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# **TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION**



## ***Performance Measures Are Needed to Evaluate the Results of Direct Pay Bond Processing Changes***

**June 24, 2020**

**Reference Number: 2020-10-032**

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.

### **Redaction Legend:**

1 = Tax Return/Return Information

2 = Law Enforcement Techniques/Procedures and Guidelines for Law Enforcement Investigations or Prosecutions

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## HIGHLIGHTS

### PERFORMANCE MEASURES ARE NEEDED TO EVALUATE THE RESULTS OF DIRECT PAY BOND PROCESSING CHANGES

## Highlights

**Final Report issued on June 24, 2020**

Highlights of Reference Number: 2020-10-032 to the Commissioner of Internal Revenue.

### IMPACT ON TAXPAYERS

The United States finances two-thirds of all infrastructure projects through the issuance of municipal bonds. The Federal Government subsidizes this type of borrowing through tax-advantaged bonds, such as direct pay bonds. The IRS makes the subsidy payments, on behalf of the Federal Government, to either the issuer of the bond or a designated third party. These bonds were intended to help State and municipal governments obtain funding to pay interest on the debt for projects such as roads, schools, and hospitals, which benefit millions of taxpayers throughout the country.

### WHY TIGTA DID THE AUDIT

The IRS's Tax Exempt Bonds office processed an average of \$5 billion in direct pay bond subsidy payment requests in Tax Years 2013 through 2018. In Fiscal Year (FY) 2016, the IRS implemented processing changes intended to streamline and standardize how subsidy payment requests are processed and paid to bond issuers. This audit was initiated to assess whether the IRS developed and implemented controls to accurately and timely pay direct pay bond subsidy payment requests.

### WHAT TIGTA FOUND

TIGTA reviewed a sample of 117 of the 10,619 subsidy payment requests processed during FY 2017 and determined that payments made after the processing changes were timely and accurate.

The IRS estimated the new direct pay bond processing changes would save approximately 163 minutes of total processing time per

payment subsidy request, which is a 40 percent reduction. However, the Tax Exempt Bonds office lacks performance measures to assess its progress in achieving these expected savings. Without such measures and data, decision makers cannot fully determine whether additional changes are warranted.

Processing changes limited the ability of IRS employees to make corrections to customer payment requests that contained simple filing mistakes, like entering information on the wrong line of the form. As a result, the IRS rejected more payment requests; however, management was not tracking the number of rejected payments or the related correspondence needed to correct these types of errors. In addition, the IRS can make other procedural improvements to ensure that payment requests are valid.

Since FY 2010, the IRS has annually made an average of more than \$460,000 in interest payments resulting from the late processing of subsidy payment requests. However, the IRS did not regularly track interest payments until August 2018 and had not taken actions to identify the causes for the interest payments or taken any corrective actions.

### WHAT TIGTA RECOMMENDED

TIGTA recommended that the Commissioner, Tax Exempt/Government Entities Division, develop performance measures that track the effectiveness of subsidy payment request processing, including interest payments, and determine if adjustments should be made to the subsidy payment request process.

In their response, IRS management partially agreed with the first recommendation and agreed with the second recommendation. Management plans to take corrective actions.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

**DEPARTMENT OF THE TREASURY**  
**WASHINGTON, D.C. 20220**

June 24, 2020

**MEMORANDUM FOR COMMISSIONER OF INTERNAL REVENUE**

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

**SUBJECT:** Final Audit Report – Performance Measures Are Needed to Evaluate  
the Results of Direct Pay Bond Processing Changes  
(Audit # 201910015)

This report presents the results of our review to assess whether the Internal Revenue Service has developed and implemented controls to accurately and timely pay direct pay bond subsidy payment requests. This audit is included in the Treasury Inspector General for Tax Administration's Fiscal Year 2020 Annual Audit Plan and addresses the major management challenge of Improving Tax Reporting and Payment Compliance.

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

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations. If you have any questions, please contact me or Heather M. Hill, Acting Assistant Inspector General for Audit (Management Services and Exempt Organizations).



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***Performance Measures Are Needed to Evaluate the  
Results of Direct Pay Bond Processing Changes***

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***Performance Measures Are Needed to Evaluate the  
Results of Direct Pay Bond Processing Changes***

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***Abbreviations***

DPB	Direct Pay Bond
DSS	Debt Service Schedule
FAST	Field Agent Service Team
FY	Fiscal Year
GECU	Government Entities Compliance Unit
IRS	Internal Revenue Service
OSPC	Ogden Submission Processing Center
TEB	Tax Exempt Bonds
TE/GE	Tax Exempt and Government Entities
TIGTA	Treasury Inspector General for Tax Administration



## ***Performance Measures Are Needed to Evaluate the Results of Direct Pay Bond Processing Changes***

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### **Background**

The United States, *i.e.*, State and local governments, finances two-thirds of all infrastructure projects through the issuance of municipal bonds. Infrastructure projects include roads, bridges, airports, schools, hospitals, water treatment facilities, power plants, and other public buildings. During Calendar Years 2008 and 2009, the country experienced an economic downturn that resulted in fewer municipal bond investments. Banks and other financial institutions suffered significant investment losses, which reduced their willingness to broker or invest in tax-advantaged municipal bonds. As a result, many State and local governments had difficulty obtaining favorable funding for capital projects such as the construction of highways, bridges, or schools.

To respond to the downturn in the municipal bond market, Congress passed two bills to assist State and local governments in obtaining funding: the *American Recovery and Reinvestment Act of 2009* (hereafter referred to as the Recovery Act)<sup>1</sup> and the *Hiring Incentives to Restore Employment Act of 2010* (hereafter referred to as the HIRE Act).<sup>2</sup> The Recovery Act introduced taxable bonds with direct payment or tax credit options, while the HIRE Act extended direct payment options to certain tax credit bonds. Under the direct payment option, the Federal Government subsidizes a percentage of the interest payable on the bonds, through payments made by the Internal Revenue Service (IRS), to either the issuer of the bond or a designated third party.<sup>3</sup> If the direct pay option is not elected, the bondholder receives a tax credit that reduces the interest income and Federal income tax liability. The Recovery Act's direct payment and tax credit options ranged from 35 to 45 percent of the total interest, while the HIRE Act extended the direct payment option range from 70 to 100 percent of the total interest.

For example, if a bond issuer elects the direct payment option and is required to make interest payments of \$1 million every six months to all bondholders (investors) and the bond qualifies for a 35 percent direct payment option, the Federal Government subsidizes \$350,000 of this payment. The State or local government pays \$650,000 to make up the \$1 million in total interest payments. Bondholders are required to report the amount received in interest payments as interest income when filing their individual or corporate tax returns.

The issuance of Recovery Act direct pay bonds ended in December 2010 and the issuance of HIRE Act direct pay bonds ended in December 2017. However, the direct pay bonds' maturity

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<sup>1</sup> Pub. L. No. 111-5, 123 Stat. 115 (2009).

<sup>2</sup> Pub. L. No. 111-147, 124 Stat. 71 (2010).

<sup>3</sup> A designated third party is an outside entity, such as a trustee bank, that makes periodic interest payments to bond investors on behalf of the bond issuer.



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## ***Performance Measures Are Needed to Evaluate the Results of Direct Pay Bond Processing Changes***

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dates could extend 20 years or more; therefore, the IRS will continue to process direct payments for decades. The IRS annually receives approximately 10,000 requests for direct payment.

To receive direct payments, bond issuers are required to document their intent to make the irrevocable election for the direct payment option in their books and records. Prior to requesting a payment, issuers must file a one-time information return with the IRS that contains required information about the bond issuance such as the Debt Service Schedule (DSS) for repayment of the obligation.<sup>4</sup> The IRS's Tax Exempt Bonds (TEB) office administers the Federal Government tax laws applicable to tax-advantaged bonds. TEB office tax law specialists review the initial information returns and input bond data into an approved transaction table that is used to verify the validity of future direct payment requests.

If the bond issuer elected the direct payment option, the issuer filed Form 8038-CP, *Return for Credit Payments to Issuers of Qualified Bonds*, with the IRS to request the subsidy for each interest payment date. Nearly 65,000 Forms 8038-CP were filed for Tax Years 2013 through 2018, which totaled more than \$28 billion in direct payments.<sup>5</sup> The subsidy payment requests can range from a few dollars to more than \$65 million.

In Fiscal Year (FY) 2009, the Treasury Inspector General for Tax Administration (TIGTA) performed an audit of the IRS's readiness to process Forms 8038-CP after the Recovery Act was enacted.<sup>6</sup> TIGTA reported that, in general, all complete requests for payment of the Build America Bond Federal subsidies were processed accurately and timely. TIGTA also reported that from May through September 2009, all State and local governments submitting complete Forms 8038-CP received the correct payments. In FY 2016, the IRS implemented significant procedure changes intended to streamline and standardize how Forms 8038-CP are processed and paid to bond issuers. This audit was initiated to evaluate those changes and to determine whether direct pay bond subsidy payment requests were processed accurately and timely.<sup>7</sup>

This review was performed at the Government Entities Compliance Unit (GECU) and the Wage and Investment Submission Processing Center in Ogden, Utah; TEB offices in Little Rock, Arkansas, and Salt Lake City, Utah; and the Tax Exempt and Government Entities (TE/GE) Division office in Denver, Colorado, during the period August 2018 through August 2019. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to

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<sup>4</sup> The DSS is a table listing the periodic payments necessary to meet principal and interest requirements over the life of the bond. The DSS for direct pay bonds also identifies the expected subsidy payments for each interest payment date.

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

<sup>6</sup> TIGTA, Ref. No. 2010-11-083, *Initial Build America Bond Subsidy Payments Were Processed Accurately and Timely* (July 14, 2010).

<sup>7</sup> The changes did not affect tax credit claims; therefore, tax credit processing was not included in the scope of this audit.





## ***Performance Measures Are Needed to Evaluate the Results of Direct Pay Bond Processing Changes***

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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.



## ***Performance Measures Are Needed to Evaluate the Results of Direct Pay Bond Processing Changes***

### **Results of Review**

#### **New Procedures Were Intended to Reduce Direct Payment Subsidy Processing Time, but There Are Few Evaluative Performance Measures**

In May 2016, TE/GE Division management completed a cost efficiency study, which resulted in processing changes intended to streamline and standardize how Forms 8038-CP are processed and paid to bond issuers.<sup>8</sup> The study identified potentially significant cost reductions by reassigning the compliance review responsibility from TEB office technical employees to lower graded employees in the GECU and the Field Agent Service Team (FAST), and the code and edit<sup>9</sup> responsibilities to the Ogden Submission Processing Center (OSPC).<sup>10</sup> The study, which included observation and pilot tests, estimated that the original process took 403 minutes while the new process would take 240 minutes, ultimately saving 163 minutes of processing time. Figure 1 shows the original and new processes' estimated processing times.

**Figure 1: Form 8038-CP Processing Times – Original and New Processes**

#### **Original Process**

Receipt & Control Operations	GECU & TEB Office	Document Perfection & Data Conversion	Input Correction Operations & Imaging
<ul style="list-style-type: none"><li>• Open and stamp return</li><li>• Sort and batch</li></ul>	<ul style="list-style-type: none"><li>• Code and edit</li><li>• Assign report number</li><li>• Capture *2* data fields in the Direct Pay Bond (DPB) database</li><li>• Compliance review</li><li>• Identify suspended Forms 8038-CP</li><li>• Scan returns</li><li>• Document perfection</li><li>• First time compliance review</li><li>• Claim disallowance</li><li>• Referrals for examination</li><li>• Generate Form 3210, <i>Document Transmittal</i></li></ul>	<ul style="list-style-type: none"><li>• Numbering</li><li>• Acknowledge Form 3210</li><li>• Data transcription</li></ul>	<ul style="list-style-type: none"><li>• Error resolution</li><li>• Reject processing</li></ul>
25 minutes	270 minutes	37 minutes	71 minutes
Total Estimated Processing Time = 403 minutes			

<sup>8</sup> TE/GE Division Lean Six Sigma Data Collection Results, August 17, 2016.

<sup>9</sup> Code and edit is the process to correct and format fields for computer entry and direct computer programs to perform certain functions.

<sup>10</sup> The study was performed while GECU employees were responsible for the compliance review of the Forms 8038-CP; however, these duties are now assigned to FAST employees.



## **Performance Measures Are Needed to Evaluate the Results of Direct Pay Bond Processing Changes**

### **New Process**

Receipt & Control Operations	GECU & FAST	Document Perfection & Data Conversion	Input Correction Operations & Imaging
<ul style="list-style-type: none"> <li>Open and stamp return</li> <li>Sort and batch</li> </ul>	<ul style="list-style-type: none"> <li>No code and edit</li> <li>Assign report number</li> <li>Capture *2* fields in the DPB database</li> <li>***2*** compliance review</li> <li>Refer exceptions to TEB office tax law specialist</li> <li>No identification of suspended Forms 8038-CP</li> <li>Only identified Forms 8038-CP are scanned</li> <li>Generate Form 3210</li> </ul>	<ul style="list-style-type: none"> <li>Code and edit</li> <li>Numbering</li> <li>Acknowledge Form 3210</li> <li>Data transcription</li> </ul>	<ul style="list-style-type: none"> <li>Error resolution</li> <li>Reject processing</li> </ul>
25 minutes	76 minutes	68 minutes	71 minutes
<b>Total Estimated Processing Time = 240 minutes</b>			

Source: TIGTA analysis of TE/GE Division Lean Six Sigma Study, August 17, 2016.

*Standards for Internal Control in the Federal Government*<sup>11</sup> requires organizations to establish performance measures that monitor ongoing operations, reveal process weaknesses, and provide data to correct deficiencies. During the study, TE/GE Division management established performance measures to determine the efficiency of the changes. After the initial testing phase of the new processing changes, management reported that new process changes:

- Reduced the total direct time employees spent processing subsidy payment requests by 56 percent.
- Reduced the number of subsidy payment requests that needed TEB office tax law specialist resolution by 94 percent.
- Reduced the number of subsidy payment requests that required correspondence by 58 percent.
- Reduced the number of frozen or rejected subsidy payment requests by 99 percent.

Although these measures may provide some useful information, additional measures should be considered to fully assess progress toward achieving and maintaining the benefits anticipated by the processing changes. For example, neither TEB office management nor OSPC management is currently measuring the number of errors identified by OSPC employees, the number of subsidy payment requests that require correspondence with the OSPC, or the number of subsidy payment requests rejected during OSPC processing. Additionally, TEB office management \*\*\*\*\*2\*\*\*\*\* and

<sup>11</sup> Government Accountability Office, GAO-14-704G, *Standards for Internal Control in the Federal Government* (Sept. 2014).



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## ***Performance Measures Are Needed to Evaluate the Results of Direct Pay Bond Processing Changes***

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management did not track or monitor interest paid due to the late processing of subsidy payment requests until August 2018. Without such measures and data, decision makers cannot fully determine whether the changes were cost effective or if additional changes are warranted.

We reviewed a random sample of 117 of the 10,619 subsidy payment requests processed during FY 2017 and determined that payments were timely and accurate for all sampled requests. These results indicate that the subsidy payment processing changes have not yet resulted in problems with inaccurate or untimely payments. However, we identified risks associated with the changes that could result in improper payment amounts and reduced customer service when not monitored with adequate performance measures.

### **The TEB office and the OSPC do not track the volume of correspondence associated with subsidy payment request errors or the number of rejected payments**

The internal processing changes shifted the administrative burden among different IRS offices and reduced the involvement of skilled TEB office tax law specialists. Previously, GECU employees would refer returns with errors to TEB office tax law specialists who contacted the customers via telephone to resolve errors and obtain a corrected return. Now, many simple errors on Forms 8038-CP are resolved via correspondence, which takes longer than telephone contact.

If a direct pay bond subsidy payment request (Form 8038-CP) is missing pertinent information, the IRS corresponds with the requester using Letter 4617C, *Form 8038-CP*, *Form 8038-TC*, *Form 8038-B*, and *Form 8703 Missing Information Request*. However, Letter 4617C requests information to resolve errors for multiple forms and not just Form 8038-CP.<sup>12</sup> Because multiple errors are resolved with this letter and the data are not isolated by type, management does not know how many customers they contact via written correspondence to resolve direct payment subsidy request errors. Without this information, management cannot determine whether procedure changes that were intended to reduce processing time are meeting performance goals.

Errors not corrected via written correspondence may result in the rejection of the subsidy payment request. Between May 2016 and January 2019, the IRS rejected 56 subsidy payment requests due to errors, which is an average of approximately 14 payments each year. This number compares to \*\*\*\*\*1\*\*\*\*\* an average of \*\*\*\*\*1\*\*\*\*\* each year. Payments were rejected for errors such as the customer putting the correct amount on the wrong line, incorrect amounts on lines used to

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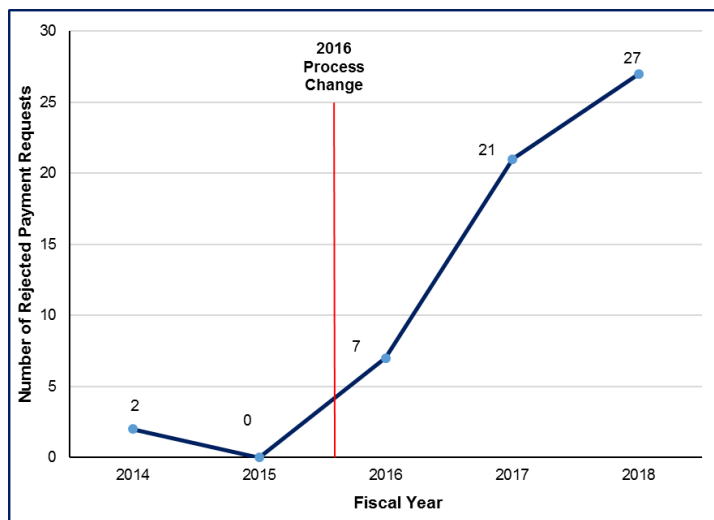
<sup>12</sup> In addition to the Form 8038-CP, the Letter 4617C is also used to request missing information for: Form 8038-TC, *Information Return for Tax Credit Bonds and Specified Tax Credit Bonds*, Form 8038-B, *Information Return for Build America Bonds and Recovery Zone Economic Development Bonds*, and Form 8703, *Annual Certification of a Residential Rental Project*.



## ***Performance Measures Are Needed to Evaluate the Results of Direct Pay Bond Processing Changes***

determine the subsidy payment, and incomplete Forms 8038-CP. \*\*\*\*1\*\*\*\* shows how rejected payment requests have been increasing since the processing changes took effect.

***Figure 2: Rejected Direct Bond Payments - FYs 2014 to 2018***



*Source: TIGTA analysis of IRS Master File data.*

We determined that 47 (84 percent) of the 56 payment requests rejected since implementation of the new process had errors that could have been resolved either through a telephone call with the customer or a review of the DSS. Most of these forms had the correct payment amount, but were missing entries, contained simple math errors, or information was on the wrong line of the form. For example, bond issuers sometimes entered the correct subsidy payment amount, but did not enter the correct interest payable amount or entered the calculated allowable subsidy amount on the wrong line for the bond type.

We determined that 22 (39 percent) of the 56 rejected payment requests used the interactive, “verify and print” Form 8038-CP developed by TEB office management as part of the processing changes. The online form contains programming to prevent blank mandatory fields and common errors. However, due to an undetected issue with the interactive form, errors on the Forms 8038-CP were not prevented as expected. Because IRS management does not track information for Forms 8038-CP requiring correspondence, TEB office management was unaware of the errors and the issue with the “verify and print” Form 8038-CP.

### **Management Action:**

During our review, TE/GE Division management stated that they made corrections to the “verify and print” Form 8038-CP. Although we did not review direct pay bond subsidy payment requests made after these corrections were made, we believe that if these corrections were made as described, the number of rejected payment requests would be reduced.



However, \*\*\*\*\*2\*\*\*\*\* does not significantly affect processing time. The DSS is converted to a portable document format and electronically linked to the bond record in the DPB database's approved transaction table. Employees have the capability to click on the link in the DPB database and compare the payment amounts with the amounts shown on the DSS for that payment date. If requested subsidy amounts do not match the DSS, GECU and FAST employees send the requests to a TEB office

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## ***Performance Measures Are Needed to Evaluate the Results of Direct Pay Bond Processing Changes***

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tax law specialist to correct the discrepancies with the issuers, request updated Forms 8038-CP, and obtain an updated DSS if necessary.

TEB office management stated that there are \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*. Management believes that their rigorous front-end DPB compliance review process confirms the validity of obligations, and they have an intensive process to approve every Form 8038-CP filed. We did not identify any incorrect payments, and TEB office management views that result as confirmation of the acceptable risk level they assume. TEB office management also stated that \*\*\*\*\*2\*\*\*\*\* would require significant resource commitments that are likely to only reveal explainable differences.

Although we did not identify any fraudulent activity or improper payments, such risks could be mitigated by \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*.

### **The TEB office did not track or monitor interest payments**

Our analysis of all Forms 8038-CP filed through FY 2019 determined that the number of interest payments and the amount of interest paid increased significantly beginning in FY 2013. This trend may be attributable, in part, to a Federal deficit reduction strategy known as sequestration, which started in March 2013.<sup>15</sup> As part of these automatic spending cuts, direct pay bond subsidy payments are automatically reduced by the appropriate sequestration rate each year. The processing of subsidy payments must be suspended until IRS computer systems are updated to reflect annual changes to sequestration rates. The IRS must pay interest on the subsidy request if the payment is not sent within 45 days (the latter of the date the bond issuer's interest payment is due, the date of receipt of the return, or the date of correspondence to correct the return if information is incorrect or missing). Figure 3 shows the upward trend related to interest paid by fiscal year.

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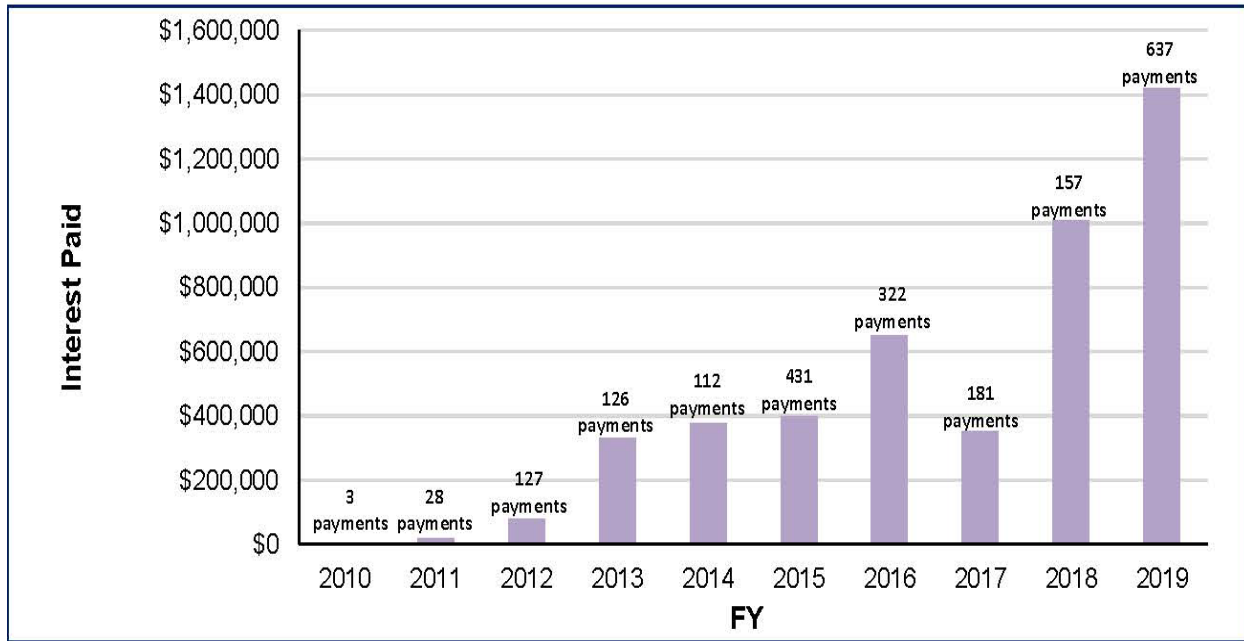
<sup>15</sup> Sequestration is a procedure in U.S. law that limits the size of the Federal budget by setting a cap on the amount of Government spending, which automatically imposes an across-the-board spending cut that affects all departments and programs by an equal percentage. These sequestration spending cuts were imposed by the *Budget Control Act of 2011* (Pub. L. No. 112-25 (2011)). Pursuant to the *Balanced Budget and Emergency Deficit Control Act of 1985* (Pub. L. No. 99-177 (1985)), as amended, sequestration applies to direct pay bonds. The direct pay bond sequestration rate in FY 2013 was 8.7 percent and has decreased to 5.9 percent in FY 2020. These sequestration cuts are not cumulative. For example, if a \$1,000 subsidy payment was requested in FY 2020, the IRS would reduce the subsidy payment by 5.9 percent to \$941.





## ***Performance Measures Are Needed to Evaluate the Results of Direct Pay Bond Processing Changes***

**Figure 3: Form 8038-CP Interest Payments - FYs 2010 to 2019**



Source: TIGTA analysis of Master File data from FY 2010 to FY 2019.

IRS management did not track, nor were they aware of, the amount of interest related to subsidy payment requests until they began monthly reporting in August 2018. However, the monthly reports did not identify the cause for late payments that required interest to be paid.

### **Management Action:**

During our review, the IRS began using the monthly reports to determine the cause for interest payments. Management also completed a study of OSPC processing and determined that some payments were processed late and required interest to be paid. According to IRS management, the payment delays were caused by turnover in processing personnel, failure to timely process payment requests after missing information is obtained, and sequestration rate updates. IRS management stated that they plan to perform a follow-up review of Forms 8038-CP processing and evaluate the interest paid.





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## ***Performance Measures Are Needed to Evaluate the Results of Direct Pay Bond Processing Changes***

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### ***Recommendations***

The Commissioner, TE/GE Division, should:

**Recommendation 1:** Develop performance measures that track the efficiency of subsidy payment request processing, including processing time, employee's total direct time, the number of subsidy payment requests that require error resolution and correspondence, the number of payments that are rejected, and the amount of interest paid.

**Management's Response:** IRS management agreed in part with this recommendation. The IRS agreed to consider developing additional performance measures to track the efficiency of its processes. However, the IRS stated that it does not believe that tracking the number of subsidy payment requests that require error resolution and correspondence, and the number of rejected payments would be indicative of processing inefficiencies.

**Office of Audit Comment:** TIGTA continues to believe that the implementation of performance measures, which track the number of subsidy payment requests that require error resolution and correspondence, and the number of rejected payments is important. The subsidy payment request processing changes reduced the number of return errors resolved by TEB office tax law specialists, but increased the number of return errors requiring correspondence by OSPC employees. The IRS cannot determine whether these changes continue to reduce processing time or meet performance goals because TEB office and OSPC management no longer measure the number of errors.

**Recommendation 2:** Determine if adjustments should be made to \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\* for subsidy payment request accuracy.

**Management's Response:** The IRS agreed with this recommendation. TE/GE Division management agreed to determine whether adjustments \*\*\*\*\*2\*\*\*\*\* are warranted and, if so, they will make appropriate changes.



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## ***Performance Measures Are Needed to Evaluate the Results of Direct Pay Bond Processing Changes***

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### **Appendix I**

#### **Detailed Objective, Scope, and Methodology**

Our overall objective was to assess whether the IRS has developed and implemented controls to accurately and timely pay direct pay bond subsidy payment requests. To accomplish our objective, we:

- I. Determined whether the TEB office developed and implemented controls over the bond subsidy payment process.
  - A. Identified current controls for accurate and timely payment of bond refund claims.
  - B. Interviewed GECU employees to determine their compliance and payment processing procedures.
  - C. Interviewed TEB office Technical Unit management to identify controls related to the DPB database. We determined whether the TEB office Technical Unit performs reconciliation activities and reliability testing on the DPB database.
  - D. Performed independent testing of the DPB database to determine the validity of the data and identify any payment error trends.
  - E. Determined the number of subsidy payment errors detected in processing by the GECU prior to May 2016 and after May 2016.
  - F. Determined the number of subsidy payment denials by the GECU prior to May 2016 and after May 2016.
  - G. Conducted a walkthrough at the OSPC to identify the processing flow of Forms 8038-CP, *Return for Credit Payments to Issuers of Qualified Bonds*.
- II. Determined whether IRS procedures ensure that bond subsidy payments are issued to the correct parties (issuer or designated recipients), are issued accurately with the correct payment amount, and are issued timely. We consulted with a contract statistician and selected a stratified random sample of 117 of the 10,619 Forms 8038-CP processed during FY 2017 (October 1, 2016, through September 30, 2017) using a 90 percent confidence level and a precision rate of plus or minus 5 percent. The error rate varied based on the stratum as follows: 1) payments under \$1 (5 percent error rate), 2) payments of \$1 to \*\*\*2\*\*\* (10 percent error rate), 3) payments of \*\*\*2\*\*\* to \*\*\*\*2\*\*\*\* (10 percent error rate), and 4) payments of \$10 million and up (5 percent error rate).
  - A. Determined whether bond subsidy payments are issued to the correct parties (issuer or designated recipient).



## ***Performance Measures Are Needed to Evaluate the Results of Direct Pay Bond Processing Changes***

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- B. Determined whether IRS procedures ensure that bond subsidy payments are accurately issued with the correct payment amount.
- C. Determined whether IRS procedures ensure that bond subsidy payments are issued timely. We reviewed all interest payments related to Forms 8038-CP from FY 2010 to FY 2018.

### **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: GECU procedures for reviewing Forms 8038-CP for accuracy and completeness prior to processing the return, verifying that the issuer or designated payee matches the information in the DPB database, perfecting Form 8038-CP through research of the Integrated Data Retrieval System or contact with the issuer, editing specific lines on the forms, validating the amounts of subsidy payments, and tracking the timeliness of the return processing.



***Performance Measures Are Needed to Evaluate the  
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**Appendix II**

**Major Contributors to This Report**

Heather M Hill, Acting Assistant Inspector General for Audit (Management Services and  
Exempt Organizations)  
Carl L. Aley, Director  
Brian G. Foltz, Audit Manager  
Julia Moore, Lead Auditor  
Andrew Burns, Senior Auditor



***Performance Measures Are Needed to Evaluate the  
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**Appendix III**

**Report Distribution List**

Deputy Commissioner for Services and Enforcement  
Assistant Deputy Commissioner, Government Entities/Shared Services, Tax Exempt and  
Government Entities Division  
Director, Exempt Organizations, Tax Exempt and Government Entities Division  
Director, Enterprise Audit Management



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***Performance Measures Are Needed to Evaluate the  
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**Appendix IV**


**Management's Response to the Draft Report**



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

May 26, 2020

MEMORANDUM FOR MICHAEL E. MCKENNEY  
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Tamera L. Ripperda   
Commissioner,  
Tax-Exempt and Government Entities Division (TE/GE)

SUBJECT: Draft Audit Report – Performance Measures Are Needed to  
Evaluate the Results of Direct Pay Bond Processing Changes  
(Audit #201910015)

Thank you for the opportunity to review and comment on the subject draft audit report, which evaluates procedural changes intended to streamline and standardize how Forms 8038-CP are processed and determines whether the direct pay bond subsidy payment requests on those forms were processed accurately and timely.

We appreciate your acknowledgment that "payments were timely and accurate for all" of the random sample of Fiscal Year (FY) 2017 payment requests you reviewed. You also confirmed that IRS tested the procedural changes before permanently implementing them, and during testing we found the new procedures reduced the total direct employee time spent processing requests, the number of requests requiring tax law specialist resolution, the number of payments requiring correspondence, and the number of frozen or rejected requests. While we believe this demonstrates that IRS is accurately, timely, and efficiently processing such payments, we continually seek to improve and ensure the efficiency and accuracy of our processes and procedures.

We partially agree to consider developing additional performance measures to track the efficiency of our processes. We currently track the number of subsidy payment requests that require TEB tax law specialist resolution and the amount of interest paid, which is relevant for determining the efficiency and accuracy of our processing. As indicated above, we have already documented that the processing changes achieved the goal of reducing the amount of time spent by tax law specialists in processing returns by increasing the use of standard processing procedures for error resolutions. While you suggest we track items including the number of subsidy payment requests requiring correspondence and those that are rejected, it is not clear that such data points would



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## ***Performance Measures Are Needed to Evaluate the Results of Direct Pay Bond Processing Changes***

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be indicative of our processing efficiencies. For instance, the number of subsidy payment requests that require correspondence may not be a measure of the efficiency of the process but a measure of issuers' accuracy in completing the return. Similarly, the rejection rate is most likely a measure of the issuers' timely response to correspondence concerning errors on the return. Moreover, based upon the information in the report, we determined the rejection rate in FY 2017 using the new process was less than one quarter of one percent (21 out of 10,619 returns).

We agree to determine whether adjustments to the review process are warranted as described in the second recommendation in the report. However, we do not believe that we can forego the balancing that appropriately utilizes resources available, particularly when available data does not demonstrate there would be increased compliance benefits. As your report states, no incorrect payments have been identified under the rigorous standards currently in place. However, we agree to determine whether adjustments in the vetting procedures can be done without causing unnecessary delays in processing.

We appreciate the opportunity to review and comment on the draft report. Attached is a detailed response to your recommendations. If you have any questions, you or your staff may contact me at (202) 317-8647, or Margaret A. Von Lienen, Director, Exempt Organizations and Government Entities, at (513) 975-6562.

Attachment



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Attachment

**Corrective Actions for TIGTA Draft Audit Report –  
Performance Measures Are Needed to Evaluate the Results of Direct Pay Bond  
Processing Changes (Audit #201910015)**

The Commissioner, TE/GE Division, should:

**RECOMMENDATION 1:**

Develop performance measures that track the efficiency of subsidy payment request processing, including: processing time, employee's total direct time, the number of subsidy payment requests that require error resolution and correspondence, the number of payments that are rejected, and the amount of interest paid.

**CORRECTIVE ACTION:**

As discussed in our memorandum, it is not clear that developing performance measures for all of the additional items identified would be indicative of the efficiency of our processes.

However, we will consider whether tracking additional performance measures would improve TEB oversight of the processing of subsidy payment requests.

**IMPLEMENTATION DATE:**

April 15, 2021

**RESPONSIBLE OFFICIAL(S):**

Director, Exempt Organizations and Government Entities, TE/GE

**CORRECTIVE ACTION MONITORING PLAN:**

IRS will monitor this corrective action as part of our internal management system of controls.

**RECOMMENDATION 2:**

Determine if adjustments should be made \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\* for subsidy payment request accuracy.

**CORRECTIVE ACTION:**

We will determine whether adjustments are warranted and if so, will make appropriate changes.

**IMPLEMENTATION DATE:**

November 15, 2021

**RESPONSIBLE OFFICIAL(S):**

Director, Exempt Organizations and Government Entities, TE/GE

**CORRECTIVE ACTION MONITORING PLAN:**

IRS will monitor this corrective action as part of our internal management system of controls.