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United States Government Accountability Office
Washington, DC 20548

January 10, 2005

The Honorable Mark W. Everson
Commissioner of Internal Revenue

Subject: *Opportunities to Improve Timeliness of IRS Lien Releases*

Dear Mr. Everson:

Among the Internal Revenue Service's (IRS) many tools to collect outstanding taxes is its ability to use the property of a taxpayer as security for an outstanding tax debt. IRS exercises this power when it files a federal tax lien against the property of a taxpayer.¹ As part of its tax collection activities, IRS reported filing more than 548,000 tax liens against taxpayer property in fiscal year 2003.² Since a lien encumbers taxpayer property, IRS's ability to file a lien is a powerful tool in enforcing the tax laws. With this power, however, comes the responsibility to ensure that liens are released timely once taxpayers satisfy their tax debt. The Internal Revenue Code (IRC) addresses timeliness by requiring IRS to release liens within 30 days of the tax debt's satisfaction.³

If IRS fails to timely release federal tax liens, taxpayers can suffer undue hardship and burden. Because federal tax liens appear on commercial credit reports,

- businesses may be unable to obtain necessary credit because lenders may assume they are bad credit risks,
- individuals may miss an opportunity to buy a home or an automobile because they are unable to obtain financing, and
- individuals may be unable to sell their home because of the presence of a tax lien on their property.

¹Under section 6321 of the Internal Revenue Code, IRS has the authority to file a lien upon all property and rights to property, whether real or personal, of a delinquent taxpayer.

²IRS can file multiple liens against a taxpayer to cover property the taxpayer owns in different geographical locations.

³Under section 6325 of the Internal Revenue Code, IRS is required to release a federal tax lien within 30 days after the tax liability has been satisfied, has become legally unenforceable, or the Secretary of the Treasury has accepted a bond for the assessed tax.

Failure to timely release liens thus conflicts with IRS's mission of providing top-quality service to the nation's taxpayers.

Every year since our audit of IRS's fiscal year 1999 financial statements, we have reported on IRS's inability to consistently release tax liens within 30 days of the tax debt's satisfaction, as required by law. When we first identified the lack of timely release of tax liens as a compliance issue, we recommended that IRS monitor the release of tax liens to ensure that they were released within 30 days of the date the related tax liability was fully satisfied.⁴ In our April 2004 report to IRS on the status of our financial management-related recommendations, IRS agreed with us that this issue had still not been effectively addressed.⁵

Subsequently, we continued to find a high level of noncompliance with the lien release requirements of the IRC during our audit of IRS's fiscal year 2004 financial statements. In the first 9 months of fiscal year 2004, IRS identified 103,000 taxpayers who had satisfied their tax liability and should have had a lien released. Based on a statistical sample of taxpayers who had resolved their tax debt during the first 9 months of fiscal year 2004, performed as part of our audit of IRS's fiscal year 2004 financial statements, we estimated that 22 percent—almost 23,000—of taxpayers with liens who resolved their tax debt in fiscal year 2004 did not have their liens released within 30 days.⁶

In our recent audit report on IRS's fiscal year 2004 financial statements, we again highlighted the issue, and we identified as a contributing factor IRS's failure to timely resolve problems noted on certain lien exception reports. Lien exception reports are generated when (1) lien data are transmitted from one system to another and the data do not match and (2) accounts have manually calculated interest or penalties. If used effectively, exception reports can serve as a critical internal control to help IRS ensure that liens are accounted for and timely released and that outstanding tax debt has been collected before liens are released. If exception reports are not resolved promptly, however, the lien release process is delayed.

This follow-on report discusses in greater detail deficiencies that we identified in IRS's use of exception reports, and includes our recommendations for corrective action.

⁴GAO, *Internal Revenue Service: Recommendations to Improve Financial and Operational Management*, GAO-01-42 (Washington D.C.: Nov. 17, 2000).

⁵GAO, *Internal Revenue Service: Status of Recommendations from Financial Audits and Related Financial Management Reports*, GAO-04-523 (Washington D.C.: Apr. 28, 2004).

⁶GAO, *Financial Audit: IRS's Fiscal Years 2004 and 2003 Financial Statements*, GAO-05-103 (Washington D.C.: Nov. 10, 2004). We are 95 percent confident that the error rate does not exceed 33 percent.

Results in Brief

We found problems with IRS's use of three types of exception reports. First, IRS produces a weekly exception report for lien filings that fail to post to taxpayer accounts. The key is to timely resolve any items on the exception report so that the lien can be released. As of May 21, 2004, IRS had more than 8,500 liens that could not post to taxpayer accounts, 74 percent of which predated 2004. IRS produces a second exception report weekly when taxpayer accounts with liens have been fully satisfied and identified for lien release but the taxpayer accounts do not match accounts in IRS's lien system. We found that IRS was also not timely resolving these "unmatched exception reports" and, as a result, the number of unresolved lien cases from these reports had increased, from almost 1,800 at the end of 2003 to 3,180 by mid-June 2004. A third weekly exception report lists all taxpayer accounts identified for lien release that have manually calculated interest or penalties.⁷ We found that IRS was also not timely resolving items on this exception report.

In addition to untimely resolution of lien cases on these exception reports, all of which ultimately affect the timely release of tax liens, we found that one report had a serious design flaw in that it was not cumulative, meaning that accounts from one week's report that were not resolved did not carry over to the following week's report. This flaw in the design of the unmatched exception report contributed significantly to the fact that 99 percent of the taxpayer accounts listed on the report at the end of 2003 were still unresolved as of the end of June 2004.

We were unable to definitively quantify the extent to which IRS's failure to resolve cases showing up on these exception reports contributed to the overall number of liens IRS failed to timely release. Based on the nature of IRS's delays in releasing liens that we found in our fiscal year 2004 sample, however, we estimate that about 30 percent of the delayed releases likely resulted from IRS's failure to effectively resolve exception reports.⁸

IRS's inability to promptly resolve the lien exception reports has contributed to its inability to ensure that tax liens are timely released. This condition can negatively affect taxpayers, adversely affect IRS's mission of providing top-quality customer service, and result in noncompliance with the legal requirement that liens be released within 30 days after satisfaction of the related tax debt. Although IRS has begun to take steps to address untimely resolution of lien exception reports, critical steps

⁷Some interest and penalties must be manually calculated because the capability to calculate interest and penalties in accordance with certain legal requirements has not been programmed into IRS systems. IRS refers to this as "restricted" interest or penalties.

⁸We are 95 percent confident that the actual figure does not exceed 58 percent of the untimely released liens. This estimate applies only to the exception reports that are produced by the ALS system, namely, the unmatched lien exception report and the manual interest or penalties exception report. We were unable to estimate the effect that the unposted liens exception report had on the timeliness of lien releases. Additionally, at this time, we are unable to determine the cause of the untimely lien releases for the remaining cases in our fiscal year 2004 sample.

remain to be taken and backlogs of unresolved exception reports remain to be resolved.

We are making nine recommendations to IRS to assist it in strengthening controls over the lien release process.

In its comments, IRS agreed with our recommendations and described actions it was taking or planned to take to address the control weaknesses described in this report. At the end of our discussion of each of these issues, we have summarized IRS's related comments and provided our evaluation.

Background

Congress granted IRS the power to file a lien against the property of taxpayers who neglect or refuse to pay all their assessed federal taxes. The lien becomes effective when IRS provides notice of its lien interest by filing the lien with a designated office, such as a courthouse in the county where the taxpayer's property is located. The lien serves to protect the interest of the federal government and as a public notice to current and potential creditors of the government's interest in the taxpayer's property.

IRS has established separate offices, known as lien units, to handle lien processing, including the release of tax liens. The lien units' responsibilities also include answering inquiries from taxpayers and other IRS personnel regarding liens and lien releases. As of June 1, 2004, IRS had 33 lien units located throughout the United States. IRS is currently reorganizing the physical structure and management of its lien units. By mid-2005, IRS plans to have consolidated the lien units into one physical location at its Cincinnati Campus. IRS's goal in centralizing these units' core functions and standardizing lien processing is to reduce operating costs, increase efficiency, and improve customer service. IRS believes the consolidation will enhance management of lien processing and provide for uniform guidance and operations for all lien processing.

The collection of unpaid taxes begins with IRS sending up to three notice letters to the taxpayer advising the taxpayer of the debt and requesting payment. If after proper notification the taxpayer fails to pay the tax debt, and the delinquency does not meet the criteria that require IRS to make in-person contact with the taxpayer,⁹ IRS sends the taxpayer another notice letter explaining that a lien will be filed if the taxes owed are not promptly paid. If the taxpayer fails to promptly pay the taxes, IRS generally files a lien. IRS personnel initiate the creation of a lien with IRS's Automated Collection System (ACS),¹⁰ which sends the information necessary to file a lien, such

⁹Such criteria include the type of tax (e.g., estate or excise) and whether the dollar amount owed exceeds a certain amount. See I.R.M. § 5.19.5.3.1 Exh. 5.19.5-10 (Jan. 1, 2000).

¹⁰ACS is a computerized system that maintains balance-due accounts and tax return delinquency investigations; it is designed to allow cases to be worked by priority. (ACS is also a major collection function at IRS.)

as the taxpayer's name and address and the dollar amount of the lien, to IRS's Automated Lien System (ALS).¹¹ If the delinquency meets the criteria requiring IRS to make in-person contact with the taxpayer and after such contact IRS decides to file a lien, IRS personnel initiate creation of a lien with IRS's Integrated Collection System (ICS),¹² which sends the information necessary to file a lien to ALS. ALS generates a physical lien document. After ALS prints the lien, the lien unit mails it to the taxpayer's local courthouse,¹³ where it is recorded as a legal lien against the taxpayer's property. Until the lien is recorded at the courthouse, it is not legally enforceable and does not preserve IRS's rights with respect to the taxpayer's property. Concurrent with generating the lien document, ALS electronically updates the taxpayer's account in IRS's Masterfile¹⁴ to show that a lien was filed.¹⁵ A weekly exception report is generated for liens that cannot post to Masterfile because the ALS and Masterfile account data do not match. Figure 1 provides an overview of the lien recording process.

¹¹ALS is a comprehensive database that prints federal tax liens and lien releases, stores taxpayer information, and documents lien activity.

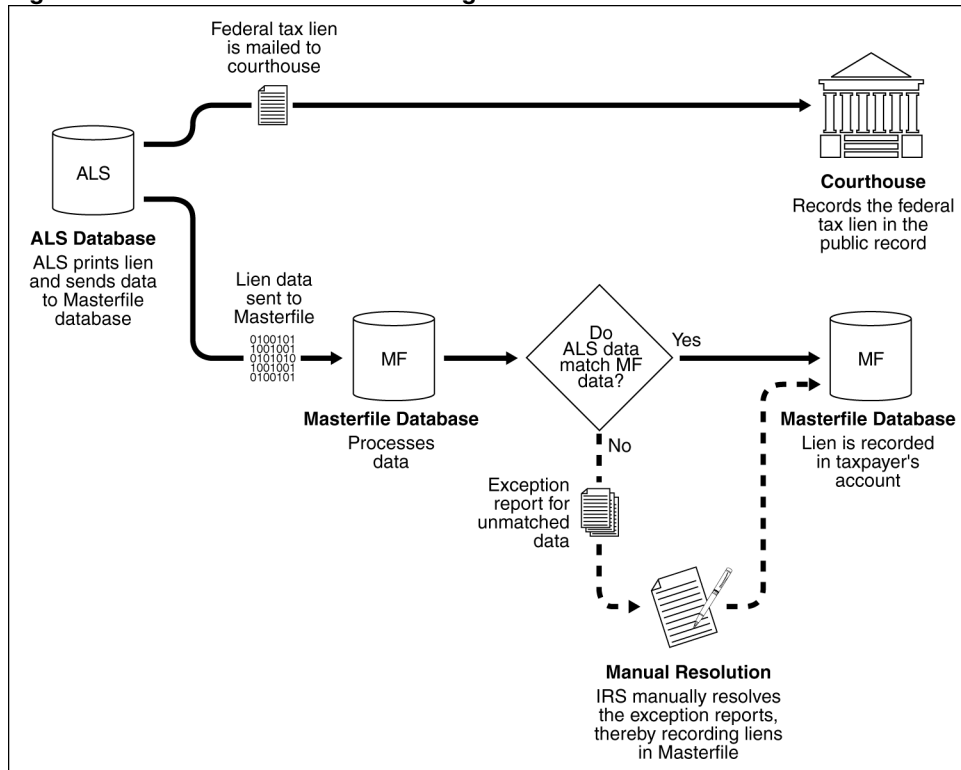
¹²ICS is the computer system used by revenue officers to track collection actions taken on taxpayer accounts.

¹³The local courthouse is the courthouse in the county where the taxpayer's property is located. Liens can also be filed elsewhere as determined by state law.

¹⁴Masterfile is the IRS database that stores various types of taxpayer account information. It includes individual, business, employee plan, and exempt organization data.

¹⁵ALS first updates the lien information in taxpayer accounts in the Integrated Data Retrieval System (IDRS), which is an online data retrieval and entry system. Once a week, IDRS updates the taxpayer accounts in Masterfile with this information. For simplicity, we discuss this as one step—ALS updating Masterfile.

Figure 1: Overview of the Lien Recording Process



Source: GAO.

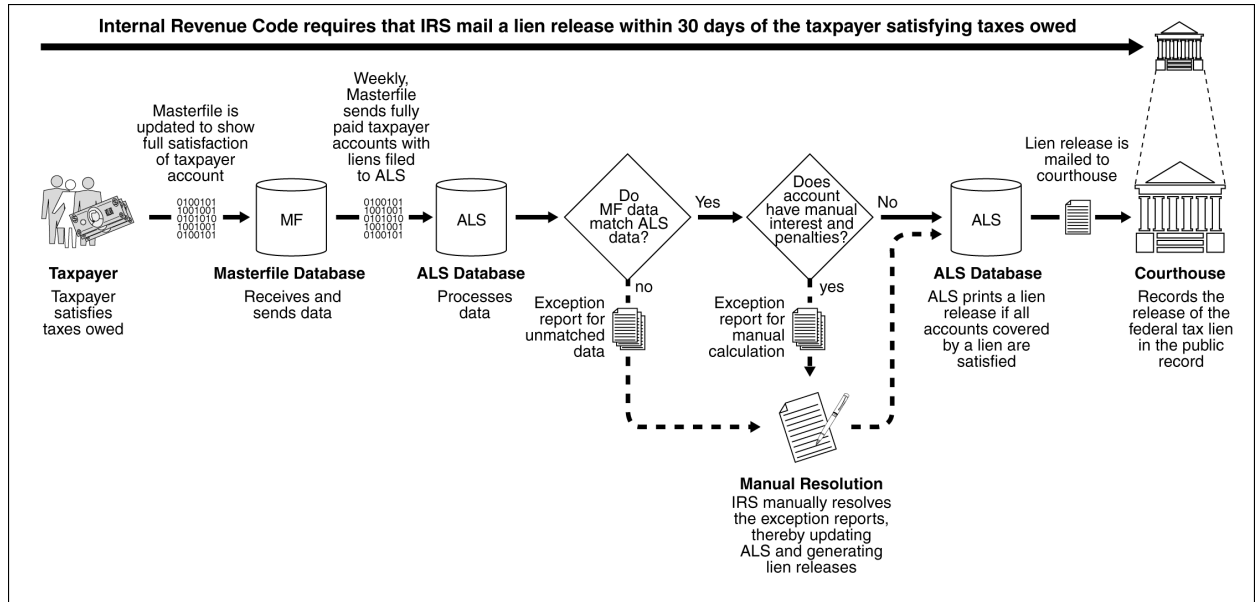
IRS’s automated lien release process begins when a taxpayer’s Masterfile account is paid in full or otherwise settled. Each week, Masterfile automatically downloads to ALS all the satisfied taxpayer accounts with liens. The taxpayer’s account in Masterfile must have a lien recorded against it in order to trigger the automated lien release process. When notified via the Masterfile download that a taxpayer account with a lien has been fully paid or otherwise satisfied, ALS generates a lien release document.¹⁶ Upon generating the lien release document, ALS updates the taxpayer’s account in Masterfile to show that the lien has been released. Lien unit personnel then access ALS to print a lien release certificate, which they then mail to the courthouse, where it is recorded in the public record and provides conclusive evidence that the lien has been extinguished.

Two types of exception reports are generated when Masterfile downloads to ALS all the satisfied taxpayer accounts with liens. One report lists taxpayer accounts whose Masterfile information (e.g., taxpayer identification number, Masterfile tax code, tax period) does not match taxpayer account information in ALS. The second exception report consists of taxpayer accounts with manually calculated interest or penalties. IRS removes these accounts from the automated lien release process because the interest and penalty calculations are more prone to error. For these accounts, IRS

¹⁶Liens can cover debt arising from one or more tax periods. ALS does not generate a lien release until all the tax periods covered by a lien are satisfied.

must verify that taxpayers have paid the full amount of interest and penalties due. The lien units must manually research and resolve these exception reports before the liens on the taxpayer accounts listed on the reports can be released. Therefore, timely processing of these exception reports is an important control in ensuring the timely release of liens. Figure 2 provides an overview of the automated lien release process.

Figure 2: Overview of the Automated Lien Release Process



Source: GAO.

Scope and Methodology

We reviewed the tax lien release process in conjunction with our audits of IRS’s fiscal years 2003 and 2004 financial statements to better understand the potential causes of continuing delays in IRS’s release of tax liens. We focused our review on the use of exception reports by IRS lien units because of their integral role in identifying issues that would affect the timely release of tax liens. We did not review activities affecting liens that occur before or after the activities that take place within the lien units. For example, we did not review processes in Masterfile that can cause delays in releasing tax liens, nor did we review the process of transport and delivery of lien releases from lien units to courthouses.

In conducting our review, we selected the 3 lien units with the most lien release activity,¹⁷ and we selected 2 additional lien units judgmentally. In total, the 5 lien units we reviewed were responsible for resolving exception reports for 11 lien units

¹⁷The lien release activity per lien unit was based on fiscal year 2002 data.

(including themselves),¹⁸ and these 11 units released 39 percent of the reported tax liens released in fiscal year 2003.

At the three lien units we reviewed, we interviewed management and key staff and observed the various lien processes. In addition to these interviews at the lien units, we interviewed other IRS officials associated with the lien process, such as ALS programmers, lien compliance policy analysts, and lien unit consolidation coordinators, to gain an understanding of the lien process. We also reviewed detailed lien information by analyzing the results of data queries obtained from IRS systems to identify potential causes of delays in releasing tax liens. We also reviewed IRC provisions related to IRS's lien authority and lien release requirements and relevant sections of the Internal Revenue Manual, which contains IRS's formalized policies and procedures. Additionally, we obtained and reviewed the various exception reports used in the lien release process.

We conducted our work in conjunction with our fiscal years 2003 and 2004 financial statement audits, completing our work in October 2004. We conducted our audit in accordance with generally accepted government auditing standards. We requested comments on a draft of this report from the Commissioner of the Internal Revenue Service. We received written comments from the Commissioner and have reprinted the comments in enclosure I.

Lien Exception Reports Are Not Being Timely Resolved

As discussed previously, several exception reports are generated from IRS's systems to assist IRS in identifying and resolving problems related to lien processing. A weekly report is generated for liens that fail to post to the Masterfile due to taxpayer account data in Masterfile and ALS not matching. Additionally, two other exception reports are generated when Masterfile downloads to ALS all satisfied taxpayer accounts with existing liens, one for taxpayer accounts whose Masterfile information does not match the taxpayer account information in ALS and another for taxpayer accounts with manually calculated interest or penalties, which require manual review. If used effectively, these exception reports provide a critical control to assist IRS in resolving issues so that tax liens can be timely resolved.

We found that IRS is not timely resolving problems identified on certain lien-related exception reports and, in some cases, is not addressing information in the reports at all. We were unable to definitively quantify the extent to which IRS's failure to resolve these exception reports contributed to the overall number of liens IRS failed to timely release in fiscal year 2004. However, based on the nature of the delays in releasing liens that we found in our statistical sample of liens during our fiscal year 2004

¹⁸The five lien units we selected for review were responsible for resolving exception reports for specific IRS "areas," four of which consisted of more than one lien unit.

financial audit, we estimate that about 30 percent of the delayed releases likely resulted from IRS's failure to effectively resolve certain exception reports.¹⁹

The failure to timely resolve exception reports results in untimely release of liens, which places undue hardship and burden on taxpayers, conflicts with IRS's mission of providing top-quality service to U.S. taxpayers, and leads to noncompliance with the IRC. It also directly increases lien units' workloads. Because liens that appear on exception reports are not released until the reports are resolved, affected taxpayers may be forced to contact the lien units for assistance in order for their liens to be released. According to IRS personnel, providing assistance to taxpayers is one of the most time-consuming lien unit functions. During our review, one of the reasons most commonly cited by lien unit staff for taxpayer calls was to have IRS release a lien that should have been previously released. If IRS timely resolved lien-related exception reports, more liens could be timely released, resulting in fewer taxpayers contacting the lien units to resolve their lien problems and thereby lessening lien units' workloads.

Unpostable Liens Are Not Being Timely Resolved

When a lien is generated, ALS updates the taxpayer's account in Masterfile to indicate that a lien has been filed. If a lien cannot post to the taxpayer's Masterfile account, usually because the taxpayer identification number or account name in ALS does not match the one in Masterfile, the lien is included in a weekly exception report that lists unpostable liens. If a lien is not posted to a taxpayer's Masterfile account, IRS does not have the information it needs to identify the taxpayer account for lien release when the tax debt is fully satisfied. Therefore, timely resolution of this exception report is an important control to ensure that liens are recorded on taxpayers' accounts and, consequently, to ensure that liens are timely released. The Internal Revenue Manual requires that exceptions listed in this report be resolved within 5 days of the report's generation.²⁰

As of May 21, 2004, IRS had a total of 8,529 liens that could not post to taxpayer accounts in Masterfile.²¹ Despite the requirement that the exceptions listed in the report be resolved within 5 days, 99 percent of the 8,529 unpostable liens had initially appeared in exception reports generated more than 5 days earlier, and 74 percent had initially appeared in exception reports generated prior to calendar year 2004.

¹⁹We are 95 percent confident that the actual figure does not exceed 58 percent of the untimely released liens. This estimate applies only to the exception reports that are produced by the ALS system, namely, the unmatched lien exception report and the manual interest or penalties exception report. We were unable to estimate the effect that the unposted liens exception report had on the timeliness of lien releases.

²⁰I.R.M § 5.12.6.9(1)(F) (Oct. 1, 2003).

²¹IRS performed a special query of its system to determine the number of unpostable liens accounts. However, the listing of unpostable liens did not go back prior to January 2002.

Taxpayers who had satisfied their tax debt but whose liens were unpostable would not have had their liens automatically identified for release. As a result, if the exception reports listing the liens were not timely resolved, such liens would not have been released timely, if at all.

In May 2004, managers at four of the five lien units we reviewed told us that they were not receiving (and therefore were not resolving) the exception report that lists unpostable liens, and the manager of the fifth lien unit told us that she was instructed to stop processing the exception report because of the upcoming consolidation of the lien units to a single physical location at IRS's Cincinnati Campus.²² This is consistent with what we had previously found. At the time of our initial review of these lien units in 2003, we determined that the units were not receiving this report because it had been placed on IRS's Electronic Online/Output Network System (EONS)²³ and was no longer being sent to lien units. The lien units, however, had not been notified of the change. In subsequent discussions with IRS officials in June 2004, they told us that the exception report had been placed on EONS during the IRS reorganization and that IRS had taken action to address this issue. Specifically, they informed us that this report had been centralized in the new lien unit in Cincinnati and that the other lien units were no longer responsible for reviewing and resolving the exception report.

IRS is now taking steps to address issues associated with this exception report and is currently reviewing exception reports in a timely manner. However, these issues were long-standing and therefore resulted in a significant backlog of unpostable liens. According to IRS, as of October 2004, about half of the backlog of 8,529 unpostable liens that existed on May 21, 2004, had been resolved. We were able to confirm this through a review of more recent exception reports, and we will continue to follow up on IRS's progress during our fiscal year 2005 financial audit.

Recommendations

To improve the effectiveness of controls over posting liens to taxpayer accounts, we recommend that you direct the Cincinnati lien unit managers to

- expedite efforts to resolve the backlog of unpostable liens, releasing liens as appropriate; and
- keep current on all new unpostable liens.

²²During our initial review of the lien units, from July through September 2003, the managers of four of the five same lien units were unaware of this exception report and were not addressing it.

²³EONS enables reports that would normally have been available in printed form only to be viewed on a personal computer.

IRS's Comments and Our Evaluation

IRS agreed with our recommendations. In its response, IRS stated that it established a team at the Cincinnati campus's Centralized Lien Processing Unit to resolve the unpostable lien exception reports. IRS added that lien transactions that do not post to a taxpayer's account will now be resolved weekly. IRS also stated that it established a separate team to resolve the backlog of unpostable liens and that it expects the backlog to be resolved by September 30, 2005. We will evaluate the effectiveness of IRS's efforts in future audits.

Unmatched Exceptions from the Automated Lien Release Process Are Not Being Timely Resolved

Each week, Masterfile automatically downloads to ALS all taxpayer accounts with liens that have been fully paid or otherwise satisfied. ALS uses this information to generate lien releases. Any downloaded taxpayer accounts whose Masterfile information does not match taxpayer account information in ALS are listed on an exception report. Processing of the liens associated with these accounts cannot proceed until the exceptions are resolved, and the liens cannot be released until processing is complete. Prompt resolution of this exception report is therefore a key control to ensure that liens are timely released. Both the Internal Revenue Manual and the ALS User Guide require that liens on this exception report be resolved weekly.²⁴ Prior to the planned consolidation of IRS lien units in mid-2005, individual units continue to be responsible for resolving the unmatched exception report.

We found that IRS was not timely resolving weekly unmatched exception reports. As of June 14, 2004, taxpayer accounts totaling 3,180 that had previously appeared on the unmatched exception report had not been resolved.²⁵ More than 1,400 of these unresolved cases were added during the first 6 months of calendar year 2004. Ninety-eight percent of the 3,180 accounts had appeared in reports generated more than 7 days earlier, and 88 percent had appeared in reports generated more than 30 days earlier. Because these unmatched accounts were not timely resolved, taxpayer liens were not timely processed and released.

For the five lien units we reviewed, we found that two were not timely resolving unmatched exception reports as of June 2004.²⁶ One unit manager informed us that the unit was at least 4 months behind in resolving these reports, and we found that

²⁴I.R.M. § 5.12.6.9(1)(A) (Oct. 1, 2003) and the ALS User Guide (July 2002).

²⁵IRS performed a special query of its system to determine the number of unresolved accounts. However, the listing did not go back further than August 2002.

²⁶During our initial review of the lien units, from July through September 2003, none of the five same lien units were timely resolving the unmatched exception report.

the other lien unit did not resolve these reports at all.²⁷ Staff responsible for resolving the report at these two lien units stated, and the unit managers confirmed, that the staff had not been trained on how to resolve the report, which contributed to the units' failure to resolve the report.²⁸ We identified all the taxpayer accounts from the February 11, 2004, and May 5, 2004, reports that belonged to these two lien units and found that of the 32 taxpayer accounts identified, 29 remained unresolved as of June 2, 2004.²⁹

Recommendations

To improve the effectiveness of controls over taxpayer accounts rejected from the automated lien release process, we recommend that you direct lien unit managers to

- research and resolve the current backlog of unresolved unmatched exception reports;
- research and resolve unmatched exception reports weekly; and
- provide training to designated staff on how to resolve exception reports.

IRS Comments and Our Evaluation

IRS agreed with our recommendations. In its response, IRS stated that accounts on the unmatched exception report will be resolved by matching information between the Master File and the ALS. IRS also stated that it is working to resolve the current backlog and that it expects the backlog to be resolved by September 30, 2005. Additionally, to improve overall processing of the unmatched exception reports, IRS stated that it will provide additional training and move the report resolution process to the Centralized Lien Processing Unit at the Cincinnati Campus. We will evaluate the effectiveness of IRS's efforts in future audits.

Liens with Manually Calculated Interest or Penalties Are Not Being Timely Resolved

Some taxpayer accounts contain tax debt with interest or penalties that are manually calculated. Exception reports are generated for such accounts when there exists a tax lien because procedures contained in internal IRS guidance call for a review of the calculations before the liens are released. Because liens on these taxpayers' properties will not be released until this report is resolved, its prompt resolution is a key control to help ensure that liens are timely released. Both the Internal Revenue

²⁷We were unable to determine how long it has been since this lien unit has resolved the unmatched exception report, but we know that the unit has not resolved the report for at least the last 7 years.

²⁸Since our review of the lien units in June 2004, the person responsible for resolving the report at the unit with the 4-month backlog has received training and, consequently, is now resolving the report.

²⁹Since both lien units have backlogs of at least 4 months, we chose a report that is part of the older component of the backlog and another report that is part of the recent component of the backlog.

Manual and the ALS User Guide require that this report be resolved weekly.³⁰ Prior to the planned consolidation of IRS lien units in mid-2005, individual units continue to be responsible for resolving this exception report.

We found that IRS was not reviewing the report and taking actions necessary to allow the liens on the exception report to be timely released. As of June 14, 2004, the number of accounts that appeared on the exception report totaled 1,047.³¹ Of these, 93 percent had initially been listed on reports generated more than 7 days earlier, and 75 percent had initially been listed on reports generated more than 30 days earlier. Of 854 unresolved taxpayer accounts on the exception reports containing liens with manually calculated interest or penalties as of December 31, 2003, 326 (38 percent) were still unresolved as of June 14, 2004, more than 5 months later.

Four of the five lien units we reviewed were taking actions necessary to timely release liens appearing on exception reports for liens with manually calculated interest or penalties.³² The fifth unit, however, was not taking action to release liens appearing on these exception reports. The individual at this lien unit who was responsible for resolving the report had not been trained on how to resolve it, which contributed to the unit's failure to resolve the report. For this lien unit, we reviewed the first 10 taxpayer accounts from the March 3, 2004, exception report and found that all 10 remained unresolved as of June 2, 2004. Of the 10 accounts selected, 6 had appeared on the report prior to 2004, with the earliest having appeared in August 2003. In 1 of the 10 cases we reviewed, the taxpayer fully satisfied his tax debt in December 2003 and the account was identified for lien release. However, because the account had manually calculated penalties, it was rejected from the automated lien release process and appeared on the exception report containing liens with manually calculated interest or penalties. As of June 2004, this account was still unresolved and, as a consequence, the lien on this taxpayer's property had not been released.

Recommendations

To improve the effectiveness of controls over taxpayer accounts rejected from the automated lien release process, we recommend that you direct lien unit managers to

- research and resolve the current backlog of unresolved manual interest or penalties reports;
- research and resolve exception reports containing liens with manually calculated interest or penalties weekly, as called for in the Internal Revenue Manual and the ALS User Guide; and

³⁰I.R.M. § 5.12.6.9(1)(A) (Oct. 1, 2003) and ALS User Guide (July 2002).

³¹IRS performed a special query of its system to determine the number of unresolved accounts with manual interest or penalty calculations. However, the listing did not go back further than January 2003.

³²During our initial review of the lien units, from July through September 2003, one of these five lien units was timely resolving this report.

- provide training to designated staff on how to resolve exception reports containing accounts with manually calculated interest or penalties.

IRS Comments and Our Evaluation

IRS agreed with our recommendations. In its response, IRS stated that to improve the overall processing of the exception reports, it will provide additional training and move the report resolution process to the Centralized Lien Processing Unit at the Cincinnati Campus. Additionally, IRS stated that accounts listed on the exception report containing manually calculated interest or penalties will now be sent to the Examination Case Processing function for computation and then returned to the Centralized Lien Processing Unit for either lien release or other appropriate action. IRS also stated that it is working to resolve the current backlog and that it expects the backlog to be resolved by September 30, 2005. We will evaluate the effectiveness of IRS's efforts in future audits.

Unmatched Exception Reports Are Not Cumulative

As discussed earlier, unmatched exception reports contain Masterfile taxpayer accounts for which outstanding tax debt has been satisfied but that do not match an account in ALS. Further processing of the lien release cannot continue until exceptions are manually reviewed and resolved by IRS personnel.

During our review, we identified a significant flaw in the design of this important control. Specifically, we found that the unmatched exception reports are not cumulative. They contain only accounts that have been rejected in the current week and do not include the unresolved accounts identified in prior weeks' reports. For example, although at least 3,100 unmatched taxpayer accounts were unresolved as of June 2, 2004, the weekly unmatched exception report on that day showed only 109 rejected taxpayer accounts.

Lack of a cumulative report makes it more difficult to ensure that all taxpayer accounts rejected from the automated lien release process are resolved in a timely manner, or at all, because rejected accounts are reported only once, in a single week's exception report, regardless of whether or when they get resolved. We believe that this flaw in the design of the exception report contributed significantly to the fact that at least 99 percent of the unresolved taxpayer accounts at the end of 2003 remained unresolved as of the end of June 2004. Having a cumulative report is consistent with GAO's *Standards for Internal Control in the Federal Government*, which requires that internal control activities help ensure that management's directives to mitigate risk are carried out.³³ Without an effective tool to ensure that all taxpayer accounts rejected from the automated lien release process are identified and resolved, the backlog of unresolved cases will likely increase without the

³³GAO, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: November 1999).

knowledge of lien unit management,³⁴ thereby increasing the potential for liens to not be promptly released.

Recommendation

To better ensure that taxpayer accounts rejected from the automated lien release process are timely reviewed and resolved, we recommend that IRS improve the current unmatched exception report by including a cumulative list of all unmatched taxpayer accounts that have not been resolved to date.

IRS Comments and Our Evaluation

IRS agreed with our recommendation. In its response, IRS stated that it will modify its system so that rejected items are retained on the exception report until resolved. We will evaluate the effectiveness of IRS's efforts in future audits.

This letter contains nine 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 Governmental Affairs and the House Committee on Government Reform within 60 days of the date of this letter. 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 the letter.

This letter is intended for use by the management of IRS. We are sending copies to the Chairmen and Ranking Minority Members of the Senate Committee on Appropriations; Senate Committee on Finance; Senate Committee on Governmental Affairs; Senate Committee on the Budget; Subcommittee on Transportation, Treasury, and General Government, Senate Committee on Appropriations; Subcommittee on Taxation and IRS Oversight, Senate Committee on Finance; Subcommittee on Oversight of Government Management, the Federal Workforce, and the District of Columbia, Senate Committee on Governmental Affairs; House Committee on Appropriations; House Committee on Ways and Means; House Committee on Government Reform; House Committee on the Budget; Subcommittee on Transportation, Treasury, and Independent Agencies, House Committee on Appropriations; Subcommittee on Government Efficiency and Financial Management, House Committee on Government Reform; and the Subcommittee on Oversight, House Committee on Ways and Means. In addition, we are sending copies of this letter to the Chairman and Vice-Chairman of the Joint Committee on Taxation, the Secretary of the Treasury, the Director of the Office of Management and Budget, the Chairman of the IRS Oversight Board, and other interested parties. Copies will be

³⁴ALS programmers had to perform a special query to determine the backlog of unresolved cases. The backlog of unresolved cases is not readily available to lien unit management.

made available to others upon request. This report is available at no charge at 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 audit. If you have any questions or need assistance in addressing these matters, please contact me at (202) 512-3406 or sebastians@gao.gov. Additional contacts and staff acknowledgments are provided in enclosure II.

Sincerely yours,

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

Steven J. Sebastian
Director
Financial Management and Assurance

Enclosures - 2

Comments of the Internal Revenue Service



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

December 14, 2004

Mr. Steven J. Sebastian
Director
Financial Management and Assurance
United States Government Accountability Office
Washington, D.C. 20548

Dear Mr. Sebastian:

I have reviewed the draft report entitled "Opportunities to Improve Timeliness of IRS Lien Releases" (GAO-05-26R) and agree with your recommendations. I agree that one of our main objectives is to provide timely and efficient service to taxpayers, and that liens should be released on a timely basis once satisfied.

As a result of earlier reviews of our lien release processes, and information provided in your report, many corrective actions have already been implemented. To resolve the unpostable lien transaction reports, we have established a team in our Centralized Lien Processing Unit at the Cincinnati campus. Lien transactions that do not post to a taxpayer's account will now be resolved weekly. We have also established a separate team to resolve the backlog and expect that all backlogs will be resolved by September 30, 2005.

New procedures for working the Satisfied Module (SATMOD) Reject Reports have also been developed. Accounts that are unpostable due to taxpayer entity mismatches, such as the name or tax period, will be resolved by matching information between the Master File and the Automated Lien System. Those accounts that are on the list for manual calculation of penalties or interest will now be sent to the Examination Case Processing function for computation and returned to the Centralized Lien Processing Unit for either a lien release or other appropriate action. Again, we are working to resolve the backlog of these unpostables and expect to have all backlogs resolved by September 30, 2005.

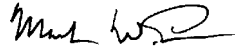
To improve overall processing of these reject reports, we will provide additional training and resolve staffing imbalances by moving the report resolution process to the Centralized Lien Processing staff. Timely report resolution is an integral function of the Centralized Lien Processing Unit, and time frames and managerial oversight are built into report resolution processes.

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Finally, you recommended enhancing the entity mismatch section of the SATMOD Reject Report to retain rejected items until they are resolved. We concur with this recommendation and will submit a systems change request for this enhancement.

We expect that all of these efforts will have a positive effect on our efficiency and effectiveness and will enable us to provide better customer service. If you have any questions, please contact me or Brady R. Bennett, Director, Collection, Small Business/Self-Employed Division, at (202) 283-2610.

Sincerely,



Mark W. Everson

Enclosure II

GAO Contacts and Staff Acknowledgments

GAO Contacts

Paul Foderaro, (202) 512-2535
William J. Cordrey, (404) 679-1873

Acknowledgments

Staff who made key contributions to this report were David Shoemaker, Mark Yoder, and Esther Tepper.

(196022)