



*Foreign Account Tax Compliance Act
Program Withholding and Refund Release 2.0
Project Development and Testing*

August 31, 2016

Reference Number: 2016-20-077

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

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HIGHLIGHTS

FOREIGN ACCOUNT TAX COMPLIANCE ACT PROGRAM WITHHOLDING AND REFUND RELEASE 2.0 PROJECT DEVELOPMENT AND TESTING

Highlights

Final Report issued on August 31, 2016

Highlights of Reference Number: 2016-20-077 to the Internal Revenue Service Chief Information Officer and the Commissioner, Large Business and International Division.

IMPACT ON TAXPAYERS

The goal of implementing the Foreign Account Tax Compliance Act (FATCA) legislation is to enhance voluntary tax compliance and improve U.S. taxpayer transparency abroad. Successful implementation of FATCA Release 3.0 (which includes Withholding and Refund Release 2.0) should significantly improve taxpayer compliance internationally and enhance tax administration.

WHY TIGTA DID THE AUDIT

The FATCA Program is an important development in the IRS's efforts to improve U.S. tax compliance involving foreign financial assets and offshore accounts. The IRS has implemented FATCA functionality since December 2013. The overall objective of this review was to determine whether the IRS properly developed and sufficiently tested the system for withholding and refund fraud detection.

WHAT TIGTA FOUND

The IRS made improvements, based on prior TIGTA reviews, to strengthen systems development requirements management controls for FATCA projects. However, in an attempt to meet the project schedule and manage resources, Withholding and Refund Release 2.0 went forward despite critical data quality problems that resulted in unplanned work and a four-month implementation delay. In addition, improvements are needed to ensure that high-risk issues are given priority.

While the IRS implemented Withholding and Refund Release 2.0 on the revised February 2016 deployment date and there is agreement that the system was built to requirements, the IRS spent \$15 million delivering functionality that has not provided the intended business results. The IRS first identified data matching issues in May 2015. Although the initial data matching issues were resolved, the IRS identified new data matching issues as recently as February 2016. The IRS does not have a timetable for when the latest data matching issues will be resolved and automated functionality will provide all of the expected business results.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Chief Information Officer ensure that future projects, and new releases of current projects, using forms for data matching for the first time are given sufficient time prior to the finalization of requirements to allow the business unit to completely understand the data to ensure that it will deliver the expected results, and ensure that corrective actions and timelines to address critical risks are given high priority and that disagreements as to the level of risk are promptly elevated.

The IRS agreed with the first recommendation and plans to provide guidance to projects that use forms for data matching for the first time. Whenever possible and practicable, projects that use forms for matching for the first time will be implemented under the Agile Path Enterprise Life Cycle model.

The IRS disagreed with the second recommendation. The IRS Information Technology (IT) organization stated there was alignment between the IT organization and the business unit regarding the rating, evaluation, and escalation of risks. However, the IRS did not provide evidence to support this alignment. In addition, the IRS's lessons learned documentation stated that risk reporting was not consistent between the business unit and the IT organization and that the criticality of risks at a program level may not have been fully communicated.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

August 31, 2016

MEMORANDUM FOR COMMISSIONER, LARGE BUSINESS AND INTERNATIONAL
DIVISION
CHIEF INFORMATION OFFICER

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Foreign Account Tax Compliance Act Program
Withholding and Refund Release 2.0 Project Development and Testing
(Audit #201520022)

This report presents the results of our review of the Foreign Account Tax Compliance Act¹ system for withholding and refund fraud detection. The overall objective of this review was to determine whether the Internal Revenue Service (IRS) has properly developed and sufficiently tested the Foreign Account Tax Compliance Act system for withholding and refund fraud detection. This is our third audit of systems development activities conducted by the Foreign Account Tax Compliance Act Enterprise Program Management Office. This audit is included in our Fiscal Year 2016 Annual Audit Plan and addresses the major management challenge of Implementing the Affordable Care Act and Other Tax Law Changes.

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

Copies of this report are also being sent to the IRS managers affected by the report recommendations. If you have any questions, please contact me or Danny Verneuille, Acting Assistant Inspector General for Audit (Security and Information Technology Services).

¹ Pub. L. No. 111-147, Subtitle A, 124 Stat 71, *96-116 (2010) (codified in scattered sections of 26 U.S.C.).



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Abbreviations

CTO	Chief Technology Officer
FATCA	Foreign Account Tax Compliance Act
FFI	Foreign Financial Institution
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
IT	Information Technology
LB&I	Large Business and International
PMO	Program Management Office
RRP	Return Review Program
TIGTA	Treasury Inspector General for Tax Administration
W&R	Withholding and Refund



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Background

The Foreign Account Tax Compliance Act (FATCA)¹ Program is an important development in the Internal Revenue Service's (IRS) efforts to improve U.S. tax compliance involving foreign financial assets and offshore accounts. The FATCA legislation was enacted in March 2010 by Congress as part of the Hiring Incentives to Restore Employment Act² to:

- Combat tax evasion by U.S. persons holding investments in offshore accounts.
- Expand the IRS's global presence.
- Pursue international tax and financial crimes.
- Fill a gap in the IRS's information reporting system.
- Generate additional enforcement revenue.

On January 28, 2013, the Department of the Treasury issued the final FATCA regulations. The primary objective of the FATCA is to improve disclosure by foreign financial institutions (FFI)³ of U.S. account holders. FATCA withholding provisions, which took effect on July 1, 2014, impose a 30 percent withholding tax on certain types of U.S. sourced payments. To comply with the FATCA legislative requirements, the FFIs are required to provide identifying information on U.S. accounts maintained by the institution. The overarching goal of implementing the FATCA legislation (specifically regarding FFI registration) is to enhance voluntary tax compliance and improve U.S. taxpayer transparency abroad through information returns reporting and collaboration with the FFIs worldwide. In January 2014, an FFI automated registration application system was implemented to address the FATCA regulations.

Since the implementation of the FFI Registration System, the IRS has implemented the International Data Exchange Service to facilitate secure electronic submission, receipt, and exchange of FATCA data among financial institutions from many countries. In addition, the IRS has developed the International Compliance Management Model database to process FATCA data. The IRS expanded the FATCA Program into additional areas to include:

- **Refund Processing and Fraud Detection** to process returns with requests for refunds against withholding deposits and to identify and prevent potential refund fraud.
- **FATCA Compliance Strategy** to identify and integrate data elements for compliance case selection and case management.

¹ Pub. L. No. 111-147, Subtitle A, 124 Stat 71, *96-116 (2010) (codified in scattered sections of 26 U.S.C.).

² Pub. L. No. 111-147, 124 Stat. 71 (2010).

³ See Appendix V for a glossary of terms.



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Figure 1 provides the FATCA Program systems deployment.

Figure 1: FATCA Program Systems Deployment

FATCA Release	Description
Release 1.1 – deployed December 2013	<p>FFI Registration System – A web-based 24/7 access registration system that:</p> <ul style="list-style-type: none"> • Allows financial institutions worldwide to establish an online account with the IRS and manage all affiliate financial institutions. • Includes a new international numbering scheme – Global Intermediary Identification Number – to implement a standardized worldwide residence-based information reporting regime. • Publishes the approved IRS FFI List and provides a search and download tool and associated user guide.
Release 2.0 – deployed January 2015	<p>International Data Exchange Services – A managed service that:</p> <ul style="list-style-type: none"> • Publishes/subscribes information returns globally, facilitating financial institution reporting to the IRS and the exchange of information between the IRS and foreign tax authorities under intergovernmental agreements. • Supplies help desk activities for the FFIs and Host Country Taxing Authorities when submitting files. <p>International Compliance Management Model – High-level functionality that ingests electronic and paper forms, <i>e.g.</i>, Form 8938, <i>Statement of Specified Foreign Financial Assets</i>, and Form 1042, <i>Annual Withholding Tax Return for U.S. Source Income of Foreign Persons</i>, into FATCA information repository notifications and alerts.</p> <p>Withholding and Refund (W&R) Release 1.0 – Implementation of a series of filing season changes to the current processing environment that:</p> <ul style="list-style-type: none"> • Creates a 180-day expiring credit freeze for Chapter 3 and Chapter 4 credits. Chapter 3 requires withholding agents to collect tax from foreign persons and corporations. Chapter 4 requires withholding agents to withhold tax on certain payments to FFIs. • Gathers and prepares the data that would be used for later releases to do automated matching.
Release 2.1 – deployed August 2015	<p>International Compliance Management Model – High-level functionality that:</p> <ul style="list-style-type: none"> • Implements new electronic and paper submission processing to receive, process, and store FATCA returns. • Provides capability to manage stored data and provide reports to facilitate future document matching and compliance activities. • Implements capability to collect data and create output files for exchange with governments under Model 1 reciprocal intergovernmental agreements.

Source: IRS Large Business and International (LB&I) Division and FATCA Information Technology (IT) Program Management Office's (PMO) Program Summary Documentation.



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Figure 2 shows approved funding and actual expenditures for the FATCA Program for Fiscal Years 2014 through 2016:

Figure 2: FATCA Program Funding for Fiscal Years 2014 Through 2016

Fiscal Year 2014		Fiscal Year 2015		Fiscal Year 2016	
Planned	Actual	Planned	Actual	Planned	Actual
\$46,576,000	\$40,899,510	\$65,145,661	\$64,886,105	\$58,825,467	TBD

Source: IRS budget documentation.⁴

FATCA Release 3.0 includes the work to develop and deploy W&R Release 2.0 functionality that will use the data that were prepared in the prior FATCA Release 2.0 (via W&R Release 1.0) to conduct automated matching and make a credit determination as to whether certain refund claims are valid. Specifically, this functionality aligns with the following three components:

1. **Data Preparation** – These are computer tasks or jobs that are used to import data from external systems to the FATCA Data Store. Data Preparation consists of four separate jobs: one job imports recipient copy data for Form 1042-S, *Foreign Person’s U.S. Source Income Subject to Withholding*,⁵ from the International Compliance Management Model and three jobs import Information Returns Master File, Individual Master File, and Business Master File data from the Integrated Production Model.
2. **Match Data** – This application compares fields on the recipient copy of Form 1042-S with data from the withholding agent copy of Form 1042-S. Based on matching criteria, the result of the comparison will be used to either allow or deny the credit. If the credit is denied, indicators are sent downstream to corporate data systems that will result in sending out denial letters.
3. **Sum Deposit** – This application compares what the withholding agents are submitting on Form 1042-S (the withholding agent copy) with actual deposits to determine if there is a shortfall. Deposit shortfalls may also trigger a credit denial in the Match Data application.

The scope of this audit focused on delivery of W&R Release 2.0. The project team assembled to implement the three main components of W&R Release 2.0 consisted of members from several different IRS organizations. The FATCA IT PMO owns delivery of the entire FATCA Program and is responsible for designing, developing, and deploying FATCA projects to meet business needs. The LB&I Division (the business unit) is responsible for defining the business unit

⁴ The planned and actual Fiscal Year 2015 and Fiscal Year 2016 costs exclude the cost to implement W&R Release 2.0 because that effort was funded under the Return Review Program initiative.

⁵ Form 1042-S is a multipart form with copies for the IRS, the recipient, and the withholding agent.



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requirements based on FATCA legislation. The LB&I Division also interacts with the FFIs and withholding agents.

In March 2015, the FATCA Governance Board decided to realign the W&R Release 2.0 project from the FATCA IT PMO to the Return Review Program (RRP) Delivery Services organization under the Revenue Integrity and Compliance PMO. The realignment was implemented because most of the core W&R Release 2.0 functions were expected to be performed by the RRP. For FATCA W&R Release 3.0, a division of the RRP was assigned as the project management lead, reporting up to the FATCA IT PMO. The FATCA Release 3.0 project team is comprised of members from the FATCA IT PMO, the LB&I Division, the W&R project office, and supporting IT organization staff.

W&R Release 2.0 had a budget of \$15.5 million and was originally scheduled to deploy in October 2015. If the IRS did not implement W&R Release 2.0, taxpayers would either be owed interest because taxpayer forms would not be processed and credit determinations could not be made or compliance checks would be limited in number and scope.

This review was performed in the FATCA PMO and the Revenue Integrity and Compliance PMO in the New Carrollton Federal Building in Lanham, Maryland, during the period June 2015 through March 2016. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.



Results of Review

Improvements Have Been Made to Strengthen Systems Development Requirements Management Controls

Internal Revenue Manual (IRM) 2.16.1, *Enterprise Life Cycle*, guidance speaks to the processes, techniques, and tools that are to be used to manage and control project requirements. The Enterprise Life Cycle guidance also emphasizes the importance of such activities as capturing, verifying, and tracing requirements throughout the life cycle.

In a prior audit report,⁶ the Treasury Inspector General for Tax Administration (TIGTA) identified the need for the IRS to keep an up-to-date Requirements Traceability Verification Matrix in place for its future FATCA projects to ensure complete traceability between project requirements and test cases. TIGTA further recommended that the Chief Technology Officer (CTO) ensure that IRM guidelines would be followed in the future so that Requirements Traceability Verification Matrices are established at the beginning of the testing life cycle, and updated and maintained throughout the requirements management and testing processes. The IRS agreed with this recommendation. For the W&R Release 2.0 project, the IRS produced multiple Requirements Traceability Verification Matrices that showed the project release requirements and associated test cases.

Further, TIGTA previously identified⁷ the need for the IRS to improve traceability of system requirements to testing through continued, consistent use of the IRS's standard for requirements management during systems development—specifically, IBM's Rational Tool Suite automated tool, RequisitePro. During the current audit, the W&R Release 2.0 project team provided multiple Requirements Traceability Verification Matrices generated by RequisitePro. Also, the use of RequisitePro contributed to FATCA IT PMO/W&R project personnel more effectively managing the additional testing of new test cases and corresponding affected requirements during the four-month deployment delay period.

⁶ TIGTA, Ref. No. 2013-20-118, *Foreign Account Tax Compliance Act: Improvements Are Needed to Strengthen Systems Development Controls for the Financial Institution Registration System* (Sept. 2013).

⁷ TIGTA, Ref. No. 2014-20-094, *While the Financial Institution Registration System Deployed on Time, Improved Controls Are Needed* (Sept. 2014).



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In an Attempt to Meet the Project Schedule and Manage Resources, Withholding and Refund Release 2.0 Went Forward Despite Critical Data Quality Problems

IRM 2.16.1 states that an important consideration during system testing is verifying the system's fitness for implementation. A key criterion for determining fitness for implementation is evaluating whether the functionality tested meets defined requirements and delivers expected business results. Further, the Government Accountability Office defines data reliability as data that are reasonably complete and accurate, meet the intended needs of the user, and are not subject to inappropriate alteration. Accuracy is characterized in greater detail by the extent that recorded data reflect the actual underlying information. Completeness is defined further by the extent that records are present and the fields in each record are properly populated.

The project schedule dictated that requirements development and approval be completed prior to the time in which the LB&I Division had electronic access to the Form 1042-S recipient copy. The W&R Release 2.0 project office approved requirements in February 2015. In April 2015, the RRP requested a live data waiver to obtain live data from the International Compliance Management Model production environment for testing. In May 2015, the live data waiver was approved and the W&R Release 2.0 project team was initially provided access to live data copied from the International Compliance Management Model production environment into the performance simulation environment which enabled a comparison of actual Form 1042-S recipient copy data against Form 1042-S withholding agent copy data. The Applications Development organization's RRP personnel identified data quality issues related to transcription errors and data not coming in as expected. The LB&I Division further identified that the issues would result in an unacceptably high 94 to 98 percent mismatch rate and would amount to a "no-go" decision for the system. In response, the LB&I Division submitted three change requests in June 2015 that took 63 business days to approve:

- **Change Request 75** created a new field amount tolerance for the matching of dollar amount fields on the Form 1042-S withholding agent copy and recipient copy. The business unit added this change request because five fields with dollar values were being treated differently by the system that receives the Form 1042-S withholding agent copies and the system that the Form 1042-S recipient copies are transcribed into. Specifically, when dollar amounts on the Form 1042-S withholding agent copies were entered into the IRS electronic returns filing system, the system was rounding the dollar amounts up to the nearest whole dollar. In contrast, when dollar amounts on the Form 1042-S recipient copies were entered into the taxpayer remittance processing system, the system only used the whole dollar amount.
- **Change Request 76** replaced exact match requirements with proximal matching of the Withholding Agent's Name and Recipient's Name on the Form 1042-S withholding agent copy and recipient copy. The business unit added this change request because



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when name fields from the Form 1042-S withholding agent copy were entered, the withholding agents were not following instructions. This led to mismatches in the name fields on the Form 1042-S recipient copy when the name fields were transcribed by the taxpayer remittance processing system.

- **Change Request 77** created a new requirement to match the last four digits of the Taxpayer Identification Number field on the Form 1042-S withholding agent copy and recipient copy when the recipient copy contained a truncated Taxpayer Identification Number. The business unit added this change request because regulations allowed the use of a truncated Taxpayer Identification Number in lieu of the taxpayer's full Taxpayer Identification Number.

Change requests 75, 76, and 77 were implemented in August and September 2015.

A second critical delay occurred in October 2015 after conducting user acceptance testing with all received Form 1042-S recipient copies. The LB&I Division identified additional data quality issues not observed in the May 2015 data comparison that uncovered new gaps in requirements and defects which needed to be resolved. The W&R Release 2.0 project team compiled a list of 22 "show-stopper" issues. The IRS delayed implementation by four months (from October 13, 2015, to February 9, 2016) to implement the necessary fixes to these issues.

A third critical delay occurred in February 2016 after conducting two additional rounds of user acceptance testing in December 2015 and January 2016. The W&R Release 2.0 project was deployed in February 2016; however, the LB&I Division determined that the system would not meet intended business needs and deferred execution of the data match functionality. Further, the LB&I Division submitted several additional change requests to resolve the current "inoperable W&R system functionality." As of March 2016, the IRS had not finished work to assess the development level of effort needed and the timeline to implement solutions for the latest accepted change requests.

Eight of 16 change requests identified between June 2015 and November 2015 were the result of an initial lack of understanding of how the data would be processed by the W&R application of the RRP. The frequency of changes starting in June 2015 resulted in unplanned development work that steadily pushed planned development activities out and compressed time available for testing. As a result of not incorporating detailed analysis of the data sources into the requirements and design, the W&R Release 2.0 project team had to address the impacts of data that were different than originally expected in three cycles of user acceptance testing.

The W&R Release 2.0 project team was unable to perform an in-depth analysis of the process to be used to compare the Form 1042-S withholding agent copies to the recipient copies. LB&I Division management stated that the ongoing delay was caused by unfamiliarity with the data, which likely could have been remedied by additional time to better understand the data prior to requirements signoff at the beginning of the systems development process. In addition, the W&R Release 2.0 project team encountered challenges getting agreement from IRS



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IT organization management to assess critical change requests due to a concern that accepting the change requests would not only delay the schedule but could also have an adverse impact on already constrained project resources.

While the IRS implemented FATCA W&R Release 2.0 on February 9, 2016, and there is agreement between the FATCA IT PMO and the LB&I Division that the system was built to requirements, the LB&I Division decided that the functionality delivered did not provide expected business results due to a high credit (or refund) denial rate resulting from incorrect credit (refund) determinations for taxpayers. In the interim, the LB&I Division is using an internally developed semi-automated tool to process the Tax Year 2014 Form 1042-S data while the IRS evaluates additional change requests to correct the current “inoperable W&R system functionality.” The IRS first identified data matching issues in May 2015. Although the initial data matching issues were resolved, the IRS identified new data matching issues as recently as February 2016. The IRS does not have a timetable for when the latest data matching issues will be resolved and automated functionality will deliver the expected business results.

Recommendation

Recommendation 1: The Chief Information Officer should ensure that future projects, and new releases of current projects, using forms for matching for the first time are given sufficient time prior to the finalization of requirements to completely understand the data to ensure that it will deliver expected business results.

Management Response: The IRS agreed with this recommendation, stating that the Associate Chief Information Officer, Strategy and Planning, is responsible for providing guidance to projects that are similar to the W&R Release 2.0. Whenever possible and practicable, projects that use forms for matching for the first time will be implemented under the Agile Path Enterprise Life Cycle model. Under the Agile Path, requirements are not baselined prior to start of development, and the product owner (business unit) will have the latitude to prioritize the order of the features to be implemented.

Improvements Are Needed to Ensure That High-Risk Issues Are Given Priority

IRM Section 2.16.1 defines risk management as the process of identifying, monitoring, and mitigating project and program risks. Although the IRM gives some consideration in the event the project cannot make the “operational readiness” date, the IRM also emphasizes the importance of managing project risks to the extent necessary to ensure successful project completion. Further, Enterprise Life Cycle guidance states the following objectives: standardize the approach for managing, governing, and supporting projects; improve the probability of project success within budget and schedule; and further help ensure project success by reducing risk.



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On May 19, 2015, the IRS added the following risk (Risk #25498) into the risk management tracking system, the Item Tracking Reporting and Control system, “If the [Form] 1042-S, *Recipient Copy*, data quality issues are not resolved, then the data matching functionality will not work correctly and erroneous refund claims may be released.” The FATCA IT PMO and the LB&I Division assigned a risk probability rating of high, indicating a greater than 75 percent chance of the risk occurring, and a risk impact scoring of severe, for an overall risk criticality of red.⁸ After the development team examined the live data at the end of May 2015, the FATCA IT PMO determined that the data match risk event occurred. On June 5, 2015, the FATCA IT PMO converted Risk #25498 to Issue #25526 in the Item Tracking Reporting and Control system with a high-priority rating.

In the June 18, 2015 FATCA CTO briefing, the Enterprise PMO reported that the business owner, the LB&I Division, would be submitting three change requests to update rules and requirements to address the data matching issues documented in Risk #25498, *e.g.*, dollar match, name match, and truncated Taxpayer Identification Number match issues. The briefing to the CTO also noted that there was no slack in the W&R project schedule. On June 18, 2015, the CTO decided that the W&R Release 2.0 project would not assess any change requests to address W&R data matching issues despite each of the three change requests containing the following language in the business/risk impact: “The Withholding and Refund system would be developed with an unacceptably high 94 to 98 percent mismatch rate and would amount to a “no-go” for the system.” This CTO decision led the Enterprise PMO to downgrade Issue #25526 from high to low priority status on June 25, 2015, noting in the Item Tracking Reporting and Control system that, “This issue has been moved to a low priority because the IT organization has not approved change requests to address data matching issues that will result in 98 percent of credits being denied. This is a high business risk.” The LB&I Division continued to rate the issue as high.

As part of the Enterprise Life Cycle requirements for Milestone 4b exit, the IRS held a meeting to discuss the lessons learned. In the lessons learned document, the IRS stated that risk reporting was not consistent between the business unit and the IT organization. While the IT organization downgraded Issue #25526 from high to low with the June 2015 CTO decision not to accept three change requests, from the LB&I Division’s perspective, this issue remained high. In lessons learned documentation, the W&R Release 2.0 project team specifically cited that the delay in implementing the three data matching change requests resulted in the LB&I Division rating the risk as red, but the IT organization rated the risk as green because it had not approved the change requests. The lessons learned also noted that the criticality of the risks, at a program level, may not have been fully communicated.

The IRS IT organization stated that the CTO was aware of the project risk and his participation and engagement demonstrated his awareness of the impact. At the June 18, 2015, CTO meeting, the CTO expressed concerns that accepting the change requests would not only delay the schedule but also could have an adverse impact on already constrained project resources. On

⁸ See Appendix IV for the control risk criticality definitions and issue priority levels.



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July 9, 2015, the business owner escalated the data match issue to high priority. On July 20, 2015, the Enterprise PMO received notification that the CTO reversed the June 2015 decision and accepted the three change requests. In addition, the W&R Release 2.0 project was instructed to start assessing the work required to address the three change requests. The initial decision to not accept and immediately assess the change requests, however, cost the IRS a month of valuable time on the project schedule that the IRS already indicated had no slack.

Recommendation

Recommendation 2: The Chief Information Officer should ensure that corrective actions and timelines to address critical risks are given high priority and that disagreements as to the level of risk are promptly elevated.

Management Response: The IRS disagreed with this recommendation, stating that the IRS already employs an established Governance process for risk discussion and escalation, through an Executive Steering Committee, whose voting members include both IT organization and business unit senior executives.

Office of Audit Comment: In discussions regarding the issues, the IRS IT organization stated there was alignment between the IT organization and the business unit on the rating, evaluation, and escalation of risks, as evidenced by an established Executive Steering Committee. However, the IRS did not provide any evidence to support this alignment. Shortly after the June 2015 CTO decision not to accept three data matching change requests to resolve critical issues which the business unit stated would result in a “no-go” for the system, the business unit escalated the issue, resulting in the CTO reversing his June 2015 decision and accepting the three change requests. If there had been a clear corrective action plan, there would not have been a need for the business unit to escalate the data match issue three weeks later. In addition, the IRS’s lessons learned documentation from this effort stated that risk reporting was not consistent between the business unit and the IT organization and that the criticality of risks at a program level may not have been fully communicated.



Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to determine whether the IRS has properly developed and sufficiently tested the FATCA¹ system for withholding² and refund fraud detection. To accomplish our objective, we:

- I. Determined the effectiveness of risk management controls for the FATCA Program and the W&R project.
 - A. Requested and reviewed the most current FATCA Program and W&R project Item Tracking Reporting and Control system risk reports.
 - B. Discussed key risks with IRS Enterprise PMO and LB&I Division officials to obtain an understanding of the risks.
- II. Determined whether the IRS is adequately managing the requirements and change management risks and systems testing activities for the W&R project.
 - A. Reviewed the initial and updated W&R requirements plans and lessons learned documents.
 - B. Obtained the Requirements Traceability Verification Matrix for both the W&R project and the FATCA IT PMO to determine that comparable requirements and associated defects were accounted for.
 - C. Obtained the total population of W&R requirements to determine the extent of requirements traceability.
 - D. Obtained the population of W&R requirements changes, including change requests, to verify adequate testing and documentation.
 - E. Reviewed and evaluated the W&R Release 2.0 project documentation to ensure that key controls were not failed, waived, or deferred to future releases.
- III. Determined whether the IRS is adequately managing the FATCA W&R Release 2.0 project.
 - A. Funding. Inquired and documented the IRS's funding strategy for the FATCA. We documented approved funding and actual expenditures for the FATCA Program for Fiscal Years 2014 through 2016.

¹ Pub. L. No. 111-147, Subtitle A, 124 Stat 71, *96-116 (2010) (codified in scattered sections of 26 U.S.C.).

² See Appendix V for a glossary of terms.



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- B. Budget. Determined the effectiveness of budget provisions. We determined the W&R project's budget and estimated life cycle costs.
- C. Timeline. Developed a timeline to identify key releases for developing and deploying FATCA systems, including key milestones and deadlines that affected systems development.
- D. Coordination. Interviewed FATCA IT PMO and W&R/RRP management to discuss the degree of project coordination required between the two efforts.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: IRM and related IRS guidelines and the processes followed in the development of information technology projects. We evaluated these controls by conducting interviews with management and staff and reviewing documentation. Documents reviewed included the FATCA Program Requirements Plan, the FATCA Risk Management Plan, and other documents that provided evidence of whether the IRS is adequately managing systems development risks for the FATCA W&R Release 2.0 project.



*Foreign Account Tax Compliance Act Program Withholding and
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Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

Commissioner
Office of the Commissioner – Attn: Chief of Staff
Deputy Commissioner for Operations Support
Deputy Commissioner for Services and Enforcement
Deputy Commissioner, Large Business and International Division
Associate Chief Information Officer, Enterprise Program Management Office
Director, Office of Audit Coordination



Appendix IV

Control Risk Criticality Definitions and Issue Priority Levels

The Item Tracking Reporting and Control User Guide includes information on risk record analysis, including risk probability rating, risk impact rating, and risk criticality color computation. The following are a series of tables from the user guide that define each component of the risk analysis. In addition, the final table illustrates the different levels of issue priority used by the IRS.

Risk Probability Rating – Describes how likely it is that a risk will occur. Figure 1 defines the risk probability rating thresholds.

Figure 1: Risk Probability Rating

Probability Pick List	Definition	Probability Rating
<25%	Probability of Risk occurrence is less than 25% and greater than 0%	Low
25% - 75%	Probability of Risk occurrence is less than 75% and greater than or equal to 25%	Moderate
>75%	Probability of Risk occurrence is less than 100% and greater than or equal to 75%	High

Source: *The Item Tracking Reporting and Control User Guide*.

Risk Impact Rating – Describes the cumulative effect of a risk on the cost, schedule, technical performance, and impact on other teams or projects. Figure 2 defines the risk impact rating thresholds.



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Figure 2: Risk Impact Rating

Risk Impact Pick List	Definition	Risk Impact Rating
Cost	A gross dollar estimate of the risk impact if no mitigation action is taken	<ol style="list-style-type: none"> 1. None: <\$10,000 2. Low: \$10,000-\$100,000 3. Mod: \$100,000-\$1,000,000 4. High: \$1,000,000-\$10,000,000 5. Severe: >\$10,000,000
Schedule	A high-level estimate of the risk impact on schedule if no mitigation action is taken	<ol style="list-style-type: none"> 1. Minimal or No Impact 2. Additional Resources Required 3. Minor Slip in Key Milestones 4. Major Slip in Key Milestones 5. Cannot Achieve Key or Major Milestone
Technical Performance	A high-level estimate of the risk impact on technical performance if no mitigation action is taken	<ol style="list-style-type: none"> 1. Minimal or No Impact 2. Minor Technical Shortfall 3. Moderate Technical Shortfall 4. Major Workaround Available 5. Not Meeting Minimum Requirements
Impact on Other Team	A high-level estimate of the risk impact on other teams and projects if no mitigation action is taken	<ol style="list-style-type: none"> 1. None 2. Some Impact 3. Moderate Impact 4. Major Impact 5. May Impact the Release Window

Source: The Item Tracking Reporting and Control User Guide.

Risk Criticality Color Computation – Combines the probability of risk occurring with the risk’s impact. The risk criticality designation helps identify priorities to quickly get IRS management’s attention and to allocate resources properly. Figure 3 defines the risk criticality color computation.



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Figure 3: Risk Criticality Color Computation

Risk Probability Rating	Risk Impact Rating	Criticality Color
High	Moderate	Red
High	High	Red
High	Severe	Red
Low	Severe	Red
Moderate	High	Red
Moderate	Severe	Red
High	Low	Yellow
Moderate	Moderate	Yellow
Low	High	Yellow
Low	Low	Green
Low	Moderate	Green
Moderate	Low	Green

Source: *The Item Tracking Reporting and Control User Guide.*

Issue Priority – Documents the impact and time frame for resolution. Figure 4 defines the issue priority.

Figure 4: Issue Priority

Issue Priority	Description
Low	<ul style="list-style-type: none"> Has a significant impact and must be resolved within 30 days.
Moderate	<ul style="list-style-type: none"> Has a moderate impact and must be resolved within 60 days.
High	<ul style="list-style-type: none"> Has a high impact and must be resolved within 90 days.

Source: *The Item Tracking Reporting and Control User Guide.*



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Appendix V

Glossary of Terms

Term	Definition		
Business Master File	The IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, taxes on businesses, and excise taxes.		
Enterprise Life Cycle Phases and Milestones	Phase	General Nature of Work	Milestone
	Vision and Strategy/ Enterprise Architecture Phase	High-level direction setting. This is the only phase for enterprise planning projects.	0
	Project Initiation Phase	Startup of development projects.	1
	Domain Architecture Phase	Specification of the operating concept, requirements, and structure of the solution.	2
	Preliminary Design Phase	Preliminary design of all solution components	3
	Detailed Design Phase	Detailed design of solution components.	4A
	System Development Phase	Coding, integration, testing, and certification of solutions.	4B
	System Deployment Phase	Expanding availability of the solution to all target users. This is usually the last phase for development projects.	5
	Operations and Maintenance Phase	Ongoing management of operational systems	System Retirement
<i>Source: The Enterprise Life Cycle Guide.</i>			
Fiscal Year	Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government’s fiscal year begins on October 1 and ends on September 30.		



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Term	Definition
Foreign Financial Institution	Includes any non-U.S. entity that accepts deposits, holds financial assets, or engages in the business of investing; this includes foreign banks, foreign branches of U.S. banks, and businesses organized under a foreign law that would be a securities broker-dealer if located in the United States, <i>e.g.</i> , money transmitter, currency exchanger.
Foreign Financial Institution Registration System	An international system developed to detect offshore tax evasion and to support the requirements of the FATCA legislation. The FFIs will register and then provide offshore account information that is reported through the registration system.
Global Intermediary Identification Number	An identification number that is assigned to a participating FFI or a registered deemed-compliant FFI after its FATCA registration is submitted and approved.
Individual Master File	The IRS database that maintains transactions or records of individual tax accounts.
Information Returns Master File	An IRS database that contains third-party information return documents for taxpayers, such as Form W-2, <i>Wage and Tax Statement</i> , and Form SSA-1099, <i>Social Security Benefit Statement</i>
Information Returns Reporting	Any person engaged in a trade or business, including a corporation, partnership, individual, estate, and trust, who makes reportable transactions during the calendar year, must file information returns to report those transactions to the IRS.
Integrated Production Model	A data warehouse that consolidates information from a variety of internal and external sources.
International Compliance Management Model	Incorporates capability to receive, store, and process return data from the International Data Exchange Service or via paper, and manages data to conduct analytics for future compliance assurance.
International Data Exchange Service	Enables FFIs and governments with Intergovernmental Agreements in place – as well as domestic Financial Institutions - to submit information to the IRS and enables the IRS to send certain information received from domestic Financial Institutions to countries with an Intergovernmental Agreement.
Item Tracking Reporting and Control System	A system used by the IRS to maintain an inventory of current risks.



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Term	Definition
Large Business and International Division	Serves corporations, subchapter S corporations, and partnerships with assets greater than \$10 million. These entities typically have large numbers of employees, deal with complicated issues involving tax law and accounting principles, and conduct their operations in an expanding global environment.
Rational RequisitePro	An application used for requirements management. The IRS has established RequisitePro as its Enterprise Architecture standard for requirements management. It is used to capture detailed requirement data such as the requirement text and any supporting attributes to organize or clarify the requirement. The application also has the capability to create and maintain full requirements traceability within a single project or across multiple projects.
Release	A specific edition of software.
Requirement	A formalization of a need and is the statement of a capability or condition that a system, subsystem, or system component must have or meet to satisfy a contract, standard, or specification.
Requirements Traceability Verification Matrix	A tool that documents requirements and establishes the traceability relationships between the requirements to be tested and their associated test cases and test results.
Return Review Program	An automated system that will enhance the IRS's capabilities to prevent, detect, and resolve criminal and civil tax noncompliance.
Risk Management	The process of identifying, monitoring, and mitigating project and program risks.
Taxpayer Identification Number	A nine-digit number assigned to taxpayers for identification purposes.
Tax Year	The 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.
Traceability	Describes the life of a requirement from the initial source through its development and actual deployment into operations.



Foreign Account Tax Compliance Act Program Withholding and Refund Release 2.0 Project Development and Testing

Term	Definition
Withholding	The portion of an employee's wages that is not included in his or her paycheck because it is remitted directly to the Federal tax authority. Withholding reduces the amount of tax employees must pay when they submit their annual tax returns. The amount withheld is based on the employee's income, marital status, number of dependents, and number of jobs. When too much money is withheld, it is returned to the employee as a tax refund.
Withholding Agent	A U.S. or foreign person who has control, receipt, custody, disposal, or payment of any item of income of a foreign person that is subject to withholding. A withholding agent may be an individual, corporation, partnership, trust, association, or any other entity, including any foreign intermediary, foreign partnership, or U.S. branch of certain foreign banks and insurance companies.



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Appendix VI


Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224

AUG 01 2016

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Gina Garza 
Chief Information Officer

SUBJECT: The Foreign Account Tax Compliance Act
Withholding and Refund Release 2.0 Project" (Audit
#201520022). (e-trak # 2016-83445)

Thank you for the opportunity to review your draft audit report and to discuss the earlier draft report versions with the audit team. I appreciate the positive feedback received from the TIGTA regarding the improvement that the IRS has made to strengthen systems development requirements and management controls for FATCA projects. The IRS is committed to ensuring complete traceability between project requirements and test cases.

Over the course of the audit period, the IRS and TIGTA teams engaged in multiple review sessions and conversations. The report is an accurate reflection of those conversations.

Among other things, the Withholding and Refund system was designed to match data that had never been used in a matching program. Due to a lack of understanding of how the data would behave as it was processed in the new system, the matching component did not produce outputs as expected by the business customer. Although the system was developed according to requirements the business opted to not utilize the matching component of the system after it was placed into production. A different component of the system is fully functional and is currently being used.

We agree with the TIGTA recommendation that future projects, and new releases of current projects, using forms for data matching for the first time, are given sufficient time prior to the finalization of requirements to allow the business to completely understand the data to ensure it will deliver the expected results. We believe using the IRS' established agile development path will allow us to provide that flexibility, in circumstances where we are not working with legislative timeframes for delivery. Under the agile path, requirements are not baselined prior to start of development; and the product owner (business) will have the latitude to prioritize the order of the features to be implemented.

The IRS disagrees with the second recommendation regarding risk prioritization and escalation. TIGTA recommends that the IRS ensure that corrective actions and timelines to address critical risks are given high priority and that disagreements as to the level of risk are promptly elevated. Differences in the risks will occur between the business and



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2

IT, because what represents a risk, and the level of criticality of the risk, can be viewed differently by each area. The IRS employed an established Governance process for risk discussion and escalation. The Executive Steering Committee (ESC) is attended by IT and Business Senior Executives and this risk was specifically discussed in that venue; evidence of such was provided to the audit team.

The IRS values the analysis and recommendations your organization provides to improve our IT systems and business processes. If you have any questions, please contact me at (240) 613-9373, or contact Karen Mayr on (202) 368-8396.



Foreign Account Tax Compliance Act Program Withholding and Refund Release 2.0 Project Development and Testing

Attachment
The Foreign Account Tax Compliance Act Withholding and Refund Release 2.0 Project"
(Audit #201520022)

RECOMMENDATION #1: The Acting Chief Information Officer should ensure that future projects, and new releases of current projects, using forms for matching for the first time are given sufficient time prior to the finalization of requirements to completely understand the data to ensure it will deliver expected business results.

CORRECTIVE ACTION #1: The IRS agrees with the recommendation. The IRS will implement the corrective action by providing guidance to projects that are similar to Withholding and Refund Release 2.0 (W&R R2). Whenever possible and practicable, projects that use forms for matching for the first time will be implemented under the Agile Path Enterprise Lifecycle (ELC) model. Under the Agile Path, requirements are not baselined prior to start of development; and the Product Owner (business) will have the latitude to prioritize the order of the features to be implemented.

IMPLEMENTATION DATE: January 15, 2017.

RESPONSIBLE OFFICIALS: Associate Chief Information Officer, Strategy and Planning (S&P)

CORRECTIVE ACTION MONITORING PLAN: We enter accepted Corrective Actions into the Joint Audit Management Enterprise System (JAMES) and monitor them on a monthly basis until completion.

RECOMMENDATION #2: The Acting Chief Information Officer should ensure that corrective actions and timelines to address critical risks are given high priority and that disagreements as to the level of risk are promptly elevated.

CORRECTIVE ACTION #2: The IRS disagrees with recommendation 2. The IRS already employs an established Governance process for risk discussion and escalation, through an Executive Steering Committee (ESC), whose voting members include both IT and Business Senior Executives.

IMPLEMENTATION DATE: N/A

RESPONSIBLE OFFICIALS: N/A

CORRECTIVE ACTION MONITORING PLAN: N/A