cargo door. Without sufficient controls for monitoring contractual compliance and other controls to detect unauthorized access to taxpayer information transferred from one processing facility to another, IRS cannot ensure that this information will be properly safeguarded during transit. Additionally, because there is the potential for taxpayer receipts to be included in

these shipments, IRS cannot ensure that taxpayer receipts will be safeguarded during transit.⁵⁷

Internal control standards require physical controls to limit access to vulnerable assets and require that access to resources and records, such as taxpayer receipts and taxpayer information, be limited to authorized individuals to reduce the risk of unauthorized use or loss to the government.⁵⁸ Additionally, the IRM states that tax information transmitted from one location to another must be provided adequate safeguards.⁵⁹ The IRM also requires that IRS facilities management take responsibility for the security and accountability of taxpayer receipts and information during transit. By not ensuring that courier vehicles and their contents are appropriately secured during transit between the SCCs and their off-site processing facilities, IRS increases the risk of loss, theft, and misuse of taxpayer information and receipts.

Recommendations

We recommend that you direct the appropriate IRS officials to do the following:

- Enforce existing contractual requirements for the cargo doors of contract courier vehicles to be locked after picking up taxpayer information.
- Establish procedures to prevent or detect unauthorized access to taxpayer information in contract courier vehicles during transit. These procedures should detail specific activities to be performed by both the business units sending and receiving the information transported by the contract courier.
- Revise the guidance for conducting the periodic reviews of the contract couriers transporting taxpayer information from one IRS processing facility to another to include procedures for (1) physically verifying that courier vehicle cargo doors are locked after picking up this information and remain locked during transit to the final destination and (2) documenting the basis for the reviewer's conclusions.

IRS Comments and Our Evaluation

IRS agreed with our recommendations and indicated that it has already taken actions and has other actions under way to address them. Specifically, IRS stated that in February 2011, it sent a notice to key staff and managers reminding them of the

⁵⁷When IRS receives mail containing taxpayer information and receipts, it is opened and sorted through various extraction methods. Cash and noncash receipts are sometimes overlooked during the initial mail extraction phase and are found later during further processing of the mail. According to IRS, the identified receipts are called “discovered remittances.”

⁵⁸[GAO/AIMD-00-21.3.1](#).

⁵⁹IRM § 10.2.13.3.2.4 (1), *Information Protection: Transmission* (Sept. 30, 2008).

contract requirements for secure transport, and began monthly random reviews of compliance with requirements beginning in April 2011. IRS also indicated that by December 2011 it will (1) establish procedures to prevent and detect unauthorized access to taxpayer information in contract courier vehicles during transit and (2) revise the guidance for conducting periodic reviews of the contract couriers to include physically verifying that courier vehicle cargo doors are locked after pickup and remain locked during transit to the final destination. IRS added that the Submission Processing unit will begin conducting a separate monthly review and documenting the results beginning in January 2012. IRS's proposed actions, if successfully carried out, should address the intent of our recommendations. We will evaluate the effectiveness of IRS's efforts during our audit of IRS's fiscal year 2011 financial statements and future audits.

Document Transmittal Forms

During our fiscal year 2010 audit, we found that IRS did not adequately monitor or document required reviews of internal control procedures over tracking and monitoring taxpayer receipts and information transmitted between IRS locations. When IRS's Small Business/Self-Employed Division (SB/SE) units transmit taxpayer receipts, information, or both to another IRS location, they are required to include a document transmittal form listing the documents and receipts included in the package. Recipients are required to acknowledge receipt of the items; if the recipient does not acknowledge receipt within 10 days, the sender is required to initiate follow-up.⁶⁰ To facilitate this, senders must maintain a control copy of each transmittal form sent and track which ones have been appropriately acknowledged by the recipient in order to know which ones require follow-up. To help enforce the transmittal requirements, the IRM requires unit managers to perform periodic reviews of the document transmittal process to determine whether all of the required controls are in place and operating effectively and to document such reviews.

During our fiscal year 2010 financial audit, we found that at seven of the eight SB/SE units we visited, unit managers either did not perform or did not document periodic reviews of the document transmittal control process as required. Specifically, at four locations we visited, managers asserted that the reviews were performed, but we found that the scope of the reviews was not sufficient to determine whether the information sent was timely received and acknowledged by the recipient. At the fifth location, the manager informed us that the review was performed, but it was not documented. At the sixth location, the manager documented the reviews, but the review documentation did not show the review dates. At the seventh location, the manager told us that he did not perform the reviews because he thought that the location was exempt from performing them because of a shortage of staff to perform the reviews.

⁶⁰IRM § 5.1.2.4.3, *Revenue Officer Procedures for Form 795/795A* (July 13, 2010); IRM § 5.1.2.4.5.1, *Form 795 Follow up* (July 13, 2010), and IRM § 5.1.2.4.4, *Collection Field Clerical Staff Procedures for Form 795/795A Processing* (Aug. 15, 2008).

Internal control standards require agencies to (1) establish physical controls to secure and safeguard vulnerable assets, (2) ensure that ongoing monitoring occurs in the course of normal operations, and (3) enforce adherence to management policies and procedural requirements.⁶¹ The IRM requires that SB/SE unit managers perform reviews of the transmittal process to help enforce the transmittal requirements. However, the process it describes for conducting these reviews does not ensure that all controls are effectively assessed. For example, the IRM directs managers to retrieve document transmittal forms by random date and to verify that controls over the transmittal process were followed for those forms. However, should the manager retrieve document transmittals that were timely received from recipients, the manager is unable to determine, from the process described in the IRM, whether staff are (1) maintaining control copies of document transmittal forms, (2) reconciling all document transmittal forms to ensure that all transmittals were received, or (3) following up on transmittals that are not timely received. Additionally, while the IRM states that managers must document their reviews, the guidance does not provide any minimum requirements for the documentation. For example, the IRM includes suggested documentation methods, but none of the methods are explicitly required. Without a thorough process for assessing key controls and specific guidance for documenting the reviews, SB/SE unit managers did not sufficiently conduct the periodic monitoring intended to help ensure that employees appropriately track taxpayer receipts and information transmitted between IRS locations.

Consequently, we observed several weaknesses in the transmittal process that managers had not identified during their reviews, including senders of document transmittals not (1) maintaining control copies of document transmittals, (2) tracking the status of transmittals sent, or (3) following up with recipients who had not acknowledged receipt of transmittals within 10 business days as required. By not adequately monitoring the key controls over taxpayer receipts and information transmitted between locations, IRS increases the risk that SB/SE unit employees will not follow procedures for tracking taxpayer receipts and information sent from one IRS location to another, thus increasing the risk of loss, theft, and misuse of taxpayer receipts and information.

Recommendations

We recommend that you direct the appropriate IRS officials to revise the IRM to do the following:

- Include a comprehensive process that SB/SE unit managers should follow when performing reviews of the document transmittal process for determining whether staff are (1) maintaining control copies of document transmittal forms, (2) reconciling all document transmittal forms on a biweekly basis to

⁶¹[GAO/AIMD-00-21.3.1.](#)

ensure that all transmittals were received, and (3) following up on transmittals that are not timely acknowledged.

- Include specifying minimally acceptable steps SB/SE unit managers should follow in documenting the results of required reviews of the document transmittal process.

IRS Comments and Our Evaluation

IRS agreed with our recommendations and stated that it would update the IRM by November 2011 to refine the current review requirements and clarify the minimally acceptable documentation that SB/SE managers should complete when conducting the reviews and reporting the results. IRS's proposed actions, if successfully carried out, should address the intent of our recommendations. We will evaluate the effectiveness of IRS's efforts during future audits.

Compliance Reviews of Off-site Processing Facilities

During our fiscal year 2010 financial audit, we found that IRS did not complete compliance reviews of its off-site processing facilities once every 2 years as required in the IRM. IRS's Physical Security and Emergency Preparedness personnel conduct reviews to assess compliance with established minimum physical security standards and requirements for which managers and employees are responsible. These compliance reviews are IRS's primary tools for evaluating the effectiveness and appropriateness of existing security procedures and requirements at its processing facilities as well as identifying areas for future security program emphasis. At the conclusion of a compliance review, the review team meets with upper management to discuss its findings, related recommendations for improving controls, and time frames for implementing corrective actions. Consequently, these reviews are an important control to help IRS ensure that the facilities used to process taxpayer receipts, returns, and other information are adequately equipped with the appropriate security controls to prevent unauthorized access and to protect the data and people at these facilities.

Four of IRS's 10 SCCs utilize off-site processing facilities that are not located on the premises of the main campus. These off-site processing facilities perform key tax processing functions, such as receiving, extracting, and sorting receipts and other taxpayer information; transcribing hard-copy taxpayer information and related documents to an electronic format; and analyzing original tax documents for final processing and review. Each function is a key component of IRS's responsibility for processing taxpayer receipts and related taxpayer information. At the off-site processing facility we visited in April 2010, IRS officials stated that compliance reviews for that facility were being performed once every 3 years. However, IRS officials at this facility could not provide documentation supporting the 3-year requirement and, as a result, informed us that they would perform future compliance reviews at that facility once every 2 years. We subsequently inquired and found that

compliance reviews were also being performed once every 3 years at the other three off-site processing facilities.

Internal control standards require that agencies establish physical controls to secure and safeguard vulnerable assets, ensure that ongoing monitoring occurs in the course of normal operations, and communicate deficiencies found during monitoring to appropriate levels of management.⁶² These standards also require that agencies identify and analyze relevant risks associated with achieving objectives. The analysis may include assessing the likelihood of occurrence, deciding how to manage the risk, and determining what actions should be taken. The IRM states that at a minimum, compliance reviews of processing and computing center facilities will be conducted every 2 years (or more frequently if circumstances warrant, such as major renovations or relocations) and that reviews of all other offices will be conducted every 3 years (or more frequently if circumstances warrant).⁶³

After we informed IRS that all four off-site processing facilities were only receiving compliance reviews once every 3 years, IRS officials responded that the intent of the IRM requirement to conduct compliance reviews once every 2 years only pertained to SCCs, and that all other facilities associated with that campus, whether they processed taxpayer receipts and returns or not, were only required to receive such reviews once every 3 years. However, the IRM does not define “processing facility” as limited to SCCs, nor does it contain a separate 3-year compliance review requirement for off-site facilities that process taxpayer receipts and information. In addition, IRS had not performed an assessment of the operational activities at these off-site facilities to establish the minimum frequency requirement for the compliance reviews. Because these off-site processing facilities perform many of the same functions as SCCs with respect to taxpayer receipts and information, they carry the same risks and thus warrant similar controls as those required of SCCs.

Without clear guidance or instructions from IRS management on the definition of processing facilities and the required frequency of compliance reviews for these off-site processing facilities, IRS increases the likelihood that reviews designed to assess physical security controls at its revenue receipt processing facilities may not occur as intended. This, in turn, increases the risk that IRS management will not detect control deficiencies in a timely manner and thus may fail to adequately safeguard taxpayer receipts and information.

Recommendations

We recommend that you direct the appropriate IRS officials to do the following:

- Define and specify in the IRM what types of IRS facilities constitute a processing facility.

⁶²GAO/AIMD-00-21.3.1.

⁶³IRM § 10.2.2, *Physical Security Compliance Reviews* (Sept. 26, 2008).

- Perform an assessment of the off-site processing facilities to determine the frequency with which compliance reviews should be performed for these locations commensurate with the specific operational activities performed and the assessed level of risk associated with the facility.
- Based on the results of an assessment of off-site processing facilities that process taxpayer receipts and related taxpayer information, revise the IRM to specify the frequency with which compliance reviews should be performed at these facilities.

IRS Comments and Our Evaluation

IRS agreed with our recommendations and stated that by November 2011 it would revise the IRM to define and specify the types of facilities that constitute a processing facility and require compliance reviews to be performed at off-site processing facilities every 2 years. IRS's proposed actions, if successfully carried out, should address the intent of our recommendations. We will evaluate the effectiveness of IRS's efforts during future audits.

After Dark Security Controls

During our fiscal year 2010 financial audit, we found that IRS's physical security controls intended to help prevent and detect unauthorized access to its processing facilities were not always effective. Specifically, we observed that four exterior security lights were not functioning at one SCC, which hindered the security guards' closed-circuit television (CCTV) coverage of the exterior perimeter of the campus. The security guard on duty during our review informed us that the security guards were aware of the lighting outages, but none of the outages were reported to management because they did not know the process for reporting them. Based on further inquiries and analysis, we found that IRS did not provide specific and consistent instructions in its security guard post orders for reporting such issues.⁶⁴ At five of its six SCCs with revenue receipt processing functions and four of its seven lockbox banks, IRS did not provide instructions in the security guards' post orders for reporting exterior lighting outages to management for correction. In addition, while IRS performs several different reviews on a monthly, quarterly, and annual basis to monitor and assess physical security controls at SCCs and lockbox banks, there was no requirement for any of these reviews to occur after dark. Consequently, these reviews would not necessarily detect exterior lighting outages.

Internal control standards require that management establish physical controls to secure and safeguard vulnerable assets.⁶⁵ Additionally, the IRM requires that IRS's

⁶⁴Post orders are step-by-step procedures that specifically guide security guards in their current duties. The post orders specify the duties of each guard or post officer, along with instructions on how to perform those duties.

⁶⁵[GAO/AIMD-00-21.3.1](#).

facilities management implement exterior protective lighting to provide a minimum acceptable level of protection.⁶⁶ Similarly, the LSG requires lockbox banks to have adequate exterior lighting to ensure personnel security, safety, and CCTV functionality.⁶⁷ Functioning artificial lighting is a key component to CCTV effectiveness. By allowing nonfunctioning exterior security lights to go unreported by its security guards and undetected by its security reviews, IRS increases the risk that the perimeter of its processing facilities will not be sufficiently illuminated to allow security guards to detect security breaches. As a result, the risks of loss, theft, and misuse of taxpayer receipts and information are increased.

Recommendations

We recommend that you direct the appropriate IRS officials to do the following:

- Revise the post orders for the SCC and lockbox bank security guards to include specific procedures for timely reporting exterior lighting outages to SCC or lockbox bank facilities management. These procedures should specify (1) whom to contact to report lighting outages and (2) how to document and track lighting outages until resolved.
- Revise the nature and scope of the SCCs' and lockbox banks' physical security reviews to include periodic after dark assessments of physical security controls.

IRS Comments and Our Evaluation

IRS agreed with our recommendations and stated that it would update the LSG by October 2011 and the IRM by November 2011 for lockbox banks and SCCs, respectively, to require post orders to include specific procedures for timely reporting lighting outages, including who to contact and how to document and track the outages until resolved. IRS also stated that it is in the process of updating the IRM to require that SCC physical security reviews include periodic after dark assessments of physical security, and planned to establish this requirement for lockbox banks by January 2012. IRS's proposed actions, if successfully carried out, should address the intent of our recommendation. We will evaluate the effectiveness of IRS's efforts during future audits.

Property and Equipment Records

During our fiscal year 2010 financial audit, we found that IRS incorrectly recorded the asset purchase prices for some of its assets in its Information Technology Asset Management System (ITAMS), which is the system IRS uses to track its property and

⁶⁶IRM § 10.2.11.9 (2)(c), *Submission Processing Center and Facility Security Level (FSL) IV Campus Protective Measures* (Sept. 28, 2009).

⁶⁷LSG § 2.3.2 (2)(h), *Perimeter Security* (Jan. 1, 2011).

equipment. In our fiscal year 2001 financial audit,⁶⁸ we reported instances where assets recorded in IRS's administrative accounting system were not recorded in IRS's property and equipment system. IRS developed procedures in fiscal year 2004 to help ensure that the procurement award and requisition numbers recorded in the property records were accurate in order to link the assets recorded in the accounting records to a corresponding asset record in ITAMS. However, during our fiscal years 2007, 2008, and 2009 audits, we continued to find differences between the two systems in the way some assets were recorded. For example, we continued to find assets recorded in IRS's Integrated Financial System (IFS), its current accounting system, that were not recorded in ITAMS.⁶⁹

In testing fiscal year 2010 property and equipment purchases, we did not identify any instances in which asset purchases were not recorded in ITAMS as in previous years. However, we found that the acquisition price recorded in ITAMS was not always consistent with the price recorded in IFS. Specifically, we selected a nonstatistical sample of five purchase transactions consisting of 22 assets, and found that IRS inaccurately recorded the purchase price of 3 of the assets in ITAMS. The purchase prices of the 3 items—which were all computer servers—were correctly recorded in IFS but were incorrectly recorded in ITAMS. For example, the purchase price of one of these servers was correctly recorded in IFS as \$367,609 but was incorrectly recorded in ITAMS as \$459,626, a difference of over \$92,000. In all three instances, the vendor provided erroneous price information to IRS on the Asset Management Report, which IRS property staff used to create the asset records in ITAMS.⁷⁰ IRS did not identify these errors because it did not compare the price on the Asset Management Report with the invoice price recorded in IFS.

Internal control standards require that control activities ensure that all transactions are completely and accurately recorded.⁷¹ Although the IRM requires that certain minimum information must be kept accurate and current in ITAMS, such as the asset assignment (e.g., whether the asset is in use, retired, or disposed of), barcode, serial number, building code, cost center, system name, computer name, and contact name, the IRM did not specify accurate recording of the asset purchase price.⁷² We also found that IRS did not have procedures to help ensure that the asset purchase price entered in ITAMS was consistent with the asset purchase price recorded in IFS. By

⁶⁸[GAO-02-746R](#).

⁶⁹IFS is IRS's administrative accounting system, which IRS uses to facilitate its core financial management activities, such as general ledger, budget formulation, accounts payable, accounts receivable, funds management, cost management, and financial reporting.

⁷⁰The Asset Management Report is an electronic packing slip that vendors provide to IRS prior to shipping the items ordered.

⁷¹[GAO/AIMD-00-21.3.1](#).

⁷²IRM § 2.14.1.9.1, *ITAMS Asset (Device) Record* (Sept. 21, 2007).

not ensuring that the information contained in ITAMS is accurate and complete, management may be relying on inaccurate data for management decision making.

After we identified the weakness, IRS established standard operating procedures in February 2011 to require that asset management staff compare the asset purchase price on the Asset Management Report with the asset purchase price recorded in IFS and, if any variances are identified, research and resolve the variances prior to entering the information in ITAMS. While we commend IRS for taking action, effective implementation is needed to help ensure that asset purchase prices are recorded accurately in the property records.

Recommendation

We recommend that you direct the appropriate IRS officials to take steps to effectively implement the procedures requiring property staff to verify that the asset purchase price shown in the Asset Management Report agrees with the asset purchase price shown in IFS and to resolve any variances before entering the information into ITAMS.

IRS Comments and Our Evaluation

IRS agreed with our recommendation and reiterated that it revised its standard operating procedures in February 2011 to require asset management staff to conduct appropriate research to validate the price data on the Asset Management Report against the pricing information in IRS's requisition tracking system, which interfaces with IFS, prior to uploading the data into ITAMS. However, it did not describe the steps it has taken since then to implement these procedures. We will assess IRS's implementation of the new requirement during our audit of IRS's fiscal year 2011 financial statements to determine if the objective of the recommendation has been met.

Disposal Process for Copiers

During our fiscal year 2010 financial audit, we found that IRS disposed of photocopy machines (copiers) without determining if the copiers' hard drives contained sensitive taxpayer information and ensuring that such information was appropriately destroyed or removed. IRS has approximately 4,500 copiers located throughout its facilities nationwide. Some of these copiers contain hard drives that store images of the documents copied. Because of the nature of IRS's work, the copier hard drives may contain confidential taxpayer information or sensitive information on IRS employees or operations. Consequently, it is critical that IRS establish and maintain controls to help ensure that such information is not compromised. However, at the time we conducted property physical inventory site visits to nine IRS locations in July 2010 as part of our financial audit, we found that IRS did not have a policy or procedures to help ensure that the copier hard drive memories were appropriately erased or that the hard drives were removed prior to disposal of the copiers.

IRS officials informed us that they realized in April 2010 that this vulnerability existed. Subsequently, IRS's Real Estate Facilities Management (REFM) Copier Contract Program Manager notified the REFM staff responsible for copier disposal on May 10, 2010, not to release any copiers until IRS could determine how to properly dispose of the hard drives. However, three IRS employees subsequently disposed of three additional copiers without wiping or destroying the hard drives. According to IRS officials, the REFM Acting Chief of Logistics, the REFM Acting Territory Manager, and an IRS Criminal Investigation Unit employee each released a copier because they were not aware of the notification. Both of the acting managers in REFM had authority to physically dispose of copiers; however, the notification was issued prior to their assuming these acting positions, and they had not been responsible for copier disposals in their prior positions. The Criminal Investigation Unit employee was not aware that he did not have the authority to dispose of copiers. According to IRS officials, only REFM personnel were authorized to physically dispose of copiers, thereby serving as the control point to help ensure that the hard drives of copiers were wiped or destroyed prior to copier disposal. IRS informed us that it later located the three copiers and removed and destroyed the hard drives.

The Internal Revenue Code provides that tax returns and return information obtained by IRS are confidential and must be protected from unauthorized disclosure.⁷³ This means that unless a limited statutory exception applies, the code prohibits IRS from disclosing such sensitive taxpayer information to third parties, including other government agencies. Also the Privacy Act of 1974 requires each federal agency to establish appropriate administrative, technical, and physical safeguards to ensure the security and confidentiality of records and to protect against any anticipated threats to their security or integrity that could result in substantial harm, embarrassment, inconvenience, or unfairness to any individual on whom information is maintained.⁷⁴ The IRM requires that all IRS employees prevent unnecessary disclosure of personally identifiable information in information systems, programs, electronic formats, and hard-copy documents by adhering to proper safeguarding measures.⁷⁵ Because of the sensitive nature of the information maintained on the copier hard drives, it is important that IRS have procedures in place to ensure that this equipment is not disposed of without first wiping or destroying each hard drive. Without adequate controls to help ensure that sensitive information is identified and appropriately removed from copier hard drives before their disposal, there is an increased risk that taxpayer data or other sensitive data could be compromised.

After we brought this issue to its attention, IRS drafted procedures in February 2011 for the receipt, shipping, and destruction of all electronic media, including hard drives found in some copiers. Specifically, the new procedures require copier hard

⁷³See Internal Revenue Code, 26 U.S.C. § 6103 (Confidentiality and Disclosure of Returns and Return Information).

⁷⁴See the Privacy Act of 1974, which is *codified, as amended, in part at* 5 U.S.C. § 552a(e)(10).

⁷⁵IRM § 10.5.1.5.1, *IRS Employees* (May 5, 2010).

drives to be removed and destroyed prior to copier disposal. These new procedures, once finalized, appropriately disseminated to help ensure that all those responsible are aware of the requirements, and effectively implemented, should reduce the risk that taxpayer data or other sensitive information could be compromised.

Recommendations

We recommend that you direct the appropriate IRS officials to do the following:

- Finalize procedures requiring that copier hard drives be removed and destroyed or otherwise appropriately cleaned before disposing of copiers.
- Revise the IRM to incorporate the new copier disposal procedures that require that copier hard drives be removed and destroyed or otherwise appropriately cleaned before disposing of copiers.
- Issue a memorandum to all business units reminding them that only designated REFM staff are authorized to dispose of copiers.

IRS Comments and Our Evaluation

IRS agreed with our recommendations and stated that it published written procedures in March 2011 for the REFM field offices requiring removal and destruction of copier hard drives prior to the disposal of copiers and planned to revise the IRM to include the proper procedures for handling copier hard drives prior to disposal. In addition, IRS stated that the REFM Director will issue a memorandum to all IRS business units in June 2011 reminding them that only designated REFM staff are authorized to dispose of copiers. IRS's proposed actions, if successfully carried out, should address the intent of our recommendations. We will review the updated policies and procedures and evaluate the effectiveness of IRS's efforts during our audit of IRS's fiscal year 2011 financial statements.

This report contains recommendations to you. The head of a federal agency is required by 31 U.S.C. § 720 to submit a written statement on actions taken on these recommendations. You should submit your statement to the Senate Committee on Homeland Security and Governmental Affairs and to the House Committee on Oversight and Government Reform within 60 days of the date of this report. A written statement must also be sent to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of this report. Furthermore, to ensure that GAO has accurate, up-to-date information on the status of your agency's actions on our recommendations, we request that you also provide us with a copy of your agency's statement of actions taken on open recommendations. Please send your statement of actions to me or Doreen Eng, Assistant Director, at engd@gao.gov.

This report is intended for use by the management of IRS. We are sending copies to the Chairmen and Ranking Members of the Senate Committee on Appropriations; Senate Committee on Finance; Senate Committee on Homeland Security and Governmental Affairs; Subcommittee on Taxation and IRS Oversight, Senate Committee on Finance; House Committee on Appropriations; and House Committee on Ways and Means, and to the Chairman and Vice-Chairman of the Senate Joint Committee on Taxation. We are also sending copies to the Secretary of the Treasury, the Director of the Office of Management and Budget, and the Chairman of the IRS Oversight Board. The report also is available at no charge on GAO's Web site at <http://www.gao.gov>.

We acknowledge and appreciate the cooperation and assistance provided by IRS officials and staff during our audits of IRS's fiscal years 2010 and 2009 financial statements. Please contact me at (202) 512-3406 or sebastians@gao.gov if you or your staff have any questions concerning this report. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in enclosure III.

Sincerely yours,

A handwritten signature in black ink that reads "Steven J. Sebastian". The signature is written in a cursive style with a large, stylized initial "S".

Steven J. Sebastian
Director
Financial Management and Assurance

Enclosures – 3

Enclosure I: Details on Audit Methodology

To fulfill our responsibilities as the auditor of the Internal Revenue Service's (IRS) financial statements, we did the following.

- Examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements. This included selecting statistical samples of unpaid assessments, revenue, refunds, payroll and nonpayroll expenses, property and equipment, and undelivered order transactions.⁷⁶
- Examined evidence supporting IRS's compliance with IRS learning and education policies. This included selecting nonstatistical samples to determine if employees completed all mandatory briefings within the required time frames.
- Assessed the accounting principles used and significant estimates made by management.
- Evaluated the overall presentation of the financial statements.
- Obtained an understanding of IRS and its operations, including its internal control over financial reporting.
- Considered IRS's process for evaluating and reporting on internal control and financial systems under 31 U.S.C. § 3512 (c), (d), commonly referred to as the Federal Managers' Financial Integrity Act of 1982, and Office of Management and Budget Circular No. A-123, *Management's Responsibility for Internal Control*.
- Assessed the risk of (1) material misstatement in the financial statements and (2) material weakness in internal control over financial reporting.
- Tested relevant internal control over financial reporting.
- Evaluated the design and operating effectiveness of internal control over financial reporting based on the assessed risk.
- Tested compliance with selected provisions of the following laws and regulations: Internal Revenue Code; Antideficiency Act, as amended; Purpose Statute; Prompt Payment Act; Pay and Allowance System for Civilian Employees; Federal Employees' Retirement System Act of 1986, as amended;

⁷⁶These statistical samples were selected primarily to determine the validity of balances and activities reported in IRS's financial statements. We projected any errors in dollar amounts to the population of transactions from which they were selected. In testing some of these samples, certain attributes were identified that indicated deficiencies in the design or operation of internal control. These attributes, where applicable, were statistically projected to the appropriate populations.

Social Security Act of 1935, as amended; Federal Employees Health Benefits Act of 1959, as amended; Economic Stimulus Act of 2008; American Recovery and Reinvestment Act of 2009; Worker, Homeownership, and Business Assistance Act of 2009; Homebuyer Assistance and Improvement Act of 2010; and Financial Services and General Government Appropriations Act, 2010.

- Tested whether IRS's financial management systems substantially complied with the three requirements of the Federal Financial Management Improvement Act of 1996.
- Performed such other procedures as we considered necessary in the circumstances.

Enclosure II: Comments from the Internal Revenue Service



COMMISSIONER

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

June 9, 2011

Mr. Steven J. Sebastian
Director
Financial Management and Assurance
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Sebastian:

I am writing in response to the Government Accountability Office (GAO) draft report titled *Management Report: Improvements Are Needed to Enhance the IRS's Internal Controls and Operating Effectiveness (GAO-11-494R)*. As GAO noted in the report titled *Financial Audit: IRS's Fiscal Years 2010 and 2009 Financial Statements*, we continue to make significant progress in addressing remaining financial management challenges and have substantially mitigated weaknesses in internal controls.

During fiscal year 2010, IRS improved its compliance with requirements of the Federal Financial Management Improvement Act by bringing its financial management systems into compliance with the *United States Standard General Ledger*. The enclosed response addresses each of your recommendations.

We are committed to implementing appropriate improvements to ensure that the IRS maintains sound financial management practices. If you have any questions, please contact me, or a member of your staff may contact Pamela LaRue, Chief Financial Officer, at (202) 622-6400.

Sincerely,

A handwritten signature in black ink, appearing to read "D. Shulman", written over a horizontal line.

Douglas H. Shulman

Enclosure

Enclosure

**Government Accountability Office (GAO)
Recommendations and IRS Responses to
Management Report: Improvements Are Needed to
Enhance IRS's Internal Controls and Operating Effectiveness
GAO-11-494R**

Recommendation #1: We recommend that you direct the appropriate IRS officials to put procedures in place to periodically monitor the effectiveness of the new First-Time Homebuyer Credit (FTHBC) validity checks for the duration of the filing of FTHBC claims to verify they are working as intended.

Comments: The IRS agrees with this recommendation. The IRS has established procedures to monitor the effectiveness of our validity checks and controls, via the "Individual Master File UNPOSTABLES BY REASON CODE" daily reports. The IRS reviews and resolves the unpostable codes to monitor the effectiveness of the new FTHBC validity check. This process will continue beyond the duration of the filing of FTHBC claims.

Recommendation #2: We recommend that you direct the appropriate IRS officials to establish a mechanism to enforce the existing requirement for appropriate managers to immediately notify the Manual Refund Unit of any personnel changes affecting the approval or processing of manual refunds. This may be accomplished through mechanisms such as periodic alerts, providing training and/or having the Manual Refund Unit perform quarterly validations of the list of manual refund approving officials.

Comments: The IRS agrees with this recommendation. The IRS will incorporate a procedural change in Internal Revenue Manual (IRM) 3.17.79, *Accounting Refund Transactions*, by August 2011. This will require all Service Center Accounting functions to provide a list of manual refund authorizers to the Head of Office in each Business Operating Division (BOD) to validate individuals who are still authorized to sign manual refunds. This listing will be required on a quarterly basis starting at the end of June 2011.

Recommendation #3: We recommend that you direct the appropriate IRS officials to send out a reminder to all staff to follow policies and procedures for obtaining approval and funding of proposed purchases prior to entering into an agreement with vendors.

Comments: The IRS agrees with this recommendation. The IRS will send out a reminder by the end of July 2011 to all employees to follow policies and procedures for obtaining approval and funding of proposed purchases prior to entering into an agreement with vendors. We will place the reminder on the IRS intranet site (IRWeb), and send notification via *IRS Headlines...and More*.

Recommendation #4: We recommend that you direct the appropriate IRS officials to establish formal written procedures requiring staff to review purchase contract terms against the goods and services received to date before requesting additional goods or services.

Comments: The IRS agrees with this recommendation. The IRS will develop formal written instructions by the end of June 2011 to address the requirement to review contract terms and status of deliverables, and ensure that all related ordering activity is in compliance with the terms and conditions of the contract. We will place the written instructions on the Office of Procurement's website, as well as send it to all web Requisition Tracking System (webRTS) users and business units.

Recommendation #5: We recommend that you direct the appropriate IRS officials to establish procedures to centrally review and monitor the timeliness of personnel action requests and approvals to help ensure compliance with the IRM and applicable Office of Personnel Management (OPM) regulations and guidance.

Comments: The IRS agrees with this recommendation. In April 2011, IRS developed a report and process that enables us to centrally review and monitor timeliness of non-competitive personnel actions. We will establish a similar system to track the timeliness of competitive actions by the end of August 2011. In addition, we plan to establish a centralized quality review program to further support the on-going evaluation of results and identify improvement opportunities by the end of July 2011.

Recommendation #6: We recommend that you direct the appropriate IRS officials to adopt the local field office's timekeeping procedures or similar procedures for entering and verifying the accuracy of time and attendance information entered into the Single Entry Time Reporting system (SETR) throughout IRS for use by all units in which employees do not enter their own time charges directly to SETR.

Comments: The IRS agrees with this recommendation. The IRS will modify Standard Operating Procedure (SOP) MPC-02, revision 1, *Time & Attendance Reporting, Approval and Maintenance Requirements*, by the end of August 2011 to include the recommended requirements. We will place the revised SOP on the IRWeb, and forward it to all SETR Business Unit points of contact that are currently able to approve time sheets in SETR to disseminate.

Recommendation #7: We recommend that you further revise your detailed procedures for implementing the requirement to validate the appropriateness of the National Finance Center's (NFC) programming changes after such changes are made. These revisions should (1) clarify the criteria for determining what programming changes will be subject to validation, (2) identify officials responsible for making and documenting these determinations, and (3) require post-implementation statistical sampling from a targeted population that consists of employees that are most likely to be affected by the NFC programming change.

Comments: The IRS agrees with this recommendation. The IRS will develop a detailed SOP by the end of September 2011. When drafting the SOP we will ensure that all three items in the recommendation are addressed.

Recommendation #8: Removed by GAO.

Comments: The recommendation was removed by GAO. It will be deleted from the final report.

Recommendation #9: We recommend that you direct the appropriate IRS officials to take steps to effectively implement procedures at the Beckley Finance Center (BFC) requiring cash receipts be immediately logged under dual control when first discovered in the mail room.

Comments: The IRS agrees with this recommendation. In August 2010, the IRS revised its check deposit process, updated its desk procedures, and trained employees on the new process to address the requirement of cash receipts being immediately logged under dual control when first discovered in the mail room.

Recommendation #10: We recommend that you direct the appropriate IRS officials to take steps to effectively implement procedures at BFC requiring mail room staff to maintain custody of the control log at all times.

Comments: The IRS agrees with this recommendation. In August 2010, the IRS revised its check deposit process, updated its desk procedures, and trained employees on the new process to address the requirement of mail room staff maintaining custody of the control log at all times.

Recommendation #11: We recommend that you direct the appropriate IRS officials to take steps to effectively implement procedures at BFC requiring that the amount of cash receipts initially discovered in the mail room be independently reconciled to the amount deposited and recorded in the general ledger.

Comments: The IRS agrees with this recommendation. In August 2010, the IRS revised its check deposit process, updated its desk procedures, and trained employees on the new process to address the requirement of cash receipts initially processed in the mail room being independently reconciled to the amount deposited and recorded in the financial system.

Recommendation #12: We recommend that you direct the appropriate IRS officials to perform a review of all existing contracts under \$100,000 that (1) do not have an appointed Contracting Officer's Technical Representative (COTR), and (2) do not require that contract employees obtain background investigations, to assess whether the services performed under the contract warrant a requirement that contract employees obtain background investigations.

Comments: The IRS agrees with this recommendation. The IRS will issue the Contractor Security Lifecycle Program (CSLP) Office policy in December 2012, and will review all existing service contracts under \$100,000. The IRS will determine by June 2013 whether the services performed under these contracts warrant obtaining background investigations on the contract employee(s). The policy will require business units to identify service contracts where contractors will have routine, unescorted, unsupervised, physical access to taxpayer information, document the risk of exposure to taxpayer data, and ensure that the requirements of the Internal Revenue Service Acquisition Procedures 1052.204-9005, *Submission of Security Forms and Related Materials*, are included in the contract, as applicable.

Recommendation #13: We recommend that you direct the appropriate IRS officials, based on a review of all existing contracts under \$100,000 without an appointed COTR that should require contract employees to obtain favorable background investigation results, to amend those contracts to require that favorable background investigations be obtained for all relevant contract employees before routine, unescorted, unsupervised physical access to taxpayer information is granted.

Comments: The IRS agrees with this recommendation. The IRS will ensure all existing service contracts under \$100,000, identified in the above-mentioned review, contain the necessary security requirements by September 2013.

Recommendation #14: We recommend that you direct the appropriate IRS officials to establish a policy requiring collaborative oversight between IRS's key offices in determining whether potential service contracts involve routine, unescorted, unsupervised physical access to taxpayer information, thus requiring background investigations, regardless of contract award amount. This policy should include a process for the requiring business unit to communicate to the Office of Procurement and the Human Capital Office the services to be provided under the contract and any potential exposure of taxpayer information to contract employees providing the services, and for all three units to (1) evaluate the risk of exposure of taxpayer information prior to finalizing and awarding the contract, and (2) ensure that the final contract requires favorable background investigations as applicable, commensurate with the assessed risk.

Comments: The IRS agrees with this recommendation. By December 2012, the IRS CSLP Office, in conjunction with Agency-Wide Shared Services (AWSS) Procurement and the IRS Human Capital Office (HCO), will establish a policy and associated procedures requiring business units to identify service contracts where contractors will have routine, unescorted, unsupervised, physical access to taxpayer information, document the risk of exposure to taxpayer data, and ensure that the requirements of the Internal Revenue Service Acquisition Procedures 1052.204-9005, *Submission of Security Forms and Related Materials*, are included in the contract, as applicable.

Recommendation #15: We recommend that you direct the appropriate IRS officials to establish procedures to provide a consistent methodology for calculating and

establishing allowable deposit courier trip time limits to be used by both Service Center Campuses (SCCs) and lockbox banks that would assist in detecting potential unauthorized stops or other contractual violations for deposit couriers. Such procedures should include instructions for documenting and supporting how the trip limits were determined and require justification and approval for all established time limits that exceed the average trip time.

Comments: The IRS agrees with this recommendation. The IRS updated each campus' courier contract Statement of Work (SOW) to reflect new delivery timeframes for daily deposits to the depository drop-off location based on data gathered during courier surveillance. The IRS also updated the Lockbox Security Guidelines (LSG) 2.16, *Establishing Courier Timeframes*, in January 2011, which serves as the SOW for lockbox banks, to include procedures to provide a consistent methodology to calculate and establish allowable deposit courier trip time limits for lockbox banks. The LSG procedures document and support how the trip limits are determined and require justification and approval for deviations from established time limits. Additionally, IRS will explore the use of real-time Global Positioning System technology to track the deposit courier trip for each delivery in order to monitor a driver/vehicle 24 hours a day, 7 days a week and/or use of bank staff to transport paper deposits in lieu of a dedicated courier. The IRS anticipates completing these actions by December 2011.

Recommendation #16: We recommend that you direct the appropriate IRS officials to establish procedures to require periodic reassessments of, and updates to, deposit courier allowable trip time limits to account for changes in courier routes or other conditions that may affect trip times.

Comments: The IRS agrees with this recommendation. The IRS updated the IRM 3.5.45, *Manual Deposit Process*, in April 2011 to reflect established timeframes that will be re-evaluated each year during the annual unannounced security reviews or whenever changes occur in the drop-off location. The IRS will also establish procedures by December 2011 to require periodic reassessments of, and updates to, deposit courier allowable trip times to account for changes in courier routes or other conditions that may affect trip times.

Recommendation #17: We recommend that you direct the appropriate IRS officials to enforce existing contractual requirements for the cargo doors of contract courier vehicles to be locked after picking up taxpayer information.

Comments: The IRS agrees with this recommendation. The IRS sent a notice to the sub-COTRs and Logistics Chiefs in each territory in February 2011 reminding them of the contract requirements for secure transport. Starting in April 2011, IRS implemented a monthly random review of contractor adherence to the secure transport requirements, including the requirement for cargo doors of contract courier vehicles to be locked after picking up taxpayer information.

Recommendation #18: We recommend that you direct the appropriate IRS officials to establish procedures to prevent or detect unauthorized access to taxpayer information in contract courier vehicles during transit. These procedures should detail specific activities to be performed by both the business units sending and receiving the information transported by the contract courier.

Comments: The IRS agrees with this recommendation. The IRS will establish procedures to prevent and detect unauthorized access to taxpayer information in contract courier vehicles during transit to and from offsite processing facilities by December 2011. In February 2011, IRS sent a notice to the sub-COTRs and Logistics Chiefs in each territory to remind them of the contract requirements for secure transport. Starting in April 2011, IRS implemented a monthly random review of contractor adherence to the secure transport requirements.

Recommendation #19: We recommend that you direct the appropriate IRS officials to revise the guidance for conducting the periodic reviews of the contract couriers transporting taxpayer information from one IRS processing facility to another to include procedures for (1) physically verifying that courier vehicle cargo doors are locked after picking up this information and remain locked during transit to the final destination, and (2) documenting the basis for the reviewer's conclusions.

Comments: The IRS agrees with this recommendation. By December 2011, IRS will revise the guidance for conducting periodic reviews of the contract couriers transporting taxpayer information to include physically verifying that courier vehicle cargo doors are locked after pick up and remain locked during transit to the final destination. Starting in January 2012, Submission Processing will conduct one review each month and document the results. In February 2011, IRS sent a notice to the sub-COTRs and Logistics Chiefs in each territory to remind them of the contract requirements for secure transport. Starting in April 2011, IRS implemented a monthly random review of contractor adherence to the secure transport requirements, including the requirement for cargo doors of contract courier vehicles to be locked after picking up taxpayer information.

Recommendation #20: We recommend that you direct the appropriate IRS officials to revise the IRM to include a comprehensive process that Small Business/Self-Employed Division (SB/SE) managers should follow when performing reviews of the document transmittal process for determining whether staff are (1) maintaining control copies of document transmittal forms, (2) reconciling all document transmittal forms on a biweekly basis to ensure that all transmittals were received, and (3) following up on transmittals that are not timely acknowledged.

Comments: The IRS agrees with this recommendation. The IRS will update IRM 1.4.50, *Collection Group Manager, Territory Manager, and Area Director Operational Aid*, by November 2011. The IRS will refine the current review requirements to clarify the actions management should take to determine whether staff are 1) maintaining control copies of document transmittal forms, 2) reconciling all document transmittal

forms on a bi-weekly basis to ensure that all transmittals are acknowledged, and 3) performing the follow-up procedures required in IRM 5.1.2.4.4(1)g, *Collection Field Clerical Staff Procedures for Form 795/795A Processing*.

Recommendation #21: We recommend that you direct the appropriate IRS officials to revise the IRM to include specifying minimally acceptable steps SB/SE managers should follow in documenting the results of required reviews of the document transmittal process.

Comments: The IRS agrees with this recommendation. The IRS will update IRM 1.4.50, *Collection Group Manager, Territory Manager, and Area Director Operational Aid*, by November 2011. The IRS will clarify the minimally acceptable documentation the SB/SE managers should complete when conducting the review and reporting the results.

Recommendation #22: We recommend that you direct the appropriate IRS officials to define and specify in the IRM what types of IRS facilities constitute a processing facility.

Comments: The IRS agrees with this recommendation. The IRS will revise IRM 10.2.2, *Physical Security Compliance Reviews*, by November 2011 to define and specify the types of facilities that constitute a processing facility.

Recommendation #23: We recommend that you direct the appropriate IRS officials to perform an assessment of the off-site processing facilities to determine the frequency with which compliance reviews should be performed for these locations commensurate with the specific operational activities performed and assessed level of risk associated with the facility.

Comments: The IRS agrees with this recommendation. The IRS currently has a 2-year requirement established for Compliance Reviews at Main Campus locations, and we will revise IRM 10.2.2, *Physical Security Compliance Reviews*, by November 2011 to require that compliance reviews be performed at off-site processing facilities every 2 years due to the sensitive data processed at these locations.

Recommendation #24: We recommend that you direct the appropriate IRS officials, based on the results of an assessment of off-site processing facilities that process taxpayer receipts and related taxpayer information, to revise the IRM to specify the frequency with which compliance reviews should be performed at these facilities.

Comments: The IRS agrees with this recommendation. The IRS will revise IRM 10.2.2, *Physical Security Compliance Reviews*, by November 2011, to require that compliance reviews be performed at off-site processing facilities every 2 years due to the sensitive data processed at these locations.

Recommendation #25: We recommend that you direct the appropriate IRS officials to revise the post orders for the SCCs and lockbox bank security guards to include specific procedures for timely reporting exterior lighting outages to SCC or lockbox bank facilities management. These procedures should specify (1) whom to contact to report lighting outages, and (2) how to document and track lighting outages until resolved.

Comments: The IRS agrees with this recommendation. The IRS will update the Lockbox Security Guidelines section 2.3.4.1.1, *Post Orders*, by October 2011 with requirements for reporting lighting outages and direct the banks to revise the lockbox security guards' post orders to include specific procedures for timely reporting exterior lighting outages to the lockbox bank facilities management. The IRS will also revise IRM 10.2.12, *Security Guard and Explosive Detector Dog Services and Programs*, by November 2011 to require that post orders include procedures for Service Center Campus guards to report lighting outages. The IRS will revise the procedures to specify who to contact to report lighting outages and how to document and track the lighting outages until the issue is resolved.

Recommendation #26: We recommend that you direct the appropriate IRS officials to revise the nature and scope of the SCCs' and lockbox banks' physical security reviews to include periodic after-dark assessments of physical security controls.

Comments: The IRS agrees with this recommendation. The IRS is currently updating IRM 10.2.12, *Security Guard and Explosive Detector Dog Services and Programs*, to require that physical security reviews of the SCCs include periodic after-dark assessments of physical security. In January 2012, the IRS will update the IRM to require after-dark reviews in the lockbox security guards' post orders, LSG section 2.3.4.1 (6) (c) and 2.3.4.1.3, and Exhibit 13 of LSG 2.3 for consistency.

Recommendation #27: We recommend that you direct the appropriate IRS officials to take steps to effectively implement the procedures requiring property staff to verify that the asset purchase price shown in the Asset Management Report agrees with the asset purchase price shown in the Integrated Financial System (IFS) and to resolve any variances before entering the information into Information Technology Asset Management System (ITAMS).

Comments: The IRS agrees with this recommendation. The IRS revised its internal Standard Operating Procedures in February 2011 to require that Asset Management personnel conduct appropriate research to validate the price data supplied on the Asset Management Report against the pricing information in webRTS prior to uploading the data in ITAMS.

Recommendation #28: We recommend that you direct the appropriate IRS officials to finalize procedures requiring that copier hard drives be removed and destroyed or otherwise appropriately cleaned before disposing of copiers.

Comments: The IRS agrees with the recommendation. The IRS National Copier Contract COTR published written procedures in March 2011 to the Real Estate and Facilities Management (REFM) field offices requiring removal and destruction of copier hard drives prior to the disposal of copiers.

Recommendation #29: We recommend that you direct the appropriate IRS officials to revise the IRM to incorporate the new copier disposal procedures that require that copier hard drives be removed and destroyed or otherwise appropriately cleaned before disposing of copiers.

Comments: The IRS agrees with the recommendation. In June 2011, IRS will revise IRMs 1.14.4.12.24, 2.7.4, and 10.8.1.4.7.3 to include the proper handling procedures of copier hard drives prior to the disposal of copiers.

Recommendation #30: We recommend that you direct the appropriate IRS officials to issue a memorandum to all business units reminding them that only designated REFM staff are authorized to dispose of copiers.

Comments: The IRS agrees with this recommendation. In June 2011, the Director, REFM, will issue a memorandum to all IRS business units reminding them that only designated REFM staff are authorized to dispose of copiers.

Enclosure III: GAO Contacts and Staff Acknowledgments

GAO Contact

Steven J. Sebastian, (202) 512-3406 or sebastians@gao.gov

Staff Acknowledgments

In addition to the contact named above, the following individuals made major contributions to this report: Doreen Eng, Assistant Director; Cynthia Teddleton, Auditor-in-Charge; Sharon Byrd; Nina Crocker; Oliver Culley; Chuck Fox; Ryan Guthrie; Mary Ann Hardy; Tuan Lam; Jenny Li; Cynthia Ma; Joshua Marcus; Emily Matic; Jean Mathew; Julie Phillips; John Sawyer; Christopher Spain; Chevalier Strong; Lien To; LaDonna Towler; and Cherry Vasquez.

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