United States Government Accountability Office

Report to the Secretary of the Treasury

November 2015

FINANCIAL AUDIT

IRS's Fiscal Years 2015 and 2014 Financial Statements

GAO-16-146

November 2015

GAO Highlights

Highlights of GAO-16-146, a report to the Secretary of the Treasury

FINANCIAL AUDIT

IRS's Fiscal Years 2015 and 2014 Financial Statements

Why GAO Did This Study

In accordance with the authority granted by the Chief Financial Officers Act of 1990, GAO annually audits IRS's financial statements to determine whether (1) the financial statements are fairly presented and (2) IRS management maintained effective internal control over financial reporting. GAO also tests IRS's compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements.

IRS's tax collection activities are significant to overall federal receipts, and the effectiveness of its financial management is of substantial interest to Congress and the nation's taxpayers.

What GAO Recommends

Based on prior financial statement audits, GAO made numerous recommendations to IRS to address internal control deficiencies. GAO will continue to monitor and will report separately on IRS's progress in implementing prior recommendations that remain open. Consistent with past practice, GAO will also be separately reporting on the new internal control deficiencies identified in this year's audit and providing IRS recommendations for corrective actions to address them.

In commenting on a draft of this report, IRS stated that it is dedicated to continuing to improve its financial management, internal controls, and information security.

View GAO-16-146. For more information, contact Cheryl E. Clark at (202) 512-3406 or clarkce@gao.gov.

What GAO Found

In GAO's opinion, the Internal Revenue Service's (IRS) fiscal years 2015 and 2014 financial statements are fairly presented in all material respects. However, in GAO's opinion, IRS did not maintain effective internal control over financial reporting as of September 30, 2015, because of a continuing material weakness in internal control over unpaid tax assessments. GAO's tests of IRS's compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements detected no reportable instances of noncompliance in fiscal year 2015.

The material weakness in internal control over unpaid tax assessments was primarily caused by financial system limitations and errors in taxpayer accounts that rendered IRS's systems unable to readily distinguish between taxes receivable, compliance assessments, and write-offs in order to properly classify these components for financial reporting purposes. These deficiencies necessitated the use of a compensating estimation process to determine the amount of taxes receivable, the most material asset on IRS's balance sheet. Through this compensating process, IRS made over $9 billion in adjustments to the 2015 fiscal year-end gross taxes receivable balance produced by its financial systems. To address this material weakness, in fiscal year 2015, IRS took a significant step in developing a long-term corrective action plan. However, the plan does not include milestones or related dates for most of the actions, so it is unclear when IRS will fully address the issues that cause significant inaccuracies in the unpaid tax assessments information maintained in its accounting systems.

During fiscal year 2015, IRS continued to make important progress in addressing deficiencies in internal control over its financial reporting systems. However, GAO identified continuing and new deficiencies in internal control over information security, including missing security updates, insufficient audit trails and monitoring for certain key systems, and use of weak passwords, that collectively constituted a significant deficiency in IRS's internal control over financial reporting systems. Until IRS takes the necessary steps to fully address these control deficiencies over its financial reporting systems, its financial and taxpayer data will remain at increased risk of inappropriate and undetected use, modification, or disclosure.

In addition to its internal control deficiencies, IRS faces significant ongoing financial management challenges related to (1) safeguarding the large volume of sensitive hard copy taxpayer receipts and associated information, (2) significant invalid refunds based on identity theft, and (3) implementing the tax provisions of the Patient Protection and Affordable Care Act. The difficulties confronting IRS in its efforts to effectively manage each of these challenges are further magnified by the need to do so in an environment of diminished budgetary resources.

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Abbreviations

APTC	Advanced Premium Tax Credit
BHP	Basic Health Program
CFO	Chief Financial Officer
CMS	Centers for Medicare & Medicaid Services
CSR	Cost-Sharing Reduction
FASAB	Federal Accounting Standards Advisory Board
FMFIA	Federal Managers’ Financial Integrity Act of 1982
HCERA	Health Care and Education Reconciliation Act of 2010
IRS	Internal Revenue Service
PPACA	Patient Protection and Affordable Care Act
PTC	Premium Tax Credit
RSI	required supplementary information
SRP	Shared Responsibility Payment

U.S. GOVERNMENT ACCOUNTABILITY OFFICE
441 G St. N.W.
Washington, DC 20548

November 12, 2015

The Honorable Jacob J. Lew
Secretary of the Treasury

Dear Mr. Secretary:

The accompanying report presents the results of our audits of the fiscal years 2015 and 2014 financial statements of the Internal Revenue Service (IRS). Specifically, we found

- IRS's financial statements as of and for the fiscal years ended September 30, 2015, and 2014, are presented fairly, in all material respects, in accordance with U.S. generally accepted accounting principles;
- IRS's internal control over financial reporting was not effective as of September 30, 2015, because of a continuing material weakness[1] in internal control over unpaid tax assessments; and
- no reportable noncompliance in fiscal year 2015 with the laws, regulations, contracts, and grant agreements we tested.

This report also provides a discussion of a continuing significant deficiency[2] in IRS's internal control over financial reporting systems that we believe merits the attention of those charged with governance of IRS. In addition, this report discusses ongoing financial management challenges that IRS faces related to (1) safeguarding hard copy taxpayer receipts and associated information, (2) its exposure to significant invalid refunds from identity theft, and (3) implementation of the tax-related provisions of the Patient Protection and Affordable Care Act.

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[1]A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.

[2]A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit the attention of those charged with governance.

We performed our audit pursuant to authority conferred by the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994.

We are sending copies of this report to the Chairman and Vice Chairman of the Joint Committee on Taxation, the Chairmen and Ranking Members of the Senate Committee on Finance and the House Committee on Ways and Means, and other interested congressional committees and subcommittees. We are also sending copies of this report to the Commissioner of Internal Revenue, the Director of the Office of Management and Budget, and other interested parties. In addition, the report is available at no charge on the GAO website at http://www.gao.gov.

If you or your staff have any questions concerning this report, please contact me at (202) 512-3406 or clarkce@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report.

Sincerely yours,

Cheryl E. Clark

Cheryl E. Clark
Director
Financial Management and Assurance

U.S. GOVERNMENT ACCOUNTABILITY OFFICE
441 G St. N.W.
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Independent Auditor's Report

To the Commissioner of Internal Revenue

In our audits of the 2015 and 2014 financial statements of the Internal Revenue Service (IRS), we found

- IRS's financial statements as of and for the fiscal years ended September 30, 2015, and 2014, are presented fairly, in all material respects, in accordance with U.S. generally accepted accounting principles;
- IRS's internal control over financial reporting was not effective as of September 30, 2015; and
- no reportable noncompliance for fiscal year 2015 with the provisions of applicable laws, regulations, contracts, and grant agreements we tested.

The following sections discuss in more detail (1) our report on the financial statements and on internal control over financial reporting, which includes required supplementary information (RSI),[1] other information[2] included with the financial statements, and three significant financial management challenges confronting IRS related to safeguarding hard copy taxpayer receipts and information, its exposure to significant invalid refunds from identity theft, and its increasing responsibilities under the Patient Protection and Affordable Care Act (PPACA);[3] (2) our report on IRS's compliance with laws, regulations, contracts, and grant agreements; and (3) IRS's comments.

[1]RSI consists of Management's Discussion and Analysis and other supplementary information that is required by federal accounting standards to be included with the financial statements.

[2]Other information consists of information included with the financial statements, other than RSI and the auditor's report.

[3]Pub. L. No. 111-148, 124 Stat. 119 (Mar. 23, 2010), as amended by the Health Care and Education Reconciliation Act of 2010 (HCERA), Pub. L. No. 111-152, 124 Stat. 1029 (Mar. 30, 2010). In this report, references to PPACA include any amendments made by HCERA.

Report on the Financial Statements and on Internal Control over Financial Reporting

In accordance with our authority conferred by the Chief Financial Officers (CFO) Act of 1990, as amended by the Government Management Reform Act of 1994, we have audited IRS's financial statements.[4] IRS's financial statements comprise the balance sheets as of September 30, 2015, and 2014; the related statements of net cost, changes in net position, budgetary resources, and custodial activity for the fiscal years then ended; and the related notes to the financial statements. We have also audited IRS's internal control over financial reporting as of September 30, 2015, based on criteria established under 31 U.S.C. § 3512(c), (d), commonly known as the Federal Managers' Financial Integrity Act (FMFIA).

We conducted our audits in accordance with U.S. generally accepted government auditing standards. We believe that the audit evidence we obtained is sufficient and appropriate to provide a basis for our audit opinions.

Management's Responsibility

IRS management is responsible for (1) the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; (2) preparing, measuring, and presenting the RSI in accordance with U.S. generally accepted accounting principles; (3) preparing and presenting other information included in documents containing the audited financial statements and auditor's report, and ensuring the consistency of that information with the audited financial statements and the RSI; (4) maintaining effective internal control over financial reporting, including the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; (5) evaluating the

[4] See the CFO Act of 1990, Pub. L. No. 101-576, 104 Stat. 2838 (Nov. 15, 1990), codified, in relevant part, as amended, at 31 U.S.C. § 3521(g); see also the Government Management Reform Act of 1994, Pub. L. No. 103-356, 108 Stat. 3410 (Oct. 13, 1994), codified, in relevant part, as amended, at 31 U.S.C. § 3515(c). Under the authority of 31 U.S.C. § 3515, the Office of Management and Budget requires IRS to issue annual audited financial statements that are separate from those of the Department of the Treasury. Although the CFO Act designates the agency's inspector general, or where applicable, an independent external auditor, as the responsible auditor of an agency's financial statements, the act also gives GAO the authority to perform such audits at its discretion. Based on that authority, we audit IRS's financial statements because of the significance of IRS's tax collections to the consolidated financial statements of the U.S. government, which GAO is required to audit. See 31 U.S.C. § 331 (e)(2).

effectiveness of internal control over financial reporting based on the criteria established under FMFIA; and (6) providing its assertion about the effectiveness of internal control over financial reporting as of September 30, 2015, based on its evaluation, included in the accompanying Management's Report on Internal Control over Financial Reporting in appendix I.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements and an opinion on IRS's internal control over financial reporting based on our audits. U.S. generally accepted government auditing standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement, and whether effective internal control over financial reporting was maintained in all material respects. We are also responsible for applying certain limited procedures to the RSI and other information included with the financial statements.

An audit of financial statements involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the auditor's assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances. An audit of financial statements also involves evaluating the appropriateness of the accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, evaluating the design and operating effectiveness of internal control over financial reporting based on the assessed risk, and testing relevant internal control over financial reporting. Our audit of internal control also considered the entity's process for evaluating and reporting on internal control over financial reporting based on criteria established under FMFIA. Our audits also included performing such other procedures as we considered necessary in the circumstances.

We did not evaluate all internal controls relevant to operating objectives as broadly established under FMFIA, such as those controls relevant to preparing performance information and ensuring efficient operations. We limited our internal control testing to testing controls over financial reporting. Our internal control testing was for the purpose of expressing an opinion on whether effective internal control over financial reporting was maintained, in all material respects. Consequently, our audit may not identify all deficiencies in internal control over financial reporting that are less severe than a material weakness.[5]

Definitions and Inherent Limitations of Internal Control over Financial Reporting

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

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements due to fraud or error. We also caution that projecting any evaluation of effectiveness to future periods is subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Opinion on Financial Statements

In our opinion, IRS's financial statements present fairly, in all material respects, IRS's financial position as of September 30, 2015, and 2014, and its net cost of operations, changes in net position, budgetary resources, and custodial activity for the fiscal years then ended in accordance with U.S. generally accepted accounting principles.

[5]A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.

However, misstatements may nevertheless occur in other financial information reported by IRS and not be detected as a result of the internal control deficiencies described in this report.

In accordance with federal accounting standards, IRS's financial statements do not include an estimate of the dollar amount of taxes that are owed the federal government but have not been reported by taxpayers or identified through IRS's enforcement programs, often referred to as the tax gap, nor do they include information on tax expenditures.[6] Further detail on the tax gap and tax expenditures, as well the associated dollar amounts, is discussed in other information included with the financial statements.

Opinion on Internal Control over Financial Reporting

In our opinion, because of a material weakness in internal control over unpaid tax assessments,[7] IRS did not maintain, in all material respects, effective internal control over financial reporting as of September 30, 2015, based on criteria established under FMFIA.

Despite the material weakness in IRS's internal control over unpaid tax assessments, which also existed in prior years, IRS made necessary and appropriate adjustments to its records and was therefore able to prepare financial statements that were fairly presented in all material respects for fiscal year 2015. However, the material weakness may adversely affect any decisions by IRS's management that are based, in whole or in part, on information that is inaccurate because of this weakness. This material weakness, which is discussed in more detail below, is also disclosed by IRS in its fiscal year 2015 (1) FMFIA assurance statement to the

[6]As described in the other information to IRS's financial statements, the estimated magnitude of the tax gap is based on a study conducted to measure the compliance rate of taxpayers based on an examination of a statistical sample of tax returns filed for tax year 2006. The tax gap does not include actual or estimated refund payments disbursed because of identity theft-based fraudulent refund claims, which are financial management challenges for IRS and are discussed later in this report. Tax expenditures represent the amount of revenue that the government forgoes resulting from federal tax law provisions that (1) allow a special exclusion, exemption, or deduction from gross income or (2) provide a special credit, preferential rate, or deferred tax liability.

[7]An unpaid tax assessment is a legally enforceable claim against a taxpayer and consists of taxes, penalties, and interest that have not been collected or abated (i.e., the tax assessment reduced by IRS). Internal Revenue Manual § 1.34.4, *Unpaid Tax Assessments* (August 2015).

Department of the Treasury[8] and (2) Management's Report on Internal Control over Financial Reporting. We considered this material weakness in determining the nature, timing, and extent of our audit procedures on IRS's fiscal year 2015 financial statements.

In addition, our fiscal year 2015 audit identified continuing and new deficiencies concerning IRS's financial reporting systems that while not considered a material weakness, are important enough to merit the attention of those charged with governance of IRS. Therefore, we considered these continuing and new issues affecting IRS's internal control over financial reporting systems collectively to be a significant deficiency[9] in internal control in fiscal year 2015. This significant deficiency is discussed in more detail below.

In addition to the material weakness and significant deficiency in internal control, we also identified other deficiencies in IRS's internal control over financial reporting that we do not consider to be material weaknesses or significant deficiencies. Nonetheless, these deficiencies warrant IRS management's attention. We have communicated these matters to IRS management and, where appropriate, will report on them separately.

Material Weakness in Internal Control over Unpaid Tax Assessments

During fiscal year 2015, we continued to find control deficiencies that affected IRS's management and reporting of unpaid tax assessments. Specifically, we continued to find (1) IRS's reported balances for taxes receivable and other unpaid tax assessments were not supported by its core general ledger system for tax transactions;[10] (2) system deficiencies in IRS's subsidiary ledger[11] and supporting financial systems for unpaid tax assessments did not allow it to produce reliable and useful information with which to manage and report; and (3) various other control

[8]FMFIA requires the agency head to provide an annual Statement of Assurance on whether the agency has met the statutory requirements. 31 U.S.C. § 3512(d)(2).

[9]A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit the attention of those charged with governance.

[10]IRS's Redesigned Revenue Accounting Control System is the general ledger system IRS uses for tax-related transactions.

[11]IRS's Custodial Detail Data Base functions as its subsidiary ledger for unpaid tax assessments.

deficiencies that led to errors in taxpayer accounts. Because of these deficiencies, IRS's financial systems currently do not provide the accurate and complete transaction-level financial information necessary to enable IRS to reliably classify and report unpaid tax assessment balances in accordance with federal accounting standards.[12]

As we have reported in prior audits,[13] IRS's balance for federal taxes receivable,[14] which comprised over 80 percent of total assets reported on IRS's fiscal year 2015 balance sheet, was not produced from its general ledger through the summation of taxpayer account transaction data,[15] but rather was the product of a compensating, labor-intensive, and manual estimation process.[16] This process is necessary because limitations in IRS's financial systems and errors in taxpayer accounts render its systems unable to readily distinguish between taxes receivable, compliance assessments, and write-offs in order to properly classify these components for financial reporting purposes. Since IRS derives the taxes

[12]Federal accounting standards classify unpaid tax assessments into one of the following three categories for reporting purposes: federal taxes receivable, compliance assessments, and write-offs. Federal taxes receivable are taxes due from taxpayers for which IRS can support the existence of a receivable through, for example, taxpayer agreement or a court ruling determining an assessment. Compliance assessments are proposed tax assessments where neither the taxpayer (when the right to disagree or object exists) nor the court has affirmed that the amounts are owed. Write-offs represent unpaid tax assessments for which IRS does not expect further collections because of factors such as the taxpayer's death, bankruptcy, or insolvency. Federal accounting standards require only federal taxes receivable, net of an allowance for uncollectible taxes receivable, to be reported on the financial statements. See Statement of Federal Financial Accounting Standards No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, May 10, 1996. See also Internal Revenue Manual, § 1.34.1, *Definitions and Acronyms* (June 2009).

[13]GAO, *Financial Audit: IRS's Fiscal Years 2014 and 2013 Financial Statements*, GAO-15-173 (Washington, D.C.: Nov. 12, 2014).

[14]IRS reports federal taxes receivable on its balance sheet, net of an allowance for uncollectible taxes receivable.

[15]For financial reporting, in order to reflect its compensating statistical estimate for its gross taxes receivable amount, IRS records an adjusting journal entry to correct the gross taxes receivable amount produced by its systems, and then reduces the adjusted gross taxes receivable amount by an allowance for uncollectible taxes receivable to report the amount of net taxes receivable on its balance sheet.

[16]This compensating process involves IRS testing statistical samples of data extracted from its master files and extrapolating the results to estimate the year-end balances to be reported as (1) taxes receivable in its financial statements and the RSI and (2) compliance assessments and write-offs in the RSI.

receivable balance reported on its balance sheet and the balances of compliance assessments and write-offs reported in its RSI from the results of this estimation process rather than from the general and subsidiary ledgers, it cannot trace these amounts through its general ledger system, and back to underlying transaction-level taxpayer source documents. Such traceability is necessary to enable IRS to ensure that recorded transactions are complete, accurate, and supported by underlying records.

In addition, in 2015, similar to what we have reported in prior years,[17] we found that the system limitations and errors in tax records resulted in IRS having to make numerous adjustments to sampled account balances as part of its process for estimating the balance of net taxes receivable and other unpaid tax assessments. When reviewing its sample of taxpayer accounts initially classified by its systems as taxes receivable, IRS adjusted the affected taxpayer accounts to reflect the correct value when it identified misclassified cases or inaccurate balances. Based on a statistical projection of these individual adjustments, IRS made multibillion-dollar adjustments to the year-end balances of all three categories of unpaid tax assessments generated by its subsidiary ledger in order to produce reliable amounts for external reporting on its balance sheet and the RSI. For example, through its statistical sampling and estimation process, IRS recorded over $9 billion in adjustments to the 2015 fiscal year-end gross taxes receivable balance produced by its subsidiary ledger. Absent the use of this statistical estimation process, the various unpaid tax assessment balances produced by its subsidiary ledger may have been materially inaccurate, and IRS had no other means of evaluating the accuracy of these balances.

The cumulative impact of these control deficiencies is such that a reasonable possibility exists that a material misstatement of IRS's financial statements would not be prevented, or detected and corrected, on a timely basis. Consequently, these control deficiencies collectively represent a material weakness in IRS's internal control over unpaid tax assessments. Because of this material weakness and the associated system deficiencies that existed during fiscal year 2015, IRS's financial management systems were unable to report financial information in accordance with federal accounting standards, and did not comply with

[17] See, for example, GAO-15-173.

federal financial management systems requirements. However, IRS's financial management systems did substantially comply with the *U.S. Government Standard General Ledger* at the transaction level.

In response to our recommendations from prior audits, IRS has taken actions over the years to improve its management and reporting of unpaid tax assessments, including the phased-in implementation of its subsidiary ledger for unpaid tax assessments, to enable it to analyze and classify unpaid tax assessment account balances from the master file into the various financial reporting categories. However, IRS's actions to date have not been effective at fully addressing all the issues that continue to cause a lack of transaction traceability and material inaccuracies produced by this subsidiary ledger.

In 2015, IRS developed a long-term action plan to address the unpaid assessments material weakness. This plan identifies and documents (1) the specific system and control deficiencies that result in errors in taxpayer accounts and inaccurate classification of unpaid assessments amounts; (2) the actions IRS needs to take to address each related deficiency; and (3) the IRS organizational units that need to be involved in the actions. While the development of this plan is a significant step toward addressing the remaining deficiencies, IRS has not documented milestones or target completion dates for most of the actions. Therefore, it is unclear when IRS will be able to fully address the issues that cause significant inaccuracies in the unpaid tax assessments information maintained in its accounting systems.

Significant Deficiency in Internal Control over Financial Reporting Systems

During fiscal year 2015, IRS continued to focus on securing its information systems and protecting sensitive taxpayer and financial information. Key among its actions during fiscal year 2015 were further restricting access privileges on key financial applications and continuing its migration to multifactor authentication across the agency. However, the collective effect of the deficiencies in information security from prior years that continued to exist in fiscal year 2015, along with new deficiencies we identified during this year's audit that are discussed further below, is important enough to merit the attention of those charged with governance of IRS and therefore represents a significant deficiency in IRS's internal control over financial reporting systems as of September 30, 2015.

One of the deficiencies that remained throughout fiscal year 2015 was that IRS did not install appropriate security updates on certain databases and servers that support financial systems, which increased the risk that known information security vulnerabilities could be exploited. In addition, communications between key financial applications were still at risk of compromise[18] because the applications were not using sufficiently strong encryption, thus limiting the agency's ability to ensure data integrity and confidentiality. Another deficiency that continued to exist during fiscal year 2015 was insufficient audit trails and monitoring for certain key systems, limiting IRS's ability to detect unauthorized or unusual activity and ensure individual accountability and compliance with security policies. We have been reporting on and making recommendations to address these issues for several years.

This year's audit work also identified new deficiencies in internal control over IRS's financial reporting systems. For example, we identified password deficiencies, such as with a certain key financial system containing an account in which the password was the same as the account name, as well as system administrators using desktop files, shared files, and instant messaging to store and transmit passwords used to access systems and servers. Such deficiencies make systems and their databases more susceptible to compromise. In addition, similar to issues remaining from prior years, we identified a database supporting tax account administration that was no longer supported by its vendor and had not received security updates since June 2011, increasing the risk that known information security vulnerabilities could be exploited. Further, audit plans for certain financial systems had not been updated to reflect current policy, and for one administrative accounting system, the plan was not consistently followed. These newly identified deficiencies, along with the previously reported but unresolved monitoring issues, reduce IRS's ability to detect unauthorized or unusual activities in a timely manner.

Although IRS had a comprehensive framework for its information security program, some aspects of it continued to be ineffectively implemented. For example, IRS's information security testing approach did not always determine whether required controls were operating effectively; consequently, we continued to identify control deficiencies in key financial systems that IRS had not detected. In addition, IRS had not completed

[18]The term compromise refers to the access of an automated system, disclosure or alteration of the data and applications it processes, or both by individuals who are not authorized to do so.

updating key mainframe policies and procedures to address issues such as audit and monitoring of access from one processing environment to another, thereby increasing the risk that unauthorized access to tax processing systems may not be detected. Further, IRS had not ensured that many of its corrective actions to address previously identified deficiencies were effective. For the 28 prior recommendations that IRS told us that it had implemented, we determined that deficiencies associated with 9 of them had not been effectively corrected.

In light of the control risks created by IRS's ongoing information security deficiencies, continued and consistent management commitment and attention to an effective information security program will be essential to the maintenance of, and continued improvements in, its information system controls. Until IRS takes the necessary steps to address these control deficiencies, its financial and taxpayer data will remain at increased risk of inappropriate and undetected use, modification, or disclosure.

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles issued by the Federal Accounting Standards Advisory Board (FASAB) require that RSI be presented to supplement the financial statements. Although RSI is not a part of the financial statements, FASAB considers this information to be an essential part of financial reporting for placing the financial statements in appropriate operational, economic, or historical context. We have applied certain limited procedures to the RSI in accordance with U.S. generally accepted government auditing standards, which consisted of inquiries of management about the methods of preparing the RSI and comparing the information for consistency with management's responses to the auditor's inquiries, the financial statements, and other knowledge we obtained during the audit of the financial statements, in order to report omissions or material departures from FASAB guidelines, if any, identified by these limited procedures. We did not audit and we do not express an opinion or provide any assurance on the RSI because the limited procedures we applied do not provide sufficient evidence to express an opinion or provide any assurance.

Other Information

IRS's other information contains a wide range of information, some of which is not directly related to the financial statements. This information is presented for purposes of additional analysis and is not a required part of the financial statements or the RSI. We read the other information included with the financial statements in order to identify material inconsistencies, if any, with the audited financial statements. Our audit was conducted for the purpose of forming an opinion on IRS's financial statements. We did not audit and do not express an opinion or provide any assurance on the other information.

Other Financial Management Challenges

In addition to the challenge of addressing its internal control deficiencies, IRS also faces other significant financial management challenges related to (1) safeguarding of taxpayer receipts and associated information, (2) significant invalid refunds based on identity theft, and (3) implementation of the tax provisions contained in PPACA. The difficulties confronting IRS in its efforts to effectively manage each of these challenges are further magnified by the need to do so in an environment of diminished budgetary resources.[19]

Safeguarding Taxpayer Receipts and Associated Information

IRS continues to face an ongoing management challenge from the millions of hard copy tax returns and hundreds of billions of dollars in associated taxpayer payments it receives and processes each year. As long as IRS continues to receive large volumes of hard copy taxpayer payments and supporting data, there will continue to be a significant risk to the government and taxpayers alike that loss of receipts or inappropriate disclosure or compromise of taxpayer information may occur during this process. Safeguarding these taxpayer receipts and associated taxpayer information to prevent such events is among IRS's most important and demanding responsibilities.

During our financial audits of IRS, including this year's audit, we continued to identify deficiencies in IRS's internal control intended to safeguard taxpayer receipts and associated information that while not constituting a significant deficiency or material weakness either individually or in the aggregate, are nonetheless sensitive matters requiring IRS management's attention. We have made numerous recommendations to address these issues, to which IRS has been

[19]IRS's budgetary resources have declined approximately $1.2 billion (10 percent) from fiscal years 2010 through 2015, and its staffing has declined by about 13,000 full-time equivalents, or 14 percent, since fiscal year 2010. IRS's latest full year appropriation was approximately $10.9 billion. Consolidated Appropriations Act, 2015, Pub. L. No. 113-235, 128 Stat. 2129, 2336-37 (Dec. 16, 2014).

responsive.[20] However, several deficiencies that we had reported in prior years and which IRS had previously resolved reemerged during this year's audit. Specifically, our audit tests during fiscal year 2015 identified control deficiencies relating to ineffective monitoring and implementation of policies and procedures IRS put in place to address the pervasive control deficiencies we reported as a significant deficiency over hard copy taxpayer receipts and information during fiscal years 1997 through 2007.[21] These deficiencies, which we intend to report separately to management, involve controls designed to prevent unauthorized access to IRS facilities and hard copy taxpayer receipts and related sensitive information.

Congressional and taxpayer expectations for safeguarding receipts and associated taxpayer information are justifiably high, and as IRS strives to create efficiencies in this area by leveraging technology and better utilizing available resources, it is critical that IRS continues to monitor and maintain the effective internal control necessary to appropriately mitigate the significant risk related to this activity and ensure that operating effectiveness of controls does not deteriorate over time.

Preventing and Detecting Fraudulent Refunds Based on Identity Theft

Tax refund fraud associated with identity theft is a complex and rapidly changing threat facing the nation's tax system. Identity theft refund fraud occurs when a refund-seeking identity thief obtains an individual's identifying information, such as a Social Security number, and uses it to file a fraudulent tax return. Identity theft refund fraud burdens taxpayers who have had fraudulent tax returns filed in their names because they must deal with delays as they authenticate their identities with IRS. Identity theft refund fraud takes advantage of IRS's "look-back" compliance model. Because of pressures to issue refunds quickly, under this model, rather than holding refunds until completing all compliance

[20]We have reported these deficiencies and recommendations to address them, as well as IRS's associated corrective actions, in various management and status of recommendations reports to IRS. See, for example, GAO, *Management Report: Improvements Are Needed to Enhance the Internal Revenue Service's Internal Control over Financial Reporting*, GAO-15-480R (Washington, D.C.: May 29, 2015).

[21]See, for example, GAO, *Financial Audit: IRS's Fiscal Years 2007 and 2006 Financial Statements*, GAO-08-166 (Washington, D.C.: Nov. 9, 2007).

checks, IRS issues refunds before fully verifying the information on tax returns.[22] After the refunds are issued, IRS performs further validation of the tax return information, which has enabled IRS to detect significant amounts of identity theft refund fraud after the fact.[23]

IRS continues to devote significant resources to address identity theft, and continues to enhance its programs to detect, resolve, and prevent identity theft-based refund fraud. For example, IRS (1) offers identity protection personal identification numbers for past fraud victims to help them prevent a recurrence of identity theft,[24] (2) uses identity theft filters to screen returns during tax return processing, and (3) investigates third-party leads regarding suspected identity theft refund fraud. While the estimates have inherent uncertainty, for tax filing season 2014,[25] IRS estimated that approximately $25.57 billion in identity theft refund fraud was attempted. Of this amount, IRS prevented approximately $22.45 billion in identity theft refunds (88 percent) and paid $3.12 billion (12 percent).[26]

[22]IRS is required to pay interest on a tax overpayment if the refund is issued more than 45 days after the last day prescribed for filing the return or, in the case of a return filed after such last date, more than 45 days after the filing date. 26 U.S.C. § 6611(e). IRS informs taxpayers to anticipate their refunds generally within 21 days after filing and actively tries to meet this target. Therefore, IRS issues refunds after only doing some selected, automated reviews of the information the taxpayers submit to verify identity (e.g., name and Social Security number); filtering out returns with indicators of fraud, such as a mismatched name and Social Security number; and correcting obvious errors, such as calculation mistakes and claims for credits and deductions exceeding statutory limits. Because of the need to issue refunds quickly, some of IRS's refund validation steps are not performed until after the refund is issued.

[23]Such validation checks consist of looking for duplicate returns and matching tax returns to third-party information provided to IRS by employers, financial institutions, and others.

[24]Identity protection personal identification numbers are single-use identification numbers sent to identity theft victims who have validated their identities with IRS.

[25]The tax filing season is the period when IRS processes most tax returns and provides services, including telephone, correspondence, and website assistance, for tens of millions of taxpayers. IRS's analysis on identity theft refund fraud covered filing season 2014, which occurred from January 1, 2014, to December 31, 2014.

[26]IRS's estimates for tax filing season 2014 cannot be compared to those of previous years because of significant changes in its methodology. We are currently reviewing IRS's identity theft refund fraud estimates in a separate engagement.

IRS has been exploring several possible pre-refund tools to better prevent identity theft refund fraud. For example, IRS has been exploring the costs and benefits of matching wage information that IRS receives from employers (on Form W-2, Wage and Tax Statement) to tax returns before issuing refunds. While IRS believes pre-refund Form W-2 matching could prevent billions of dollars in estimated identity theft refund fraud, IRS indicated that there would be costs for this matching. In addition, this tool would likely require some combination of accelerated due dates for information returns, a delayed start to the annual tax filing season, delayed refund issuance, and investments in IRS information systems with the capability of doing real-time matching.[27]

Two other pre-refund options that the agency is exploring are (1) tracking device identification numbers to determine when multiple returns are filed from the same device (such as the same laptop computer) and (2) authenticating the identity of a taxpayer before issuing a refund through the use of security questions, passwords, and other techniques. However, the options available to IRS in attempting to minimize identity theft-related refund claims are affected by a number of constraints. For instance, (1) the personal information contained in tax returns and related information submitted to IRS is confidential and is protected from disclosure except as specifically authorized by statute[28] and (2) the benefits of more rigorous screening for potentially fraudulent tax returns must be weighed against the adverse effects of increased taxpayer burden as the closer scrutiny inevitably causes delays in the payment of valid refunds to legitimate taxpayers.

IRS recognizes that refund fraud based on identity theft is a major challenge affecting the agency and has responded to this threat with new ways to combat it. If IRS is to minimize the effects of identity theft-related refund claims on taxpayers and the associated loss to the federal government, it is critical for IRS to continue to explore options available in order to effectively identify, design, and implement the most appropriate

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[27]GAO, *Identity Theft and Tax Fraud: Enhanced Authentication Could Combat Refund Fraud, but IRS Lacks an Estimate of Costs, Benefits and Risks*, GAO-15-119 (Washington, D.C.: Jan. 20, 2015).

[28]26 U.S.C. § 6103. The statute places limitations on IRS's ability to share personal information contained in tax returns with certain other entities affected by identity theft, including law enforcement agencies.

measures and internal controls for preventing and detecting identity theft-related refund fraud.

Implementing Patient Protection and Affordable Care Act Tax-Related Provisions

PPACA, enacted in March 2010, includes provisions to expand access to public and private health insurance, including the creation of health insurance exchanges, also known as marketplaces, in each state beginning in 2014.[29] In addition, PPACA made a number of changes affecting the provision of private health insurance that involved numerous complex changes to the nation's tax laws. While some provisions took effect immediately or retroactively, others are to take effect as late as 2018, requiring IRS's responsibilities to increase each year. Consequently, implementing PPACA's tax-related provisions is a significant undertaking for IRS and requires extensive coordination, not only within IRS but also with multiple agencies and external partners.[30] For example, IRS must work closely with partner agencies, such as the Department of Health and Human Services' Centers for Medicare & Medicaid Services (CMS), to fully implement information systems that can share data with other agencies. CMS has overall responsibility for key federal systems supporting Healthcare.gov, the website through which consumers access the marketplaces to shop for and enroll in private health insurance coverage. IRS, along with several other federal agencies, plays a key role in maintaining systems that connect with CMS systems to perform eligibility-checking functions. A number of commercial entities, including CMS contractors, participating issuers of qualified health plans, agents, and others also connect to the network of systems that support enrollment in coverage offered through the marketplaces.

[29]PPACA requires the establishment of a health insurance exchange—referred to as a marketplace—in each state where eligible individuals can compare and select among insurance plans offered by participating issuers of health coverage. The Centers for Medicare & Medicaid Services is responsible for overseeing the establishment of these marketplaces, including creating a federally facilitated marketplace in each state that did not establish its own.

[30]PPACA involves major health care stakeholders, including federal and state governments, employers, issuers of qualified health plans, and health care providers. IRS is one of several agencies accountable for implementing the legislation and has responsibilities pertaining to 47 PPACA provisions.

In addition to the necessary system coordination, IRS must work closely with CMS concerning PPACA-related payments. For example, while CMS management administers PPACA programs that process, approve, and calculate the monthly Advance Premium Tax Credit (APTC), Cost-Sharing Reduction (CSR), and Basic Health Program (BHP) payments to qualifying individuals,[31] IRS management is responsible for managing and administering the federal appropriations used to pay the issuers of health insurance plans to cover the payments.[32] IRS is also responsible for processing and paying the Premium Tax Credit (PTC)[33] to taxpayers and for processing the Shared Responsibility Payment (SRP), which is paid to IRS by taxpayers.[34] Further, IRS is responsible for the financial reporting of PPACA-related payment transactions.

Because IRS relies on CMS for APTC, CSR, and BHP payment information, any deficiencies in CMS's controls over the payment information could adversely affect the amounts reported on IRS's financial statements. Consequently, IRS must coordinate closely with CMS to ensure that CMS has effective controls over the integrity of the payment information that it provides to IRS. IRS must also continually monitor

[31]The APTC is generally available to eligible taxpayers and their dependents who are (1) enrolled in one or more qualified health plans through a marketplace and (2) not eligible for other health insurance coverage that meets certain standards. If eligible, taxpayers may qualify for advance payments made directly to the issuers of the qualified health plan in which the taxpayers enrolled. The amount of advance payments is reconciled with the actual premium tax credit when the taxpayers file their tax returns. CSR generally refers to costs that an individual must pay when using services that are covered under the health plan in which the individual is enrolled. Common forms of CSR include co-payments and deductibles. BHP refers to health benefits coverage program for low-income individuals who would otherwise be eligible to purchase coverage through a marketplace. See Pub. L. No. 111-148, 124 Stat. 119, § 1401, § 1402 and § 1331. 26 U.S.C. § 36B sets forth the refundable credit for a qualified health plan.

[32]See 26 U.S.C. § 36B.

[33]The PTC is generally available to help pay the cost of premiums for taxpayers and their dependents with coverage through a marketplace who are not eligible for other health insurance, such as employer-provided coverage, and with household incomes from100 percent to 400 percent of the federal poverty level, among other requirements. See 26 U.S.C § 36B. Individuals can choose to have the PTC paid in advance to their insurance companies, thus lowering their monthly premium payments, or may claim all of the credit when they file their tax returns.

[34]Under PPACA, individuals must pay a penalty, known as the individual SRP, if they do not maintain certain levels of health care coverage for themselves and their dependents and do not qualify for an exemption. Individuals who owed SRPs were required to report the SRPs on their tax year 2014 tax returns, which were due in 2015. 26 U.S.C. § 5000A.

these controls and develop procedures to mitigate any risks to IRS's financial reporting.

IRS has developed a strategic approach to implement this massive program; however, it has continued to face ongoing management challenges and risks as it proceeds. For example, in January 2015, IRS began processing tax year 2014 tax returns, on which taxpayers were first required to report health care coverage information.[35] IRS also started verifying taxpayers' PTC claims using data from the marketplaces.[36] However, IRS's ability to validate taxpayer-reported information was hindered by the lack of complete, accurate, and timely information from the marketplaces.[37] This and other delays[38] outside of IRS's control resulted in IRS having limited information with which to verify (1) the 2014 health coverage, exemption, and SRP information that taxpayers reported and (2) taxpayer's compliance with the health care coverage requirements for tax year 2014. According to IRS officials, IRS is using its standard examination processes to check the information taxpayers report and, based on available resources, will balance its compliance

[35]IRS is responsible for ensuring that individuals, employers, and issuers of coverage comply with certain reporting requirements. Beginning with tax year 2014, individuals are required to report their health care coverage on Form 8962, Premium Tax Credit (PTC); exemptions to the coverage requirement on Form 8965, Health Coverage Exemptions; and any shared responsibility penalty on their Form 1040 and Form 1040A, U.S. Individual Income Tax Returns, and Form 1040EZ, Income Tax Return for Single and Joint Filers With No Dependents. See 26 C.F.R. §§ 1.5000A-0—1.5000A-5. Beginning with tax year 2015, health coverage issuers and certain large employers will be required to provide new information returns, Form 1095-B, Health Coverage, and Form 1095-C, Employer-Provided Health Insurance Offer and Coverage, respectively. See 26 C.F.R. §§ 1.6055-1, 301.6056-1.

[36]At the time of filing, IRS's system compares the information taxpayers reported on their tax returns to information the marketplaces provided, potentially identifying math errors or discrepancies with marketplace data.

[37]GAO, *Patient Protection and Affordable Care Act: IRS Needs to Strengthen Oversight of Tax Provisions for Individuals*, GAO-15-540 (Washington, D.C.: July 29, 2015). Most marketplaces did not submit complete 2014 coverage year data for their states to IRS by the January 2015 due date. In addition, some marketplaces issued incorrect versions of Form 1095-A, Health Insurance Marketplace Statement, to taxpayers. Form 1095-A includes information on the covered individuals, the period of coverage, monthly premiums, and the amount of APTC paid to the insurer on behalf of the taxpayer.

[38]PPACA required health insurance issuers and large employers to submit information returns to IRS and taxpayers beginning with tax year 2014. In July 2013, the Department of the Treasury provided transition relief to affected reporting entities by delaying the reporting requirement until tax year 2015.

efforts related to the health coverage requirements issue with compliance efforts on other issues.[39] For tax year 2015 tax returns, IRS plans to begin implementing additional PPACA provisions that will expand its capability to verify compliance with the health care coverage requirements by using information reported by health issuers and employers.

These ongoing and new implementation and compliance difficulties are significant management challenges for IRS. Given the necessary coordination between IRS, CMS, and the marketplaces, until these challenges are fully addressed, IRS faces increased risks of processing and issuing inaccurate PTC amounts to taxpayers and processing inaccurate SRPs. Therefore, it is important for IRS to continue to work closely with the agencies and external partners involved in carrying out PPACA provisions in order to improve the timeliness and accuracy of the information provided by those entities and ensure that valid and accurate payments are processed.

Report on Compliance with Laws, Regulations, Contracts, and Grant Agreements

In connection with our audits of IRS's financial statements, we have tested compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements consistent with our auditor's responsibility discussed below. We caution that noncompliance may occur and not be detected by these tests. We performed our tests of compliance in accordance with U.S. generally accepted government auditing standards.

Management's Responsibility

IRS management is responsible for complying with laws, regulations, contracts, and grant agreements applicable to IRS.

Auditor's Responsibility

Our responsibility is to test compliance with selected provisions of laws, regulations, contracts, and grant agreements applicable to IRS that have a direct effect on the determination of material amounts and disclosures in the IRS financial statements, and perform certain other limited procedures. Accordingly, we did not test compliance with all laws, regulations, contracts, and grant agreements applicable to IRS.

[39] GAO-15-540.

Results of Our Tests for Compliance with Laws, Regulations, Contracts, and Grant Agreements

Our tests for compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements disclosed no instances of noncompliance for fiscal year 2015 that would be reportable under U.S. generally accepted government auditing standards. However, the objective of our tests was not to provide an opinion on compliance with laws, regulations, contracts, and grant agreements applicable to IRS. Accordingly, we do not express such an opinion.

Intended Purpose of Report on Compliance with Laws, Regulations, Contracts, and Grant Agreements

The purpose of this report is solely to describe the scope of our testing of compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements and the results of that testing, and not to provide an opinion on compliance. This report is an integral part of an audit performed in accordance with U.S. generally accepted government auditing standards in considering compliance. Accordingly, this report on compliance with laws, regulations, contracts, and grant agreements is not suitable for any other purpose.

Agency Comments

In commenting on a draft of this report, the Commissioner of Internal Revenue stated that IRS was pleased to receive an unmodified opinion on its financial statements for the 16th consecutive year. He stated that IRS is dedicated to continuing to improve its financial management, internal controls, and information security. The complete text of IRS's response is reprinted in appendix II.

Cheryl E. Clark

Cheryl E. Clark
Director
Financial Management and Assurance

November 10, 2015

Management's Discussion and Analysis

Internal Revenue Service

Management's Discussion and Analysis
Fiscal Year 2015

"Taxes are what we pay for a civilized society."
Oliver Wendell Holmes, Jr., U.S. Supreme Court Justice

INTERNAL REVENUE SERVICE
Management's Discussion & Analysis
Fiscal Year 2015

IRS VISION, MISSION, AND ORGANIZATION

Vision

We will uphold the integrity of our nation's tax system and preserve the public trust through our talented workforce, innovative technology and collaborative partnerships.

Mission

Provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.

History

The IRS is one of the oldest bureaus in the United States Government. Article 1, Section 8 of the Constitution gave the Federal Government the power to "lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States..." In 1862, President Lincoln and the Congress established the Bureau of Internal Revenue and the nation's first income tax. In 1953, the Bureau of Internal Revenue's name was changed to the Internal Revenue Service (IRS).

Strategic Goals

The IRS 2014-2017 strategic goals provide a central direction for the attainment of our mission and vision. Our strategic foundation for organizational excellence supplements the strategic goals and describes the internal initiatives required to support our taxpayer-facing actions. Our two primary strategic goals align to the service and enforcement areas.

Strategic Foundation for Organizational Excellence: Invest in our workforce and the foundational capabilities necessary to achieve our mission and deliver high performance for taxpayers and stakeholders.

Strategic Goal 1: Deliver high quality and timely service to reduce taxpayer burden and encourage voluntary compliance.

Strategic Goal 2: Effectively enforce the law to ensure compliance with tax responsibilities and combat fraud.

Employees

In FY 2015, the IRS employed approximately 90,000 people, including more than 16,200 temporary and seasonal staff.

Location

The IRS headquarters is located at 1111 Constitution Ave., NW, Washington, DC 20224. There are also approximately 550 offices in all states and territories and some U.S. embassies and consulates.

1

Internet

The IRS provides tax information, taxpayer services, forms, and publications at www.IRS.gov.

Organization Structure and Accountability

The IRS has three commissioner-level organizations.

Commissioner, Internal Revenue Service	Deputy Commissioner for Services and Enforcement	Deputy Commissioner for Operations Support
(Specialized IRS units report directly to the Commissioner's Office)	*(Reports directly to the Commissioner and oversees the four primary operating divisions and other service and enforcement functions)*	*(Reports directly to the Commissioner and oversees the IRS support functions, facilitating economy of scale efficiencies and better business practices)*
• Chief Counsel • Appeals • Taxpayer Advocate Service • Equity, Diversity and Inclusion • Research, Analysis, and Statistics • Communications and Liaison • Office of Compliance Analytics • Office of the Chief Risk Officer	• Wage and Investment Division • Large Business and International Division • Small Business/Self Employed Division • Tax Exempt and Government Entities Division • Criminal Investigation • Office of Professional Responsibility • Affordable Care Act Office • Office of Online Services • Return Preparer Office • Whistleblower Office	• Information Technology • Agency-Wide Shared Services • Privacy, Governmental Liaison and Disclosure • Human Capital Office • Chief Financial Office • Office of Planning, Programming, and Audit Coordination

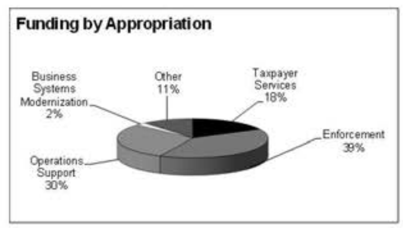
Tax Statistics Highlights

FY 2015 Tax Stats at a Glance	
Total Returns Processed	201 million
Total Returns and Other Forms Processed	244 million
Total Revenue Collected	$3.3 trillion
Enforcement Revenue Collected	$54.2 billion
Total Refunds and Outlays	$403 billion
Avg. Individual Refund	$2,735
E-File Rate – Individual	85.3%
E-File Rate – Business	47.0%
IRS.gov Page Views	2.0 billion
"*Where's My Refund?*" Usage	234.7 million
Number of Downloads from IRS.gov	132.6 million

FINANCIAL RESOURCES

The IRS's FY 2015 operating level was $10.95 billion, which is $345.6 million less than the FY 2014 enacted level. The actual reduction is closer to $600 million when including approximately $250 million of unfunded requirements consisting of congressionally mandated employee pay raises, benefits, and non-labor inflation. Compared to the FY 2010 enacted level, the IRS budget was reduced $1.2 billion, causing the IRS to implement severe controls on all expenditures, including restrictions on replacing departed staff, which resulted in a reduction of approximately 15,500 permanent employees during this period. When inflation is considered, the operating level aligns closely with the FY 1998 budget, when there were 30 million fewer individual and business return filers and the security of the tax return process was less costly. In addition to the annually appropriated budget, IRS funding also included $1.2 billion from user fees, offsetting collections, and unobligated balances from prior years and a mandatory transfer in. This raised the IRS budget authority (discretionary and mandatory) to $12.2 billion.

Funding by Appropriations ($ thousands)



Taxpayer Services *[$2,186,554]* funds the processing of tax returns and related documents, and assistance for taxpayers in filing returns and paying taxes due.

Enforcement *[$4,769,000]* funds examination of tax returns, collection of balances, the administrative and judicial settlement of taxpayer appeals of examination findings, as well as providing resources for strengthened enforcement to reduce invalid claims and erroneous filings associated with the Earned Income Tax Credit (EITC) program as well as other refundable tax credits.

Operations Support *[$3,699,446]* funds overall planning, direction, and support for the IRS, including shared service support related to facilities services, rent payments, printing, postage, and security. This appropriation funds headquarters policy and management activities such as corporate support for strategic planning; communications and liaison; finance; human resources; equity, diversity and inclusion; research and statistics of income; and necessary expenses for information systems and telecommunication support, including development, security, and maintenance of the IRS's information systems.

Business Systems Modernization *[$290,000]* funds capital asset acquisitions of information technology systems to modernize key tax administration systems.

In addition to the core appropriations, the IRS has the following appropriations (special funds):

Other Resources: User Fees *[$390,518]* from payment for services provided and *[$261,770]* from prior year balances brought forward October 1; **Offsetting Collections Resources** *[$116,332]*, **Unobligated Balance Transferred In (50 percent Carryover)** *[$60,716]*, and **Unobligated Balances** *[$363,828]* brought forward October 1, and **Mandatory Transfer** of *[$7.6 million]* for the Spectrum Relocation Fund as directed in OMB SRF Pre-Transfer Guidance to Agencies.

INTERNAL REVENUE SERVICE
Management's Discussion & Analysis
Fiscal Year 2015

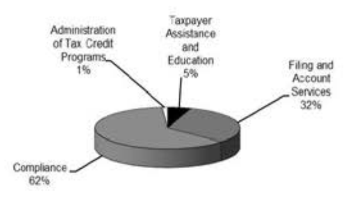
Use of Resources

The IRS uses a cost allocation methodology to assign support and overhead costs to each program described below. The Statement of Net Cost reflects the use of IRS resources in conducting its major programs and reports the full cost of these programs in accordance with the Statement of Federal Financial Accounting Standards No. 4, "Managerial Cost Accounting."

- **Taxpayer Assistance and Education** activities [five percent] include taxpayer education and outreach, tax publication issuance and distribution.
- **Filing and Account Services** activities *[32 percent]* include filing tax returns, maintaining customer accounts, processing taxpayer information, providing service to taxpayers, and resolving issues.
- **Compliance** activities *[62 percent]* include pre-filing agreements, document matching, examination, collection, and criminal investigation activities.
- **Administration of Tax Credit Programs**[1] *[one percent]* primarily includes costs for Earned Income Tax Credit (EITC) program activities.

In addition to EITC, which is the single largest refundable tax credit program, the IRS also administers 16 other tax credit programs whose costs are reflected in the IRS Financial Statements.

How IRS Uses Its Resources



Use of Resources ($)		
Program	**FY 2015**	**FY 2014**
Taxpayer Assistance and Education	$636,587	$607,745
Filing and Account Services	$3,906,070	$3,828,087
Compliance	$7,672,207	$8,030,757
Administration of Tax Credit Programs	$153,872	$164,621

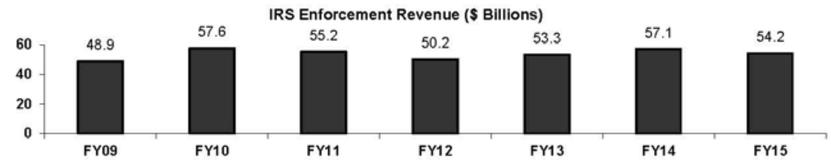
PERFORMANCE SUMMARY

Enforcement of the tax law is an integral part of the IRS effort to enhance voluntary compliance, especially as tax administration becomes increasingly complex. The IRS has maintained a

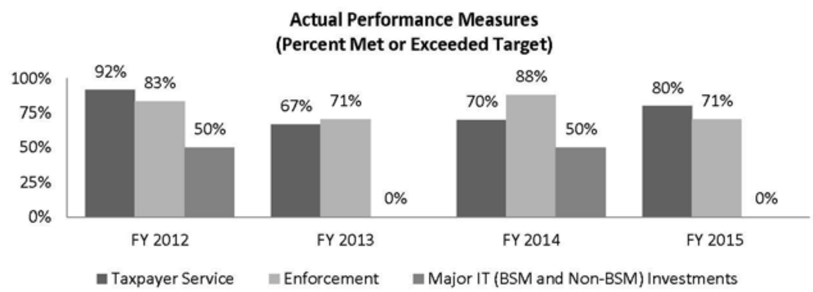
[1] Prior to fiscal year 2012, this program also included the costs of administering the health coverage tax credit (HCTC) which was discontinued in 2014. Obligations made prior to discontinuation are now included under Filing and Account Services activities, except for costs related to HCTC obligations made prior to FY 2012, which remain here.

4

balanced and effective enforcement program despite many challenges, collecting more than $50 billion in enforcement revenue in FY 2015, for the sixth year in a row.



In FY 2015, the IRS had an overall success rate of 69 percent in meeting or exceeding the targets for 20 of its 29 performance measures. Detailed information on performance is presented in the Performance Summaries and Explanation of Shortfalls under each of Strategic Foundation, Goal 1, and Goal 2 and in Appendix A, Performance Measures Descriptions; Appendix B, Performance Measurement Data Appendix C, Long-Term Measure Definitions; and Appendix D, Long-Term Measure Data.



The IRS has been conducting research on behavioral responses to IRS actions over the last several years. These efforts allow the IRS to gather pertinent information on various segments of the taxpayer population and develop and test products and services, such as redesigned notices and forms, to improve the tax preparation process.

One behavioral study included a pilot on the use of outreach methods designed to encourage taxpayers to participate in the tax system. The pilot conducted last year demonstrated that generic informational postcards could influence filing behaviors among taxpayers who appear to be eligible for the Earned Income Tax Credit, but have not filed a return in recent years to claim it. The increased participation does not seem to have resulted in increased noncompliance, meaning the outreach appears to move three key indicators in a positive direction for the IRS: the Voluntary Filing Rate, the EITC participation rate, and the improper payment rate. The FY 2015 outreach tested variations in the language used and the timing of the postcard messages to increase participation. Preliminary FY 2015 results indicate that there were increases in participation, even among those who owed tax and/or did not receive a refund.

The Nonfiler/Late-filer Survey is another behavioral study designed to help the IRS understand the drivers of nonfiling and gather burden data to populate the IRS Taxpayer Compliance Burden Model (TCBM). The study is conducted as an expansion of the post-filing TY 2014 Taxpayer Compliance Burden Survey. The Nonfiler/Late-filer Survey population consists of individuals who received an Automated Substitute for Return (ASFR) notice and subsequently filed the related return. Qualitative data such as the reason(s) that these taxpayers did not file on time, what prompted them to finally file a return, and a matrix rating the burden associated with post-filing activities will help the IRS improve the taxpayer experience. The data from the study will provide additional insights into the issues associated with individuals who are at risk to stop filing and inform refinement of treatments for those individuals who do fail to file a required return.

Another FY 2015 behavioral study focused on understanding the impact of penalties on taxpayer behaviors, specifically as they relate to future voluntary compliance. Research, Analysis, and Statistics (RAS) completed an initial paper describing this research and outlining future efforts to understand how accuracy-related penalties and failure-to-pay penalties influence taxpayer behavior.

Beyond applying principles of behavioral economics to the design and analysis of outreach and enforcement treatments, RAS has been analyzing the salience and flow of information associated with these treatments on subsequent behavior by both the treated taxpayer as well as the indirect effects on other taxpayers that might be aware of the occurrence of the treatment. This indirect effects research is being conducted for outreach, examination, collection, and penalty research projects.

PERFORMANCE GOALS, OBJECTIVES, AND RESULTS

The IRS continues to focus on its mission to provide America's taxpayers top-quality service and helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.

The IRS needs to create an integrated approach to identify, capture, evaluate, retrieve, and share the IRS's information assets. These assets will need to include databases, documents, policies, procedures, and previously un-captured expertise and experience (including institutional knowledge) possessed by individual employees.

If IRS is to realize its desired future state, specialized audits and risk data analysis technology will need to be part of the mainstream and not simply for auditors. In order to manage and minimize exposure to tax fraud and identity theft, a more integrated information system is required to perform more robust analyses that will quickly and more accurately identify unusual cases within the data system. Our focus needs to be on anomaly and fraud detection, along with network intrusion, and other infrequent events that may have great significance but are hard to find.

Outreach and education programs help to build partnerships with various groups so that the agency can better understand their needs and tailor assistance, updates, and information to them. Education needs to be focused on helping businesses and individuals meet their tax obligations and better inform them about compliance.

Future success depends on the IRS's ability to facilitate voluntary compliance, deter non-compliance, leverage and collaborate with external stakeholders, cultivate a talented and diverse workforce, utilize analytics, drive agility and efficiency, strengthen cyber defense, and prevent identity theft and refund fraud. The IRS focused on these five priority objectives from the FY 2014-2017 Strategic Plan in order to work toward that future vision:

- Invest in building a highly talented, diverse workforce and cultivating an inclusive and collaborative environment.
- Invest in innovative, secure technology needed to protect taxpayer data and support taxpayer, partner, and IRS business needs.
- Design tailored service approaches with a focus on digital customer service to meet taxpayer needs, preferences, and compliance behaviors in order to facilitate voluntary compliance.
- Enforce domestic and international compliance by strengthening expertise, adopting innovative approaches, and streamlining procedures.
- Identify trends, detect high-risk areas of noncompliance, and prioritize enforcement approaches by applying research and advanced analytics.

STRATEGIC FOUNDATION: Invest in our workforce and the foundational capabilities necessary to achieve our mission and deliver high performance for taxpayers and stakeholders

To achieve its service and enforcement strategic goals, the IRS must have a strong strategic foundation. The IRS strives to cultivate a well-equipped, diverse, skilled, and flexible workforce. To support its workforce, the IRS invested in innovative technology to expand on the core capabilities and provide value-added online services, faster problem resolution, and versatile communication channels. Expanding this success in the future required that the IRS make the right strategic IT investments in FY 2015.

Strategic Foundation Facts

- IRS.gov facilitated more than 270 million visits and maintained 100 percent availability during tax season 2015.
- IRS.gov had six million visits on its site including a peak of over 8,700 hits per second on April 15, 2015.
- IRS.gov successfully handled 493.2 million page visits in FY 2015.
- CADE 2 Daily Processing posted more than 149.4 million returns and issued over 115.2 million refunds totaling $317.7 billion.
- As of September 30, 2015, taxpayers submitted more than 235.6 million individual returns and over 29.1 million business returns (includes both Federal and State submissions) through Modernized e-File (MeF).

- On April 15, 2015, Modernized e-File processed 13.4 million submissions (up 13 percent from 11.9 million on April 15, 2014).
- The IRS received seven million Forms 1095-A, *Health Insurance Marketplace Statement,* from the Healthcare Marketplaces via the Centers for Medicare & Medicaid Services (CMS) Data Hub.
- The IRS collected $8 billion in Insurance Provider Fees (IPF) and $3 billion in Branded Prescription Drug (BPD) Fees in the 2014 Fee Year. The IRS collected over $11 billion in IPF and $3 billion in BPD in the 2015 Fee Year.

♦ **(Priority) Objective 1: Invest in building a highly talented, diverse workforce and cultivating an inclusive and collaborative environment**

The IRS focused on enhancing communication, cultivating an inclusive and collaborative environment, and encouraging employee engagement. To do that, the IRS developed and empowered current employees by relying on their expertise to improve systems and processes and also by focusing on knowledge management, data analytics, and training for new ACA and FATCA requirements. The IRS successfully hired seasonal staff to support filing season, recruited veterans, and employees with targeted disabilities, and hired experts in the international area, while maintaining an exception-only hiring freeze.

To increase employee engagement, the IRS developed the FY 2015 Leadership Engagement Action Plan (LEAP) to tie numerous planned employee engagement efforts throughout the IRS into a single, corporate engagement strategy. The LEAP focuses on aligning engagement activities to a strategic vision, investing in employees and building support systems and tools to equip both leaders and employees for success. It is founded upon the Four Pillars of Engagement: Lead, Listen, Develop, and Support.

The IRS encourages an inclusive and collaborative environment through its employee communications, including more than 50 Commissioner or Deputy Commissioner employee email messages, articles in the IRS all-employee newsletter, articles in the IRS all-managers newsletter, and moderated panel discussions with IRS executives. The IRS also conducted special events for employees including a Leadership Forum featuring Commissioner Koskinen with NTEU National President, Colleen Kelley, Commissioner's Award and Deputy Commissioners' Awards programs, and an open office hours program that allowed employees to have one-on-one face time with the Deputy Commissioner Operations Support.

The IRS is changing the conversation about diversity to focus on the business benefits of a highly diverse, multi-talented workforce. Included in this effort was the development of an e-learning product for leaders titled, *Our World is Changing: Are You Ready? – A Diversity and Inclusion Primer for IRS Leaders.* This training encourages diversity of thought, perspective, experience, cultural background, and a multitude of other factors that enrich the workplace but require that leaders become competent in capitalizing on differences to drive better business outcomes and innovative solutions to challenges.

During FY 2014 and FY 2015, there were significant changes in the senior executive team. Recognizing that all employees would feel the effects of the significant change in senior leadership, the IRS staged a series of six leadership panels entitled, *Our World is Changing:*

Meet Your Leaders. The capstone session was a conversation between the Commissioner and the president of the National Treasury Employees Union. The live panels were streamed to desktops (and recorded for playback) providing an opportunity for employees to see and hear their new leaders in dialogue with colleagues answering questions about themselves, their backgrounds and their leadership philosophy.

The IRS remains committed to strengthening its integrated framework to ensure IRS has the right employees, in the right place, at the right time. However, due to resource limitations, the exception-only hiring policy imposed in FY 2010 continues; in FY 2015 the IRS's limited external hiring demographic included 8.9 percent of overall new external hires being veterans, 4.7 percent disabled veterans, 11.1 percent disability hires, and 1.8 percent targeted disability hires.

For those external hires the IRS was able to complete, procedures were developed to improve timeliness of both background checks and new hire access to computer systems, and to increase geographically-targeted advertising to address applicant shortages.

The examination process was reengineered using the "Getting it Right Together" process, which incorporated employee feedback and included virtual meetings with more than 1,600 employees participating. Results included a 2.5-hour training product addressing changes to the main stages of examinations: planning, execution, and resolution.

The IRS implemented a broad focus on education and expansion of knowledge management including these specific examples:

- Began the 2015-2016 Leadership Succession Review (LSR) cycle, which included assessment, talent review, and strategic planning by executives in FY 2015.
- Led a succession planning assessment identifying criticality and retention of key CFO positions along with departure risk and departure impact of individuals in these positions.
- Documented financial management transition and knowledge transfer plans including a five-year hiring plan and training plans.
- Developed and delivered customized training to improve skills and provided managerial rotational opportunities.
- Delivered guidance to all employees on protecting Personally Identifiable Information (PII) through multiple communication vehicles and developed guidelines for sending PII to external email addresses.
- Created Knowledge Networks in 10 tax law technical areas for employees in Employee Plans and Exempt Organizations who share a common interest, need, or expertise in a given technical subject area and interact regularly to share knowledge and experiences.
- Delivered *Analyst Virtual Continuing Professional Education (CPE)* to more than 400 analysts and included a mandatory orientation session for all managers of analysts.

- Delivered *Application Skills Training* to International Examiners and Revenue Agents covering global business and taxation, transfer pricing concepts, and examination techniques to share knowledge on an expanding area.

- Delivered *Disclosure Refresher* training to ensure employees are aware of their respective responsibilities to protect taxpayer information and avoid inadvertent disclosure.

- Delivered *IMS Returning User* training to more than 1,000 Issue Management System (IMS) users, including a live session for participants to share best practices.

- Deployed the Joint Statistical Research Program (JSRP) providing collaborative research opportunities between IRS analysts and researchers at leading academic institutions. Twelve projects were selected in a competitive review process. The program brings leading researchers in economics, accounting, and law together to work with the IRS on tax administration research issues and provides training and development opportunities for IRS analysts.

- Deployed a pilot program to develop Data Driven Innovation Fellows with strong quantitative skills, talent for innovation, and business acumen. The pilot included three paid summer interns (Data Driven Innovation Interns).

- Provided 20 future business leaders with developmental opportunities that built expertise in strategic analytics, data driven decision-making, application of test-and-learn to innovate rapidly but safely, agile implementation, and successful cross-organization collaboration and communication.

- Presented Data-Driven Innovation Seminars to more than 160 IRS current and future leaders, providing them with insights into how strategic analytics and test-and-learn approaches can be used to accelerate innovation while mitigating risks associated with new endeavors.

- Fostered a learning environment to support emerging leaders, encourage career development and enhance employee engagement through 35 Geographic Leadership Communities (GLC) covering 76 percent of IRS executives and supervisors.

- Partnered with SkillSoft and the American Council on Education to provide IRS employees an opportunity to earn college credit through free, online courses, resulting in over 1,100 employees enrolled.

- Participated in the Treasury Competency Assessment Process (TCAP) with 88 percent of 1,047 participating human resources professionals creating development plans.

In support of the Patient Protection and Affordable Care Act (ACA), the IRS's efforts to train employees in FY 2015 included:

- Published 10 ACA self-paced electronic training products that have been completed by 18,730 IRS staff.

- Published six ACA articles for IRS employees, including articles in *IRS Headlines* newsletters.
- Provided 1,791 IRS campus personnel CPE credits in ACA implementation.

The IRS met the challenges of implementing new provisions of FATCA both by transferring employee experts and by hiring nine new professionals with unique skills. Some new staff supported the International Data Exchange System (IDES) and established a common analytical platform for the FATCA program users to create reports and conduct analysis. Other hires performed compliance activities to ensure financial institutions comply with registration, account documentation, reporting, and withholding requirements under FATCA.

The IRS extended nationwide training sessions on technical and general topics to all IRS employees that work with tax-exempt organizations and broadened the scope of the topics delivered to include: Unrelated Business Income Tax (UBIT), Private Foundations, credit counseling and foreclosure assistance organizations, Private Benefit & Inurement, Time Management, Risk Management, Hospitals/Healthcare, social and recreation clubs, and Effectively Collaborating with Chief Counsel. Implementation of a new training approach, using a hybrid delivery of virtual and face-to-face meetings, saved the IRS time and money by reaching more employees while holding fewer class sessions. By providing identical training to IRS personnel simultaneously, the IRS built a more flexible and well-trained workforce and ensured consistent application of the tax laws nationwide.

The IRS enhanced its employee debt management program (for employees who owe administrative debts for non-payment of Federal Employee Health Benefit premiums while in non-work status, late or corrected personnel actions, corrected time and attendance records and other Payroll adjustments) leading to an almost 13 percent reduction in the number of employee debts since last year. More than 300 employees have been referred to the Treasury Offset Program for enforced collection activities.

◆ **Objective 2: Ensure a secure environment that protects the safety of our people and security of our facilities**

The IRS continues its ongoing efforts to ensure a work environment that protects its people and facilities and safeguards receipts from taxpayers.

In FY 2015, the IRS enhanced employee awareness through service-wide emergency response training and promoted the safety and security of IRS employees and critical infrastructure by developing and delivering an Active Shooter/Threat and Workplace Violence mandatory briefing. The updated mandatory annual physical security briefing for employees and contractors included information that can be used in their initial response to an active threat situation in the workplace. The IRS also delivered face-to-face Active Shooter/Threat and Workplace Violence mandatory training to employees at 175 large PODs and Campuses and completed 155 facilities security risk assessments.
The IRS also improved physical safeguarding of receipts from taxpayers.

- Monitored the process used by service center campuses and lockbox banks to acknowledge and track transmittals of unprocessable items with receipts.

- Analyzed contractor access arrangements and required security awareness training for all IRS contractors who are provided unescorted physical access to IRS facilities or taxpayer receipts and information.
- Amended existing contracts to require that favorable background investigations be obtained for all relevant contract employees before routine, unescorted, unsupervised physical access to taxpayer information is granted.
- Established allowable deposit courier trip time limits to be used by both service center campuses and lockbox banks in detecting potential unauthorized stops or other contractual violations by deposit couriers.

◆ **Objective 3: Implement and maintain a robust enterprise risk management program that identifies emerging risks and mitigates them before they impact performance**

The Enterprise Risk Management (ERM) program focuses on identifying emerging risks and facilitating mitigating steps before performance is impacted. The IRS's critical strategies for the ERM program in FY 2015 included continuing program implementation and execution; providing outreach, communication, and training; and supporting operationalization of risk management throughout the IRS. To support these strategies, the IRS delivered online ERM General Awareness Training for more than 12,700 managers/management officials in early FY 2015. The IRS also launched a series of ERM podcasts that introduce and explain key ERM concepts that are available to all employees through a new ERM website on IRS's intranet. The IRS developed and deployed new tools and processes to support the identification and assessment of risks across the organization and developed guidelines for creating Key Risk Indicators to improve the monitoring of identified risks. In 2014, the IRS identified 15 categories of enterprise risks and undertook numerous mitigation actions to help alleviate the impact of these risks to the agency. The second annual enterprise risk assessment began in May 2015, following the end of filing season.

Individual business unit efforts also included risk management activities including:

- Additional organization-specific Risk Management Webinars were held for managers and senior staff in the business units in order to increase knowledge about risk management, foster open discussions about risk at all levels, and outline the risk management process.
- For employees who work with small business or self-employed taxpayers, a Risk Management intranet site was created to provide information about the Risk Management process including a manager's toolkit and a consolidated list of identified risks.

◆ **Objective 4: Realize operational efficiencies and effectively manage costs by improving enterprise-wide resource allocation and streamlining processes**

The IRS has continued efforts to resource the IRS for success and to streamline processes enterprise-wide. Notable successes have occurred in reducing rent, negotiating contract savings, and transitioning some information system support from contractor to IRS.

Rent is one of the IRS's largest organizational operating expenses. The IRS completed 59 projects to release more than 624,300 rentable square feet of space from inventory for an annual rent savings of more than $17 million.

Negotiations leading to contract savings included price, labor hours, travel costs, considerations attained, schedule changes, price discounts, and more. In FY 2015, $68.6 million of savings were realized through contract negotiations.

The IRS completed the transition of information systems support of the Joint Operations Center (JOC) from contractor to IRS. The transition included hardware, communications, and systems management. Servers were moved to the IRS's Enterprise Computing Center. The IRS's Information Technology organization now provides software and third party data acquisition, data management, Federal Information Security Management Act (FISMA) security support, and analytic tools to the JOC.

- **(Priority) Objective 5: Invest in innovative, secure technology needed to protect taxpayer data and support taxpayer, partner and IRS business needs**

The IRS continues to invest in technology to thwart fraud, provide virtual taxpayer assistance, improve identity authentication, protect privacy, provide a positive end-to-end taxpayer experience, and meet the business needs of the IRS and its employees.

Attempts to obtain taxpayer information fraudulently through false IRS websites and other electronic methods continue. The IRS identified and quickly shut down 1,474 false websites in FY 2015 to protect tax information and maintain public confidence. The schemes are changing from sites used for credit card fraud to requests for tax-related information such as the Social Security Number, Filing Status, Identity Protection Personal Identification Number (IP PIN), and e-File PIN. The IRS shut down these schemes within a median of 30 minutes after detection. Phishing/Malware Sites are fake IRS websites designed to harvest a potential victim's personal and financial information. Malware sites contain malicious software designed to disrupt computer operation, gather sensitive information, or gain unauthorized access to computer systems. The IRS shut down 588 malware sites in FY 2015 and 297 sites in FY 2014.

Protecting Personally Identifiable Information (PII) is critical to sustaining public confidence in the tax system. Data breaches can result from human error and gaps in system security features and may reduce public confidence in the IRS. The IRS ensures privacy is a key component of emerging processes, technical solutions, and new legislation including Online Services, Taxpayer Digital Communications, Third-Party Access to Taxpayer Account Information, SharePoint Records Pilot, Affordable Care Act, and the Foreign Account Tax Compliance Act.

The IRS deployed new capabilities associated with Online Bill Pay, IRS Direct Pay, Online Payment Agreement, Return Preparer Lookup, and the IRS2Go mobile application in time for the traditional start of the tax filing season in spite of challenging IT budget reductions.

In support of this year's Health Insurance Marketplace Open Enrollment, the IRS received and responded to millions of real-time requests from State and Federal Insurance Marketplaces to support determination of an individual's eligibility for an Advance Premium Tax Credit with income and family size verification and credit calculation. Technology to support the Affordable Care Act was integrated into Filing Season 2015 tax administration processing, allowing taxpayers to report health insurance coverage, claim health coverage exemptions, report a shared responsibility payment, and claim the ACA Premium Tax Credit. The IRS built a new system, the ACA Verification Service (AVS), to enable at-filing checks of tax returns for reporting the Premium Tax Credit, leveraging third-party data from the Insurance Marketplaces, and validating ACA-related tax forms. This system, which processed more than 150 million tax returns, helped identify fraudulent and erroneous returns at the initial processing stage, reducing the number of refunds disbursed in error.

The IRS Web Services Infrastructure maintained 100 percent availability even during annual updates on Free File, EITC, Alternative Minimum Tax (AMT), Sales Tax Deduction Calculator (SDTC), FATCA, and Foreign Financial Institution (FFI), and the migration of Stayexempt.irs.gov from an externally hosted website into the Content Management System (CMS) that hosts IRS.gov. Supported services included easy access to forms and publications, electronic payment transactions, delivery of transcripts, tracking of refunds and amended returns, modernized e-filing, free-file for certain classes of taxpayers, and other electronic services.

In January 2015, the IRS achieved a major milestone by opening the first release of the new International Data Exchange Service (IDES) Gateway. IDES enables both Financial Institutions and Host Country Tax Administrations to comply with their FATCA obligations by safely and securely sending electronic FATCA reports to the IRS. IDES held several testing windows to allow foreign partners to submit test files and receive notifications back on the success or failure of the file submission. The IRS assisted the FATCA third-party reporting community through weekly Technical Forum calls with foreign partners, a comments application for IDES on IRS.gov, and a code-sharing website to share code samples with users to assist in data preparation and decryption. The IRS also produced an IDES User Guide, a large number of Frequently Asked Questions (FAQs), a trouble-shooting guide, and sample reporting files. More than 8,000 users have enrolled in the IDES system, representing 5,195 Foreign Financial Institutions and 75 Host Country Tax Authorities. The enrolled users uploaded over 36,000 files during the 2015 FATCA filing season, which ended on September 30, 2015.

The IRS also initiated and deployed the International Compliance Management Model (ICMM). This new system receives, processes, manages, and stores new FATCA data and modernized communications with foreign governments that have Intergovernmental Agreements (IGAs) and Competent Authority Arrangements (CAAs). ICMM processes all new FATCA reports that are filed either electronically or on paper. ICMM generates and sends notifications to participating FFIs and Host Country Tax Authorities and other filers of those FATCA reports. ICMM also deployed functionality to fulfill the U.S. obligations under FATCA Model 1A IGAs for reciprocal exchange with certain foreign governments. ICMM successfully exchanged information with 26 jurisdictions by the September 30, 2015, deadline.

The Return Review Program (RRP) deployed and expanded the identity theft pilot for filing season 2015 that resulted in additional returns selected as potential identity theft fraud, thus increasing the IRS's identity theft revenue protection over prior years.

The IRS has multiple aging case management systems that operate independently yet share many of the same requirements for critical workflow processes. In FY 2015, the IRS created a business-driven Enterprise Case Management Program Management Office to address these multiple case management systems that are costly to operate and increase the burden on taxpayers and the IRS to ensure compliance. The Enterprise Case Management solution is expected to yield efficiencies, increase performance of the compliance resources and process; and improve quality by establishing a common infrastructure platform and standard case management functions.

To limit the exposure to internet threats, the IRS maintains perimeter security controls within its Trusted Internet Connection environment that block an average of more than two million malicious, suspicious, or prohibited events targeting IRS employees, systems, or networks on a daily basis. Over the past year, the IRS Cybersecurity Computer Security Incident Response Center (CSIRC) also identified, mitigated, and responded to 1,128 cyber incidents and produced 540 advisories and bulletins informing responsible business units, system administrators, and users of mitigation actions to address current vulnerabilities and threats affecting the IRS enterprise.

The Customer Account Data Engine (CADE) 2 Transition State 2 (TS2) five-year Release Plan, including expansion of CADE 2 capabilities, was approved. Implementing the plan will address the Unpaid Assessment Financial Material Weakness, leverage the CADE 2 database as the authoritative source for Financial Statement Audit and Reporting, and begin the migration of core Individual Master File (IMF) functions from Assembly Language Code (ALC) to a modern computer language. Notably, an update in FY 2015 prevented issuance of erroneous notices for limited Failure to Pay Penalties and another enabled capturing historic financial data expected to be useful in audit processes.

IRS implemented a multi-phased approach to meet the Executive Order to archive email electronically by January 2017 and, to the extent possible, all permanent records by January 2020. The "IRS Strategic Approach to Records and Information Management" documents a comprehensive plan for records management at the IRS and addresses challenges in managing all electronic records, including digital communications. In FY 2015, the IRS implemented Capstone, an electronic archiving software, for IRS Senior Leadership emails and an interim email retention policy. The IRS now ensures manager assurance that all records with ongoing retention needs are secured prior to computer hard drive disposal. To address future needs, the new Enterprise Electronic Records Management Team (EeRMT) developed preliminary requirements for long-term technical solutions for all electronic records.

Through FY 2015, the IRS completed Windows 7 upgrades to more than 105,000 workstations across approximately 550 locations. This upgrade was necessary because Microsoft discontinued Windows XP operating system support in April 2014. Without security patches and operating system updates, the enterprise would have been exposed to additional risks, malicious code vulnerability, unauthorized system access, data exposure/ destruction and/or system failure. The potential for substantial damage to business systems or exposure of taxpayer data could have resulted in loss of productivity due to system downtime, financial implications, and reputational damage.

To mitigate risks of a significant breach of IRS employee data, the IRS exercise-tested the Enhanced Breach Response Plan. Through this exercise, participants strengthened expertise in privacy, information technology, cyber and physical security, incident management, safeguards, communications, business continuity and disaster recovery.

- **Objective 6: Implement enterprise-wide analytics and research capabilities to make timely, informed decisions**

The IRS established the new Office of Planning, Programming and Audit Coordination (PPAC) to support a more formal and robust approach to strategic planning and enterprise-wide investment decisions. In addition, PPAC cultivates a collaborative partnership between the IRS and the Government Accountability Office (GAO) and the Treasury Inspector General for Tax Administration (TIGTA) officials engaged in audits of the agency. Key accomplishments of PPAC during FY 2015 include:

- Implemented a consistent process for the interaction between IRS and GAO/TIGTA officials to ensure an efficient and repeatable audit process.
- Designed and deployed an electronic enterprise audit inventory tracking and reporting system to better manage GAO and TIGTA audit activity.
- Facilitated senior executive team meetings to develop strategic "themes" that advance IRS's Strategic Plan in a more focused fashion.
- Engaged the senior executive team in prioritizing major investment initiatives for the FY 2017 budget submission to reflect strategic priorities within those themes.

Some examples of improved analytics to drive strategic planning and program analysis include the Payment Card Initiative, the work of the eAuthentication Fraud Detection team, new risk-based prioritization of Safeguards reviews, and development of a new database of non-resident returns.

The IRS Payment Card Initiative addresses small business income underreporting, the largest portion of the Tax Gap estimated at $140 billion annually. The Payment Card team achieved three key milestones in this multi-year program: 1) Reduced taxpayer burden by implementing the "Card Not Present" flag on Form 1099-K to account for those businesses that operate solely online, by phone, or via catalogue sales; 2) Expanded the Pilot of the web-based Payment Mix Comparison Tool to five major preparer associations, representing 75,000 preparers, allowing them to compare their clients' cash vs card mix to similar businesses to reduce possible reporting errors and increase voluntary compliance; and 3) Developed an enhanced case selection algorithm to move the program toward production-ready case selection to improve the impact of the audits performed, while reducing burden on compliant taxpayers.

Electronic Authentication (eAuth) is the IRS web-based gateway in which taxpayers must authenticate their identities to gain access to personal tax information and services online. In FY 2015, the IRS experienced over 330,000 unauthorized accesses to the Get Transcript application by sophisticated criminals who had enough information about American taxpayers to successfully answer the authentication questions. The IRS is strengthening the eAuthentication application and plans to bring it back online as soon as possible.

In 2015, the electronic Fraud Detection (eFD) Team established the capability to quantify high risk behaviors in eAuth and identified and quantified the prevalence of identity theft for over 50 attributes believed to be indicative of fraudulent eAuth online account creation. This analysis will inform future analytic methodologies used in near-real time analytics and monitoring.

The team also focused its efforts on conducting analyses to understand the scope, scale, and underlying patterns associated with the unauthorized eAuth access event. The analyses included supporting the identification of primary and secondary taxpayer IDs impacted by the event and analyzing attributes linked to the impacted population. These analyses helped the Service understand additional risk in the system, assess current vulnerabilities and inform the solutions proposed to re-launch Get Transcript. Lastly, the team implemented a phased test-and-learn approach to help mitigate risks associated with the process of re-launching the application.

In 2015, the IRS extended its compliance burden modeling capability to include the post-filing burdens associated with the notice, exam, collection, penalty, and appeals processes. Taken together with the existing compliance burden modeling capability for pre-filing, filing, and amended return activity, this provides the IRS with an end-to-end view of the taxpayer experience. The model was used in 2015 to inform the campus exam plan as well as the design and analysis of nonfiler treatments.

The IRS developed a model to address risks and prioritize Safeguard reviews of Federal, State, and local agencies receiving federal tax information. The historical schedule of Safeguard reviews could not be sustained under limited resource and expanding workload conditions. The risk-based model considers results of prior reviews of operational controls, computer security, and physical security issues in combination with risk factors such as the turnover of agency employees and agency type to support data-driven decisions related to tailored reviews and risk mitigation strategies. The IRS generated agency risk scores in FY 2015 and plans to adjust future reviews. The model is expected to improve both security and efficiency and focus more attention on high-risk exchange partners.

More than 105,000 1040NR *Non-Resident* 2013 tax returns (over 20 percent of all tax year 2013 1040NR returns) were scanned and the content captured in a database. This database allowed the international individual compliance team to begin developing filters to more quickly and efficiently identify high-risk Form 1040NR returns for examination. More than 600,000 tax year 2014 Forms 1040 NR were added for analysis in FY 2016. This database will also eliminate costs and risk of data loss from shipping paper returns and will reduce delays for taxpayers.

Strategic Foundation Missed Opportunities

While the IRS was able to make significant progress in achieving Strategic Foundation objectives, results were affected by continued budgetary restrictions. Additional investment could improve information technology, human capital, and rent reduction.

Information Technology

IRS had planned significant investment in people, hardware, and software to improve information technology at all levels of the organization. Budgetary limitations have diluted the IRS's ability to accomplish those plans. Some of the impacts (and the investment needed) include:

- The IRS had to limit investment in the people, processes, and technology needed to deliver and test software products more quickly and accurately at less cost. A $6 million investment would help meet this goal.
- The IRS is facing a loss of financial and operational efficiencies by not moving its IT services to a shared cloud infrastructure. Lack of funding prevents the IRS from finalizing all the architecture and engineering designs to address security and privacy controls needed for shared services. A $13.3 million investment would assist the IRS to meet GSA's "Cloud First" mandate.
- The IRS faces serious risks to system reliability and uptime due to insufficient labor resources to manage and run day-to-day IT operations. Since 2012, staffing for daily operations has been reduced by more than 600 people as highly skilled and experienced employees were redirected to work on legislative mandates in programs like ACA and FATCA. Additionally, IRS has not been able to fill behind the critical operations personnel that were redirected to these programs or who have left the IRS. An investment of $75 million would allow the IRS to augment this critical staffing.
- The IRS has not been able to refresh important networking and telecommunications equipment. The budget cuts limit IT effectiveness by deferring the consolidation of voice and video services that would reduce costs by replacing aged equipment. A $7.8 million investment in this consolidation would add productivity features that increase employee efficiency.
- Important space reduction efforts in IRS Data Centers that would create cost savings exceeding the one-time investment of $9.2 million have been delayed. Deferral of space reductions will result in the IRS not meeting OMB's 2015 mandate for data center space decreases.
- Full resumption of improvements in identity card implementation was prevented. Slowing the effort affects building security, as Federal legacy building access control systems cannot be replaced.

Cybersecurity

Delayed cybersecurity initiatives included:

- Implementation of network segmentation to proactively control access to computer systems.
- Enhancement of network access controls ensuring only authorized PC and mobile devices are allowed to connect to the network.
- Implementation of simulated attack/response testing for all Enterprise Life Cycle projects.
- Implementation of Windows Infrastructure and additional application audit trails.

Additional releases for the Safeguarding PII Data Extracts (SPIIDE) project were also not funded. SPIIDE is an automated process to assess vulnerabilities for the three states of data – data in motion (data transmitted outside the IRS firewall), data at rest (data stored in persistent storage like disk or tape), and data in use (data being processed or accessed). Currently, SPIIDE focuses on data in motion. Deferred SPIIDE releases would have expanded data safeguards to reduce the risk of insider threats and other losses of PII.

IT Upgrades for other business needs

The IRS was unable to implement the OPM mandate to convert from paper to electronic official personnel folders (eOPF). Converting OPFs for approximately 84,000 employees from paper files to an electronic, on-line version would cost $12 million.

There is a lost opportunity to strengthen records and information management through an Enterprise Content Management process enabling IRS to comply with electronic records management and retention requirements. IRS records are currently stored in manual and electronic decentralized systems. As a result, the IRS frequently converts electronic files to paper for records management purposes. This makes locating the right information in a timely manner costly and more challenging, which directly affects both Freedom of Information Act requests and discovery procedures.

The IRS works on cases involving complex issues while still being tasked to resolve cases in a prompt and accurate manner. Many of these case issues require the issuance of specialized letters. Optimally, these letters would be generated by the case management system, with pre-populated language and taxpayer data. However, many letters are not yet programmed in the case management system, and thus compliance officers must manually prepare them. Preparing letters manually risks accuracy and timeliness. In addition, employee surveys have shown that this is a major source of employee dissatisfaction.

A number of hardware infrastructure and software upgrades have also been delayed due to lack of funding. Consequently, the stability and reliability of IRS information systems are in jeopardy, resulting in increased system downtime, possible system failures, and lost employee productivity. At the end of FY 2015, approximately 67 percent of the IRS's IT equipment was outdated (up from approximately 43 percent at the end of FY 2014). With system software behind current versions, operating a number of unsupported software platforms makes it difficult to correct hardware or software issues when they occur. Delays in upgrading outdated software also make implementing future upgrades more complex and expensive. An estimated $93 million would have helped to stabilize IRS systems and deter future system failures.

Delaying upgrades for Contact Center systems resulted in lower levels of service for taxpayers calling the IRS. An additional $7.9 million would allow upgrades to the aged, inefficient Contact Center systems and addition of new services like online chat.

Human Capital

In FY 2015, the IRS's exception-only hiring policy reduced staffing levels and adversely affected enforcement, service, and internal administrative functions. The cumulative effect of reductions since FY 2010 is significant. Since FY 2010, overall IRS staff is down 20 percent. Staffing levels in key occupations are also down (29 percent for revenue agents, 38 percent for revenue officers, 18 percent for Tax Examiners, and less than one percent for customer service representatives).

IRS-wide training was also delayed or modified due to budgetary constraints:

- Senior manager training was delayed and only four classes could be held in FY 2015 leaving 148 managers untrained.

- Labor relations staff was unable to attend special workforce relations training, which included live negotiation skills training, leaving a shortage of 25 Area Leadership Specialists that affected internal IRS communications in 14 geographic areas.

- Leadership coaching services could not be purchased from an external vendor to provide highly qualified and experienced in-person coaching services to employees and managers in critical positions. Instead, the IRS developed virtual coaching which had limited capacity while coaches were being trained.

- Discontinuation of the IT platform WebEx technology eliminated the IRS's ability to allow external stakeholders to conduct CPE training in FY 2015. This indirectly affects taxpayer service; for example, because 256 employees could not receive Life and Property and Casualty insurance training, their taxpayer cases requiring this specialized expertise were returned to a queue to await expert resolution.

Other Missed Opportunities

Government-wide implementation of Federal Investigative Standards (FIS) requires the IRS to provide records to federal agencies to ensure individuals meet suitability and security criteria when seeking federal employment, a federal contract, or a national security clearance with periodic reinvestigations. Budgetary constraints have delayed work on a fully automated standardized "FIS Tax Check" request form and data exchange process that complies with disclosure rules. This process could lead to reimbursable agreements with 22 federal investigative agencies and should provide the capability to fulfill one million tax checks annually by January 2017.

Apart from employees' salaries, the IRS's largest operating expense is rent. Budget constraints have impeded progress on the rent reduction initiative. The IRS was unable to take action to reduce 287,497 rentable square feet. This reduction would have saved the IRS and taxpayers $5.7 million annually in rent and the $15.7 million investment would have been paid for in less than three years through rent savings.

Strategic Foundation Performance Measures

In FY 2015, the IRS did not meet either of its Major IT Investments targets.

Strategic Foundation: Invest in our workforce and the foundational capabilities necessary to achieve our mission and deliver high performance for taxpayers and stakeholders

Performance Measure	FY 2015 Target	FY 2015 Actual
Percent of Major IT Investments within +/- 10% Cost	90.0%	73.7%
Percent of Major IT Investments within +/- 10% Schedule Variance	90.0%	89.5%

Note: Beginning in FY 2015, this measure includes all major investments (BSM and non-BSM).

Shortfall Explanations (Based on 4th Quarter Results)

Percent of Major IT Investments within +/- 10% Cost Variance: Not Met: 14 of 19 major investments (73.68 percent) were within the cost variance at the close of the fourth quarter.

Reductions in the budget have generated an inability to hire, changes in scope, and a realignment, rescheduling, and consolidation of activities that have resulted in less spending than planned. Baseline Change Requests (BCRs) are in process to address these updated plans. In FY 2016, IRS IT will continue to rigorously monitor program activities and address any issues associated with cost on a timely basis.

Four of the five investments that did not meet the cost variance threshold were due to under spending; e-Services (e-SVS), Account Management Services (AMS), Foreign Account Tax Compliance Act (FATCA), and IRS End User Systems and Services (EUSS). The Electronic Fraud Detection System (EFDS) investment was slightly over budget due to the delay of planned FY 2014 work until FY 2015 and expiration of a work contract that had to be renewed.

Percent of Major Investments within +/- 10% Schedule Variance: Not Met: 17 of 19 major investments (89.47 percent) were within the schedule variance at the close of the fourth quarter. With funding at less than planned, budget conditions continue to inhibit IRS's ability to operate according to plan. In FY 2016, IRS IT will continue to rigorously monitor program activities and address any issues associated with schedule on a timely basis. The two investments that did not meet the schedule variance are discussed below:

- **IRS End User Systems and Services (EUSS) –** the ahead of schedule variance results from the reduction and refocus of FY 2015 activities as funding and resources have been realigned to reflect the current budget. As Copier Multifunctional Device project activities are being completed, rescheduled and/or consolidated, the investment will align with the current budget and the remaining FY 2015 activities are being completed slightly ahead of the original plan.

- **IRS Main Frames and Servers Services and Support (MSSS) –** the ahead of schedule variance is due to the Kansas City Service Center consolidation activity that completed movement of all remaining hardware/equipment ahead of schedule.

GOAL 1: Deliver high quality and timely service to reduce taxpayer burden and encourage voluntary compliance

Providing taxpayers top-quality service and helping them understand and meet their tax obligations remain top priorities for the IRS. The IRS focused on tailored assistance, education, and services to taxpayers, and efficient processing of information and returns. The IRS provided innovative digital interactions and supported victims of identity theft, and also enhanced support and communication with the tax community and government partners.

Highlights of the 2015 Filing Season

The IRS delivered another successful filing season in 2015, opening the season on schedule despite challenges. In preparing for filing season, the IRS prepared for new provisions of the Foreign Account Tax Compliance Act (FATCA) and the Premium Tax Credit (PTC) and Individual Shared Responsibility Payment (ISRP) provisions of the Affordable Care Act (ACA). Additionally, the IRS updated its systems, tax forms, and instructions in response to tax extender legislation passed in December 2014. The IRS processed tax returns and refunds smoothly as evidenced by the fact that the IRS issued nine out of 10 refunds in less than 21 days.

Some results of the 2015 filing season include[2]:

- Published more than 90 percent of the 700 revised or newly created individual and business tax products prior to the start of filing season.
- Received more than 139 million individual returns, of which 87 percent were filed electronically.
- Answered more than 9.7 million assistor calls and 29.2 million automated calls.
- Processed more than 3.6 million returns from Volunteer Income Tax Assistance (VITA) sites.

Taxpayer Service Facts

In FY 2015, the IRS provided valuable services to millions of taxpayers while making it easier for them to participate in the tax system. The IRS:

- Assisted over 217,000 customers with return preparation at VITA sites through Facilitated Self-Assistance (FSA) and 30,000 using Virtual VITA.
- Launched the Free File campaign at the beginning of the 2015 filing season and received more than 650,000 visits in the first week.
- Completed evaluations and onsite visits for 61 countries with a signed or agreed-in-substance intergovernmental agreement (IGA) to determine a country's ability to safeguard taxpayer information, in accordance with FATCA guidelines.
- Produced 117 Tax Tips (110 with Spanish translations) reaching more than 632,000 e-mail subscribers.
- Issued 102.6 million refunds to individuals totaling $276.9 billion.

Assisting taxpayers with their tax questions before they file their returns prevents inadvertent noncompliance and reduces burdensome post-filing notices and other correspondence from the IRS. Accordingly, the IRS provided year-round assistance to millions of taxpayers through many sources, including outreach and education programs, issuance of tax forms and publications, rulings and regulations, toll-free call centers, IRS.gov, Taxpayer Assistance Centers (TACs), VITA sites, and Tax Counseling for the Elderly (TCE) sites.

- **(Priority) Objective 1: Design tailored service approaches with a focus on digital customer service to meet taxpayer needs, preferences and compliance behaviors in order to facilitate voluntary compliance**

  Taxpayer expectations and behaviors indicate a growing preference for online self-service. As taxpayers' desire for improved self-service tools has increased, the IRS has enhanced

[2] 2015 filing season denotes January - April

online self-service offerings. By making greater use of new technologies, the IRS has become more agile and service-friendly to the taxpayer.

The IRS has continued to invest in and prioritize online services to meet taxpayer demand for anytime, anywhere, any device access to their personal tax information. These improvements to online content, products, and performance help taxpayers navigate a complex tax system and understand and meet their tax obligations in an efficient and effective manner for both the taxpayer and for the IRS. As part of this move to digital access, the IRS created the Service On-Demand digital service strategy. A cross-functional team conceptualized, developed, and socialized this multi-channel customer service strategy to help IRS leaders reimagine the future of taxpayer service. Guided by the IRS's strategic goal of delivering high quality and timely service to reduce taxpayer burden and encouraging voluntary compliance, the Service On-Demand team synthesized data across platforms, products, and channels to establish a Digital First Vision.

The Service On-Demand team identified transformative improvements that could take place over the next five years to provide better service to taxpayers and deliver taxpayer service more efficiently, which have been identified in four phases:

- **Phase 1** - Aggregate data and research to evaluate current state and define future state channel mixes, as well as identifying 16 clusters of taxpayer service needs.

- **Phase 2** - Develop blueprints for the future-state taxpayer experience, supporting business capabilities and processes, and rough IT costs for over 160 recommendations aimed at improving customer satisfaction and overall efficiency.

- **Phase 3** - Aggregate, prioritize, and sequence project groupings of recommended projects based on expected benefits and cost to implement, as well as develop conceptual solution architecture and assess impacts to people, processes, technology, and policies to create a detailed roadmap for FY 2016 delivery and FY 2017 investment.

- **Phase 4** – Begin implementing new service capabilities aligned to six Service On-Demand programs: Online Account, Taxpayer Digital Communications, 3rd Party Services, Taxpayer Analytics, Payments, and Forms and Publication.

Work has begun on projects within each program. Successful execution of the Service On-Demand pillar projects is expected to transform the IRS's ability to design tailored service approaches with a focus on digital customer service to meet taxpayer needs and preferences.

In FY 2015, the IRS launched several new products and enhanced existing products to better meet taxpayers' needs, including:

- **IRS2Go Mobile, Version 5** updates enable taxpayers to make electronic payments as well as select a map view for the VITA Site Locator. The app also now adapts to the different screen sizes of various mobile devices, and comes with an improved look and feel for Android and iOS platforms. Version 5.0 launched on January 31, 2015. In FY 2015 (including all versions), IRS2Go was downloaded more than 2.3 million times and had over 3.8 million active users.

- **Third Party Data Services Pilot** enabled IRS to share refund status data with third parties (tax preparation firms, tax preparation software, and state and federal agencies) that require individual taxpayer information. All information sharing requires prior taxpayer consent and is conducted via Application Programming Interface, or API.

- **Online Payment Agreement (OPA)** Release 2 launched on March 2, 2015. Updates improved the user experience for a number of functions including login and authentication, setting up direct debit, and providing better access for business users. During FY 2015, more than 360,000 OPA agreements have been completed representing over $1.4 billion in revenue from web transactions.

- **IRS Direct Pay, Release 3** added responsive design and enhancements for guest users (i.e., those taxpayers who do not create a username and password); email confirmations of payments, cancellations, or reversals; and a Spanish version. Since the November 2013 launch, the IRS has collected $21.6 billion through this application and $18.9 billion in FY 2015.

- **Directory of Federal Preparers with Credentials and Select Qualifications** provided a lookup tool to find return preparers by location. Attorneys, CPAs, enrolled agents, enrolled retirement plan agents, enrolled actuaries, and Annual Filing Season Program (AFSP) participants with valid preparer tax identification numbers (PTINs) for 2015 are included. Since launch in January 2015, more than 280,000 searches were performed.

In addition, several web and mobile tools launched in FY 2014 have continued to grow in popularity. Examples include:

- **Payment Mix Comparison Tool Pilot** enables preparers, on behalf of the business taxpayer community, to compare the portion of gross receipts from card receipts the business plans to report to results of similar businesses from prior years. This tool is intended to encourage accurate reporting by payment recipients according to Forms 1099-K, *Payment Card and Third Party Network Transactions*, and help close the tax gap.

  Get Transcript provided a current digital display and print of an individual's tax record across five transcript types using enterprise-wide authentication. During the 2015 filing season, an incident occurred involving the IRS "Get Transcript" web application where criminals used taxpayer-specific personal information obtained from non-IRS sources to gain unauthorized access to information in approximately 100,000 tax accounts. These criminals gained sufficient taxpayer information which allowed them to clear the application's multi-step authentication process, including several personal verification questions that typically are only known by the taxpayer. In the immediate aftermath of this incident, the "Get Transcript" application was suspended and the IRS provided free credit monitoring services for approximately 100,000 taxpayers whose accounts were accessed. Following this incident, the IRS conducted an extensive review to assess whether other suspicious activity occurred and identified over 200,000 total attempts to access data and notified all of these taxpayers about the incident. The IRS mailed letters to about 220,000 taxpayers where there were instances of possible or potential access to "Get Transcript" taxpayer account information. As an additional protective step, the IRS also mailed letters to approximately 170,000 other households alerting them that their personal information could be at risk even though identity thieves failed in efforts to access the IRS system.

A wide variety of actions to protect taxpayers are being taken beyond the mailings, including offering taxpayers free credit protection, as well as Identity Protection PINs. The IRS takes the security of taxpayer data extremely seriously, and is working to continue to strengthen security for "Get Transcript," including enhancing taxpayer-identity authentication protocols.

The IRS completed 17 cross-organizational projects to upgrade and improve existing website content to better meet the needs of online audiences, continually improving the online experience provided to taxpayers on many key IRS.gov website pages. The IRS developed a multi-year strategy to convert many tax publications and instructions into the user-friendly e-Pub electronic format. This digital publishing standard adapts traditional paper formats into a format readable by mobile devices such as tablets, e-readers, and smartphones and meets accessibility requirements. Currently there are 29 tax publications available as eBooks on IRS.gov, including Publication 17, *Your Federal Income Tax (For Individuals)*, which averages 166 downloads per day.

Expanded use of Quick Response (QR) code technology directs taxpayers to products and services available on IRS.gov. The QR codes allow users to access IRS web sites for information quickly and to view and download a published item with content to their mobile device (Smartphone or tablet). In the Taxpayer Assistance Centers, placards with QR Codes were inserted in the slot for Form 1040EZ or out-of-stock forms, directing taxpayers to IRS.gov for the form and to IRS Free File. The QR code directs the taxpayer to the IRS.gov location of the electronic product.

The IRS has also improved the IRS.gov experience for international taxpayers. For most taxpayers living abroad, the IRS website is their preferred, and sometimes only, channel for tax information. Enhancements include:

- A redesigned international taxpayer landing webpage organized roughly 260 pages for international individuals into one of six categories (Taxpayers Living Abroad, Resident Aliens, Nonresident Aliens, Foreign Students and Scholars, Territory Residents, and Other). Each category links to a separate landing page with additional links in relevant categories (such as Filing Requirements, Income, Deductions, Credits, Withholding, Nonresident Aliens with a U.S. Trade or Business, Forms, or Resources).
- The Help and Resources section on the international taxpayer landing webpage provides easy access to other relevant pages such as FBAR (Report of Foreign Bank and Financial Accounts), FATCA (Foreign Account Tax Compliance Act), and Streamlined Procedures. Links were added to the *Directory of Federal Tax Return Preparers with Credentials and Select Qualifications* and *Streamlined Filing Compliance Procedures* to address concerns raised by U.S. Embassies and taxpayers around the world.
- Created a new webpage, Affordable Care Act (ACA) and the International Taxpayer, to provide information on Individual Shared Responsibility, Additional Medicare Tax, Net Investment Income Tax, and links to topics on the ACA page that are relevant to international individual taxpayers.

- Created a new webpage, Helpful Tips for Effectively Receiving a Tax Refund for Taxpayers Living Abroad, to help overseas taxpayer receive their tax refunds in a timely manner.

- Implemented six YouTube videos to demonstrate navigating international webpages on www.IRS.gov, providing guidance to international individual taxpayers to determine their filing requirements and filing status, their need for an ITIN, and their qualifications for foreign tax credits and foreign earned income exclusion.

The IRS also streamlined processes to better serve taxpayers. One example is the streamlined Voluntary Closing Agreement Program (VCAP). Announcement 2015-02 *Tax-exempt Bonds (TEB) Voluntary Closing Agreement Program: Relief from violation of qualified ownership and use requirements for qualified 501(c)(3) bonds* describes a streamlined process for bond issuers to resolve violations and allows organizations to participate whose exempt status was revoked then reinstated. The IRS plans to expand this service approach to other challenges facing tax-exempt bond issuers.

♦ **Objective 2: Deliver clear and focused outreach, communications and education programs to assist taxpayer understanding of tax responsibilities and emerging tax laws**

The IRS continued to communicate with taxpayers to reduce their compliance burden and increase understanding of their tax responsibilities through outreach and education campaigns, including social media efforts, to reach key taxpayer segments, which include the underserved, multilingual, international, and tax-exempt communities.

For the 2015 filing season, the IRS launched a major consumer education campaign, in partnership with tax professional organizations, to help taxpayers choose tax return preparers wisely and understand the different categories of tax return preparers. The IRS released multiple communications including a Fact Sheet titled "Understanding Who You Pay to Prepare Your Tax Return" and a video titled "Choose a Tax Preparer Wisely." The IRS also unveiled IRS.gov/chooseataxpro, a page that explains the different categories of professionals, and a new partner page on IRS.gov that provides links to the web sites of national non-profit tax professional groups, which can help provide additional information for taxpayers seeking the right type of qualified help.

The IRS used social media tools to share the latest information on tax changes, initiatives, products and services to help taxpayers better understand their tax responsibilities. FY 2015 highlights include:

- Issued 67 tax tips and three "Special Edition" tax tips for the 2015 filing season, with all translated to Spanish. Subscriptions to Tax Tips have grown to more than 632,000 subscribers, a seven percent increase compared to last fiscal year.

- Displayed more than 100 filing season Tax Tips videos on the IRS YouTube channels. Podcasts for each of these videos were also available in English and Spanish as MP3 file downloads on IRS.gov.

- Issued more than 4,900 tweets to the Corporate Twitter accounts and more than 325 Tumblr posts.

Additional outreach efforts included the following:

- Conducted monthly meetings with the national tax professional organizations where IRS leaders briefed stakeholders on current issues and delivered messages that the organizations' representatives communicated to their members.
- Maintained an active email listserv that provided current information on policies and procedures to tax professional organizations and the IRS advisory group.
- Published *e-News for Tax Professionals* weekly with a current subscriber base of more than 300,000 tax professionals and organizations.
- Announced the opening of Free File and conducted interviews with 23 radio networks (resulting in a total reach of 658 stations nationwide) and TV interviews with 29 network affiliates including four in the Top 10 English media markets and eight in the Top 10 Spanish media markets.
- Continued IRS efforts to educate taxpayers through EITC Awareness Day events. This credit was promoted nationally through a national media release in English and Spanish, YouTube videos, social media, newsletter articles, and radio and television public service announcements. Over 500 IRS partner outreach activities and events were held and over 30 internal news stories were published.
- Provided free tax preparation to approximately 3.8 million taxpayers at more than 12,000 Volunteer Income Tax Assistance/Tax Counseling for the Elderly (VITA/TCE) sites. To support VITA/TCE partners and volunteers, the IRS conducted and leveraged over 1,100 Affordable Care Act (ACA) outreach events and activities nationwide, which included weekly partner calls, webinars, and ACA facilitator sessions to answer partner-related questions. In addition, the IRS recorded an ACA webinar covering the ACA impacts to Form 1040, including new Form 8965, *Health Coverage Exemptions*, and Form 8962, *Premium Tax Credit*.
- Developed Publication 5157, *VITA/TCE Affordable Care Act*, as a training resource for partners and volunteers. The IRS posted a modified version, Publication 5187, *The Health Care Law: What's New for Individuals and Families*, on IRS.gov. This publication was used as a tool for IRS outreach staff and Relationship Managers and was shared with the general tax professional community and Congressional staff members.

During FY 2015, the IRS implemented the Real Time Early Intervention Concept of Operations (CONOPS) Initiative, which is intended to determine the most appropriate treatment stream for taxpayers using deposit information. The goal is to proactively contact taxpayers before delinquencies are assigned to the field for contact. Contacting more taxpayers earlier in the process is expected to lower taxpayer burden by reducing future non-compliance issues and Federal Tax Deposit (FTD) penalties.

The IRS is committed to increasing productivity through the Alternative Dispute Resolution (ADR) processes and has taken several steps to ensure taxpayers are more aware of alternative dispute resolution opportunities available to help them resolve tax controversies. The Appeals ADR web page on IRS.gov was redesigned to be less technical, more visual, and user-friendly to help taxpayers better understand the ADR program options. The Post-

Appeals Mediation (PAM) program for Offer in Compromise (OIC) and Trust Fund Recovery Penalty (TFRP) cases has also been implemented nationwide. Post Appeals Mediation is required and takes place after unsuccessful settlement discussions with Appeals. This is generally applicable to large dollar Examination cases in the Exam/TEGE, Industry Case (IC) and Coordinated Industry Case (CIC) work streams. Additionally, certain provisions for Fast Track Mediation (FTM) and PAM are now available for Collection Cases in the OIC and TFRP work streams.

The IRS conducted an extensive public campaign to raise awareness about the Taxpayer Bill of Rights. As part of this campaign, the IRS issued a tax tip and 10 fact sheets weekly during filing season, in English and Spanish, to highlight individual taxpayer rights. IRS also used Twitter to increase interest in the fact sheets, tweeting weekly and linking to the fact sheets posted to IRS.gov. The IRS also continued to provide information to taxpayers via a dedicated Taxpayer Bill of Rights page on IRS.gov. The Taxpayer Bill of Rights takes the existing rights embedded in the tax code and groups them into 10 broad categories, making them more visible and easier for taxpayers to find online. Publication 1, *Your Rights as a Taxpayer,* includes the Taxpayer Bill of Rights and is sent to millions of taxpayers when they receive IRS notices. The 10 provisions of the Taxpayer Bill of Rights are:

- The Right to Be Informed
- The Right to Quality Service
- The Right to Pay No More than the Correct Amount of Tax
- The Right to Challenge the IRS's Position and Be Heard
- The Right to Appeal an IRS Decision in an Independent Forum
- The Right to Finality
- The Right to Privacy
- The Right to Confidentiality
- The Right to Retain Representation
- The Right to a Fair and Just Tax System

♦ **Objective 3: Provide timely assistance through a seamless, multichannel service environment to encourage taxpayers to meet their tax obligations and accurately resolve their issues**

The IRS has expanded its suite of online services to quickly and reliably address frequent taxpayer requests in a secure manner. To become more accessible to today's taxpayers, the IRS provides a consistent multichannel experience that includes significantly expanded digital service delivery. Specific focuses include Affordable Care Act (ACA), international taxpayer assistance, social media monitoring, and virtual service delivery.

During 2015, ACA implemented a "web first strategy" via IRS.gov/aca. New content was published and distributed online first, then in hard copy (paper) form, to communicate impacts of the Marketplace Provisions for individuals, employers, and insurers, in an effort to ensure compliance when filing their 2014 tax returns.

Some FY 2015 ACA Highlights include:

- Received almost 3.9 million visitors requesting information from IRS.gov/aca.
- Developed 151 Marketplace external communication products.
- Created Q&As for Form 1095-A, *Health Insurance Marketplace Statement*, and announcements regarding emerging issues - including 1095-A penalty relief, amended returns, consumer alerts, and proof of coverage on the newly created *What's Trending* page.
- Updated eight sets of Q&As for individuals and families, employers, and insurers and updated major web pages as new areas of emphasis were identified - such as the requirement for Applicable Large Employers and providers with more than 250 information returns to file electronically.
- Collaborated with other government agencies (e.g. Health and Human Services/Centers for Medicare and Medicaid Services (HHS/CMS), Small Business Administration (SBA)) to develop and deliver shared messages.
- Conducted more than 1,100 Outreach events, reaching more than one million participants from more than 500 organizations.
- Issued 10 ACA Special Edition Congressional Updates to ensure Congressional staffs were aware of topics on irs.gov/aca such as Healthcare Tax Tips.
- Issued 13 items of published guidance on ACA provisions, including final regulations on information reporting of Minimum Essential Coverage, Information Reporting by Applicable Large Employers, Shared Responsibility for Employers regarding health care coverage, and final rules establishing the Basic Health Program.

International and offshore compliance is another area of strategic importance to IRS. An initiative to streamline filing compliance procedures and the Offshore Voluntary Disclosure Program (OVDP) initiative is an integral component of the overall offshore strategy. The program provides new options to help individual taxpayers, both those residing overseas and those residing in the United States with compliance failures resulting from non-willful acts. Since the announcement in June 2014, more than 20,000 taxpayers either filed delinquent returns or corrected returns to reflect unreported income from foreign sources.

The IRS has also continued to engage in process improvement efforts to identify further efficiencies for the processing of applications for tax-exempt status. Previously, if an applicant failed to respond to requests during the course of processing a Form 1023 application, *Application for Recognition of Exemption*, the IRS placed the application in suspense for 90 days. As a result of process improvement efforts, the IRS eliminated the suspense process so as to align with the current process for handling Form 1023-EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*. The IRS also modified case assignment processes and improved determination timeliness by 208 days.

Cases will be closed when an applicant fails to respond within a 35-day period from receipt of the initial information request. Ending the suspense process will further achieve the goals of treating all taxpayers consistently due to standard response timeframes. This process change will eliminate excessive handling of thousands of suspense cases per year within the Exempt Organization Determinations Processing Unit.

In addition, ending the suspense process will address on-going risks identified by the IRS. Some of the risk mitigations include ending the on-going paper file retention standard that is deemed unmanageable, establishing an electronic historical repository that would allow for records destruction, and avoiding paper file transport to the Cincinnati Federal Building to minimize potential release of personally identifiable information.

In addition, the IRS instituted a process to reject incomplete applications for tax-exempt status and return them to the applicant, per criteria from Revenue Procedure 2013-9, *Procedures for exemption determination letters and rulings*. Organizations with incomplete applications are sent a rejection notice outlining the missing items. It is estimated that 25 percent of received applications were rejected as incomplete. This new process eliminates the need for agents to perfect incomplete submissions, maintains consistency with the rejection criteria for Form 1023-EZ applications, further educates taxpayers about criteria for complete applications, and frees staff to work complete applications.

The IRS monitored Twitter and Facebook daily as part of the Customer Early Warning System initiative, an effort to quickly identify emerging systemic issues affecting taxpayers. Identified issues included:

- *"Where's My Refund?"* and reporting of the Shared Responsibility Payment as an offset. Within 48 hours, the issue was reported to the IRS, real-world examples were pulled from social media, the problem was identified, and a solution was found.
- Tweets from a major payroll services provider that were directing taxpayers to call the IRS for missing W2s during the peak President's Day weekend. The issue was elevated and the IRS worked with the payroll provider to adjust the tweet language to direct taxpayers to call the IRS after the peak call period.

The IRS 2015 Service Approach focused on a web-first strategy and promoted alternative service channels. This year's approach supported the IRS's effort to "Go Green" by reducing the number and quantity of paper products stocked in TACs and promoted no-cost options for making payments. Taxpayers were encouraged to view and download forms from IRS.gov or to file their tax returns electronically instead of picking up paper copies at TACs or outlet partners. Taxpayers making payments (cash and non-cash) in TACs were educated and encouraged to use online and other payments options rather than coming into a TAC.

Employees in TACs with FSA kiosks helped taxpayers understand the use of online services. For the calendar year, kiosk use to obtain forms increased 28 percent over last year and nearly 6,300 Direct Pay transactions were performed on FSA terminals/kiosks.

As taxpayers become more familiar with electronic filing and using IRS.gov to meet their needs, they will rely less on visits to TACs for these services. This will result in taxpayers spending less time traveling to a TAC or waiting for service. The IRS will also benefit by reducing costs for printing, shipping, and stocking paper tax products and increasing its capacity to handle more complex account issues.

In accordance with the Service Approach, the IRS conducted a test in February 2015 to provide taxpayers the option to make appointments for walk-in service. The test started at 10 large TAC locations with another 34 TACs added later. Appointment schedulers educated taxpayers on alternative ways to obtain service, which led to many taxpayers' issues being resolved without requiring an appointment. Approximately 216,000 appointments were made at the test locations, improving traffic flow and wait time.

Some taxpayers, including some small businesses, are unable to obtain a bank account and thus cannot transfer funds electronically. Interim guidance has been prepared to clarify when relief from failure to deposit penalties would be appropriate for those taxpayers. This provides a uniform and consistent guidance on this issue for taxpayers who made a reasonable attempt but were unable to obtain a bank account.

- **Objective 4: Strengthen refund fraud prevention and provide prompt assistance to support victims of identity theft**

Tax fraud has emerged as an increasingly prevalent threat. The IRS recognizes the importance of this issue and has dedicated significant resources to address it. The IRS provided specialized outreach and education campaigns to help taxpayers avoid fraud and augmented staffing to assist taxpayers who have become victims of identity (ID) theft. The IRS strengthened its ability to identify and respond to fraud by bolstering analytics capabilities, making full use of existing data sources and exploring potential new data sources and techniques that allow better identification of anomalies and flagging of suspect accounts.

Outreach and education through social media were key components of the IRS communications strategy on identity theft. FY 2015 highlights include:

- Continued efforts during filing season to educate taxpayers about a pervasive phone scam involving criminals impersonating IRS agents, including issuing numerous Tax Tips and news releases warning taxpayers about the phone scam and featuring it as one of this year's "Dirty Dozen" tax scams. The IRS also issued a national news release spotlighting a new YouTube video, featuring tips for how to avoid being victimized by the scam. IRS employees teamed with local law enforcement personnel to expand taxpayer awareness of the phone scam by holding press conferences.

- Hosted a security summit with members of the tax preparation, software, banking, and employment service community to foster collaboration to reduce Identity Theft and enhance Identity Protection. The group met several times to provide the Commissioners and CEOs of the tax administration eco-system with short-term recommendations for next filing season and longer-term recommendations for subsequent years.

- Updated five rotating spotlight sections on the home page of IRS.gov throughout the year with the latest information on scams and resources taxpayers can use if they become a victim of identity theft. There have been over 70 Tumblr posts, two different Facebook tabs, and more than 400 tweets from the corporate Twitter accounts directing viewers to content on IRS.gov.

The IRS centralized the Identify Theft Victim Assistance program to more efficiently serve victims of identity theft. A new headquarters policy group with blended expertise was created to provide identity theft policy oversight, while field operations and caseworkers were realigned to consolidate identity theft victim assistance skills within a single organization. Their core objectives are to gain end-to-end accountability and focused oversight of identity theft victim assistance activities. The IRS plans to leverage the diverse skills and knowledge of these employees for identity theft re-engineering efforts.

Despite the ongoing and diligent efforts of the IRS to combat identity theft, attempts to obtain taxpayer information through false IRS websites and other electronic methods continue. The IRS partnered with software developers, banks, and other industries to better address identity theft and to prevent federal monies from reaching the hands of identity thieves. This partnership recovered more than $813 million.

The Return Review Program Transition State-1 (RRP TS-1) successfully loaded and scored over 99 million electronic refund returns. Of those returns, 796,161 were identified as potential identity theft fraud, representing more than $4.7 billion in government revenues protected. In FY 2015 the overall false positive rate was 18.6 percent (28.3 percent for selections identified exclusively through RRP). By identifying suspicious cases up front, RRP has been able to reduce the amount of manual analysis work by 20 percent. In its inaugural filing season, RRP TS-1 did not miss a single day of processing returns, identifying potential identity theft, and protecting taxpayer revenues.

In addition to the identity theft prevention efforts, the IRS was also successful in stopping fraudulent refunds. The IRS stopped more than 1.7 million fraudulent returns with associated refunds of over $14 billion.

The IRS prisoner program continued to be successful in preventing fraudulent refunds. The prisoner file is a vital source of information, which continues to provide revenue protection results. The IRS stopped over 30,000 fraudulent prisoner returns with associated refunds of more than $1.2 billion.

The Electronic Fraud Detection System (EFDS) has successfully loaded and analyzed 125 million individual electronic tax returns and 12.8 million paper returns. Of that number, nearly 1.1 million returns were identified as fraudulent, representing $6.8 billion in revenue protected.

- **Objective 5: Reduce taxpayer burden and increase return accuracy at filing through timely and efficient tax administration processing**

The technology and procedures used to process returns have evolved over the course of many decades. The IRS has invested in the systems required to process electronically-filed returns, expanding the types of returns accepted through this more efficient digital channel. Further, the IRS increased the efficiency of the filing and payment processes. The ongoing strategy to assist more taxpayers by providing access to self-service tools continued to pay dividends, with taxpayers utilizing services across multiple channels.

Web service completions increased by 59.6 million more than the prior year. Use of the "*Where's My Refund?*" application represents 79 percent of all web self-service completions with the Transcript Delivery Service-Integrated Enterprise Portal application being the second most used application.

TAC employees continue to provide quality service by assisting over 5.6 million taxpayers. In addition, in TACs where FSA kiosks are available, employees offered taxpayers the option to obtain forms, prepare tax returns, request transcripts, and set up payment agreements.

More than 3.75 million tax returns were prepared at 12,057 Volunteer Income Tax Assistance/Tax Counseling for the Elderly (VITA/TCE) sites. More than 217,000 returns were prepared through Facilitated Self-Assistance, the leading alternative filing model, while more than 30,000 returns were prepared using Virtual VITA. The volunteer-prepared returns e-File rate held relatively steady at 96.1 percent. The accuracy rate was 94.1 percent, which exceeded last year's accuracy rate of 92.2 percent.

Level of service (LOS) was 37.4 percent for the filing season due to reduced telephone resources. With increased demand for telephone services and limited capacity to meet that demand, the IRS issued 11.2 million disconnects this filing season compared to 630,000 in the prior year. However, the average speed of answer was 25 minutes, well below the forecasted wait time of up to 56 minutes. The use of disconnects as a means of controlling demand positively affected wait times for callers. Disconnects also provide telephone scripts that alert taxpayers of alternative ways to obtain service.

The IRS successfully integrated the Affordable Care Act (ACA) within its work processes by addressing program oversight, training, quality, stakeholder engagement, coordination, and communications. IRS issued guidance and developed scripts to ensure employees provide consistent messaging, correct responses, and promote the use of alternative service options. A referral process was also developed to elevate questions or issues for expeditious handling. The IRS also created and launched an ACA webpage to serve as a centralized location to access all ACA references.

The IRS developed and delivered training in preparation for the first filing season requiring taxpayers to report health care coverage on tax forms. The IRS updated over 100 courses and developed seven new ACA courses to address key provisions. A total of 19,079 employees attended ACA training for a total of 46,601 course completions.

During normal processing of individual tax returns, any tax returns impacted by the ACA Premium Tax Credit (PTC) are run through validation checks that match third-party data provided by the Healthcare Insurance Marketplaces, or Exchange Periodic Data (EPD), to tax return data. These systems identify tax returns with questionable PTC claims, which are subsequently referred for examination.

Nearly 13,000 taxpayers used walk-in service this fiscal year for ACA-related topics. Issues regarding Shared Responsibility Payment and the Premium Tax Credit reflect 39 percent and 61 percent of this traffic, respectively. Although ACA is a new topic, quality has not been adversely affected. With 120 reviews identified with ACA as the primary topic, 90 percent were accurate.

Another program that has helped reduce taxpayer burden is the Compliance Assurance Process (CAP) Program, which allows large corporate taxpayers to resolve tax issues prior to filing a tax return. CAP consists of three distinct components:

- Pre-CAP – Provides interested taxpayers with clear direction on how to gain entry into CAP. In FY 2015, 21 taxpayers participated in Pre-CAP.
- CAP Maintenance – Allows taxpayers who have been in CAP, have few complex issues, and have established a track record of working cooperatively to receive a reduced level of IRS review. The program had 72 participants in 2015.
- CAP – A total of 193 taxpayers participated in CAP (including Pre-CAP and CAP Maintenance), with 181 of them returning from the previous year.

◆ **Objective 6: Improve service delivery and support effective tax administration by fostering strong relationships with our tax community and government partners**

The IRS works closely with the tax community to help meet the needs of taxpayers. In cooperation with other U.S. governmental entities and foreign nations, the IRS worked to ensure correct application of tax laws and to achieve the IRS mission. The growing frequency of cross-border business transactions required close collaboration with foreign governments to ensure fair tax administration, while legislative mandates required significant new interactions with foreign governments and financial institutions.

The U.S. collaborated with other governments to develop intergovernmental agreements (IGAs) to implement FATCA, to reduce burdens on Foreign Financial Institutions (FFI) located in partner jurisdictions, and safeguard mutual data exchanges. In 61 IGAs, partner jurisdictions agree to report to the IRS specified information about the U.S. accounts maintained by all FFIs with reporting requirements located in their respective jurisdiction. In return, these jurisdictions requested similar financial account information from the U.S., which the IRS provides only after ensuring that the partner countries have adequate safeguards in place to protect taxpayer confidentiality. In order to provide assurance of the adequacy of partner safeguards, the U.S. adopted and performed a plan to conduct safeguard evaluations that each jurisdiction has to pass before reciprocal data will be sent. The evaluation covers four strategic areas of concern for the U.S.: Legal Framework, Information Security Management, Monitoring and Enforcement, and Infrastructure. The IRS exchanged information on these safeguards practices with the 61 jurisdictions, and performed on-site visits to discuss the elements of confidentiality in more detail.

The IRS has also maintained strong relationships and increased dialogue with the tax professional community, including holding monthly meetings with two of the Commissioner advisory groups – the Internal Revenue Service Advisory Council and the Information Reporting Program Advisory Committee. This allowed the IRS to hear about newly identified systemic problems because the stakeholders were seeing outcomes first hand and reported potential problems. These close relationships also allowed the IRS to leverage the knowledge, talents, and skills of the tax professional community for feedback as it considered service or enforcement initiatives and built tools for the taxpayer or the tax professional.

In September 2014, the IRS's Office of Professional Responsibility (OPR) established a new process to ensure that tax return preparers who have demonstrated gross incompetence or committed misconduct do not represent taxpayers before the IRS. In general, the regulations, commonly known as Treasury Circular 230, prescribe the rules that apply to attorneys, CPAs, and enrolled agents in their representation of clients with tax matters before the IRS. There have also been a series of IRS revenue procedures that impose requirements and restrictions on preparer-representatives. Using newly delegated authority, the Commissioner authorized OPR to enforce revenue procedures which, for example, prohibit representation of taxpayers by preparers who use false or misleading advertising, misrepresent information to clients or the IRS, or have been convicted of a federal tax crime. Enforcement includes making determinations (after notice and an opportunity to respond) that a preparer is no longer eligible to represent any taxpayers. During FY 2015, OPR opened numerous cases. When OPR determines that a preparer is not eligible to represent or continue to represent taxpayers, the preparer's practice privileges will be terminated. Preventing return preparers who violate the law or standards of conduct from harming taxpayers and the audit process helps to protect the public's interest in effective federal tax administration.

The IRS continues outreach to foster and build stronger relations with Congress and engages with appropriate committee staff (including Appropriations, Ways and Means, Finance, and Joint Committee on Taxation) to communicate our position on many topics and issues of concern. During filing season, IRS legislative affairs experts operated a new ACA hotline for Members of Congress and their staff who had questions about the law. Together the hotline and normal operations handled more than 370 ACA-related congressional inquiries. In addition, IRS offered congressional staff five ACA webinars focused on the marketplace provisions affecting individuals and families and two on employer shared responsibility and information reporting.

- **Objective 7: Enhance the quality of tax services by strengthening the outreach, education and tools provided to the tax professional community**

In recent years, the IRS has significantly expanded outreach to the tax professional community, which includes enrolled agents, certified public accountants, attorneys and other tax return preparers. The IRS has registered hundreds of thousands of paid tax return preparers since 2010 and also conducted educational visits and sent educational letters aiming to improve the accuracy of tax returns and heighten awareness of preparer responsibilities.

During FY 2015, the IRS provided news and information to tax professionals through the following:

- A dedicated Twitter channel reaching more than 35,000 individuals. The content on Twitter directs tax professionals to more detailed information on IRS.gov.
- A weekly *e-News for Tax Professionals* email newsletter, which reached more than 300,000 tax professionals and organizations.
- Annual IRS Nationwide Tax Forums that reached nearly 11,000 tax professionals, providing updates on changes to tax laws and delivering certified continuing education credits for Enrolled Agents, Certified Public Accountants, and Certified Financial Planners. The IRS Nationwide Tax Forums Online (NTFO) uploaded 15 additional

seminars during the fiscal year. The number of NTFO registered users increased by 20 percent to more than 7,500 and the website issued approximately 300 certified continuing education credits.

- An expanded IRS.gov web page for tax professionals with information specifically on the Affordable Care Act.
- A Security Summit for representatives from the tax software industry, banks, and the states to develop recommendations for the Commissioner, state revenue officials, and the CEOs of tax software providers and banks who provide refund products to stem the tide of identity theft fraud.

The IRS remains strongly committed to educating the tax professional community about their duties and restrictions under Treasury Department Circular No. 230, *Regulations Governing Practice before the Internal Revenue Service*, and their ethical obligations to taxpayers and to tax administration. The IRS educated tax professionals (mainly tax return preparers) about relevant Circular 230 provisions during five IRS Nationwide Tax Forums and filmed a new webinar, *Practicing Before the IRS – Circular 230 A to Z*, to address key provisions of Circular 230 with emphasis on proposed amendments. In FY 2015, IRS reached more than 41,000 tax professionals and IRS employees during 90 events, including in-person, telephone, and electronic media.

The IRS introduced a new voluntary program for paid tax return preparers. The IRS issued an Annual Filing Season Program Record of Completion to return preparers who obtained a certain number of continuing education hours for a specific tax year. The return preparer was shown as having an AFSP Record of Completion in the Directory of Federal Tax Return Preparers with Credentials and Select Qualifications. For 2015, more than 44,000 preparers completed the requirements to receive a Record of Completion.

Lastly, the IRS system used for the registration and renewal of preparer tax identification numbers (PTINs) had its most successful season since the inception of the PTIN program. The IRS experienced a high volume of transactions with a record low call demand and system availability of 99.8 percent. More than 604,000 renewals and 80,000 new PTIN applications were processed.

Strategic Goal 1 Missed Opportunities

The IRS strives to deliver high quality and timely service to taxpayers and stakeholders. Although the IRS had significant accomplishments serving taxpayers in FY 2015, budget constraints limited the opportunity to make investments in any but the highest priority areas. The IRS would have liked to further improve communication, the online experience for taxpayers and stakeholders, and IRS information processing.

Communication

Budgetary limitations adversely affected communication with taxpayers, employers, and stakeholders. Although the IRS communicated with taxpayers using a multichannel service environment, the IRS would like to have responded more quickly to telephone calls, correspondence, and requests for in-person service. Additional resources would have enabled the IRS to deliver a higher LOS to taxpayers on phones, respond more timely to correspondence, shorten wait times at TACs, clarify instructions to employers, and communicate more directly with the tax community.

The IRS requested funding to increase staffing in order to provide support for taxpayers during the 2015 filing season. The funding would have provided resources to achieve a phone level of service of 80 percent, additional assistors at our TAC to help taxpayers comply with new legislation, and additional staff to respond to correspondence. The allocated funding received only allowed the IRS to provide a 37.4 percent level of service during filing season, a 47 percent decrease compared to the same period in 2014, and to assist over 2.1 million taxpayers in TACs, nearly 4.0 percent fewer than in 2014.

One of the IRS's main goals is education and outreach intended to minimize the number of practitioners who fail to meet their ethical obligations. However, reduced travel prevents the IRS from reaching many practitioner groups around the country. Outreach activities have been reduced to local travel or, for smaller groups, communication via phone, virtual conferencing, or a Q&A session after watching a pre-recorded webinar. The IRS's new voluntary continuing education program for unlicensed return preparers requires a minimum of two credit hours per year of training in ethics to receive an Annual Filing Season Program Record of Completion. IRS staff is most qualified to do this training and without a representative at the events there will either be no ethics presentation, or there is a risk that the presentation may be done by an inexperienced or unqualified person resulting in misinformation and/or confusion about ethical obligations and due diligence requirements.

Online experience for taxpayers and stakeholders

Although the IRS made significant advances in improving the taxpayer's online experience and expanding digital customer service offerings, budgetary limitations delayed some improvements:

- Electronic filing and processing of Form 1040X, *Amended U.S. Individual Income Tax Return*, was delayed until Tax Year 2016/Processing Year 2017. Benefits of electronic processing include detailed data capture and reporting; increased detection of fraud, non-compliance, and identity theft; automated and efficient Form 1040X processing; improved inventory and case management; improved workload balancing; reduced cost associated with scanning the paper returns; and reduced storage cost of individual amended returns. In FY 2015, the IRS processed 3.7 million paper amended returns.

- *"Where's My Refund?"* enhanced messaging on web and telephone automated applications would provide victims of identity theft the accurate status of their refund. The IRS estimated the updated language would reduce call demand by approximately 250,000 taxpayers and provide better customer service to potential victims of tax-related identity theft through less costly channels. The new messaging would provide taxpayers, in specific cases, a more accurate estimated processing time and refer them to the IDverify.IRS.gov website to authenticate their identity.

IRS information processing

The IRS strives to provide timely and efficient information processing to minimize burden on taxpayers. Budgetary limitations have interfered with improvements to processing in several areas and lower staffing levels have created challenges.

Programming changes that establish bypass indicators for IRS tax debts in Injured Spouse claims have been delayed indefinitely. When an injured spouse files a claim, if there is no tax debt owed by the non-injured spouse, the refund generates systemically. However, if the non-injured spouse has a tax debt, an employee must issue a manual refund, which costs the IRS more than a systemic refund. To avoid issuing a manual refund, programming should be initiated to establish bypass indicators for IRS tax debts on injured spouse accounts. If implemented, these changes could reduce manual refund volumes by approximately 23,000 for an estimated annual savings of more than $1.2 million and 16 full-time equivalents (FTE). By automating this process, the IRS could eliminate errors in refunds to injured spouses.

The One-System technology solution would provide the functionality of several primary systems currently in use in TACs. Current technology includes several individual systems that operate independently of one another and require different vendors to support them. The current systems have compatibility issues, need significant and costly upgrades in order to meet mandates, and are not compatible with Section 508 of the Rehabilitation Act governing accessibility of federal information technology for people with disabilities. The One-System solution meets all requirements and provides additional capabilities that will improve service to taxpayers; such as a real-time matching of taxpayer service demand, ability to deliver service to taxpayers in remote locations without costly video-conferencing equipment; and supports analysis of employee/taxpayer interactions in order to identify trends. The cost to install the One-System is $5.9 million versus $19.9 million to update existing systems to meet mandates and acquire new or expanded functionality.

There is also a need to improve the technology with which the IRS processes Disclosure Authorizations providing third-parties access to taxpayer records. Due to the cost of maintaining the existing system, it was retired requiring the IRS to revert to manual, paper processing of these requests. The cost to process nearly 3.65 million requests manually in FY 2015 was 218 FTE, resulting in a five-day delay in processing the requests and providing the requested information to the taxpayer.

Strategic Goal 1 Performance Measures

The IRS met or exceeded 80 percent (8 of 10) of its Taxpayer Service performance targets in FY 2015 compared to 70 percent (7 of 10) in FY 2014.

Strategic Goal 1: Deliver high quality and timely service to reduce taxpayer burden and encourage voluntary compliance

Performance Measure	FY 2015 Target	FY 2015 Actual
Customer Service Representative (CSR) Level of Service	38.0%	38.1%
Customer Contacts Resolved per Staff Year	21,000	26,245
Customer Accuracy – Tax Law Phones	92.0%	95.0%
Customer Accuracy – Customer Accounts (Phones)	94.0%	95.5%
Timeliness of Critical Filing Season Tax Products to the Public	95.0%	89.0%
Timeliness of Critical TE/GE and Business Tax Products to the Public	95.0%	92.6%
Percent Individual Returns Processed Electronically	84.6%	85.3%
Percent Business Returns Processed Electronically	46.5%	47.0%
Refund Timeliness – Individual (Paper)	94.0%	98.8%
Taxpayer Self Assistance Rate	85.0%	88.7%

Shortfall Explanations (Based on 4th Quarter Results)

Timeliness of Critical Individual Filing Season Tax Products to the Public: The Tax Increase Prevention Act of 2014, the Tax Technical Corrections Act of 2014, and the Achieving a Better Life Experience (ABLE) Act of 2014 were enacted on December 19, 2014, and had major implications and directly impacted reaching our FY 2015 goal of 95 percent. By the CIFS measure date (January 8, 2015), 97 of the 109 (89 percent) tax products were made available to the public and 93 percent (101 of 109) of the tax products were available to the public by the January 20th filing season start date. While the Media & Publications (M&P) organization cannot control the timeliness of tax-related legislation, procedures are in place to mitigate the impact of late legislation. For example, in a Joint Committee on Taxation report dated early January 2015, there were 52 tax provisions that expired on December 31, 2014, that may be extended by legislation before the start of the 2016 filing season. The M&P organization plans to implement its "best practice" of reserving lines on tax returns in advance of anticipated extended legislation for the coming year. Reserved lines provide flexibility and expedite the process for making legislative changes due to extenders rather than initiating new development at the end of the tax year. The practice also allows for the most productive and efficient use of resources.

Timeliness of Critical TE/GE & Business Tax Products to the Public: The Tax Increase Prevention Act of 2014; the Tax Technical Corrections Act of 2014; and the Achieving a Better Life Experience (ABLE) Act of 2014, which were enacted on December 19, 2014, had major implications and directly impacted reaching our FY 2015 goal of 95 percent. By the CTB measure date, (at least 30 days before the form is required to be filed) 151 of the 163 (92.6 percent) CTB tax products were made available to the public. See above for procedures put in place to mitigate the impact of late legislation.

GOAL 2: Effectively enforce the law to ensure compliance with tax responsibilities and combat fraud

Enforcement is one of the top priorities of the IRS and is an area that is continually evolving to enable the IRS to serve taxpayers' changing needs. Effective enforcement not only directly generates revenue but is also a critical component of maintaining voluntary compliance by both reassuring taxpayers of the overall fairness of the tax administration system and deterring non-compliant behavior. The IRS has a robust plan to continue to improve enforcement despite the many challenges it faces. Investing in anomaly detection, compliance risk detection, case management, and issue identification will allow the IRS to improve voluntary compliance and increase revenue.

Highlights of Enforcement Performance

Enforcement of the tax law is critically important to the IRS mission, especially as tax administration becomes increasingly complex. Just as service is essential to enhancing voluntary compliance, so is enforcement. IRS programs like examination and collection ensure that taxpayers pay what they owe and assist those individuals who may have trouble meeting their tax liability because of hardship situations.

As a result of dedicated enforcement initiatives, the IRS collected $54.2 billion in total enforcement revenue in FY 2015. Successes were achieved in key enforcement programs including completing:

- 162,331 high income audits
- 56,810 small business audits (assets <$10 million)
- 11,525 large corporate audits (includes partnership and flow-through returns)
- More than 3.7 million automated underreporter contact closures
- More than 2.8 million collection case closures
- 36,548 tax-exempt and government entities compliance contacts

◆ **(Priority) Objective 1: Enforce domestic and international compliance by strengthening expertise, adopting innovative approaches and streamlining procedures**

The IRS continues efforts to increase domestic and international compliance. The IRS worked to deter refund fraud, pursue criminal investigations, improve appeals processes, and improve processes for collecting court-ordered restitution in criminal cases. The IRS also improved Mutual Collection Assistance Request processes and expanded use of the Treasury Enforcement Communication System. In the international area, the IRS had success in innovative approaches with international taxpayers, court cases with foreign financial institutions, cooperation with Swiss banks, and continuation of the Offshore Voluntary Disclosure program.

In an effort to deter refund fraud, the IRS implemented limits on the number of federal tax refunds that can be deposited into a single bank account. As a result, 205,019 refunds totaling $863 million were converted to paper.

IRS investigates potential criminal violations of the Internal Revenue Code and related financial crimes such as money laundering, currency violations, tax-related identity theft fraud, and terrorist financing. Using its unique statutory jurisdiction and financial expertise, the IRS contributed to important national law enforcement priorities. Performance highlights include:

- Completing 4,486 criminal investigations.
- Achieving a conviction rate of 93.2 percent.
- Maintaining a Department of Justice acceptance rate of 90.7 percent with a U.S. Attorney acceptance rate of 90.4 percent.
- Obtaining 2,879 convictions.

In recent years, the IRS engaged in a number of efforts to ensure the Appeals process is fair and impartial. In FY 2015, the IRS initiated the Docketed Examination Assistance Project that developed procedures for Appeals Officers to request examination assistance when a taxpayer provides new information that merits investigation.

The IRS collects restitution ordered by the courts in a criminal case for any tax imposed by the Internal Revenue Code. Comprehensive procedures and related training materials were developed for collection of court-ordered payments and restitution-based assessments and civil assessments. In FY 2015, the IRS made 755 restitution-based assessments totaling $650,358,713 (excluding interest).

Another initiative includes the IRS's Mutual Collection Assistance Request (MCAR) program, which supports fulfillment of obligations pursuant to Tax Treaties. Cases referred to this program by "partnering" countries are complicated international collection cases. In FY 2015, the IRS updated the process for recommending cases, streamlined procedures, and began revision of the automated MCAR database.

The Treasury Enforcement Communication System (TECS) database maintained by the U.S. Department of Homeland Security (DHS) contains information about individuals suspected of or involved in violation of federal law. IRS Revenue Officers request that a suspected taxpayer be placed on the TECS database. Subsequently DHS notifies the IRS whenever the taxpayer travels into the United States and Revenue Officers can attempt to contact the taxpayer while he or she is in the United States and/or locate the taxpayer's assets. Previously only IRS criminal investigators had direct access to TECS; DHS granted other IRS personnel direct access in FY 2015 allowing the IRS to develop streamlined procedures.

International taxpayers can now submit documents to the international revenue officer assigned to their case through IRS e-Fax. This innovative tool has improved communications and timely receipt of documents from the international customer and streamlined the collections process.

International investigative efforts included developing and leveraging strong international law enforcement partnerships; managing informants and whistleblowers; assisting with international fugitive apprehensions; identifying assets and accounts for potential seizure and coordinating bilateral financial investigations. Major cases involving foreign financial institutions in FY 2015 included Credit Suisse (ordered to pay nearly $2.6 billion), BNP Paribas (agreed to forfeit $8.8 billion and pay a criminal fine of $140 million), and the Bank Leumi Group (agreed to pay $270 million).

The IRS worked with the Department of Justice Tax Division to support the Swiss Bank Program, a voluntary disclosure program for banks that assisted U.S. citizens in hiding money offshore. Numerous negotiations with Swiss banks are ongoing and three major banks agreed to cooperate in criminal or civil proceedings and implement controls to stop misconduct involving undeclared U.S. Accounts (BSI SA, Vadian Bank AG, and Finter Bank Zurich AG).

Taxpayers who wished to voluntarily disclose to the IRS that they failed to report income from, or the existence of, offshore bank accounts continued to utilize the IRS's Offshore Voluntary Disclosure Program (OVDP). In FY 2015, the IRS received 2,863 OVDP applications.

- **Objective 2: Deter and promptly resolve noncompliance by protecting revenue from refund fraud and ensuring appropriate revenue collection**

The IRS continued its efforts to combat refund fraud schemes in many areas including those detailed in discussion of the Return Review Program (RRP p. 43), Questionable Refund Program (QRP p. 44), and the Return Preparer Program efforts related to EITC refund fraud (EITC p. 44). In FY 2015, the IRS added the ACA Verification Service (AVS p. 14).

The IRS also worked to comply with requirements of the Improper Payments and Recovery Act of 2010 (IPERA). FY 2014 marked the first time the IRS was in compliance with the improper payment reporting requirements with the exception that the IRS was unable to report an overall EITC improper payment rate below 10 percent. The IRS has developed supplemental measures to ensure compliance with Executive Order 13520 *Reducing Improper Payments*. Treasury has also designated a senior agency official responsible for the progress of the agency toward achieving full Improper Payments compliance. In addition, the IRS included a number of legislative proposals in the FY 2016 budget that would help improve EITC compliance. The IRS continues to engage with a multi-agency working group consisting of IRS, Treasury, OMB, CMS, and HHS to discuss and address issues related to ACA implementation. Successes include:

- Developing and executing a Premium Tax Credit (PTC) Risk Assessment to determine areas that might affect payment accuracy despite not being a program requirement until FY 2016.
- Conducting Internal Control testing over the Affordable Care Act (ACA) processes related to the Financial Statement.
- Developing Interim Monitoring mechanisms to define, identify, and track improper payments related to PTC.
- IRS and Department of Health and Human Services finalized plans and began efforts to perform comprehensive improper payment risk assessments for the Marketplaces and related programs to determine areas that might affect payment accuracy, and are leveraging Federally Funded Research and Development Centers (FFRDC) for the risk assessments.

- **Objective 3: Build and maintain public trust by anticipating and addressing the tax-exempt sector's need for a clear understanding of its tax-law responsibilities**

To help the tax-exempt sector understand tax law responsibilities, the IRS has transferred legal staff and streamlined communication with stakeholders in the employee plans determinations area.

The IRS migrated employees from the Exempt Organizations (EO) and Employee Plans (EP) organizations to the Office of Chief Counsel. As a result of this staffing realignment, taxpayers received products faster and more efficiently and were provided with a clearer understanding of their tax law responsibilities.

The IRS receives and processes thousands of requests and applications related to employee plans each fiscal year. The IRS developed new operational procedures to standardize and streamline the determinations process for Individually Designed Plans (IDPs) and termination applications. These procedures included:

- Requiring a complete application checklist. If the application is incomplete, the applicant is requested to provide additional information within 30 days or the case is closed.
- Providing a reference list that applicants can use to confirm that the IDP followed all of the Cumulative List amendments.
- Standardizing case management procedures and response deadlines.
- Developing new and revised letters to applicants.
- Refining procedures for resubmitting incomplete applications.

♦ **(Priority) Objective 4: Identify trends, detect high-risk areas of noncompliance and prioritize enforcement approaches by applying research and advanced analytics**

To increase compliance, the IRS fosters data-driven innovation and supports a test-and-learn approach. Some of the accomplishments include improvements to the Return Review Program pilot, return preparer program (RPP) and EITC RPP, questionable refund program, identity theft filters, suspicious device filters, and ACA implementation.

In FY 2014, the IRS deployed the first release of its new fraud/anomaly detection system, the RRP, and successfully executed an identity theft/fraudulent return pilot project. By processing all refund returns though multiple analytic models and business rules, the RRP system scores and selects suspicious returns that have a high probability of identity-theft fraud. It is more agile than the legacy system in updating the models and rules to identify and counter emerging fraud trends. RRP identified 796,161 returns representing more than $4.7 billion in government revenues protected. Moreover, RRP has had a positive impact on providing up-front efficiency in detecting suspected identity theft, reducing the manual fraud detection analysis work by approximately 20 percent.

IRS continued to engage in enforcement actions against unscrupulous or incompetent return preparers. This is accomplished through education, outreach, and coordinated cross-functional publicity. Return Preparer Program (RPP) performance in FY 2015 included:

- 266 RPP Criminal Investigations Initiated
- 324 RPP Criminal Investigations Completed
- 210 RPP Convictions
- 96.8 percent RPP Conviction Rate
- 90.7 percent RPP Publicity Rate
- 94 in-person EITC Knock and Talk Visits to educate identified at-risk return preparers about properly preparing EITC returns

- Eight RPP-related Outreach Events held for tax and accounting practitioners, the general public, and the media

The EITC Return Preparer Program is designed to increase the accuracy of EITC returns by focusing on return preparers not exercising the required due diligence when preparing taxpayer's returns claiming EITC. Use of interventions for preparers before and during the filing season was expanded in 2015 to include monitoring over 31,000 preparers with continued testing of selected strategies. The FY 2015 EITC Return Preparer Strategy protected nearly $465 million in revenue with a return on investment of $46 for every dollar spent. The proposed return preparer penalties for the 2015 effort total nearly $30 million with a Due Diligence Visit (DDV) penalty rate of approximately 85 percent. The assessments from the preparer client audits generated approximately $116 million.

The Questionable Refund Program (QRP) addresses schemes that involve one or more individuals who prepare and file fictitious tax returns claiming bogus income and deductions to generate fraudulent claims for refund. In FY 2015, IRS's Scheme Development Centers (SDCs) identified 1,281 QRP schemes, comprised of 242,080 individual tax returns with more than $1.2 billion in potentially fraudulent refund claims. QRP performance accomplishments in FY 2015 included:

- 775 QRP Criminal Investigations Initiated
- 996 QRP Criminal Investigations Completed
- 764 QRP Convictions
- 95.9 percent QRP Conviction Rate
- 89.9 percent QRP Publicity Rate on Adjudicated Investigations

The IRS continues to refine and develop new identity theft filters based on analytical models and data validation. As a result, potentially fraudulent returns are stopped much earlier in processing allowing IRS to more quickly resolve cases for identity theft victims. In FY 2015, the IRS selected 1,987,975 returns compared to 1,570,008 selections at the same time in 2014 (a 27 percent increase).

Identifying the serial number (or "fingerprint") of the device used to transmit electronically filed returns helped protect revenue, aid in identifying schemes, and improve IRS's ability to authenticate individuals who create online accounts to use IRS online services such as Get Transcript and Get IP PIN. The IRS continues to actively identify suspicious devices that share a high percentage of returns filed with common suspicious characteristics including the same refund amount, same address, old/young filers, same income, and first time filers. Additionally, to further protect revenue, the returns filed from suspicious devices are being tracked and selected for identity theft treatment. While the return goes through the identity theft process, the refund is stopped until identity theft determinations are available.

During FY 2015, the IRS successfully implemented two major provisions of ACA. The IRS implemented the premium tax credit (PTC) and individual shared responsibility (ISR) on both individual taxpayer returns and information returns from employers, insurers, and marketplace for filing season 2015 and post-filing compliance. Notable activities include:

- Conducting a preliminary analysis of PTC amount errors determining whether the taxpayer, the IRS, or the marketplace made the error.
- Initiating a PTC anti-fraud analysis plan to detect and mitigate revenue loss.
- Using the Accelerated Questionable Credit (AQC) Program to disallow questionable Premium Tax Credit (PTC) claims that were not substantiated during return processing, 12,113 potentially erroneous returns were selected for further review.
- Conducting a Shared Responsibility Payment (SRP) analysis that identified potential inconsistencies in taxpayer reporting of SRP.
- Tracking and analyzing unexpected outcomes (e.g., potential misreporting of individual SRP payments by taxpayers, potential faulty PTC adjustment calculations, and impact of frozen credits associated with self-reported SRP balance due notification) during filing season 2015.
- Developing and implementing an FY 2016 compliance data analytics strategy focusing on prioritized research projects using results to inform and enhance pre-filing/at-filing/post-filing PTC compliance processing decisions.

◆ **Objective 5: Address noncompliance by improving data, information and knowledge sharing with tax community and government partners**

To increase voluntary compliance, the IRS continued to partner with the tax community and government partners especially through the State Fraud Referral Project, with the Department of Housing and Urban Development and tax-exempt credit counseling organizations, and partnering with Federal Law Enforcement Agencies.

The IRS signed agreements to participate with 33 states in the State Fraud Referral Project and received referrals from 16 states. Results include:

- 106,075 referrals and 57,327 IRS filed returns based on these referrals
- 18,522 returns stopped with over $105.5 million in refunds claimed
- 16,625 returns identified by IRS filters for over $96.5 million in stopped refunds.

During FY 2015, the IRS continued to support and collaborate with the Department of Housing and Urban Development (HUD) to educate HUD employees and HUD-approved housing organizations on tax-exempt status for credit counseling organizations. The IRS delivered three training sessions to HUD that covered information on standards pertaining to tax-exemption, jeopardizing activities, and IRS resources available to the HUD employees. In addition, the IRS delivered a one-hour webcast covering the historical background of the credit counseling industry and its interaction with the federal tax laws governing tax-exempt organizations to both HUD employees and external stakeholders.

Identity theft and refund fraud continue to be one of IRS's main areas of investigative concentration. In a concerted effort, IRS has partnered with other Federal law enforcement agencies, to ensure an effective approach to deterring this type of fraud. As a result, IRS has taken the following steps to address the identity theft problem:

- **Identity Theft Clearinghouse (ITC):** The IRS's ITC continued to develop and refer identity theft refund fraud schemes for investigation. In FY 2015, the ITC received 891 identity theft related refund fraud leads associated with 190,437 tax returns and over $979.2 million in refund claims.
- **Law Enforcement Assistance Program (LEAP):** The Law Enforcement Assistance program helps state and local law enforcement lawfully obtain tax return data vital to their local efforts in investigating and prosecuting specific cases of identity theft. In FY 2015, 664 State/Local law Enforcement Agencies from 48 states participated in the program and 6,740 requests were received.
- **Federal Trade Commission – Identity Theft and Tax Awareness Week:** IRS partnered with the Federal Trade Commission and presented a webinar focused on what Tax Identity Theft is and the steps consumers can take to protect themselves.

IRS representatives participated in 331 outreach events to promote compliance through publicity and education. Nearly 24 percent of these events provided information about general fraud, 25 percent were identity theft related, and 16 percent provided a general overview. Audiences included tax and accounting professionals, representatives from financial institutions, business and industry managers, government representatives, and educational institutions.

- **Objective 6: Improve compliance and reduce the risk of fraud through strong partnerships with the tax professional community**

IRS continues collaborative efforts with the tax professional community to reduce the risk of fraud.

In June 2015, the Security Summit Group, which is a collaboration of public and private sector leaders from the IRS, tax industry, and state tax authorities, was established to combat identity theft refund fraud. The goal is to have new protections in place by the time taxpayers file in 2016. For example, every company that helps taxpayers file returns will be asked to provide the IRS information that will add extra layers of security and step up pre-refund authentication practices. In addition, companies will need to let the IRS know if they detect any suspicious activity or refund fraud patterns in their processes. The federal government, states, and industry will stop more fraud related to identity theft up front and, for those fraudulent returns that do get through; we will have better post-filing analytics to determine ways to adjust our security filters. The group also fosters increased communication about refund fraud by sharing aggregated data.

The OPR continues to be responsible for oversight of tax practitioner conduct and maintains exclusive authority for practitioner discipline. During FY 2015, 381 disciplinary/corrective actions were finalized including two practitioners Disbarments and 102 Suspensions. The OPR entered into five Deferred Disciplinary Agreements (DDAs) and issued 272 reprimands and/or soft notices.

Strategic Goal 2 Missed Opportunities

One of the IRS's goals is to effectively enforce the law to ensure compliance with tax responsibilities and combat fraud. However, budget cuts have undermined the IRS's ability to fully realize all of its related objectives. Competing priorities and budget cuts have led to reductions in enforcement activities, missed opportunities to expand investigations and fraud detection programs; decreases in training opportunities, and missed opportunities to improve refund handling and paper remittances. The IRS needs appropriate resources in order to continue providing quality tax enforcement to America's taxpayers.

Reduced Enforcement

Reductions in the IRS budget have led to reductions in IRS staffing including compliance employees who conduct audits of individual taxpayers, small businesses, and large corporations. These reductions have also limited the IRS's ability to expand enforcement activities in the increasingly complex global financial environment.

Due to the reduced budget levels, the IRS had to reduce the correspondence audit program by 40 FTE, which limited the IRS's impact on voluntary compliance. The related loss in closures is approximately 15,900 cases and potentially $75 million in lost revenue.

Investing an additional $200.2 million in examination, collection, and underreporter programs would potentially have generated additional annual revenue of nearly $1.6 billion, allowed an additional 500,000 cases to be resolved, and addressed key compliance issues including offshore tax evasion and high-wealth individuals. This investment could also have brought the individual examination coverage rate to closer to the historic one percent target.

The number of revenue agents fell seven percent, from 11,422 to 10,657 in FY 2015, the lowest it has been since before 2005, when there were 20 million fewer taxpayers. Examinations of large corporate taxpayers (with assets of more than $10 million) declined 20 percent from FY 2013 to FY 2014 and continued to decline in FY 2015. The IRS examined 7,858 returns of large corporate taxpayers in FY 2014, the lowest number of examinations of that type of return between 2004 and 2014. In FY 2015, the IRS examined only 7,448 returns of large corporate taxpayers.

Because financial crimes are global and borderless, the IRS should expand its international presence to maintain and enhance the IRS's overall effectiveness in combating international tax evasion, refund fraud schemes, money laundering, and other financial crimes. Lack of expansion will have a direct influence on the IRS's ability to address significant compliance issues, particularly in Africa and the Middle East. The IRS's international attachés are an invaluable asset in prosecution of illicit foreign financial institutions in Europe. As the global focus grows stronger on illicit actors and institutions in Africa and the Middle East, the IRS's lack of an investigative presence and law enforcement relationships is likely to reduce the IRS's ability to develop these investigations and address emerging issues.

The current staffing level in the Transfer Pricing Practice (TPP) is inadequate to meet demand. TPP is able to participate in fewer than half of transfer pricing issues with potential large adjustments ($100 million or more). With additional staff, the IRS could have more adequately examined significant pricing issues, participated in more large adjustment issues, and provided an estimated tax impact of $2 billion or more.

Growing identify theft crimes are one of the most serious and egregious crimes that IRS criminal investigators have been faced with in recent years. Previously, the IRS would hold an annual live training seminar for all QRP, RPP, and identity theft coordinators to discuss procedures and processes and to aid in identifying, developing, investigating, and prosecuting significant refund fraud investigations in the upcoming filing season. The simultaneous nationwide interaction ensured that all field office coordinators fully understood the latest fraud trends, the investigative and legal means of combating them, and processes for communicating evolving scheme trends to ensure IRS-wide coordination. This training seminar also provided a forum for Department of Justice to deliver mission-critical legal education. As a result of budget constraints over the last three years, the live training seminars have been replaced by a condensed, on-line class that has been less effective. Approximately $150,000 would have allowed resumption of the live training seminar to better prepare QRP/RPP coordinators for the 2015 filing season.

Additional funding ($7.3 million and 36 FTE) would have allowed the IRS to expand the Identity Theft Clearinghouse to process, analyze, and evaluate all identity theft leads received from special agents, other IRS sources, and external sources. The Identity Theft Clearinghouse monitors emerging identity theft refund schemes, tracks activity to assist in preventing release of fraudulent refunds, and combats schemes where fraudulent refunds finance other illegal activities. These additional resources would have allowed the IRS to increase participation in multi-agency task forces, cooperate with law enforcement agencies, and work with task forces to expedite prosecution by the Department of Justice while the criminal activity is still ongoing. In addition, special agents could extend current filing-season-only outreach efforts to year-round.

Additional funding ($17.8 million and 52 FTE) would have allowed the IRS to apply social network analysis to investigation of employment tax fraud and abusive schemes; two program areas that have seen decreased investigations as resources have been redeployed to combat identity theft. By establishing and implementing a financial and criminal intelligence database, the network analysis software could proactively identify potentially noncompliant taxpayers by enabling the IRS to link multiple potentially abusive returns or information items to identify the central figure behind a scheme versus applying resources to individual returns one at a time.

The IRS's National Forensic Laboratory examines evidence and supports IRS investigations. Due to decreases in staffing levels and high attrition, the National Forensic Laboratory has fewer individuals to provide support for criminal investigations through trial illustration services, polygraph examinations, document analysis, and other services needed during judicial proceedings. The lack of funding to prevent this staffing decline happened while these services are experiencing increased demand due to identity theft and international cases.

Other

Budget limitations have limited the IRS's ability to improve refund handling and paper remittances.

The IRS requested $2.6 million and 24 FTE to fund additional equipment and programming support to allow the IRS to obtain Social Security Administration (SSA) Form W-2, *Wage and Tax Statement*, and SSA Form W-3, *Transmittal of Wage and Tax Statement*, data more quickly. Quicker access to data will accelerate verification of wages and withholding on potentially fraudulent tax returns and shorten processing time for legitimate refunds.

Dishonored checks are the second highest cause of erroneous refunds. The IRS would like to enhance the Remittance Transaction Research (RTR) application to add the bank account number as a searchable field. Investing the anticipated cost of $60,000 would have allowed the IRS to post payments more accurately; more quickly identify dishonored checks, and reduce erroneous refunds.

Implementing Electronic Check Presentation (ECP), a system for "bulk" processing to convert paper remittances to electronic transactions, at the five major tax return processing centers would have completed conversion to electronic processing for the majority of paper remittances received at the IRS. An investment of $6 million over two years would enable ECP and provide for masking of Social Security Numbers on payment notices and vouchers to protect taxpayers' personal data. The current aging paper remittance processing system is high cost and high maintenance. The process requires costly courier service to deliver paper remittances for bank deposit and carries inherent security vulnerabilities. Without electronic processing, the Bureau of Fiscal Service has the authority to charge the IRS for every paper check that could lead to the IRS being assessed $17 million to $18 million annually.

Strategic Goal 2 Performance Measures

The IRS met 71 percent (12 of 17) of its enforcement performance measure targets in FY 2015 compared to 88 percent (15 of 17) in FY 2014.

Strategic Goal 2: Effectively enforce the law to ensure compliance with tax responsibilities and combat fraud

Performance Measure	FY 2015 Target	FY 2015 Actual Q4
Examination Coverage – Individual	0.8%	0.8%
Field Examination National Quality Review Score	89.6%	86.7%
Office Examination National Quality Review Score	90.2%	88.3%
Examination Quality – Large Business	90.0%	86.0%
Examination Coverage – Business (assets >$10M)	3.8%	3.9%
Examination Efficiency – Individual (1040)	135	148
Automated Underreporter (AUR) Efficiency	2,032	2,209
Automated Underreporter (AUR) Coverage	2.6%	2.3%
Collection Coverage – Units	43.8%	46.3%
Collection Efficiency – Units	2,173	2,448
Field Collection National Quality Review Score	81.6%	79.2%
Automated Collection System (ACS) Accuracy	94.0%	95.3%
Criminal Investigations Completed	3,800	4,486
Number of Convictions	2,700	2,879
Conviction Rate	92.0%	93.2%
Conviction Efficiency Rate ($)	$243,000	$221,782
TE/GE Determination Case Closures	99,942	111,940

Shortfall Explanations (Based on 4th Quarter Results)

Field Exam National Quality Review Score: During FY2015, declines occurred in 16 of the 17 quality attributes. Each Field Exam Area has a quality improvement action plan and an assigned quality champion. Beginning in FY 2016, SBSE Exam and W&I will hold bi-monthly calls to address developing issues with respect to the return preparer visitations and to ensure all agents understand actions required of them.

Office Exam National Quality Review Score: During FY2015, declines occurred in 14 of the 17 quality attributes. Each Field Exam Area has a quality improvement action plan and an assigned quality champion. Beginning in FY 2016, SBSE Exam and W&I will hold bi-monthly calls to address developing issues with respect to the return preparer visitations and to ensure all agents understand actions required of them.

Examination Quality-Large Business: The 86 percent was a result of low scores in Standard 1 (Planning), Standard 2 (Inspection) and Standard 4 (Workpapers and Reports). Actions currently underway to improve this score include direct feedback to Revenue Agents, outreach presenting the Quality Standards and ways to affect case quality improvement, quarterly CENTRA sessions to highlight and discuss actions for areas of improvement, and one-on-one report outs to industry analysts in each industry.

Automated Underreporter Coverage: The shortfall was attributable to the effect of leave during the first quarter of the fiscal year, and the SBSE Compliance Realignment. The original target of 2.6 percent was set using the pre-realignment workplan. Due to a shift in FTE and work streams, the overall closures were reduced. The consolidated phone sites are now able to handle calls from any taxpayer. This will improve efficiency and free resources to work the paper cases.

Field Collection National Quality Review Score: The shortfall in NQRS is primarily related to a decline in the timeliness measures. This is a result of training occurring during the fourth quarter of last year when 38 percent of the Field Revenue Officers (ROs) were off-line for almost two weeks and all ROs were off-line for Continuous Professional Education for another week. This training interrupted case timeliness, resulting in missed follow-up deadlines. Timeliness measures were also impacted by the need to reassign inventory after 100 ROs were moved into Offers-in-Compromise and Advisory and Abusive Tax Avoidance Transactions (ATAT) positions and another 369 were promoted, both events occurring in mid-late FY 2014. Other low scoring attributes include Verify/Analyze, Ability to Pay and Compliance. In order to improve these measures all Field Collection Areas developed and implemented action plans to ensure focus on workload management and case actions critical to timely case resolution. This will ensure all required actions, such as verifying financial statements and conducting compliance reviews, are completed prior to case closure. However, due to the timing of case closures and reviews, it could take up to 10 months after implementation before the score results begin to reflect the benefit of these plans.

SYSTEMS CONTROLS AND LEGAL COMPLIANCE

The IRS continued to enhance financial management and appropriate controls that are an integral component of all IRS programs.

Federal Managers' Financial Integrity Act (FMFIA)

The IRS provides a qualified statement of assurance that its internal controls and financial management systems meet the objectives relative to FMFIA Sections 2 and 4 due to the existing material weakness in internal control over financial reporting related to unpaid tax assessments, and the IRS financial management systems do not substantially comply with FFMIA. In addition, the IRS continues to be in noncompliance with the Improper Payments

Information Act (IPIA), as amended by the Improper Payments Elimination and Recovery Act (IPERA) of 2010, and the Improper Payments Elimination and Recovery Improvement Act (IPERIA) of 2013.

The management of the IRS is responsible for establishing and maintaining effective internal control and financial management systems that meet the objectives of the Federal Managers' Financial Integrity Act (FMFIA), the Federal Financial Management Improvement Act (FFMIA), the Office of Management and Budget (OMB) Circular A-123 Management's Responsibility for Internal Control, the Government Charge Card Abuse Prevention Act of 2012, the Reports Consolidation Act of 2000, and the Improper Payments Information Act (IPIA), as amended by the Improper Payments Elimination and Recovery Act (IPERA), signed into law on July 22, 2010, and the Improper Payments Elimination and Recovery Improvement Act (IPERIA), signed into law on January 10, 2013. The organizations under my purview are operating in accordance with the procedures and standards prescribed by the Comptroller General and OMB guidelines.

The systems of management control for the IRS organizations are designed to ensure that:

- Programs achieve their intended results.
- Resources are used consistent with the overall mission.
- Programs and resources are free from waste, fraud, and mismanagement.
- Laws and regulations are followed.
- Controls are sufficient to minimize improper or erroneous payments.
- Performance information is reliable.
- System security is in substantial compliance with all relevant requirements.
- Continuity of operations planning in critical areas is sufficient to reduce risk to reasonable levels.
- Financial management systems are in compliance with federal financial systems standards, i.e., FMFIA Section 4 and FFMIA.
- Complete and accurate data is reported on USAspending.gov.
- Controls and policies are in place to prevent fraud and inappropriate use of government charge cards.

OMB Circular A-123, "Management's Responsibility for Internal Control"

The IRS conducted its assessment of the effectiveness of internal control over financial reporting, which includes the safeguarding of assets and compliance with applicable laws and regulations, in accordance with the requirements of Appendix A of OMB Circular No. A-123.

The FY 2015 OMB Circular A-123 testing included the following activities:

- Tested internal control sets for the 23 transaction processes identified by the Department of the Treasury that are material to its Consolidated Financial Statements. The tests included 13 administrative processes covering material portions of the $10.9 billion in annual administrative transactions, seven information system processes, and three custodial processes covering material portions of the $3.3 trillion in tax revenue receipts through September 30, 2015. The transactions included additional testing for custodial activity related to tax refunds and cash reconciliation.

- Tested the compensating procedures used to produce the annually audited financial statements.

- Performed supplemental testing of the FY 2015 transactions during the fourth quarter to verify that with the exception of internal controls over financial reporting related to unpaid tax assessments, controls remained effective throughout the year.

- Conducted a self-assessment of the IRS internal control environment using an Abbreviated Internal Control Evaluation Checklist based upon GAO's Internal Control Management and Evaluation Tool.

- Reviewed the Centers for Medicare and Medicaid Services' (CMS) documented testing of internal controls related to certifying and making the Basic Health Program (BHP), Advance Premium Tax Credit (APTC) and Cost Sharing Reduction (CSR) payments.

- Performed an independent evaluation of CMS's testing of its internal controls.

- Reviewed CMS's representation letter indicating there were no material changes to the control environment around the processes executed in support of the BHP, APTC and CSR payment amounts during the period July 1, 2015 through September 30, 2015. Specifically, CMS management represented that:

    - Internal controls in place at CMS for the period January 1, 2015 through June 30, 2015 were still in place for the requested period with no material changes in the control environment.

    - No internal control gaps were identified during the period July 1, 2015 through September 30, 2015.

    - CMS management is not aware of any fraud or non-compliance with laws and regulations, and did not have any uncorrected misstatements affecting the IRS's financial statements.

Based on the results of this assessment, the IRS provides qualified assurance that its internal controls over financial reporting as of September 30, 2015, were operating effectively due to the continued material weakness related to unpaid tax assessments.

Federal Financial Management Improvement Act (FFMIA)

In November 2014, the IRS updated its remediation plan to improve reporting on unpaid assessment balances and remediate this material weakness by November 30, 2020. The plan is based on a new Customer Account Data Engine (CADE) 2 Transition State 2 (TS2) release plan to improve the accuracy of the core individual taxpayer account providing key information needed when servicing taxpayer inquiries and enabling the IRS accounting systems to leverage the information for more accurate financial reporting. The CADE 2 TS2 release plan will be deployed over seven releases, of which five will affect the material weakness and are dependent on receiving requested funding. Releases 2 through 4 will enable the CADE 2 database to become the authoritative source for the financial statements and Release 5 will address the remaining actions necessary to improve the taxpayer account. The IRS expects that once the financial systems have fully leveraged the capabilities in CADE 2 TS2, this material weakness can be downgraded.

While closure of the material weakness is largely dependent upon implementation of CADE 2 TS2, the IRS is also working on long-term actions that are needed to improve reporting on business taxpayer accounts not within the current scope of CADE 2, evaluation of the existing federal accounting standards, and improvements needed to internal procedures and methodologies for recording data to the taxpayer accounts.

In July 2015, the IRS developed a series of new long-term actions intended to address issues impacting the material weakness that are not dependent on CADE 2 TS2. The IRS is currently prioritizing and determining the funding needed to complete these actions. In the near-term, the IRS added nine initial actions to the remediation plan scheduled for completion in FY 2016.

The IRS also initiated a new, ongoing quality assurance review to monitor the accuracy of penalties recorded in taxpayer accounts that contribute to the unpaid assessments weakness. The purpose of the review is to provide reasonable assurance that the calculations for taxpayer penalty and interest in the Integrated Data Retrieval System (IDRS), Individual Master File (IMF) and Business Master File (BMF) systems are accurately recorded and reported on the financial statements prior to the GAO audit testing. The IRS requested programming changes to correct the calculation for failure to pay (FTP) with implementation planned for January 2016. The IRS also completed an independent quality review in August 2015 that identified a new error related to the estimated tax penalty and completed programming to correct the error going forward, along with recalculating historical cases.

Progress Made on Significant Deficiency

The IRS worked diligently during FY 2015 to continue to enhance its Information Technology (IT) security, currently identified as a significant deficiency. The IRS implemented a strategy and assessment process to verify the effectiveness of internal controls for the financial systems that impact the financial statements. The process supports the IRS's overall internal control framework and provides assurance that the likelihood of a material weakness reoccurring in the IT environment is low. In FY 2015, the following activities were completed:

- Complied with Federal Information Security Management Act (FISMA), Office of Management and Budget (OMB), National Institute of Standards and Technology (NIST), Department of the Treasury, and IRS security requirements.

- Performed self-assessments to ensure policies, procedures, processes, metrics, training, testing, and controls were in place to protect the IRS's infrastructure and data.
- Reviewed the security monitoring controls for IT systems owned or operated by external entities to provide assurance that their systems' security management programs were adequately documented.
- Addressed potential risks to IRS financial systems.
- Tested and validated prior year GAO recommendations to prevent premature closure and attained a high closure rate.

Federal Information Security Management Act (FISMA)

In accordance with FISMA requirements, the IRS maintained an agency-wide information security program and provided a comprehensive framework for validating the effectiveness of information security controls over resources that support IRS business operations and goals. Specifically, the IRS inventory of FISMA reportable systems is compliant with security requirements from OMB, NIST, the Department of the Treasury, and IRS internal policies. These systems completed annual security control testing, participated in required security authorization and assessment activities, and addressed required Plans of Actions and Milestones (POA&Ms) for identified weaknesses.

Continuity of Operations (COOP)

The IRS Information System Contingency Plan (ISCP) testing program incorporates critical business processes and system infrastructure into ISCPs and ensures that each plan has a documented Business Impact Analysis. The IRS validated that each ISCP for all IRS FISMA master inventory systems contained keystroke recovery procedures for each asset and ensured that each plan was updated and tested annually. The IRS conducted 280 exercises and tests to determine that the plans were current and executable, back up data was readily available and readable, and Critical Infrastructure Protection systems could be recovered within their defined Recovery Time Objective.

Improper Payments Elimination and Recovery Act (IPERA) of 2010

As of June 30, 2015, the IRS also complied with applicable laws and regulations, except for the noncompliance with Improper Payments reporting related to the requirement to maintain an overall EITC improper payment rate below ten percent. The IRS continues to face challenges to reducing the EITC error rate but has reported on the actions being taken in the 2015 Treasury Agency Financial Report (AFR). The AFR discussion includes a report on the root causes of EITC improper payments and future planned corrective actions intended to reduce the program's payment error rate. To ensure accountability, Treasury has designated a senior agency official responsible for the progress of the agency toward achieving full Improper Payments compliance. In addition, the IRS included a number of proposals in the FY 2016 budget request that would help improve EITC compliance. These proposed legislative changes include:

- Accelerating due dates for filing information returns, including Form W-2, to facilitate early detection of income misreporting and fraud, including identity theft. This will allow the IRS to identify erroneous EITC claims and stop the refunds before they are paid.
- Giving the IRS explicit authority to regulate tax return preparers which would allow the IRS to reduce erroneous EITC claims by weeding out unscrupulous and incompetent preparers.
- Providing more flexible correctable error authority which would allow the IRS to deny certain erroneous claims, including erroneous EITC claims, before refunds are paid.
- Increasing civil and criminal penalties for tax-related identity theft which would prevent erroneous EITC claims.
- Simplifying the rules for claiming EITC for taxpayers who reside with a child that they do not claim as a dependent, in order to reduce taxpayer burden and improve EITC compliance.

If enacted, these legislative changes will provide the IRS with additional tools to combat waste and fraud and additional authority to take actions that will prevent payment errors and improve EITC compliance.

Government Charge Card Abuse Prevention Act of 2012

In accordance with the requirements of the Government Charge Card Abuse Prevention Act of 2012, the IRS provides assurance that its internal controls over the use of government charge cards are effective. Specifically, the IRS complied with the Department of the Treasury Charge Card Management Plan and provided agency-wide purchase card guidance for the proper use of government charge cards. The IRS conducted monthly and quarterly reviews of charge card activity to verify proper card use and to address potential inappropriate use. Charge card policies and procedures were updated to mitigate the risk of repeating previously identified inappropriate use. In the Treasury Inspector General for Tax Administration (TIGTA) report (Reference #2015-10-070) dated July 28, 2015, TIGTA reviewed the IRS's current credit card guidance and determined that policies and controls have been established that are designed to mitigate the risk of fraud and inappropriate government travel and purchase charge card practices, including controls that address centrally billed travel card accounts.

USAspending.gov

In accordance with the requirements of the OMB Memorandum, Improving Data Quality for USAspending.gov, the IRS provides assurance that its internal controls over the underlying spending reported on USAspending.gov are effective. Specifically, the IRS performed a quarterly sample analysis to determine the accuracy of the data in order to comply with the OMB memorandum and validated USASpending.gov prime Federal award financial data with data maintained in the IRS financial system. Based on the results of our analysis, IRS records on USAspending.gov through the fourth quarter for contracts are 99.9 percent accurate and for grants are 98.9 percent accurate.

Reports Consolidation Act of 2000

In accordance with the Reports Consolidation Act of 2000, the IRS provides assurance that the IRS Critical Performance Measures are reliable. Internal Revenue Manual 1.5.1, Managing

Statistics in a Balanced Measurement System, The IRS Balanced Performance Measurement System, provides a detailed template that documents each measure's definition, formula, reliability, and reporting frequency. These controls verify that performance data is consistently and accurately collected over time.

Limitations of Financial Statements

The principal financial statements have been prepared to report the results of IRS operations, pursuant to the requirements of 31 U.S.C. 3515(b). The statements were prepared from the books and records of the IRS in accordance with generally accepted accounting principles for Federal entities and the format prescribed by OMB. The statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records. The statements should be read with the realization that the IRS is a component of the U.S. Government, a sovereign entity.

Major Management Challenges and High-Risk Areas

GAO and TIGTA identified several Management Challenges and High-Risk Areas facing the IRS. The following are the high risk area identified by GAO in its *2015 High Risk Series Update* (GAO-15-290), the management and performance challenges identified by GAO in the November 12, 2014, *Financial Audit: IRS's Fiscal Years 2014 and 2013 Financial Statements*, (GAO 15-173), and the management and performance challenges identified by TIGTA in its October 15, 2014, memorandum titled *Management and Performance Challenges Facing the Internal Revenue Service for Fiscal Year 2015*.

GAO High Risk Areas for IRS

- Enforcement of Tax Laws

GAO Management Challenges

1. Safeguarding Taxpayer Receipts and Related Information and Physical Security
2. Preventing and Detecting Improper Refunds from Identity Theft
3. Implementing the Tax Provisions of the Patient Protection and Affordable Care Act

1. SAFEGUARDING TAXPAYER RECEIPTS AND RELATED INFORMATION AND PHYSICAL SECURITY

Summary of Major Issues: Safeguard the large volume of sensitive hard copy taxpayer information, payment receipts, and related information and ensure the physical security of IRS facilities.

Actions Taken:

- Evaluated how to equip all TACs with adequate physical security controls to deter and prevent unauthorized access to restricted areas.
- Revised Internal Revenue Manual 10.23.2.14, *Personnel Security, Contractor Investigations, Re-investigation Requirements* to provide Contracting Officer Representatives (CORs) additional guidance to ensure contractor personnel have an appropriate interim access approval or a final background investigation prior to beginning work on the contract. Moderate risk position incumbents are now subject to re-investigation

every five years and CORs are responsible for initiating required re-investigations. In addition, Procurement implemented Policy and Procedure Memorandum 4.13, *Contractor Submission of Security Documentation*, dated May 12, 2015, which required background investigations for all new IRS contractors and subcontractor employees who are provided unescorted access to IRS facilities, access to sensitive but unclassified information or information systems and assets, or a combination of these.

- Established a policy requiring collaborative oversight between IRS key offices in determining whether potential service contracts involve routine, unescorted, unsupervised physical access to taxpayer information, thus requiring background investigations, regardless of contract award amount.
- Reviewed procedures for visually inspecting all envelopes after extraction of contents to ensure there are no remaining documents and/or remittances.
    - Revised the procedures in IRM 3.10.72.5.6, *Candling Procedures (Initial and Final)*, to include the time when the employee completes the information on the Final Candling Log Sheet to ensure timely deposit after finding.
    - Drafted a new monthly security review checklist to include candling as scored criteria in the submission processing centers.
    - Included use of Closed Circuit Television (CCTV) on unannounced reviews of all lockbox sites to review the candling areas.
    - Revised the questions on the Taxpayer Assistance Center (TAC) Security and Remittance Review Database (TSRRD) to include reconciliation questions using Form 14698 (a new form created to document the managerial reconciliation of logs used in the document transmittal process).
- Updated IRM 1.4.11-7, Territory and Group Manager Mandatory Reviews, Reports and Certifications, to require periodic reconciliations and documentation using Form 14698, Field Assistance TAC Remittance and Non-Remittance Logs Reconciliation and also to require TAC group managers complete the initial periodic reconciliation by April 30, 2015. Managers will be documenting their results for the first and second quarter of FY 2016 into the TSRRD database by April 30, 2016
- Reminded TAC managers to maintain control copies of the acknowledged document transmittals for the three-year retention period and to ship taxpayer receipts and information by traceable overnight mail.

Actions Planned or Underway for FY 2016 and Beyond:

- Continue tracking and monitoring compliance of Security Awareness Training.
- Continue to work with Vendors and Contracting Officer's Representatives to ensure they understand their role in ensuring that IRS contractors are properly trained to have access to systems, facilities, and information.
- Update the IRM to specify that unauthorized access awareness training requirements apply to non-IRS contractors who have unescorted physical access to IRS facilities.
- Establish a process to ensure that the requirement for unauthorized access security awareness training is explicitly communicated to non-IRS contractors who have unescorted physical access to IRS facilities.
- Establish procedures to monitor whether non-IRS contractors with unescorted physical access to IRS facilities are receiving unauthorized access awareness training.

INTERNAL REVENUE SERVICE
Management's Discussion & Analysis
Fiscal Year 2015

2. PREVENTING AND DETECTING IMPROPER REFUNDS FROM IDENTITY THEFT

Summary of Major Issues: The IRS must respond to challenges created by the large number of identity theft-based refund claims it receives by recognizing and mitigating fraudulent claims and minimizing burden on the victims of identity theft.[3]

Actions Taken*:

- Recognized and mitigated fraudulent claims.
    - Stopped more than 30,000 fraudulent prisoner returns with associated refunds of over $1.2 billion.
    - Identified 796,161 potential identity theft fraud cases, representing over $4.7 billion in government revenues protected by the Return Review Program
    - Identified 1,070,803 potentially fraudulent returns representing $6.8 billion in revenue protected by the Electronic Fraud Detection System. Shut down 1,474 false IRS phishing/websites shutting down these schemes within a median of 30 minutes from detection. The IRS shut down 588 malware sites
- Provided specialized outreach and education campaigns to help taxpayers avoid identity theft. Social media outreach included YouTube videos, Tumblr posts, Twitter tweets, and information on the IRS Facebook page.
- Continued the External Leads program collaboration efforts with software developers, banks, and other industries to determine how to better partner to address identity theft and prevent federal monies from reaching the hands of identity thieves. This partnership recovered more than $813 million.

*See TIGTA Management Challenge 4: Fraudulent Claims and Improper Payments on page 66 for additional actions taken.

Actions Planned or Underway for FY 2016 and Beyond:

- Report on findings from the data exchange pilot with state departments of correction and the feasibility of steps to mitigate prisoner refund fraud that do not include agreements to exchange information.
- Report on the results of the Security Summit initiatives addressing fraud identification, information assessment, cybersecurity framework, and raising taxpayer awareness and communication.
    - Test new tax-return related data elements to gain understanding of potential use in pre-refund authentication and identity theft refund fraud detection.
    - Continue the external leads program to detect and mitigate emerging IDT refund fraud patterns and schemes. Develop a standardized industry leads requirement.
    - Examine best practices in Identity Proofing and Trusted Source Authentication that can potentially be adapted or leveraged for the tax ecosystem.
    - Collaborate with Security Summit participants in communication efforts to reach an increasingly diverse set of taxpayers.

[3] GAO 15-173 refers to GAO, *Identity Theft: Additional Actions Could Help IRS Combat the Large, Evolving Threat of Refund Fraud*, GAO-14-633 (Washington, D.C.: Aug. 20, 2014)

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3. IMPLEMENTING THE TAX PROVISIONS OF THE PATIENT PROTECTION AND AFFORDABLE CARE ACT

Summary of Major Issues: Implement new tax provisions, including tax-related health care exchange provisions of the Patient Protection and Affordable Care Act.

Actions Taken*:

- Implemented the premium tax credit (PTC) and individual shared responsibility (ISR) on both individual taxpayer returns and the receipt of Exchange Periodic Data and information statements (Forms 1095-A) from the marketplace for filing season 2015 and post-filing compliance.
- Began using the Accelerated Questionable Credit (AQC) Program to disallow questionable Premium Tax Credit (PTC) claims that were not substantiated during return processing. Potentially erroneous refunds were reduced (12,113 returns were selected).
- Reviewed CMS representation letter indicating there were no material changes to the control environment around the processes executed in support of the BHP, APTC, and CSR payment amounts during the period July 1, 2015, through September 30, 2015. Specifically, CMS management represented that:
  - Internal controls in place at CMS for the period January 1, 2015, through June 30, 2015, were still in place for the requested period with no material changes in the control environment.
  - No internal control gaps were identified during the period July 1, 2015, through September 30, 2015.
  - CMS management is not aware of any fraud or non-compliance with laws and regulations, and did not have any uncorrected misstatements affecting the IRS's financial statements.
- Performed an independent evaluation of CMS's testing of its internal controls.

*See TIGTA Management Challenge 2: Implementing the Affordable Care Act and Other Tax Law Changes, for additional actions taken.

Actions Planned or Underway for FY 2016 and Beyond*:

*See TIGTA Management Challenge 2: Implementing the Affordable Care Act and Other Tax Law Changes, for future actions planned.

TIGTA Management Challenges

Each fiscal year (FY), TIGTA evaluates IRS programs, operations, and management functions to identify the areas of highest vulnerabilities to the Nation's tax system. For FY 2015, the top management and performance challenges, in order of priority, were:

1. Security for Taxpayer Data and IRS Employees
2. Implementing the Affordable Care Act and Other Tax Law Changes
3. Tax Compliance Initiatives
4. Fraudulent Claims and Improper Payments
5. Achieving Program Efficiencies and Cost Savings
6. Modernization
7. Providing Quality Taxpayer Service Operations
8. Globalization
9. Taxpayer Protection and Rights

10. Human Capital

The IRS addresses these issues through new and existing program activities. Measures of these program activities serve to show progress in addressing these management challenges. Summarized below are actions taken in FY 2015 and actions planned for FY 2016 and beyond to address the top management and performance challenges facing the IRS.

1. SECURITY FOR TAXPAYER DATA AND IRS EMPLOYEES

Summary of Major Issues: Promote measures for appropriate physical security and protection of financial, personal, and other sensitive information.

Actions Taken:

In order to protect the integrity of taxpayer data and minimize opportunity for fraud, the IRS took steps to improve document security and neutralize third party efforts to obtain data. In FY 2015, the IRS:

- Added a two-dimensional (2D) barcode feature that masks SSNs and improves our ability to read data on 35 individual nonpayment notices (with an annual estimated distribution of 17.5 million documents) and to 22 Automated Collection notices (with an estimated 5.2 million documents). The feature was added to these notices based on ongoing IRS efforts to balance the protection of taxpayers' identities in the short term and movement toward electronic and online correspondence in the long term.
- Identified and shut down 1,474 false websites.
- Developed templates for Memoranda of Understanding (MOUs) and Interconnection Security Agreements (ISAs) that meet the National Institute of Standards and Technology (NIST) standards; the MOU establishes the management agreement between the IRS and the external partner regarding the development, management, operation, and security of the interconnection, and the ISA documents the technical and security requirements for the interconnection.
- Identified all external interconnections used to share tax information with other entities and updated the centralized inventory accordingly.

In addition, the IRS took steps to improve physical and personnel security by:

- Completing security risk assessments at 155 facilities nationwide.
- Delivering Active Shooter/Threat and Workplace Violence training to employees at 175 large posts of duty and campuses.
- Updating Internal Revenue Manuals and Procurement policies to ensure security provisions were included in all contract documents and that contractor personnel have completed appropriate background investigation activities prior to starting work.
- Establishing policies requiring oversight of service contracts and determinations of whether unescorted/unsupervised access is required to IRS facilities, which would require background investigations for the contractor staff.

Actions Planned or Underway for FY 2016 and Beyond:

In FY 2016, the IRS will continue to protect the integrity of taxpayer data, minimize opportunities for fraud, improve physical and personnel security, and will:

- Improve the safety and security of IRS facilities and personnel by partnering with Homeland Security and federal law enforcement entities to deliver site-specific in-person security briefings to staff.

- Protect and preserve critical IRS data by implementing additional records management efforts to electronically archive email by January 2017 and, to the extent possible, all permanent records by January 2020.
- Update policy and develop procedures for monitoring the IRS's inventory of external interconnections and ensuring all appropriate agreements are approved and in place before interconnections are established.

2. IMPLEMENTING THE AFFORDABLE CARE ACT AND OTHER TAX LAW CHANGES

Summary of Major Issues: Correctly implement new tax provisions, including tax-related health care provisions of the Patient Protection and Affordable Care Act (ACA).

Implementing the Affordable Care Act

Actions Taken:

In order to ensure that the public, our partners in federal and state government, and the health care exchanges are fully versed in the details of ACA, the IRS took a number of steps to maintain open and active lines of communication, such as:

- Created and deployed communication products related to ACA tax provisions, payments, credits, and other subjects through various channels, including the http://www.irs.gov/aca site.
- Ensured consistency of messaging through continuous, open dialog and coordination with partners such as federal and state agencies, tax practitioners, software developers, and others.
- Consolidated taxpayer outreach activities within the Wage & Investment division, expanded customer service options, and created new VITA program training on ACA.

To improve on our filing season successes, the IRS also took steps to clarify provisions of the act as well as the forms and supporting documentation required by:

- Correcting mailing address issues on Form 8947, *Report of Branded Prescription Drug Information*, to improve routing and reduce processing time and errors.
- Using existing tax data and information from the Food and Drug Administration (FDA) to improve communication with medical device taxpayers in order to ensure that Form 720, *Quarterly Federal Excise Tax Return* filing requirements were met.
- Engaging with tax practitioners and other external stakeholders on filing season issues such as incorrect Forms 1095-A, *Health Insurance Marketplace Statement*, issued by the Centers for Medicare & Medicaid Services (CMS); missing or incomplete Forms 8962, *Premium Tax Credit*; and clarification of exemption processing.
    - The IRS received millions of information returns, Forms 1095-A, from the Healthcare Marketplaces via the CMS Data Hub. Certain taxpayers initially received Forms 1095-A from Marketplaces that contained erroneous information. Treasury provided relief to taxpayers who had already filed their returns using the erroneous forms at the time the error was announced by relieving them of the obligation to file an amended return unless they voluntarily chose to do so.
    - As of the end of June, approximately 3.2 million taxpayers have filed Form 8962, three million of whom reported Advanced Premium Tax Credit (APTC). These taxpayers reported a total of approximately $10 billion in APTC of the approximately $15.5 billion the Marketplaces paid out in 2014.

- Sending letters to the approximately 710,000 taxpayers who had APTC paid on their behalf but who have not filed a tax return or an extension, to remind them of the requirement that they file to reconcile the APTC payment to their entitlement.
- Corresponding with the approximately 760,000 taxpayers with APTC who filed a return but did not attach Form 8962 to reconcile those payments, as required.

The IRS also undertook efforts to minimize instances of and opportunities for error and fraud. As part of this effort the IRS:

- Updated Information Technology (IT) systems to handle filing season 2015 activities, including reconciliation of the APTC, calculation of the Premium Tax Credit (PTC), the individual shared responsibility provision, and exemptions.
- Developed a PTC compliance data analytics strategy with research projects and a data analysis plan to improve compliance check processes and fraud detection.
- Piloted a tool to assist examiners in calculating the Shared Responsibility Payment (SRP) during the course of adjusting a tax return. The IRS will assess the feasibility and cost of providing an online SRP estimator tool.
- Updated the Safeguard Security Report approval process for health care agencies to include system security test results, security awareness training, key security policies, and a security authorization memorandum.

Actions Planned or Underway for FY 2016 and Beyond:

Recognizing the ongoing challenge of protecting taxpayer data, the IRS will in 2016 be taking additional steps to ensure ACA-related tax information remains secure. Preventative actions will include revising Publication 1075, *Tax Information Security Guidelines for Federal, State and Local Agencies*, to require submission of documentation confirming information system security controls exist, have been tested, and are effective before the IRS will approve an initial Safeguard Security Report.

The IRS will also continually engage with stakeholders and undertake efforts to improve information availability and compliance activities by:

- Coordinating with Federal and State Marketplaces to update requirements for submission of Exchange Periodic Data (EPD), which is critical for reconciling claims.
- Improving communication and outreach in order to better inform taxpayers and practitioners about the acceptance and validation of information returns, processing activities, and compliance efforts.

In addition, we will engage in process improvement and compliance activities to reduce instances of error and fraud. For example, we will:

- Improve products, including instructions to IRS Form 8962, Premium Tax Credit, to help ensure taxpayers understand their responsibilities.
- Interview and survey taxpayers and preparers that made PTC errors to find causes, and communicate cautions to taxpayers.
- Reconcile PTC information returns (Form 1095-A) with tax returns to identify errors and noncompliance.
- Refine procedures for identifying non-filers from the FDA's priority registrant list and take appropriate compliance actions.
- Conduct outreach to the estimated 300,000 low-income taxpayers who reported an individual shared responsibility payment when they could have claimed a health care coverage exemption. This outreach will include informing these taxpayers about

available exemptions and providing information about the potential benefit of amending their return.
- Implement information returns reporting by applicable large employers and insurance providers.

Other Tax Law Changes

Actions Taken:

Recognizing that criminals everywhere, including those incarcerated in correctional facilities are continually exploring new avenues to defraud the government and the public, the IRS has taken numerous steps in FY 2015 to detect and deter these efforts. Actions included:

- Coordinated with state Departments of Corrections (DOCs) to establish data exchange processes to identify and prevent tax fraud by inmates. The IRS secured seven agreements on exchanges of Federal Tax Information (FTI) data, conducted a pilot of the exchange process, and analyzed the return on investment for the process, which proved to be effective for the IRS and reduced burden for the states.
- Modified filters and models to identify business filings with withholding claims that were either unsubstantiated or supported by fake or fraudulent information documents, and developed new decision models for processing year (PY) 2016.
- Analyzed a sample of Forms 1120, *U.S. Corporation Income Tax Return*, filed during processing years 2011-2013 with overpayments and refundable credits, with the results used to develop filters for business filings for identified fraudulent claims.

Actions Planned or Underway for FY 2016 and Beyond:

In the future, the IRS will continue fraud detection and compliance efforts. Planned activities include:

- Preparation of a report of the DOC data exchange pilot which will include findings and recommendations for mitigating fraud.
- Establishment of Safeguard Security Reports (SSRs) governing the exchange of data with DOCs for inmates who file false returns.
- Filing of administrative fraud or similar charges against inmates to deter future fraud.

3. TAX COMPLIANCE INITIATIVES

Summary of Major Issues: Improve compliance and fairness in the application of the tax laws.

Businesses and Individuals

Actions Taken:

As part of our efforts to improve compliance and engage more effectively with taxpayers, in FY 2015, the IRS has undertaken a number of outreach and study efforts. Both face-to-face visits and soft notice letters have been determined to be effective means of improving voluntary compliance of return preparers, with the letters being more cost effective as a compliance tool. The IRS has also developed a compliance strategy for examining questionable ITIN preparer returns during initial screening, and has developed measures to improve productivity for Merchant Card audits based on studies of past results.

In addition, the IRS has also expanded efforts to reach emerging small business segments through the use of technology and partnerships. Our efforts have included:

- Deployed the Payment Mix Comparison Tool (PMCT) pilot, which allows tax professionals to use the same analytics the IRS uses to identify potential underreported income and therefore improve voluntary reporting of cash receipts by businesses.
- Prepared information on potential misapplication of the foreign income exclusion to use in outreach activities to the Merchant Marine population.
- Established a team to research the extent and nature of partnership misreporting and the effectiveness of examinations in detecting misreporting.
- Piloted the use of data from Form 1099K, *Payment Card and Third Party Network Transactions*, to identify non-filed returns and, based on the findings, incorporated the information as part of the IRS's non-filer program.
- Implementation of a Federal Tax Deposit Alert test intended to explore how changes to the timing and nature of alerts and notices affect voluntary compliance.
- Delivered a successful Small Business Week campaign - including traditional and social media outreach as well as a video portal with webinars
- Engaged with taxpayers to increase awareness of Online Payment Agreement (OPA) options available through the OPA page of the IRS.gov web site.

Finally, to ensure that revenue officer inventory levels were maintained at close to full capacity while ensuring the inventory levels are commensurate with the complexity of the cases, the IRS issued a memorandum reminding Field Collection group managers to ensure that their revenue officer inventory levels are within current inventory levels and are appropriate, taking into account the complexity of the cases.

Actions Planned or Underway for FY 2016 and Beyond:

In the coming year the IRS will follow up on many of the projects and initiatives instituted during the current fiscal year. Efforts will include:

- Increasing the frequency of Federal Tax Deposit Soft Notice Letters to ensure earlier contact with taxpayers that are predicted to owe taxes at the end of the quarter.
- Determining the Merchant Card program's goals and strategy.
- Evaluating whether the current inventory ranges for revenue officers are appropriate as part of the ongoing study on the complexity of Field Collection cases.
- Analyzing partnership data for the purposes of understanding how many partnership structures will be impacted by proposed tax law change and determine the potential impact to the partnership examination process.
- Evaluating existing policies and procedures for backup withholding requirements on information returns, determining if changes need to be made, and developing next steps.

Additionally, the IRS expects to undertake a number of other initiatives related to tax compliance and identity theft. Actions will include:

- Incorporating calendar year 2015 Refund Hold extract data into the existing Delinquent Return Refund Hold program, and using that data to determine whether measures should focus on dollars collected, filing compliance, or inventory.
- Reviewing approximately 500 tax year 2013 business return filings for identity theft cases and any new returns systemically identified by the newly developed filters.

INTERNAL REVENUE SERVICE
Management's Discussion & Analysis
Fiscal Year 2015

Tax-Exempt Entities

Actions Taken:

Ensuring the integrity and effectiveness of our outreach and compliance efforts with the tax exempt community continues to be a high priority for the IRS. One of the key areas of focus has been on improving guidance. Significant accomplishments here include:

- Developed Internal Revenue Manual (IRM) 4.75.8, *Compliance Strategies and Critical Initiatives (CSCI),* which documents processes for initiating Compliance Initiatives Projects for exempt organization examinations, selecting cases based on Form 990, *Return of Organization Exempt From Income Tax*, data, and developing work plans.
- Crafted an exempt organization post-determination compliance process for approved applications for tax-exempt status with procedures for sampling cases, managing inventory, conducting correspondence desk audits, and drafting information document requests.
- Implemented a process for measuring compliance of organizations filing Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code,* or Form 1024, *Application for Recognition of Exemption Under Section 501(a),* that received a determination letter through the streamlined process.
- Solicited public comment on proposed changes to the Employee Plans Determination process from stakeholders in Congress and the tax professional community.
- Finalized an employee desk guide for, and conducting training on, Employee Plans Determination process changes, including the documents necessary for processing Forms 5300, *Application for Determination for Employee Benefit Plan,* and 5310, *Application for Determination for Terminating Plan*, after February 1, 2015.

In addition to these activities, the IRS is continually monitoring internal processes and procedures in order to identify opportunities for improvement. Actions included:

- Documented the risks and mitigation strategies associated with revised Employee Plans Determinations case processing procedures.
- Implemented recommendations from the Data Strategy Team draft report, resulting in the development of a pilot process for analyzing Form 1023-EZ data, the evaluation of tax-exempt revocation data in an effort to identify trends or patterns, and the assessment of the impact of a proposal to modify a program for individually designed retirement plans.

Finally, the IRS continues to monitor program performance and compliance activities in the tax exempt/government entities sector. Key actions during FY 2015 included:

- Analyzing 554 closed examinations in the Risk Modeling II (RMII) project for Employee Plans and comparing them to 17,060 closed examinations, with results indicating RMII project cases had more instances of non-compliance.
- Conducting pre-determination compliance reviews on 1,271 Forms 1023-EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code.* Of those, 1,140 were closed with 900 cases (79 percent) accepted and 223 cases (21 percent) rejected.
- Developing a post-determination compliance process and conducting an examination on statistically sampled cases of organizations that received a determination letter through the streamlined process when filing a Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code* or Form 1024, *Application for Recognition of Exemption Under Section 501(a)*.

Actions Planned or Underway for FY 2016 and Beyond:

In FY 2016, the IRS will continue its efforts to improve tax exempt outreach and compliance activities. We anticipate a number of process improvements resulting from internal projects and stakeholder recommendations. For example, in the upcoming fiscal year the IRS will:

- Assess the recommendations from the Risk Modeling II project and determine how to apply them to the Employee Plans examination case selection process in order to improve the model.
- Analyze the data from the pre-determination compliance process to determine if updates to Form 1023-EZ and instructions are needed.
- Continue the post-determination compliance process for sampled cases and analyze the results to determine if ineligible organizations obtained exemptions, what the organizational issues were, and where the IRS needs to focus in the future.
- Initiate the second phase of the post-determination compliance program, on organizations granted exemption pursuant to the Form 1023-EZ.
- Revise the individually designed plan determination letter revenue procedure to incorporate program changes recommended by a Lean Six Sigma review.
- Complete the Lean Sigma Six review of the direct pay bond credit payment process and implement options to reduce the scope of the direct pay bonds compliance reviews and to streamline the review process.

4. FRAUDULENT CLAIMS AND IMPROPER PAYMENTS

Summary of Major Issues: Increase the ability to detect, prevent, and track fraudulent tax returns, improve assistance to victims of identity theft, and identify, measure, and reduce improper payments.

Actions Taken:

The IRS continues to pursue opportunities to reduce fraud and improper payments. The constant rise of identity theft has been of increasing concern. To combat this, the IRS has:

- Engaged in a Security Summit - a joint effort among the IRS, states, and private industry intended to identify solutions for reducing identity theft and refund fraud by leveraging taxpayer data at the point of filing.
- Prepared a legislative proposal to obtain expanded access to the National Directory of New Hires database to improve the verification of claims for other income-based refundable credits.
- Prepared a legislative proposal to move the required filing date for Forms- 1098-T, *Tuition Statement*, to January 31 so that this information can be used at the time the tax return is processed to help identify improper education credit claims.
- Activated improved identity theft filters for the 2015 filing season to consider fraud potential when multiple returns are filed using the same addresses and/or refunds are requested for the same bank accounts.
- Developed and applied operational metrics and compliance treatments for the PTC using both Automated Questionable Credit and identity theft filters to complete the risk scoring model for the credit as required by the Improper Payments Elimination and Recovery Act (IPERA).
- Updated our notices to taxpayers to provide better information on how the Identity Protection Personal Identification Number (IP PIN) works in the filing process.
- Issued 1.6 million PINs to taxpayers identified by the IRS as identity theft victims and provided an additional 180,075 PINs online to taxpayers who were able to authenticate their identity and opted for an IP PIN.

- Improved our ability to identify and address the misuse of Employer Identification Numbers (EINs) in the filing of false Forms W-2, *Wage and Tax Statement*, showing nonexistent income, which are in turn used to claim a fraudulent refund by filing a fabricated Form 1040, *U. S. Individual Income Tax Return.*

In addition, recognizing that the EITC program is a significant source of improper payments, the IRS has taken steps to mitigate error and fraud related to this program. In FY 2015, the IRS:

- Expanded the use of EITC Preparer Strategy interventions before and during the 2015 filing season to include monitoring over 31,000 preparers. As a result we protected nearly $465 million in revenue as well as sent more than 15,000 warnings and nearly 800 e-file alerts to EITC Return Preparers missing Form 8867, *Paid Preparer's Earned Income Credit Checklist*.
- Analyzed National Research Program (NRP) data and determined that approximately half of EITC errors are related to qualifying child claims while nearly one-third is due to income misreporting.

The IRS has also taken steps to assess the risk of Improper Payments in the ACA PTC program. Efforts undertaken include:

- Conducting a qualitative risk assessment in compliance with both the Office of Management and Budget's (OMB's) Circular A-123 Appendix C and Department of Treasury guidance.
    - The qualitative assessment included a series of risk-based questions focused on the PTC program which were addressed with input from IRS business units and the ACA Program Management Office (PMO).
    - The assessment concluded with a medium risk of improper payments from the program.
- Engaging a contractor to support the development of a more comprehensive end-to-end risk assessment for the subsequent cycle in order to capture process flows from CMS and provide a more comprehensive view of the entire process and the potential for improper payments.
- Coordinating with Treasury, Health and Human Services (HHS), CMS, and stakeholders within the IRS to develop scenarios defining what constitutes an improper payment for the PTC program.
- Developing joint reporting language for describing in the Treasury and HHS Agency Financial Reports the progress made on ACA APTC and PTC issues as well as the next steps.

Actions Planned or Underway for FY 2016 and Beyond:

In FY 2016, the IRS will continue efforts to address improper payments, identity theft, and fraud. Planned actions include:

- Determining how to measure how paid return preparers respond to IRS efforts to curb erroneous and fraudulent EITC claims in order to identify the most effective approaches for outreach and compliance.
- Updating filters on our return processing and fraud detection systems in order to improve our ability to identify and neutralize the misuse of EINs.
- Coordinating with the Social Security Administration (SSA) to identify information that could be shared to facilitate fraud detection efforts.

- Developing a filing season 2016 pilot to verify Form W-2 data using an authentication code on e-filed Forms 1040.
- Evaluating identity theft-related refund fraud trends and using this information to improve fraud filter performance.
- Working with the contractor to develop and deploy a more robust, end-to-end qualitative risk assessment for the ACA PTC program for the FY 2016 review cycle.
- Completing the scenarios and attendant definitions around what does and does not constitute a PTC improper payment, and sharing that information with OMB.
- Delineating the impact of the renewal of the Health Care Tax Credit (HCTC) on the APTC and PTC.
- Implement information returns reporting by applicable large employers and insurance providers and send new Forms 1095-C, Employer-Provided Health Insurance Offer and Coverage, and 1095-B, Health Coverage, to applicable individuals.

5. ACHIEVING PROGRAM EFFICIENCIES AND COST SAVINGS

Summary of Major Issues: Improve program effectiveness and reduce costs.

Actions Taken:

Throughout FY 2015, the IRS has continuously looked for opportunities to find cost savings and improve the efficiency with which the Service operates. The IRS has taken numerous actions during the course of the fiscal year covering a variety of disciplines. For example, a focus on improving IT efficiency and cost effectiveness resulted in the IRS initiating the development of a process for managing software licenses on a Servicewide basis in order to ensure the IRS uses what it has, and has only what it needs.

Similarly, the IRS has taken a number of steps to improve resource management and internal prioritization practices. In FY 2015, the Service:

- Performed a cost analysis on several web-based services in order to derive data points such as the cost per digital interaction and the "Get Transcript" application.
- Evaluated the accuracy of the overhead rate applied to interagency reimbursable agreements in order to ensure that the IRS is recouping the full cost of services provided to other governmental entities.
- Analyzed the potential resource impact of closing several international offices.
- Automated the Federal Employee/Retiree Delinquency Initiative (FERDI) processing, making it more effective and efficient.
- Developed and implemented a process to ensure accuracy in matching monthly billing statements to inventory records for wireless devices.
- Continued to grow and develop the Enterprise Risk Management (ERM) program as a means for employees to identify and prioritize Servicewide risks. In the past year, the ERM program deployed podcasts and Servicewide electronic training (completed by ninety-six percent of all managers and management officials); developed guidelines for creating key risk indicators; published an overview of mitigating activities for 15 categories of enterprise risks; and created channels for employees to raise potential risks they have identified.

Additionally, the IRS has continued efforts to improve the efficiency of our taxpayer-facing programs as well. For instance, this year the IRS:

- Developed a sampling plan and introduced new data elements and industry partnerships into the Return Review Program in order to improve selections.

- Collaborated with Treasury, the Do Not Pay Office (DNP), OMB, and SSA to secure Prisoner Update Processing System (PUPS) data for testing, which could ultimately allow the sharing of PUPS data with the IRS for use in fraud detection and prevention.
- Crafted a communications outreach plan to promote e-filing for business returns, including outreach to IRS advisory groups and other stakeholders, surveys of tax professionals and small business taxpayers, focus groups of tax professionals, and updates to information available about e-filing the 940 family of forms on IRS.gov to ensure it is easily accessible and understandable.

Actions Planned or Underway for FY 2016 and Beyond:

As we begin FY 2016, the IRS will continue efforts to achieve cost efficiencies and program savings. We will carry on our IT-related efforts as we complete efforts to:

- Develop an enterprise-wide approach to tracking and managing software licenses.
- Improve software asset management through the consolidation of the Software Asset Management tool, the publication of asset management guidance and standard operating procedures, the consolidation of accountability for software asset management into the Enterprise Software Governance Board, and the establishment of self-audit procedures for license, vendor, and product management.
- Develop and implement a process to obtain current and future FPS Facility Services Assessments for IRS facilities upon completion; and integrate FPS FSA findings in risk assessments and revalidation processes performed by the IRS.
- Identify and expand the use of the Federal Payment Levy Program (FPLP) to other federal payments and plan to work with the appropriate agencies to make the necessary changes to include military retirement payments.

Moreover, the IRS will focus on improving operational efficiency through efforts that will include:

- Development of cost-based performance measures for our Notice programs.
- Identification of non-financial data that could be used to create managerial cost accounting reports.
- Deployment of updated enterprise risk management training, including specific scenario planning/response exercises focused on critical risks; the development of key risk indicators for enterprise risk themes and categories; and the launch of an enterprise-wide index of Risk Acceptance Form/Tools.

6. MODERNIZATION

Summary of Major Issues: Improve taxpayer service and efficiency of operations

Actions Taken:

Modernized systems and processes are essential to maintaining high-quality taxpayer service programs as well as to protecting IRS systems and taxpayer data. In FY 2015, the IRS addressed challenges in these areas through several actions, which include:

- Consolidation and migration of the Detroit Computing Center infrastructure to other sites in Memphis, Martinsburg, and Ogden and the backup of data to the gaining site.
- Commencement of installation of equipment in the Martinsburg and Memphis computing sites to ensure IRS networks meet "world class" standards. This included:
  - Increasing network survivability with a new telecommunications main distribution frame
  - Expanding data center usage to other agencies, including Treasury and TIGTA

- Developing a Radio Frequency Identification (RFID) system to improve hardware identification and inventory management in Martinsburg
- Deployment of code changes to multiple IRS systems in order to ensure penalty and interest calculations are performed consistently.
- Development of a Customer Account Data Engine (CADE 2) Transition State 2 Release Plan to address core Individual Master File (IMF) financial material weakness requirements for individual taxpayer accounts, leverage the CADE 2 database as the authoritative data source, and migrate core IMF functions to another code language.
- Deployment of new capabilities associated with Online Bill Pay, IRS Direct Pay, Online Payment Agreement, return preparer lookup, and the IRS2Go mobile application in time for the opening of the tax filing season.
- Creation of a business-driven Enterprise Case Management (ECM) Program Management Office to oversee the development of an ECM system that will, over time, standardize case management functions, implement an infrastructure platform, and provide common services that a case management application will leverage.

Actions Planned or Underway for FY 2016 and Beyond:

In FY 2016, the IRS will continue its modernization efforts through a series of actions intended to improve system performance and integrity. For example, the IRS will:

- Deliver several CADE 2 Transition State 2 projects that will allow downstream systems to pull CADE 2 data, correct failure to pay penalty computations for adjusted refundable credits, provide financial data to the IRS general ledger and sub-ledger, and generate data necessary to build financial and legal transcripts.
- Implement the Radio Frequency Identification (RFID) system developed for Martinsburg in order to enhance hardware identification and inventory management.
- Perform data extracts to determine risk profiles for eAuthentication users.

7. PROVIDING QUALITY TAXPAYER SERVICE OPERATIONS

Summary of Major Issues: Improve taxpayer service

Actions Taken:

Providing high quality service to taxpayers is one of the Service's ongoing goals. Despite resource constraints the IRS has made an effort to conduct outreach and improve our service delivery processes, which included:

- Piloting appointment scheduling for taxpayers who have a need for face-to-face service at the Taxpayer Assistance Center locations.
- Providing taxpayers with more digital self-service options, including modernizing the IRS public website, improving web content and design, and optimizing search capabilities.
- Implementing the use of special processing codes to expedite assignment to identity theft (IDT) victim assistance units; and deploying specialized teams to focus on older IDT cases.

We continue to look for opportunities to optimize Virtual Service Delivery (VSD). During FY 2015, we used capacity data from five sites to help guide decision-making around potential taxpayer and support site locations, while at the same time conducted outreach with Low Income Taxpayer Clinics to market VSD in the nine sites where it is presently available. In addition, we improved service in our VITA sites by:

- Promoting VITA as an alternative to the traditional face-to-face model for preparation of amended, prior, and current year returns.
- Revising policies for volunteer preparation of amended and prior-year returns, making it easier for volunteers to meet certification requirements which resulted in more taxpayers being served.

Finally, the IRS developed a multi-year strategy to add the eBook format to our existing electronic formats of PDF and HTML for tax publications and Form 1040 instructions. EBooks are readable by mobile devices such as tablets, e-readers, and smartphones. The e-Pub format meets section 508 compliance requirements, allows content searches and automatic resizing of text to the device's screen size, as well as the addition of comments and bookmarks. As of Sept 30, 2015, there are 29 tax publications available as eBooks on IRS.gov, including Publication 17, Your Federal Income Tax (For Individuals). There have been 84,213 e-pub downloads of which 41,715 were for Pub 17.

Actions Planned or Underway for FY 2016 and Beyond:

In the future the IRS will continue to look for opportunities to expand the scope and availability of taxpayer service options. We will engage in efforts to improve the availability of electronic service delivery through efforts such as:

- Focusing on development of additional web applications for taxpayers that will allow them to easily find answers to frequently asked questions (FAQs).
- Continuing efforts to educate taxpayers on the availability of self-service channels, including online channels, to supplement face-to-face services in the Taxpayer Assistance Centers.
- Developing electronic filing and processing capabilities for Form 1040X, *Amended U.S. Individual Income Tax Return.*
- Enhancing *"Where's My Refund?"* messaging on web and telephone automated applications to provide victims of identity theft the accurate status of their refund.
- Using the annual Service Approach process to ensure that the projects proposed for implementation align with the IRS's long-term vision for modernizing taxpayer service.
- Developing processes and procedures to calculate the average time it takes to resolve taxpayer accounts affected by identity theft.

Additionally, the IRS will continue to provide, and look for opportunities to improve upon, traditional means of taxpayer service. Actions will include:

- Determine how best to utilize resources to deliver taxpayer service through the Volunteer Income Tax Assistance/Tax Counseling for the Elderly programs.
- Strengthen the delivery of outreach and education to the tax professional community by identifying outreach topics which most impact voluntary compliance and the accuracy of returns.
- Provide taxpayers the option to make appointments for walk-in service at all TACs.
- Promote the increased use of alternative tax preparation methods in support of expanded access to free tax preparation services.

8. GLOBALIZATION

Summary of Major Issues: Increase the outreach efforts to foreign governments on cross-border transactions.

Actions Taken:

Many of the IRS's actions in FY 2015 focused on improving communication and compliance, and enhancing our ability to interact with global third parties, which included:

- Updating IT systems to allow foreign tax authorities and financial institutions to test file submission processes as well as register and provide their information.
- Improving the Fraud Referral Program and examinations of 501(c) tax exempt entities, which allowed the IRS to identify 19 entities suspected of being involved in illicit terrorist financing activities, refer five entities and their principals for investigation, and identify five tax-exempt organizations potentially warranting civil examination.
- Developing a formal International Collection training plan using cross-functional subject matter experts.
- Extending the Offshore Voluntary Disclosure Program to encourage taxpayers to voluntarily report their previously undisclosed foreign accounts and assets; the IRS has collected over $6 billion since program inception.

Actions Planned or Underway for FY 2016 and Beyond:

In FY 2016, the IRS will continue to address global threats to compliance and tax administration by:

- Enhancing the Foreign Account Tax Compliance Act (FATCA) registration system with additional capabilities such as permitting renewal of Foreign Financial Institution (FFI) agreements, allowing the bulk upload of sponsored entity and subsidiary branch information and the subsequent assignment of a Global Intermediary Identification Number (GIIN) to each, improving search and download features, and adding features and documents to support the certification process.
- Supporting the Organization for Economic Cooperation & Development (OECD) with efforts to develop the Common Transmission System for global tax exchanges and to ensure alignment with FATCA.
- Updating the activities in the FATCA Compliance Roadmap for identifying noncompliance by FFIs.
- Establishing controls to ensure Form 1116, *Foreign Tax Credit (FTC)*, is attached to the return when required; ensuring that any training materials and additional guidance related to FTCs are updated, and that employees comply with the updated guidance; and improving educational, outreach and enforcement activities to correct the paid preparer issues related to the FTC.
- Conducting civil examinations of tax exempt entities suspected of knowingly being involved in illicit financing of terrorist activity and initiating criminal investigations.
- Training IRS employees to recognize potential violations of U.S. tax law with respect to tax-exempt organizations and the misuse of charities to fund terrorism.

9. TAXPAYER PROTECTION AND RIGHTS

Summary of Major Issues: Apply the tax laws fairly.

Actions Taken:

Identity theft is a major area of concern for the IRS and taxpayers alike. The IRS takes its commitment to protecting taxpayer data seriously. To that end, we have engaged in a number of activities in FY 2015 to promote data protection, including partnering with external stakeholders, sharing best practice information, and validating information in returns to prevent fraudulent refunds. Some of the accomplishments include:

- Working through the State Suspicious Filers group to increase IRS collaboration with states on identity theft, fraudulent refunds, and the transmission of leads from the states to the IRS.
- Collaborating with stakeholders of the Security Summit Information Sharing Team to increase data-sharing to protect taxpayer identities and prevent identity theft.
- Stopping more than 1.7 million fraudulent returns with associated refunds of more than $14 billion.
- Reviewing and correcting the taxpayer accounts that were identified with Collection Statute Expiration Date errors.

Additionally, the IRS is working to improve the handling of complaints against tax return preparers, so that we can ensure the matters are processed timely, accurately, and consistently. Actions taken were:

- Developed goals that measure specific components of complaint processing, including timeliness.
- Created processes for separation of duties related to receiving, recording, and reconciling complaints into the Return Preparer Database.
- Developed a process to ensure that criteria for referring complaints to other IRS business functions are appropriately applied.
- Updated the functionality of the Return Preparer Database to permit the production of management information reports from the complaint module.

Finally, the IRS has updated its internal processes and policies in order to minimize potential drivers for mistreatment of taxpayers. For example:

- Updated IRM 1.5.2, *Managing Statistics in a Balanced Measurement System, Uses of Section 1204 Statistics,* to change the requirement for the frequency of mandatory training on the prohibition of the use of records of tax enforcement results (e.g. dollars collected, levies issued, etc.) in the setting of performance goals to annually instead of biennially.
- Revised IRM 1.5.3, *Manager's Self-Certification and the Independent Review Process,* to provide guidance on the use of the HR Connect e-Performance system when conducting virtual reviews as part of the Section 1204 (prohibition of the use of records of tax enforcement results) process. The changes made the process more efficient and less time-consuming, resulting in a reduction of managerial burden.
- Updated IRM procedures to reflect that the Lien Unit should verify all notice of federal tax lien (NFTL) requests in which the check box on the Form 12636, *Request for Filing or Refiling Notice of Federal Tax Lien,* box 4 is blank.

Actions Planned or Underway for FY 2016 and Beyond:

In order to protect the safety and security of taxpayer data, the IRS will:

- Continue to collaborate with Federal, State and local agencies on best practices for authentication and identity protection.
- Implement recommendations of the Security Summit Information Sharing Team.
- Establish IRM procedures to timely research taxpayer accounts when lien notices are returned with multiple reasons for return and ensure that the lien notice was mailed to the taxpayer's last known address.
- Revise the guidelines for advertising the sale of seized property and issue a memorandum to remind employees of the requirements to be followed when revising fair market values affecting minimum bids.

10. HUMAN CAPITAL

Summary of Major Issues: Enable the IRS to successfully achieve its mission.

Actions Taken:

Given the resource challenges facing the IRS, employee morale and professional development continue to be high priorities for the Service. In order to promote knowledge management, cross-training, and skills development, the IRS has in FY 2015:

- Initiated an IRS-wide focus on Knowledge Management, which is a discipline that promotes an integrated approach to identifying, capturing, evaluating, retrieving, and sharing all of an enterprise's information assets. As part of this process we:
  - Documented knowledge transfer plans and financial management training.
  - Created Knowledge Networks for 10 tax law expertise areas in Employee Plans and Exempt Organizations and created a single searchable website for these networks' resource repositories.
  - Leveraged 35 Geographic Leadership Communities (GLC) covering 76 percent of IRS executives and supervisors to create an environment focusing on career development, employee engagement, and support for emerging leaders.
- Closed the third and fourth phase of the Treasury Workforce Planning Pilot for Acquisition/Contract Specialists after assessing attrition risks and required skill sets, and projecting human resource needs.
- Determined, in conjunction with the Office of Personnel Management (OPM), whether and during what part of the hiring process the IRS can fully consider prior conduct and performance issues, The IRS will use this information, in conjunction with OPM Suitability standards, in considering prior IRS employment history when rehiring former employees.

In addition, the IRS focused on morale building and employee engagement efforts by:

- Developing a new recognition policy for non-monetary awards with details on each award and its qualifications and links to the Servicewide Recognition Web.
- Creating a Leadership Engagement Action Plan (LEAP), combining planned IRS employee engagement efforts into a single, corporate engagement strategy based on the Four Pillars of Engagement: Lead, Listen, Develop and Support.

Actions Planned or Underway for FY 2016 and Beyond:

In order to continue our human capital successes in FY 2016, the IRS will:

- Implement the new recognition initiatives, the Leadership Engagement Action Plan (LEAP), and additional Knowledge Networks on other technical topics.
- Assess the structure and operations of IRS functions, as well as their technical training and hiring needs, based on workload complexity, resource levels, geographical factors, and other considerations.
- Amend existing Section 1203(b) policy to determine how cases are handled to include a requirement to document the analysis of evidence and the basis for the decision on whether or not to mitigate penalties to something less than termination.

FINANCIAL HIGHLIGHTS

Revenue and Refund Trend Information

FY 2015 revenue receipts collected by IRS increased to $3.3 trillion from $3.1 trillion in FY 2014. Federal tax revenues are collected through six major classifications: individual income and FICA/SECA, corporate income, excise taxes, estate and gift taxes, railroad retirement, and federal unemployment taxes.

FY 2015 tax refund and outlays activity totaled $403 billion, representing an increase of almost 7.8 percent from FY 2014. Federal tax refunds include refunds of tax overpayments, payments for interest, and disbursements for refundable tax credits such as Earned Income Tax Credit and the Additional Child Tax Credit.

Excise Tax Trust Fund

The Quarterly Federal Excise Tax Return, Form 720, reports taxpayer liability for excise taxes. Taxpayers make periodic deposits in advance of filing the return. These deposits are classified as Federal Excise Tax. After the IRS receives and processes the returns, the IRS certifies amounts for several trust funds. Amounts reported on the Statement of Custodial Activity are for fiscal year collections (October 1 through September 30). Because Form 720 reporting requirements are completed after receipt of most of the deposits, the certification amounts will not match the amounts collected in the fiscal year. The table shows revised receipts certified to the Airport and Airway Trust Fund, Black Lung Disability Trust Fund, and the Highway Trust Fund for the eight liability quarters from December 2012 through September 2014. The Department of the Treasury prepares the warrants and allocations to the trust funds.

	Liability Quarter Ended	
	December 2012 – September 2013	**December 2013 – September 2014**
Airport & Airway Trust Fund	$12,867,499,487	$13,601,102,077
Black Lung Disability Trust Fund	$570,661,246	$574,405,800
Highway Trust Fund	$38,340,971,476	$39,608,225,227
Total	**$51,779,132,209**	**$53,783,733,104**

Analysis of Unpaid Assessments – Most Unpaid Assessments Are Not Receivables and Are Largely Uncollectible

The unpaid assessment balance includes amounts owed by taxpayers who file returns without sufficient payment as well as amounts assessed through the IRS enforcement programs. As reflected in the supplemental information to the IRS FY 2015 Financial Statements, the unpaid assessment balance was $389 billion as of September 30, 2015, and $201 billion (52 percent) of this balance consists of interest and penalties. Furthermore, the total outstanding balance of IRS unpaid assessments is largely uncollectible because it is composed mostly of compliance assessments and write-offs. Under federal accounting standards, unpaid assessments require taxpayer or court agreement to be considered federal taxes receivable. Assessments not agreed to by taxpayers or the courts are considered compliance assessments and are not considered federal taxes receivable. Assessments considered to have no future collection potential are called write-offs. The following provides detail on unpaid assessments:

- Taxes receivable represent $171 billion (44 percent) of unpaid assessments and increased $15 billion (10 percent) from $156 billion as of September 30, 2014. About $130 billion (76 percent) of this balance is estimated to be uncollectible due primarily because of the economic situations of the taxpayers. Except generally for bankruptcy situations, the IRS may continue collection actions for 10 years after the assessment. About $41 billion (24 percent) of taxes receivable is estimated to be collectible.

- Compliance assessments of $80 billion represent amounts that have not been agreed to by either the taxpayer or a court. These assessments result primarily from various IRS enforcement programs promoting voluntary compliance.

- Write-off amounts of $138 billion include amounts owed by defunct corporations with no assets and failed financial institutions. The remaining amounts are owed by taxpayers with extreme economic and/or financial hardships, deceased taxpayers, and taxpayers who are insolvent due to bankruptcy.

The Integrated Financial System (IFS)

The IFS is the financial management system for the IRS's administrative activities. IFS also provides timely financial statements and reports in accordance with federal accounting and reporting standards including information for budgeting, analysis, and government-wide reporting.

In addition, IFS provides the core processes of General Ledger, Accounts Payable, Accounts Receivable, Budget Execution, Cost Accounting, Administrative Tax and Travel Accounting, Cost Allocations, Budget Formulation, Labor Forecasting and Budget Execution decision support.

Appendix A

Performance Measures Descriptions

Strategic Foundation: Invest in our workforce and the foundational capabilities necessary to achieve our mission and deliver high performance for taxpayers and stakeholders	
Percent of Major IT Investments within +/- 10% Cost Variance	The percentage of Major IT Investments that are within the +/-10% threshold for cost. The cost variance is measured from the initial cost estimate versus current cost estimate.
Percent of Major IT Investments within +/- 10% Schedule Variance	The percentage of Major IT Investments that are within the +/-10% threshold for schedule. The schedule variance is measured from the initial schedule estimate to the current schedule estimate.
Goal 1: Deliver high quality and timely service to reduce taxpayer burden and encourage voluntary compliance	
Customer Service Representative (CSR) Level of Service	The number of toll free callers that either speak to a Customer Service Representative or receive informational messages divided by the total number of attempted calls.
Customer Contacts Resolved per Staff Year	The number of Customer Contacts resolved in relation to staff years expended.
Customer Accuracy – Tax Law Phones	The percentage of correct answers given by a live assistor on Toll-free tax law inquiries.
Customer Accuracy – Customer Accounts (Phones)	The percentage of correct answers given by a live assistor on Toll-free account inquiries.
Timeliness of Critical Individual Filing Season Tax Products to the Public	The percentage of critical individual filing season tax products (tax forms, schedules, instructions, publications, tax packages, and certain notices required by a large number of filers to prepare a complete and accurate tax return) available to the public in a timely fashion.
Timeliness of Critical TE/GE & Business Tax Products to the Public	Percentage of critical other tax products, paper and electronic, available to the public in a timely fashion.
Percent Individual Returns Processed Electronically	The percentage of electronically filed individual tax returns divided by the total individual returns filed.
Percent Business Returns Processed Electronically	The percentage of electronically filed business tax returns divided by the total business returns filed.
Refund Timeliness – Individual (Paper)	The percentage of refunds resulting from processing Individual Master File paper returns issued within 40 days or less.
Taxpayer Self Assistance Rate	The percentage of taxpayer assistance requests resolved using self-assisted automated services.
Goal 2: Effectively enforce the law to ensure compliance with tax responsibilities and combat fraud	
Examination Coverage – Individual (1040)	The sum of all individual 1040 returns closed by Small Business/Self Employed (SB/SE), Wage & Investment (W&I), Tax Exempt and Government Entities (TE/GE), and Large Business and International (LB&I) (Field Exam and Correspondence Exam programs) divided by the total individual return filings for the prior calendar year.
Field Exam Nat'l Quality Review Score	The score awarded to a reviewed field examination case by a Quality Reviewer using the National Quality Review System (NQRS) quality attributes.
Office Exam Nat'l Quality Review Score	The score awarded to a reviewed office examination case by a Quality Reviewer using the NQRS quality attributes.
Examination Quality – Large Business	Average of the scores of the Large Business Return (LBR) cases reviewed by LB&I Quality Measurement System (LQMS). Case scores are based on the percentage of elements passed within each of the four auditing standard.

Appendix A

Performance Measures Descriptions (Continued)

Goal 2: Effectively enforce the law to ensure compliance with tax responsibilities and combat fraud (Continued)	
Examination Coverage – Business Assets >$10 Million)	The number of LB&I returns (C and S Corporations with assets over $10 million and all partnerships) examined and closed by LB&I during the current fiscal year divided by the number of filings for the preceding calendar year.
Examination Efficiency – Individual (1040)	The sum of all individual 1040 returns closed by SB/SE, W&I, TE/GE, and LB&I (Field Exam and Correspondence Exam programs) divided by the total Full-Time Equivalent (FTE) expended in relation to those individual returns.
Automated Underreporter (AUR) Efficiency	The total number of W&I and SB/SE contact closures (a closure resulting from a case where IRS made contact) divided by the total FTE, including overtime.
Automated Underreporter (AUR) Coverage	A percentage representing the total number of W&I and SB/SE contact closures (a closure resulting from a case where SBSE and W&I made contact) divided by the total return filings for the prior year.
Collection Coverage – Units	The volume of collection work disposed compared to the volume of collection work available.
Collection Efficiency – Units	The volume of collection work disposed divided by total collection FTE.
Field Collection Nat'l Quality Review Score	The score awarded to a reviewed collection case by a Quality Reviewer using the NQRS quality attributes.
Automated Collection System (ACS) Accuracy	The percent of taxpayers who receive the correct answer to their ACS question.
Criminal Investigations Completed	The total number of subject criminal investigations completed during the fiscal year, including those that resulted in prosecution recommendations to the Department of Justice as well as those discontinued due to a lack of prosecution potential.
Number of Convictions	The number of criminal convictions.
Conviction Rate	The percent of adjudicated criminal cases that result in convictions.
Conviction Efficiency Rate ($)	The cost of Criminal Investigation's (CI) program divided by the number of convictions.
TE/GE Determination Case Closures	The number of cases closed in the Employee Plans or Exempt Organizations Determination programs, regardless of type of case or type of closing.

INTERNAL REVENUE SERVICE
Management's Discussion & Analysis
Fiscal Year 2015

Appendix B

Performance Measurement Data

	2012	2013	2014	2015	
				Target	Actual
Strategic Foundation: Invest in our workforce and the foundational capabilities necessary to achieve our mission and deliver high performance for taxpayers and stakeholders					
Percent of Major IT Investments within +/- 10% Cost Variance[1]	50.0%	0%	66.7%	90.0%	73.7%
Percent of Major IT Investments within +/- 10% Schedule Variance[1]	90.0%	83.3%	100.0%	90.0%	89.5%
Goal 1: Deliver high quality and timely service to reduce taxpayer burden and encourage voluntary compliance					
Customer Service Representative (CSR) Level of Service[2]	67.6%	60.5%	64.4%	38.0%	38.1%
Customer Contacts Resolved per Staff Year	16,320	20,767	21,018	21,000	26,245
Customer Accuracy – Tax Law Phones	93.2%	95.7%	95.0%	92.0%	95.0%
Customer Accuracy – Customer Accounts (Phones)	95.6%	96.0%	96.2%	94.0%	95.5%
Timeliness of Critical Filing Season Tax Products to the Public	97.2%	58.9%	99.1%	95.0%	89.0%
Timeliness of Critical TE/GE and Business Tax Products to the Public	94.5%	83.6%	98.7%	95.0%	92.6%
Percent Individual Returns Processed Electronically	80.5%	82.5%	84.1%	84.6%	85.3%
Percent Business Returns Processed Electronically	36.7%	40.2%	43.1%	46.5%	47.0%
Refund Timeliness – Individual (Paper)	99.7%	99.0%	98.7%	94.0%	98.8%
Taxpayer Self Assistance Rate	78.5%	83.3%	84.7%	85.0%	88.7%
Goal 2: Effectively enforce the law to ensure compliance with tax responsibilities and combat fraud					
Examination Coverage – Individual	1.0%	1.0%	0.9%	0.8%	0.8%
Field Examination National Quality Review Score	87.4%	89.2%	88.4%	89.6%	86.7%
Office Examination National Quality Review Score	91.3%	90.3%	90.6%	90.2%	88.3%
Examination Quality – Large Business[3]		92.0%	83.0%	90.0%	86.0%
Examination Coverage – Business (assets >$10M)	6.2%	5.6%	4.3%	3.8%	3.9%
Examination Efficiency – Individual (1040)	142	142	138	135	148
Automated Underreporter (AUR) Efficiency	2,041	2,025	1,935	2,032	2,209
Automated Underreporter (AUR) Coverage	3.2%	2.8%	2.6%	2.6%	2.3%
Collection Coverage – Units	48.1%	47.0%	45.9%	43.8%	46.3%
Collection Efficiency – Units	1,997	2,057	2,051	2,173	2,448
Field Collection National Quality Review Score	80.4%	81.4%	81.6%	81.6%	79.2%
Automated Collection System (ACS) Accuracy	94.7%	94.4%	95.2%	94.0%	95.3%
Criminal Investigations Completed	4,937	5,557	4,606	3,800	4,486
Number of Convictions	2,634	3,311	3,110	2,700	2,879
Conviction Rate	93.0%	93.1%	93.4%	92.0%	93.2%
Conviction Efficiency Rate ($)	$270,511	$211,048	$231,103	$243,000	$221,782
TE/GE Determination Case Closures	87,000	65,877	136,746	99,942	111,940

[1] Starting in FY 2015, this measure includes all major IT investments (BSM and non-BSM) whereas in the previous years it was only BSM.
[2] Beginning in FY 2013, targets include an increase in base user fees.
[3] As a result of program changes that occurred in the Large Business and International (LB&I) organization, starting in FY 2013, a new Examination Quality - Large Business measure replaced the two previous LB&I quality measures; Examination Quality - Industry and Coordinated Industry.

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Appendix C

Long-Term Measure Definitions

Long-Term Measure	Definition
Voluntary Compliance Rate	The amount of tax paid on timely returns divided by the amount of tax that should have been paid for a given year
American Customer Satisfaction Index (ACSI)	Overall individual taxpayer satisfaction with tax return filing process for both paper and electronic filing.
Employee Engagement	Using 11 questions from OPM annual survey (formerly Federal Human Capital Survey, currently Employee Viewpoint Survey), the IRS has developed an index that measures employee engagement and is using the index to compare itself to other large Federal agencies with 20,000 or more civilian employees.
Enforcement Satisfaction Score	The enforcement satisfaction score attempts to measure the extent to which taxpayers contacted as part of the IRS compliance efforts feel that the process was satisfactory. It attempts to measure taxpayer interactions independent of the ultimate outcome of the enforcement activity
Service Satisfaction Score	The service satisfaction score attempts to measure the extent to which taxpayers who contacted the Service for assistance feel the service provided was satisfactory.
E-file Rate (Individual)	Percent of all major tax returns filed electronically by Individuals.
E-file Rate (Business)	Percent of all major business returns filed electronically by businesses, and tax-exempt entities.
IT – End to End	The availability of software and system components of 10 critical IRS systems from 15 of the largest IRS locations.
IT – Portal Availability	Availability to the customer.
Software Currency	Proportion software products on critical systems within one version of the current release.
Service Interactions Processed Electronically	The percent of electronic interactions conducted by taxpayers relative to the total number of service interactions conducted by taxpayers across all channels (currently measured using individual taxpayer payments)
Service Interactions Available Electronically	The percent of electronic services available to the taxpayer on IRS.gov relative to the most frequent services provided to the taxpayer across all channels, including web, phone, walk-in, and mail.

Appendix D

Long-Term Measure Data

Long-Term Measure	FY 2014-2017 IRS Strategic Plan (Year)	Update (Year)	FY 2017 Target
Voluntary Compliance Rate	83% (2011)	Not Available	86%
American Customer Satisfaction Index (ACSI)	72 (2013)	73 (2014)	75%
Employee Engagement	8th of 15 (2013)	8th of 15 (2014)	Top quartile
Enforcement Satisfaction Score	72% (2012)	73% (2014)	75%
Service Satisfaction Score	91% (2013)	89% (2014)	94%
e-file Rate for Individual Returns	83% (2013)	85.3% (2015)	90%
e-file Rate for Business Returns	40% (2013)	47.0% (2015)	50%
End to End	99% (2014)	99.77% (2015)	99%
Portal Availability	100% (2014)	100% (2015)	100%
Software Currency	75% (2014)	75% (2015)	85%
Service Interactions Processed Electronically	23% (2014)	32.3% (2015)	50%
Service Interactions Available Electronically	50% (2014)	53.0% (2015)	75%

Financial Statements

Principal Financial Statements

The principal financial statements have been prepared to report the financial position and results of operations of the Internal Revenue Service, pursuant to the requirements of the *Chief Financial Officers Act of 1990* (P.L. 101-576), the *Government Management Reform Act of 1994* and the Office of Management and Budget Circular No. A-136, *Financial Reporting Requirements*. The responsibility for the integrity of the financial information included in these statements rests with the management of the IRS. The audit of the IRS principal financial statements was performed by the Government Accountability Office.

The IRS principal financial statements for fiscal years 2015 and 2014 are as follows:

- The **Balance Sheet** presents the assets, liabilities, and net position.
- The **Statement of Net Cost** presents the net cost of operations by program. It includes the gross costs less any exchange revenue earned from activities.
- The **Statement of Changes in Net Position** presents the change in net position resulting from the net cost of operations, budgetary financing sources other than exchange revenues, and other financing sources.
- The **Statement of Budgetary Resources** presents the budgetary resources; the status of those resources; the change in obligated balances during the year; and the budgetary authority and agency outlays. Additional detail by major budget accounts is available in the Required Supplementary Information section.
- The **Statement of Custodial Activity** presents the sources and disposition of non-exchange federal tax revenues collected and refunds disbursed.

Internal Revenue Service
Balance Sheet
As of September 30, 2015 and 2014

(In Millions)

	2015	2014
Assets		
Intragovernmental		
Fund balance with Treasury (Note 2)	$ 2,370	$ 2,370
Due from Treasury (Note 6)	3,025	4,722
Other assets (Note 3)	10	26
Total intragovernmental	5,405	7,118
Cash and other monetary assets (Notes 4, 6)	455	392
Federal taxes receivable, net (Notes 5, 6)	41,000	40,000
General property and equipment, net (Note 7)	1,795	1,648
Other assets (Note 3)	14	16
Total assets	**$ 48,669**	**$ 49,174**
Liabilities		
Intragovernmental		
Due to Treasury (Note 5)	$ 41,000	$ 40,000
Other liabilities (Note 8)	166	168
Total intragovernmental	41,166	40,168
Federal tax refunds payable	3,025	4,722
Other liabilities (Note 8)	1,853	1,797
Total liabilities	**46,044**	**46,687**
Net position		
Unexpended appropriations	1,480	1,493
Cumulative results of operations	1,145	994
Total net position	**2,625**	**2,487**
Total liabilities and net position	**$ 48,669**	**$ 49,174**

The accompanying notes are an integral part of these statements.

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Internal Revenue Service
Statement of Net Cost
For the Years Ended September 30, 2015 and 2014

(In Millions)

	2015	2014
Program		
Taxpayer Assistance and Education		
Gross cost	$ 636	$ 608
Earned revenue	(2)	(2)
Net cost of program	**634**	**606**
Filing and Account Services		
Gross cost	3,906	3,828
Earned revenue	(109)	(95)
Net cost of program	**3,797**	**3,733**
Compliance		
Gross cost	7,672	8,031
Earned revenue	(410)	(397)
Net cost of program	**7,262**	**7,634**
Administration of Tax Credit Programs		
Gross cost	154	164
Earned revenue	-	-
Net cost of program	**154**	**164**
Net cost of operations (Note 11)	**$ 11,847**	**$ 12,137**

The accompanying notes are an integral part of these statements.

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Internal Revenue Service
Statement of Changes in Net Position
For the Years Ended September 30, 2015 and 2014

(In Millions)

	2015		2014	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
Beginning balances	$ 994	$ 1,493	$ 795	$ 1,402
Budgetary financing sources				
Appropriations received		10,945		11,291
Transfers in/out without reimbursement	9	8	30	-
Other adjustments		(108)		(86)
Appropriations used	10,858	(10,858)	11,114	(11,114)
Other financing sources				
Imputed financing	1,161		1,233	
Transfers in/out without reimbursement	-		(10)	
Transfers to general fund	(30)		(31)	
Total financing sources	11,998	(13)	12,336	91
Net cost of operations	(11,847)		(12,137)	
Net change	151	(13)	199	91
Ending balances	$ 1,145	$ 1,480	$ 994	$ 1,493

The accompanying notes are an integral part of these statements.

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Internal Revenue Service
Statement of Budgetary Resources
For the Years Ended September 30, 2015 and 2014

(In Millions)

	2015	2014
Budgetary resources		
Unobligated balance, brought forward, October 1	$ 1,088	$ 994
Recoveries of prior year unpaid obligations	95	115
Other changes in unobligated balance	(109)	(86)
Unobligated balance from prior year budget authority, net	1,074	1,023
Appropriations (discretionary and mandatory)	11,344	11,657
Spending authority from offsetting collections (discretionary and mandatory)	130	154
Total budgetary resources	**$ 12,548**	**$ 12,834**
Status of budgetary resources		
Obligations incurred (Note 12)	$ 11,530	$ 11,746
Unobligated balance, end of year:		
Apportioned	611	648
Exempt from apportionment	7	8
Unapportioned	400	432
Total unobligated balance, end of year	1,018	1,088
Total budgetary resources	**$ 12,548**	**$ 12,834**
Change in obligated balance		
Unpaid obligations, brought forward, October 1 (gross)	$ 1,329	$ 1,296
Obligations incurred	11,530	11,746
Outlays (gross)	(11,382)	(11,598)
Recoveries of prior year unpaid obligations	(95)	(115)
Unpaid obligations, end of year (gross)	1,382	1,329
Uncollected payments, federal sources, brought forward, October 1	(38)	(31)
Change in uncollected customer payments from federal sources	14	(7)
Uncollected payments, federal sources, end of year	(24)	(38)
Memorandum (non-add) entries:		
Obligated balance, start of year	1,291	1,265
Obligated balance, end of year	**$ 1,358**	**$ 1,291**
Budget authority and outlays, net		
Budget authority, gross (discretionary and mandatory)	$ 11,474	$ 11,811
Actual offsetting collections (discretionary and mandatory)	(144)	(147)
Change in uncollected customer payments from federal sources (discretionary)	14	(7)
Budget authority, net (discretionary and mandatory)	**$ 11,344**	**$ 11,657**
Outlays, gross (discretionary and mandatory)	$ 11,382	$ 11,598
Actual offsetting collections (discretionary and mandatory)	(144)	(147)
Outlays, net (discretionary and mandatory)	11,238	11,451
Distributed offsetting receipts	(352)	(323)
Agency outlays, net (discretionary and mandatory)	**$ 10,886**	**$ 11,128**

The accompanying notes are an integral part of these statements.

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Internal Revenue Service
Statement of Custodial Activity
For the Years Ended September 30, 2015 and 2014

(In Billions)

	2015	2014
Revenue activity		
Collections of federal tax revenue (Note 13)		
Individual income, FICA/SECA, and other	$ 2,800	$ 2,605
Corporate income	390	353
Excise	77	71
Estate and gift	20	20
Railroad retirement	7	6
Federal unemployment	9	9
Total collections of federal tax revenue	**3,303**	**3,064**
Increase/(Decrease) in federal taxes receivable, net	1	5
Total federal tax revenue	**$ 3,304**	**$ 3,069**
Distribution of federal tax revenue to Treasury	**$ 3,303**	**$ 3,064**
Increase/(Decrease) in amount due to Treasury	1	5
Total disposition of federal tax revenue	**3,304**	**3,069**
Net federal revenue activity	$ -	$ -
Federal tax refund and outlay activities		
Total refunds of federal taxes and outlays (Note 14)	$ 403	$ 374
Appropriations used for refund of federal taxes and outlays	(403)	(374)
Net federal tax refund and outlay activities	$ -	$ -

The accompanying notes are an integral part of these statements.

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INTERNAL REVENUE SERVICE

Notes to the Financial Statements

For the Years Ended September 30, 2015 and 2014

Note 1. Summary of Significant Accounting Policies

A. Reporting Entity

The Internal Revenue Service (IRS), a bureau of the United States (U.S.) Department of the Treasury (Treasury), celebrated its 150-year anniversary in 2012. The IRS originated in 1862, when Congress established the Office of the Commissioner of the Internal Revenue. The IRS administers the nation's tax laws and annually collects over 90 percent of the revenues funding the Federal Government. Numerous organizational divisions and major programs within the IRS contribute to this achievement.

Operating Divisions
The IRS has four operating divisions:

- Wage and Investment provides customer support, submission processing, and compliance activities with respect to individuals with wage and investment income;
- Small Business and Self-Employed administers compliance activities for small businesses, self-employed individuals, and others with income from sources other than wages;
- Tax Exempt and Government Entities oversees and assists employee plans, tax exempt organizations, and government entities in complying with tax laws and regulations; and
- Large Business and International serves corporations, subchapter S corporations, and partnerships with assets greater than $10 million on complicated issues involving tax law and accounting principles, and conducts business in an expanding global environment.

Functional Divisions
Five functional divisions within the IRS provide enforcement services supporting both internal and external operations:

- Appeals
- Criminal Investigation
- Communications & Liaison
- Taxpayer Advocate Service
- Office of Chief Counsel

The National Taxpayer Advocate reports directly to Congress and the IRS Chief Counsel reports to the Secretary of the Treasury.

Support Divisions
Nine support divisions provide shared services support to all of the IRS organizations:

- Information Technology
- Agency-Wide Shared Services
- Stewardship
- Wage & Investment - Stewardship
- Executive Leadership and Direction
- Privacy, Governmental Liaison and Disclosure
- Human Capital Office
- Human Capital Office Corporate Programs
- Chief Financial Officer

Major Programs
The IRS has four major programs (further discussed in Note 1.J., Program Costs):

- Taxpayer Assistance and Education
- Filing and Account Services
- Compliance
- Administration of Tax Credit Programs

INTERNAL REVENUE SERVICE

Notes to the Financial Statements

For the Years Ended September 30, 2015 and 2014

B. Basis of Accounting and Presentation

The financial statements have been prepared from the accounting records of the IRS in conformity with accounting principles generally accepted in the U.S. and in accordance with the Office of Management and Budget (OMB) Circular No. A-136, *Financial Reporting Requirements*. Accounting principles generally accepted for federal entities are the standards prescribed by the Federal Accounting Standards Advisory Board, which is the official body for setting accounting standards of the Federal Government.

These comparative financial statements and related notes consist of the Balance Sheet, the Statement of Net Cost, the Statement of Changes in Net Position, the Statement of Budgetary Resources, and the Statement of Custodial Activity.

The accounting structure of federal agencies is designed to reflect both accrual and budgetary accounting transactions. Under the accrual method of accounting, revenues are recognized when earned and expenses are recognized when incurred, without regard to receipt or payment of cash. Budgetary accounting facilitates compliance with legal constraints and controls over the use of federal funds. The Statement of Custodial Activity is presented on the modified cash basis of accounting. Under this method, cash collections and transfers to Treasury are reported on a cash basis. The collections and transfers to Treasury are adjusted on the face of the statement for the net change in taxes receivable, producing modified cash basis balances.

Certain assets, liabilities, earned revenues, and costs have been classified as intragovernmental throughout the financial statements and notes. Intragovernmental is defined as transactions made between two reporting entities within the Federal Government.

C. Fund Balance with Treasury

The fund balance with Treasury is the aggregate of funds in the accounts of the IRS, primarily appropriated funds, from which the IRS is authorized to make expenditures and pay liabilities.

The status of fund balance with Treasury represents amounts obligated and unobligated. The obligated balances not yet disbursed represent the unpaid funds with budgetary obligations. Unobligated balances, available represent amounts in unexpired appropriations as of the end of the current fiscal year. Unobligated balances become available when apportioned by the OMB. Unobligated balances, unavailable represent amounts in expired appropriations and amounts not apportioned for obligation as of the end of the current fiscal year.

D. Other Assets

Accounts receivable consist of amounts due to the IRS from the public and from federal agencies.

Accounts receivable are recorded and reimbursable revenues are recognized as the services are performed and costs are incurred. The allowance for uncollectible accounts is based on an annual review of groups of accounts by age for accounts receivable balances older than one year.

Advances to the public represent cash outlays for criminal investigations and employee travel.

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Forfeited property held for sale is acquired as a result of forfeiture proceedings or foreclosure sales to satisfy a tax liability. The Federal Tax Lien Revolving Fund, established in accordance with Title 26 United States Code (USC), Section 7810, is used to redeem real property foreclosed upon by a holder of a lien. The IRS may sell the property, reimburse the revolving fund in an amount equal to the redemption, and apply the net proceeds to the outstanding tax obligation.

E. Cash and Other Monetary Assets

Imprest funds are maintained by headquarters and field offices in commercial bank accounts. Other monetary assets consist primarily of offers-in-compromise, voluntary deposits received from taxpayers pending application of the funds to unpaid tax assessments, and seized monies pending the results of criminal investigations.

F. Federal Taxes Receivable, Net and Due to Treasury

Federal taxes receivable, net, and the corresponding liability, due to Treasury, are not accrued until related tax returns are filed or assessments are made by the IRS and agreed to by either the taxpayer or the court. Accruals are made to reflect penalties and interest on taxes receivable through the balance sheet date.

Taxes receivable consist of unpaid assessments (taxes and associated penalties and interest) due from taxpayers. The existence of a receivable is supported by a taxpayer agreement, such as filing of a tax return without sufficient payment, or a court ruling in favor of the IRS. The allowance reflects an estimate of the portion of total taxes receivable deemed to be uncollectible.

Compliance assessments are unpaid assessments for which neither the taxpayer nor a court has affirmed the taxpayer owes to the Federal Government. Examples include assessments resulting from an IRS audit or examination in which the taxpayer does not agree with the results. Write-offs consist of unpaid assessments for which the IRS does not expect further collections due to factors such as taxpayers' bankruptcy, insolvency, or death. Compliance assessments and write-offs are not reported on the balance sheet. Statutory provisions require the accounts to be maintained until the statute for collection expires.

Tax Assessments

Under the Internal Revenue Code (26 USC) Section 6201, the Secretary of the Treasury is authorized and required to make inquiries, determinations, and assessments of all taxes imposed and accruing under any internal revenue law, which have not been duly paid, including interest, additions to the tax, and assessable penalties. The Secretary has delegated this authority to the Commissioner of the IRS. Unpaid assessments result from taxpayers filing returns without sufficient payments and from the enforcement programs of the IRS, such as examination, under-reporter, substitute for return, and combined annual wage reporting.

Abatements

Section 6404 of the Internal Revenue Code (26 USC) authorizes the Commissioner of the IRS to abate certain paid or unpaid portions of assessed taxes, interest, and penalties. Abatements occur for a number of reasons and are a standard part of the tax administration process. Abatements may be allowed for qualifying corporations claiming net operating losses that create a credit when carried

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back and applied against a prior year's tax liability. Additionally, abatements can correct previous assessments from enforcement programs, eliminate taxes discharged in bankruptcy, reduce or eliminate taxes encompassed in offers-in-compromise, eliminate penalty assessments for reasonable cause, eliminate contested assessments caused by mathematical or clerical errors, and eliminate assessments contested after the liability has been satisfied. Abatements may result in claims for refunds or reductions of the unpaid assessed amounts.

G. General Property and Equipment

General property and equipment is recorded at historical cost. It consists of tangible assets and software. The IRS depreciates property and equipment on a straight line basis over its estimated useful life. Except for leases meeting the 75 percent useful life and/or 90 percent of net present value (NPV) criteria, the IRS records a half-year of depreciation in the first year and the final year for all property and equipment. The IRS depreciates leases meeting the 75 percent useful life and/or 90 percent of NPV criteria over the life of the leases, with no use of a half-year convention. Disposals are recorded when deemed material.

The IRS capitalization policy for property and equipment by asset class and threshold:

Asset Class	Capitalization Threshold
ADP equipment *	Capitalized regardless of acquisition cost. However, mainframe and server components and related commercial off the shelf software purchased separately are only capitalized when the bulk cost is $50 thousand or greater.
Non-ADP equipment	Assets with bulk cost of $50 thousand or greater
Furniture	Capitalized regardless of acquisition cost
Investigative equipment	Assets with bulk cost of $50 thousand or greater
Vehicles	Capitalized regardless of acquisition cost
Major systems	Projects with costs of $20 million or greater
Internal use software	Major business systems modernization projects with an estimated cost of $10 million per year or $50 million over the life cycle.
Leasehold improvements	Improvements with bulk cost of $50 thousand or greater
Assets under capital lease	Assets with bulk cost of $50 thousand or greater

*Automated Data Processing (ADP)

Prior to the implementation of Statement of Federal Financial Accounting Standards (SFFAS) No. 10, *Accounting for Internal Use Software*, Major systems was an asset class established to account for large-scale computer systems.

Internal use software captures the costs of major Business Systems Modernization (BSM) projects in accordance with SFFAS No. 10. It encompasses software design, development, and testing of projects adding significant new functionality and long-term benefits. Costs for developing internal use software are accumulated in work in process until final acceptance and testing are successfully completed. When the software is completed and placed into service, the costs are transferred to amortizable property.

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H. Federal Tax Refunds Payable and Due from Treasury

Federal tax refunds payable is comprised of measurable and legally payable amounts due to taxpayers under established refund processes of the IRS. It is a fully funded liability offset by a corresponding asset, due from Treasury. The IRS records an amount due from Treasury to designate approved funding to pay year-end tax refund liabilities to taxpayers.

I. Financing Sources and Revenues

Appropriations Received

The IRS receives the majority of its funding through annual, multi-year, and no-year appropriations available for use within statutory limits for operating and capital expenditures. Appropriations are recognized as budgetary financing sources when the related expenses are incurred.

Appropriations

The major budget accounts are:

- Taxpayer Services
- Enforcement
- Operations Support
- Other

Taxpayer Services provides funds for the direct costs of the Taxpayer Assistance and Education and the Filing and Account Services Programs discussed in Note 1. J., Program Costs.

Enforcement provides resources for the direct costs of the Compliance Program discussed in Note 1.J., Program Costs. Additionally, it funds the direct costs of administering the Earned Income Tax Credit Program (EITC).

Operations Support funds the indirect costs of all programs. Activities include executive planning and direction; shared service support for facilities, rent, utilities, and security; procurement; printing; postage; headquarters' activities such as strategic planning, finance, and human resources; research and statistics of income; and information systems, data processing, and telecommunication.

The IRS administers various tax provisions in the *Patient Protection and Affordable Care Act of 2010* (PPACA). The administrative costs are funded in the three major budget accounts: Taxpayer Services, Enforcement and Operations Support.

Other primarily consists of the BSM appropriation, which provides resources for the planning and capital asset acquisition of information technology to modernize the business systems. Additionally, BSM is obligated pursuant to an expenditure plan submitted to Congress.

Exchange Revenues

Exchange revenues recognized by the IRS represent reimbursements and user fees. Reimbursements are recognized as the result of costs incurred for services performed for federal agencies or the public under reimbursable agreements. User fees are derived from transactions with the public and are generally recognized when the fees are collected.

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Imputed Financing Sources
Other financing sources include imputed financing sources to offset the imputed costs recognized for goods or services received from other federal agencies without reimbursement from the IRS. The imputed costs are pension and other benefit costs administered by the Office of Personnel Management (OPM), costs of processing payments and collections by the Bureau of the Fiscal Service, costs of providing training by the Federal Law Enforcement Training Center, and legal judgments paid by the Treasury Judgment Fund.

J. Program Costs

Taxpayer Assistance and Education provides services to assist taxpayers with tax return preparation. Primary activities include tax law interpretations, developing and disseminating tax forms and publications, researching customer needs and establishing partnerships with stakeholder groups, and taxpayer advocacy. In addition, these programs continue to emphasize taxpayer education, outreach, and enhancing prefiling taxpayer support through electronic media. Earned revenues include reimbursable revenues from services provided to other federal agencies.

Filing and Account Services provides resources and support services to taxpayers in filing returns or paying taxes, and for the issuance of refunds and maintenance of taxpayer accounts. Program activities include providing assistance, education, and compliance services to taxpayers through telephone, correspondence, and electronic means to resolve account and notice inquiries. Earned revenues include user fees from photocopies, U.S. Residency Certification and Income Verification Express Service, and reimbursable revenues from services provided to other federal agencies.

Compliance administers compliance activities after a return is filed to identify and correct possible errors or underpayments. This program includes examination and collection programs, which ensure proper payment and tax reporting; criminal investigation programs to uncover violations of internal revenue tax laws and other financial crimes; the development and printing of published IRS guidance materials; and support of taxpayers for pre-filing agreements, determination letters, and advance pricing agreements. It also includes specialty program examinations, international collections, and international examinations. Earned revenues are primarily from user fees for installment agreements, letter rulings and determinations, offers-in-compromise, enrollment programs and return preparer registrations, and reimbursable revenues from services provided to other federal agencies.

Administration of Tax Credit Programs primarily administers the EITC program, which works closely with internal and external stakeholders through expanded customer service and public outreach, enforcement, and research efforts to increase the number of eligible taxpayers who claim the EITC and to reduce the number of EITC claims paid in error. The EITC payments actually refunded to individuals or credited against tax liabilities are not included in program costs. This program also includes a portion of the costs related to administering the Health Coverage Tax Credit (HCTC). The HCTC program activities focus on providing staff, training, and direct support to administer the health insurance tax credit portion of the *Trade Adjustment Assistance Reform Act of 2002*. These costs do not encompass payments made to health insurance carriers on behalf of participants or tax credits refunded to qualifying individuals. In FY 2012, HCTC program activity costs were consolidated under Filing and Account Services except for costs related to HCTC obligations made prior to

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FY 2012, which are reported in this program. The consolidation was made in advance of the program's termination, effective January 1, 2014.

K. Custodial Activity

Non-exchange Revenues
The IRS collects custodial non-exchange revenues for taxes levied against taxpayers for: individual and corporate income, Federal Insurance Contributions Act (FICA) and Self-Employment Contributions Act (SECA), excise, estate, gift, railroad retirement, and federal unemployment taxes. These collections are not available to the IRS for obligation or expenditure and are recognized as custodial revenues when collected. The sources of federal tax revenue and their distribution to the general fund of the Treasury are reported on the Statement of Custodial Activity.

Permanent Indefinite Appropriations
The IRS was granted permanent and indefinite budgetary authority through legislation to disburse tax refund principal and related interest as they become due. The permanent and indefinite appropriations are not subject to budgetary ceilings set by Congress during the annual appropriation process.

Refunds due to taxpayers are reported as Federal tax refunds payable on the Balance Sheet. The IRS records an offsetting asset, Due from Treasury, to reflect the year-end budget authority to pay this liability.

Disbursements for tax refunds and related interest, reported on the Statement of Custodial Activity, are offset by appropriations used for refunds. Disbursements for refunds are not a cost to the IRS, but rather a cost to the Federal Government as a whole.

L. Funds from Dedicated Collections

In accordance with SFFAS No. 43, *Funds from Dedicated Collections: Amending Statement of Federal Financial Accounting Standards 27, Identifying and Reporting Earmarked Funds*, Funds from Dedicated Collections are financed by specifically identified revenues, which remain available over time. These specifically identified revenues are required by statute to be used for designated activities, benefits or purposes and must be accounted for separately from the Federal Government's general revenues.

The Federal Tax Lien Revolving Fund (20X4413) was established pursuant to section 112(a) of the *Federal Tax Lien Act of 1966*, to serve as the source of financing for the redemption of real property by the United States.

The Private Collection Agent Program (20X5510) was established under the *American Jobs Creation Act of 2004*. In March 2009, the IRS Commissioner announced the program would not renew the contracts with the private debt collection agencies. Unobligated funds from prior collections of delinquent federal tax liabilities were retained by the IRS to fund adjustments to prior enforcement activity obligations.

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M. Allocation Transfers

The IRS is a party to allocation transfers with other federal agencies as both a transferring (parent) entity and a receiving (child) entity. Allocation transfers are legal delegations by one department of its authority to obligate budget authority and outlay funds to another department. A separate fund account (allocation account) is created in the U.S. Treasury as a subset of the parent fund account for tracking and reporting purposes. All allocation transfers of balances are credited to this account, and subsequent obligations and outlays incurred by the child entity are charged to this allocation account as they execute the delegated activity on behalf of the parent. Financial activity related to these allocation transfers is reported in the financial statements of the parent entity, from which the underlying legislative authority, appropriations, and budget apportionments are derived. The IRS allocates funds, as the parent, to the U.S. Department of Health and Human Services (HHS). Additionally, the IRS receives allocation transfers, as the child, from the U.S. Department of Transportation's Federal Highway Administration and HHS.

N. Fiduciary Activities

Fiduciary activities are the collection or receipt, and the management, protection, accounting, investment, and disposition by the Federal Government of cash or other assets in which non-federal individuals or entities have an ownership interest the Federal Government must uphold.

The IRS fiduciary activities include the net collections for a taxable year from U.S. military and federal employees working in the U.S. territories of the Northern Mariana Islands, the U.S. Virgin Islands, Guam, and American Samoa. These fiduciary assets are not assets of the IRS.

O. Employee Compensation and Benefits

Accrued Annual, Sick, and Other Leave

Annual and compensatory leave is expensed with an offsetting liability as it is earned, and the liability is reduced as leave is taken. Each year, the IRS adjusts the balance in the accrued annual leave liability account to reflect current pay rates. To the extent current or prior year appropriations are not available to fund annual and compensatory leave earned but not taken, funding is obtained from future financing sources. Sick leave and other types of non-vested leave are expensed as taken.

Federal Employees' Compensation Act

The Federal Employees' Compensation Act (FECA) provides income and medical cost protection to covered federal civilian employees injured on the job, to employees who have incurred work-related occupational diseases, and to beneficiaries of employees whose deaths were attributed to job-related injuries or occupational diseases. The FECA program is administered by the U.S. Department of Labor (DOL), which pays valid claims and subsequently seeks reimbursement for claims paid. Accrued FECA liability represents amounts due to the DOL for claims paid on behalf of the IRS. Actuarial FECA liability represents the liability for future workers' compensation benefits, which includes the expected liability for death, disability, medical, and miscellaneous costs for approved cases. The DOL estimates the liability for future payments as a result of past events.

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Notes to the Financial Statements

For the Years Ended September 30, 2015 and 2014

Employee Pension Benefits

The IRS recognizes the full costs of its employees' pension benefits. The liabilities associated with these costs are reported by the OPM, who administers the plans. Eligibility of employees to participate in the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS) is based on their hire date with the Federal Government, and the IRS contributes a percentage of an employee's basic pay toward the employee's retirement plan.

EMPLOYEE PENSION BENEFIT CONTRIBUTION RATES

	Category	Employee	Agency
CSRS Rates	Regular	7.0%	7.0%
	Law Enforcement Officers	7.5%	7.5%
FERS Rates	Regular	0.8%	13.2%
Hired prior to January 1, 2013	Law Enforcement Officers	1.3%	28.8%
FERS – Revised Annuity Rate	Regular	3.1%	11.1%
Hired January 1, 2013 - December 31, 2013	Law Enforcement Officers	3.6%	26.5%
FERS – Further Revised Annuity Rate	Regular	4.4%	11.1%
Hired January 1, 2014 or later	Law Enforcement Officers	4.9%	26.5%

Employees covered by either CSRS or FERS are also eligible to contribute to the Thrift Savings Plan (TSP), a defined contribution plan. A TSP account is automatically established for employees participating in FERS, and the IRS makes a mandatory contribution to this plan equal to one percent of an employee's compensation. Additionally, the IRS matches up to four percent of the compensation for FERS-eligible employees contributing to their TSP accounts. No TSP matching contributions are made for employees participating in the CSRS.

Employee Health and Life Insurance Benefits

Employees are eligible to participate in the Federal Employees Health Benefit Program (FEHB) and Federal Employees' Group Life Insurance Program (FEGLI). The FEHB offers a wide variety of group plans and coverage. The coverage is available to employees, retirees, and their eligible family members. The cost for each plan varies and is shared between the IRS and the employee. An employee participating in the FEGLI program can obtain basic term life insurance, with the employee paying two-thirds of the cost and the IRS paying one-third. Additional coverage is optional, to be paid fully by the employee. The basic life coverage may continue into retirement if certain requirements are met. The IRS recognizes the full cost of providing these benefits.

P. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions related to the reporting of assets, liabilities, revenues, and expenses, and the disclosure of contingent liabilities. Actual results could differ from those estimates.

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Notes to the Financial Statements

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Note 2. Fund Balance with Treasury

(In Millions)	2015	2014
General funds	$ 2,156	$ 2,088
Special funds	206	275
Revolving funds	7	7
Other funds	1	-
Fund balance with Treasury	**$ 2,370**	**$ 2,370**

(In Millions)	2015	2014
Unobligated balances:		
Available	$ 618	$ 656
Unavailable	400	432
Obligated balance not yet disbursed	1,358	1,291
Non-budgetary FBWT	(6)	(9)
Status of fund balance with Treasury	**$ 2,370**	**$ 2,370**

Note 3. Other Assets

(In Millions)	2015		2014	
	Intra-governmental	With the Public	Intra-governmental	With the Public
Accounts receivable, net	$ 10	$ 8	$ 26	$ 9
Advances	-	6	-	7
Other assets	**$ 10**	**$ 14**	**$ 26**	**$ 16**

Note 4. Cash and Other Monetary Assets

(In Millions)	2015	2014
Imprest fund	$ 5	$ 7
Other monetary assets	450	385
Cash and other monetary assets	**$ 455**	**$ 392**

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Notes to the Financial Statements

For the Years Ended September 30, 2015 and 2014

Note 5. Federal Taxes Receivable, Net and Due to Treasury

(In Billions)	2015	2014
Federal taxes receivable	$ 171	$ 156
Allowance for uncollectible taxes receivable	(130)	(116)
Federal taxes receivable, net and due to Treasury	**$ 41**	**$ 40**

Federal taxes receivable consists primarily of tax assessments, penalties, and interest not paid or abated, which were agreed to by the taxpayer and the IRS or upheld by the courts. The Allowance for uncollectible taxes receivable represents the difference between the gross Federal taxes receivable and the portion estimated to be collectible based on projections of collectability from a statistical sample of taxes receivable. Federal taxes receivable, net is the portion of gross Federal taxes receivable estimated to be collectible, and due to Treasury is the offsetting liability to be transferred to Treasury when collected.

Note 6. Non-entity Assets

(In Millions)	2015		2014	
	Intra-governmental	With the Public	Intra-governmental	With the Public
Due from Treasury	$ 3,025	$ -	$ 4,722	$ -
Federal taxes receivable, net	-	41,000	-	40,000
Other monetary assets	-	450	-	385
Non-entity assets	**$ 3,025**	**$ 41,450**	**$ 4,722**	**$ 40,385**

Non-entity assets are not available for use by the IRS. Federal taxes receivable are collected for the U.S. Government, but the IRS does not have the authority to spend them.

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Notes to the Financial Statements

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Note 7. General Property and Equipment, Net

(In Millions)	Useful Life (Years)	Cost	Accumulated Depreciation	2015 Net Book Value	2014 Net Book Value
ADP assets	3 to 7	$ 1,255	$ (891)	$ 364	$ 426
Internal use software	2 to 15	2,048	(1,013)	1,035	716
Leasehold improvements	10	255	(131)	124	138
Major systems	7	221	(221)	-	-
Internal use software - work in process		178	-	178	260
Vehicles	5	4	(3)	1	1
Furniture and non-ADP equipment	8 and 10	165	(80)	85	96
Assets under capital lease	3.5 to 8	16	(8)	8	11
Investigative equipment	10	5	(5)	-	-
Property and equipment		**$ 4,147**	**$ (2,352)**	**$ 1,795**	**$ 1,648**

The Cost column represents the historical cost of property and equipment, net of disposals. The cost basis for FY 2015 and FY 2014 is $4,147 million and $3,853 million, respectively. Accumulated depreciation for FY 2015 and FY 2014 is $2,352 million and $2,205 million, respectively.

The IRS has 17 internal use software projects, including deployed and work in process:

- Account Management Services (AMS) provides the applications to monitor and interface with taxpayers, issue enhanced notices, and deliver improved customer support and functionality.
- Customer Account Data Engine 2 (CADE 2) is leveraging existing systems and new development to implement a single data-centric solution, which provides daily processing of individual taxpayer accounts and establishes a solid data foundation for the future. CADE 2 replaced current Customer Account Data Engine (CADE) in FY 2012.
- Customer Communications is a customer service telephone system.
- Custodial Detail Database (CDDB), the subsidiary ledger for Redesigned Revenue Accounting Control System (RRACS), provides the functionality needed for custodial financial management and reporting.
- E-Services is a system of web-based products and services for tax practitioners and the public.
- Enterprise Systems Management (ESM) is an infrastructure system allowing remote monitoring and network management.
- Foreign Account Tax Compliance Act (FATCA) is being developed to enable foreign financial institutions to report information to the IRS about financial accounts held by U.S. taxpayers or foreign entities in which U.S. taxpayers hold a substantial ownership interest.
- Information Reporting and Document Matching (IRDM) is a business document matching program designed to increase voluntary compliance and accurate reporting of income through the use of third party information reporting data.
- Integrated Financial System (IFS) is the administrative financial system.
- Integrated Procurement System (IPS) is the re-engineered procurement system meeting current enterprise architecture and security standards.
- Internet Refund Fact of Filing allows taxpayers to review the status of their refund.
- Knowledge Incident/Problem Service Asset Management (KISAM) is the asset and problem management system.

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For the Years Ended September 30, 2015 and 2014

The IRS has 17 internal use software projects, continued:

- Modernized e-file (MeF) is an electronic filing system for tax returns.
- PPACA is the development and implementation of systems to support tax administration responsibilities.
- RRACS adds enhancements to financial reporting of taxpayer receipts and adds traceability between summary records and the detailed subsidiary ledger (CDDB).
- Return Review Program (RRP) is an automated system designed to maximize fraud detection at the time tax returns are filed.
- Security and Technology Infrastructure Release (STIR) is the infrastructure for information technology security.

Deployed Internal Use Software

(In Millions)	Cost	Accumulated Depreciation	2015 Net Book Value	2014 Net Book Value
MeF	$ 381	$ (290)	$ 91	$ 121
CADE 2	259	(129)	130	167
PPACA	612	(54)	558	219
IFS	167	(154)	13	15
E-Services	141	(141)	-	-
AMS	78	(34)	44	49
STIR	76	(76)	-	-
RRP	66	(14)	52	61
IRDM	59	(25)	34	43
FATCA	116	(12)	104	28
Customer Communications	25	(25)	-	-
ESM	16	(16)	-	-
Internet Refund Fact of Filing	15	(15)	-	-
CDDB	8	(8)	-	1
IPS	8	(3)	5	6
KISAM	6	(4)	2	3
RRACS	7	(5)	2	3
Other	8	(8)	-	-
Deployed internal use software	**$ 2,048**	**$ (1,013)**	**$ 1,035**	**$ 716**

Work in Process Internal Use Software

(In Millions)	2015	2014
PPACA	$ 108	$ 225
RRP	15	15
FATCA	55	20
Work in process internal use software	**$ 178**	**$ 260**

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Notes to the Financial Statements

For the Years Ended September 30, 2015 and 2014

Note 8. Liabilities

Other Liabilities

(In Millions)	2015 Current	2015 Non-Current	2015 Total
Intragovernmental:			
Accrued payroll and benefits	$ 58	$ -	$ 58
Accrued FECA liability	41	51	92
Accrued expenses	11	-	11
Capital lease liabilities	2	3	5
Other liabilities	**$ 112**	**$ 54**	**$ 166**
With the Public:			
Accrued annual leave	$ 511	$ -	$ 511
Actuarial FECA liability	-	465	465
Accrued payroll and benefits	189	-	189
Accrued expenses	216	-	216
Liability for deposit funds, clearing accounts and custodial liabilities	451	-	451
Accounts payable	14	-	14
Energy savings performance liability	1	6	7
Other liabilities	**$ 1,382**	**$ 471**	**$ 1,853**

(In Millions)	2014 Current	2014 Non-Current	2014 Total
Intragovernmental:			
Accrued payroll and benefits	$ 52	$ -	$ 52
Accrued FECA liability	44	51	95
Accrued expenses	14	-	14
Capital lease vehicle liability	2	5	7
Other liabilities	**$ 112**	**$ 56**	**$ 168**
With the Public:			
Accrued annual leave	$ 502	$ -	$ 502
Actuarial FECA liability	-	489	489
Accrued payroll and benefits	173	-	173
Accrued expenses	240	-	240
Liability for deposit funds, clearing accounts and custodial liabilities	385	-	385
Energy savings performance liability	1	7	8
Other liabilities	**$ 1,301**	**$ 496**	**$ 1,797**

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Notes to the Financial Statements

For the Years Ended September 30, 2015 and 2014

Liabilities Not Covered by Budgetary Resources

(In Millions)	2015		2014	
	Intra-governmental	With the Public	Intra-governmental	With the Public
Accrued annual leave	$ -	$ 511	$ -	$ 502
Actuarial FECA liability	-	465	-	489
Accrued FECA liability	92	-	95	-
Capital lease liabilities	5	-	7	-
Energy savings performance liability	-	7	-	8
Liabilities not covered by budgetary resources	**$ 97**	**$ 983**	**$ 102**	**$ 999**

Liabilities not covered by budgetary resources include liabilities requiring congressional action before budgetary resources can be provided. Although future appropriations to fund these liabilities are likely, it is not certain appropriations will be enacted to fund these liabilities.

Note 9. Leases

Capital Leases

The IRS leases ADP telecommunications equipment for toll free call centers, and currently has a two-year lease and two seven-year leases.

The remaining liability on the two-year lease was paid in FY 2012, and title for the equipment remains with the vendor. The payments for the leased equipment under the seven-year leases were made at the beginning of the leases. There are no future payments due for the equipment under the seven-year leases.

The IRS has a lease with the General Services Administration (GSA) for vehicles used for enforcement and a lease for furniture. The vehicles are being leased over a period of three to five years. The furniture is being leased over a period of eight years. Future minimum payments due are as follows:

(In Millions)

Fiscal Year	Lease Payment
2016	$ 2
2017	2
2018	1
2019	-
2020	-
After 2020	-
Total future lease payments	**$ 5**

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Notes to the Financial Statements

For the Years Ended September 30, 2015 and 2014

Operating Leases

(In Millions)

Fiscal Year	Lease Payment
2016	$ 111
2017	106
2018	97
2019	87
2020	82
After 2020	163
Total future lease payments	**$ 646**

The IRS leases office space from GSA and commercial entities under non-cancelable operating leases with lease terms from 2 to 19 years. This includes all GSA occupancy agreements the IRS determined to be non-cancelable. Future lease payments under non-cancelable leases of office spaces are presented above.

Additionally, the IRS has annual operating leases with the GSA for office space and vehicles, and with commercial entities for equipment and software licenses. These leases may be canceled or renewed on an annual basis at the option of the IRS. They do not impose binding commitments on the IRS for future rental payments on leases with terms longer than one year.

Note 10. Commitments and Contingencies

The IRS is a party to legal actions whose outcome, if unfavorable, could materially affect the financial statements. As of September 30, 2015 and 2014, there were no estimated contingent liabilities arising from these actions.

For some of the legal actions to which the IRS is a party, management and legal counsel cannot determine the likelihood of an unfavorable outcome nor can any related loss be reasonably estimated. The IRS does not accrue for possible losses related to cases where the potential loss cannot be estimated or the likelihood of an unfavorable outcome is less than probable. As of September 30, 2015 and 2014, there are five cases and seven cases, respectively, for which management and legal counsel are unable to determine the likelihood of an unfavorable outcome or establish a range of potential losses. Additionally, for some of the legal actions, management and legal counsel have determined the likelihood of an unfavorable outcome is remote.

As of September 30, 2015 and 2014, the IRS does not have contractual commitments for payments on obligations related to canceled appropriations or contractual arrangements for which the IRS has not recognized liabilities for goods and services provided.

INTERNAL REVENUE SERVICE

Notes to the Financial Statements

For the Years Ended September 30, 2015 and 2014

Note 11. Cost and Earned Revenue by Programs

(In Millions)	2015 Taxpayer Assistance and Education	2015 Filing and Account Services	2015 Compliance	2015 Administration of Tax Credit Programs	2015 Total
Intragovernmental gross cost	$ 169	$ 1,763	$ 2,333	$ 42	$ 4,307
Gross costs with the public	467	2,143	5,339	112	8,061
Program costs	636	3,906	7,672	154	12,368
Intragovernmental earned revenue	(2)	(46)	(51)	-	(99)
Earned revenue from the public	-	(63)	(359)	-	(422)
Program revenues	(2)	(109)	(410)	-	(521)
Net cost of operations	**$ 634**	**$ 3,797**	**$ 7,262**	**$ 154**	**$ 11,847**

(In Millions)	2014 Taxpayer Assistance and Education	2014 Filing and Account Services	2014 Compliance	2014 Administration of Tax Credit Programs	2014 Total
Intragovernmental gross cost	$ 151	$ 1,674	$ 2,479	$ 43	$ 4,347
Gross costs with the public	457	2,154	5,552	121	8,284
Program costs	608	3,828	8,031	164	12,631
Intragovernmental earned revenue	(2)	(44)	(50)	-	(96)
Earned revenue from the public	-	(51)	(347)	-	(398)
Program revenues	(2)	(95)	(397)	-	(494)
Net cost of operations	**$ 606**	**$ 3,733**	**$ 7,634**	**$ 164**	**$ 12,137**

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INTERNAL REVENUE SERVICE

Notes to the Financial Statements

For the Years Ended September 30, 2015 and 2014

Note 12. Statement of Budgetary Resources (SBR)

Obligations Incurred

(In Millions)	2015	2014
Direct		
Category B	$ 11,427	$ 11,647
Exempt from apportionment	-	1
Total	**11,427**	**11,648**
Reimbursable		
Category B	103	98
Obligations Incurred	**$ 11,530**	**$ 11,746**

Category B apportionments distribute budgetary resources by activities or programs and are restricted by purpose for which obligations can be incurred.

Explanation of Differences Between the FY 2014 SBR and the FY 2016 President's Budget

(In Millions)	Budgetary Resources	Obligations Incurred	Distributed Offsetting Receipts	Net Outlays
Statement of Budgetary Resources (SBR)	$ 12,834	$ 11,746	$ 323	$ 11,128
Included on SBR, not in President's Budget				
Expired funds	(366)	-	-	-
Distributed offsetting receipts	-	-	(323)	323
Allocation transfer from Treasury	(1)	-	-	-
Other	(3)	5	-	2
Included in President's Budget, not on SBR				
Refundable tax credits, interest refunds to taxpayers, and other outlays	104,524	104,523	-	104,523
Informant Payments	35	35	-	35
Budget of the United States Government	**$ 117,023**	**$ 116,309**	**$ -**	**$ 116,011**

The *FY 2017 Budget of the United States Government* (President's Budget) presenting the actual amounts for the year ended September 30, 2015 has not been published as of the issue date of these financial statements. The FY 2017 President's Budget is scheduled for publication in February 2016. A reconciliation of the FY 2014 column on the SBR to the actual amounts for FY 2014 in the FY 2016 President's Budget for budgetary resources, obligations incurred, distributed offsetting receipts, and net outlays is presented above.

The President's Budget includes $104.6 billion in appropriations for refundable tax credits, interest refunds, informant payments, and other outlays. These appropriations primarily consist of EITC, Child Tax Credit, and Premium Tax Credit and are reported with refunds on the Statement of Custodial Activities and are not reported on the Statement of Budgetary Resources.

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INTERNAL REVENUE SERVICE

Notes to the Financial Statements

For the Years Ended September 30, 2015 and 2014

Undelivered Orders at the End of Period

Undelivered orders are the value of goods and services ordered and obligated, but not yet received. This amount includes any prepaid or advanced orders for which delivery or performance has not yet occurred. Undelivered orders were $898 million and $855 million for the periods ended September 30, 2015 and 2014, respectively.

Note 13. Collections of Federal Tax Revenue

(In Billions)	Tax Year 2015		Tax Year 2014	Tax Year 2013	Tax Year Prior Years	Collections Received FY 2015	Collections Received FY 2014
Individual income, FICA/SECA, and other	$ 1,792	*	$ 955	$ 28	$ 25	$ 2,800	$ 2,605
Corporate income	260	**	115	4	11	390	353
Excise	60		17	-	-	77	71
Estate and gift	-		7	1	12	20	20
Railroad retirement	5		2	-	-	7	6
Federal unemployment	4		5	-	-	9	9
Collections of federal tax revenue	**$ 2,121**		**$ 1,101**	**$ 33**	**$ 48**	**$ 3,303**	**$ 3,064**

* Includes other collections of $893 million.
** Includes tax year 2016 corporate income tax receipts of $15 billion.

Note 14. Federal Tax Refund and Outlay Activities

(In Billions)	Tax Year 2015	Tax Year 2014	Tax Year 2013	Tax Year Prior Years	Refunds and Outlays FY 2015	Refunds and Outlays FY 2014
Individual income, FICA/SECA, and other	$ 31	$ 290	$ 23	$ 7	$ 351	$ 336
Corporate income	6	21	6	17	50	36
Excise	-	1	-	-	1	1
Estate and gift	-	-	1	-	1	1
Federal tax refund and outlay activities	**$ 37**	**$ 312**	**$ 30**	**$ 24**	**$ 403**	**$ 374**

Refunds include payments for various refundable credits including EITC, child tax credit, and the PPACA. Outlays include cost sharing and basic health program payments.

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INTERNAL REVENUE SERVICE

Notes to the Financial Statements

For the Years Ended September 30, 2015 and 2014

Note 15. Fiduciary Activities

(In Millions)	2015 20X6737	20X6738	20X6740	20X6741	Total
Fiduciary net assets, beginning of year	$ -	$ 18	$ -	$ -	$ 18
Contributions	9	9	29	10	57
Disbursements to and on behalf of beneficiaries	(9)	(14)	(29)	(10)	(62)
Decrease in fiduciary net assets	-	(5)	-	-	(5)
Fiduciary net assets, end of year	$ -	$ 13	$ -	$ -	$ 13

(In Millions)	2014 20X6737	20X6738	20X6740	20X6741	Total
Fiduciary net assets, beginning of year	$ -	$ 33	$ -	$ -	$ 33
Contributions	9	12	22	10	53
Disbursements to and on behalf of beneficiaries	(9)	(27)	(22)	(10)	(68)
Decrease in fiduciary net assets	-	(15)	-	-	(15)
Fiduciary net assets, end of year	$ -	$ 18	$ -	$ -	$ 18

In fiduciary fund 20X6738, the fiduciary net assets, end of year balances are pending a tax matter resolution.

In accordance with the SFFAS No. 31, *Accounting for Fiduciary Activities*, fiduciary cash and other assets are not assets of the Federal Government. The IRS has four fiduciary funds not reported on the balance sheet:

- Internal Revenue Collections for Northern Mariana Islands 20X6737
- Coverover Withholdings – U.S. Virgin Islands 20X6738
- Coverover Withholdings – Guam 20X6740
- Coverover Withholdings – American Samoa 20X6741

Internal Revenue Code (26 USC) Section 7654 governs the tax coordination between the governments of the United States and the U.S. territories of the Northern Mariana Islands, the U.S. Virgin Islands, Guam, and American Samoa.

The collections of federal income taxes withheld from U.S. military and federal employees working in these U.S. territories are maintained in fiduciary funds of the IRS. The disbursements of these collections to these U.S. territory governments represent the transfer of the individual tax liability for a taxable year.

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INTERNAL REVENUE SERVICE

Notes to the Financial Statements

For the Years Ended September 30, 2015 and 2014

Note 16. Reconciliation of Net Cost of Operations to Budget

(In Millions)	2015	2014
Resources used to finance activities:		
Obligations incurred	$ 11,530	$ 11,746
Spending authority from offsetting collections and recoveries	(225)	(269)
Distributed offsetting receipts	(352)	(323)
Transfers to General Fund	(30)	(31)
Imputed financing	1,161	1,233
Transfers in/out without reimbursement	-	(10)
	12,084	12,346
Resources that do not fund net cost of operations:		
Changes in goods, services and benefits ordered but not yet received or provided	(41)	(9)
Costs capitalized on the balance sheet	(88)	(130)
Other	9	30
	(120)	(109)
Costs that do not require resources in current period:		
Depreciation and amortization	315	277
Increase (decrease) in unfunded liabilities	(19)	(13)
Revaluation of assets and liabilities	10	8
Other	(423)	(372)
	(117)	(100)
Net cost of operations	**$ 11,847**	**$ 12,137**

In accordance with the SFFAS No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, the budgetary resources obligated during the period for the programs and operations of the IRS must be reconciled to the net cost of operations. Budgetary accounting reports the obligations and outlays of financial resources to acquire or provide goods and services. The accrual basis of accounting reports the net cost of resources used.

INTERNAL REVENUE SERVICE

Required Supplementary Information - Unaudited

For the Years Ended September 30, 2015 and 2014

Schedule of Budgetary Resources by Major Budget Accounts

	2015				
(In Millions)	Taxpayer Services	Enforcement	Operations Support	Other	Total
Budgetary resources					
Unobligated balance, brought forward, October 1	$ 60	$ 135	$ 368	$ 525	$ 1,088
Recoveries of prior year unpaid obligations	13	17	61	4	95
Other changes in unobligated balance	28	(6)	119	(250)	(109)
Unobligated balance from prior year budget authority, net	101	146	548	279	1,074
Appropriations (discretionary & mandatory)	2,191	4,777	3,907	469	11,344
Spending authority from offsetting collections (discretionary & mandatory)	36	47	47	-	130
Total budgetary resources	**$ 2,328**	**$ 4,970**	**$ 4,502**	**$ 748**	**$ 12,548**
Status of budgetary resources					
Obligations incurred	$ 2,268	$ 4,858	$ 4,157	$ 247	$ 11,530
Unobligated balance, end of year:					
Apportioned	13	20	151	427	611
Exempt from apportionment	-	-	-	7	7
Unapportioned	47	92	194	67	400
Total unobligated balance, end of year	60	112	345	501	1,018
Total budgetary resources	**$ 2,328**	**$ 4,970**	**$ 4,502**	**$ 748**	**$ 12,548**
Change in obligated balance					
Unpaid obligations, brought forward, October 1 (gross)	$ 118	$ 290	$ 840	$ 81	$ 1,329
Obligations incurred	2,268	4,858	4,157	247	11,530
Outlays (gross)	(2,255)	(4,863)	(4,056)	(208)	(11,382)
Recoveries of prior year unpaid obligations	(13)	(17)	(61)	(4)	(95)
Unpaid obligations, end of year (gross)	118	268	880	116	1,382
Uncollected payments, federal sources, brought forward, October 1	-	(38)	-	-	(38)
Change in uncollected customer payments from federal sources	-	14	-	-	14
Uncollected payments, federal sources, end of year	-	(24)	-	-	(24)
Memorandum (non-add) entries:					
Obligated balance, start of year	118	252	840	81	1,291
Obligated balance, end of year	**$ 118**	**$ 244**	**$ 880**	**$ 116**	**$ 1,358**
Budget authority and outlays, net					
Budget authority, gross (discretionary & mandatory)	$ 2,227	$ 4,824	$ 3,954	$ 469	$ 11,474
Actual offsetting collections (discretionary & mandatory)	(36)	(61)	(47)	-	(144)
Change in uncollected customer payments from federal sources (discretionary)	-	14	-	-	14
Budget authority, net (discretionary & mandatory)	**$ 2,191**	**$ 4,777**	**$ 3,907**	**$ 469**	**$ 11,344**
Outlays, gross (discretionary & mandatory)	$ 2,255	$ 4,863	$ 4,056	$ 208	$ 11,382
Actual offsetting collections (discretionary & mandatory)	(36)	(61)	(47)	-	(144)
Outlays, net (discretionary & mandatory)	2,219	4,802	4,009	208	11,238
Distributed offsetting receipts	-	-	-	(352)	(352)
Agency outlays, net (discretionary & mandatory)	**$ 2,219**	**$ 4,802**	**$ 4,009**	**$ (144)**	**$ 10,886**

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INTERNAL REVENUE SERVICE

Required Supplementary Information - Unaudited

For the Years Ended September 30, 2015 and 2014

Schedule of Budgetary Resources by Major Budget Accounts

(In Millions)	2014				
	Taxpayer Services	Enforcement	Operations Support	Other	Total
Budgetary resources					
Unobligated balance, brought forward, October 1	$ 65	$ 104	$ 325	$ 500	$ 994
Recoveries of prior year unpaid obligations	8	19	78	10	115
Other changes in unobligated balance	167	3	41	(297)	(86)
Unobligated balance from prior year budget authority, net	240	126	444	213	1,023
Appropriations (discretionary & mandatory)	2,157	4,955	3,987	558	11,657
Spending authority from offsetting collections (discretionary & mandatory)	40	67	46	1	154
Total budgetary resources	**$ 2,437**	**$ 5,148**	**$ 4,477**	**$ 772**	**$ 12,834**
Status of budgetary resources					
Obligations incurred	$ 2,377	$ 5,013	$ 4,109	$ 247	$ 11,746
Unobligated balance, end of year:					
Apportioned	12	47	180	409	648
Exempt from apportionment	-	-	-	8	8
Unapportioned	48	88	188	108	432
Total unobligated balance, end of year	60	135	368	525	1,088
Total budgetary resources	**$ 2,437**	**$ 5,148**	**$ 4,477**	**$ 772**	**$ 12,834**
Change in obligated balance					
Unpaid obligations, brought forward, October 1 (gross)	$ 101	$ 233	$ 862	$ 100	$ 1,296
Obligations incurred	2,377	5,013	4,109	247	11,746
Outlays (gross)	(2,352)	(4,937)	(4,053)	(256)	(11,598)
Recoveries of prior year unpaid obligations	(8)	(19)	(78)	(10)	(115)
Unpaid obligations, end of year (gross)	118	290	840	81	1,329
Uncollected payments, federal sources, brought forward, October 1	-	(31)	-	-	(31)
Change in uncollected customer payments from federal sources	-	(7)	-	-	(7)
Uncollected payments, federal sources, end of year	-	(38)	-	-	(38)
Memorandum (non-add) entries:					
Obligated balance, start of year	101	202	862	100	1,265
Obligated balance, end of year	**$ 118**	**$ 252**	**$ 840**	**$ 81**	**$ 1,291**
Budget authority and outlays, net					
Budget authority, gross (discretionary & mandatory)	$ 2,197	$ 5,022	$ 4,033	$ 559	$ 11,811
Actual offsetting collections (discretionary & mandatory)	(40)	(60)	(46)	(1)	(147)
Change in uncollected customer payments from federal sources (discretionary)	-	(7)	-	-	(7)
Budget authority, net (discretionary & mandatory)	**$ 2,157**	**$ 4,955**	**$ 3,987**	**$ 558**	**$ 11,657**
Outlays, gross (discretionary & mandatory)	$ 2,352	$ 4,937	$ 4,053	$ 256	$ 11,598
Actual offsetting collections (discretionary & mandatory)	(40)	(60)	(46)	(1)	(147)
Outlays, net (discretionary & mandatory)	2,312	4,877	4,007	255	11,451
Distributed offsetting receipts	-	-	-	(323)	(323)
Agency outlays, net (discretionary & mandatory)	**$ 2,312**	**$ 4,877**	**$ 4,007**	**$ (68)**	**$ 11,128**

INTERNAL REVENUE SERVICE

Required Supplementary Information - Unaudited

For the Years Ended September 30, 2015 and 2014

Other Claims for Refunds

Management has estimated amounts that may be paid out as other claims for tax refunds. This estimate represents an amount (principal and interest), which may be paid for claims pending judicial review by the federal courts or, internally, by Appeals. In FY 2015, the total estimated payout (including principal and interest) for claims pending judicial review by the federal courts is $2.1 billion and by Appeals is $2.7 billion. In FY 2014, the total estimated payout (including principal and interest) for claims pending judicial review by the federal courts was $3.1 billion and by Appeals was $4.7 billion. To the extent judgments against the government in these cases prompt other similarly situated taxpayers to file similar refund claims, these amounts could become significantly greater.

Federal Taxes Receivable, Net

In accordance with the Statements of Federal Financial Accounting Standards No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, some unpaid assessments do not meet the criteria for financial statement recognition as discussed in Note 1.F., Federal Taxes Receivable, Net and Due to Treasury. Although compliance assessments and write-offs are not considered receivables under federal accounting standards, they represent legally enforceable claims of the IRS acting on behalf of the Federal Government. There is, however, a significant difference in the collection potential of these categories.

The components of the total unpaid assessments and derivation of net federal taxes receivable were as follows:

(In Billions)	2015	2014
Total unpaid assessments	$ 389	$ 380
Compliance assessments	(80)	(86)
Write-offs	(138)	(138)
Gross federal taxes receivables	171	156
Allowance for uncollectible taxes receivable	(130)	(116)
Federal taxes receivable, net	**$ 41**	**$ 40**

To eliminate double-counting, the compliance assessments reported above exclude trust fund recovery penalties assessed against officers and directors of businesses involved in the non-remittance of federal taxes withheld from their employees. These penalties totaled $2 billion as of September 30, 2015 and September 30, 2014. The related unpaid assessments of those businesses are reported as taxes receivable or write-offs, but the IRS may also recover portions of those businesses' unpaid assessments from any and all individual officers and directors against whom a trust fund recovery penalty is assessed.

The IRS cannot reasonably estimate the allowance for uncollectible amounts pertaining to its compliance assessments, and thus cannot determine their net realizable value or the value of the pre-assessment work-in-process.

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INTERNAL REVENUE SERVICE

Other Information - Unaudited

For the Years Ended September 30, 2015 and 2014

Schedule of Spending

The Schedule of Spending presented below is an overview of the fiscal year (FY) 2015 and 2014 resources of the IRS and how they were used. The schedule is presented to help the public better understand what money was provided to the IRS, how the IRS spent the money, and to whom the money was paid.

The data used to populate this schedule is the same underlying data used to populate the Statement of Budgetary Resources (SBR). The amounts shown below as "Total amounts agreed to be spent" agree with amounts shown as "Obligations, incurred" on the SBR.

The underlying data for this schedule also populates the information on USASPENDING.GOV, which was established to provide a single searchable website accessible to the public at no cost. USASPENDING.GOV receives and displays data pertaining to obligations incurred by agencies, but there are known differences between the website and the SBR. Most notably, the website does not contain obligations incurred for individuals (e.g., payroll expenses) or for transactions less than $25,000.

(In Millions)	2015	2014
What money is available to spend?		
Total resources	$ 12,548	$ 12,834
Less amount available but not agreed to be spent	(618)	(656)
Less amount not available to be spent	(400)	(432)
Total amounts agreed to be spent	**$ 11,530**	**$ 11,746**
How was the money spent/issued?		
Tax administration		
Personnel compensation	$ 6,241	$ 6,467
Personnel benefits	2,132	2,110
Rent, communications, and utilities	953	993
Contracts	1,600	1,537
Other	604	639
Total amounts agreed to be spent	**$ 11,530**	**$ 11,746**
Who did the money go to?		
Federal	$ 3,163	$ 3,124
Non-federal	8,367	8,622
Total amounts agreed to be spent	**$ 11,530**	**$ 11,746**

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For the Years Ended September 30, 2015 and 2014

Refundable Tax Credits and Other Outlays

Refundable Tax Credits

To offer tax relief to targeted individuals and businesses, Congress has provided assistance in the form of tax credits. For the majority of tax credits, the economic benefit is limited to the taxpayer's tax liability. Credits limited in this manner are termed non-refundable credits. Refundable credits, in contrast, are fully payable to the taxpayer, even if the credit exceeds the tax liability. These types of credits provide greater economic benefits because the taxpayer realizes the full benefit of the credit, regardless of the underlying tax liability.

The following overview summarizes the refundable credits the IRS administers and pays. The overview describes refundable credits in existence for many years, as well as those enacted as part of the *American Recovery and Reinvestment Act of 2009* (ARRA) and the *Patient Protection and Affordable Care Act of 2010* (PPACA).

Earned Income Tax Credit

The Earned Income Tax Credit (EITC) is a refundable tax credit for low to moderate income working individuals and families. Congress originally approved the tax credit legislation in 1975, in part, to offset the burden of social security taxes and to provide an incentive to work. To qualify, taxpayers must meet certain requirements and file a tax return, even if they did not have sufficient income to meet regular tax return filing requirements.

Additional Child Tax Credit

The Additional Child Tax Credit is a special credit for taxpayers who work, have earnings below an established ceiling, and have a qualifying child. The Child Tax Credit is limited to the taxpayer's tax liability and is a nonrefundable tax credit. However, certain individuals who receive less than the full amount of the Child Tax Credit may qualify for the "Additional" Child Tax Credit. Under this credit, subject to additional criteria, the taxpayer may receive the full credit amount even if such amount exceeds the taxpayer's tax liability. Consequently, the Additional Child Tax Credit is categorized as a refundable tax credit.

Health Care Tax Credit

The Health Care Tax Credit was established in 2002 to assist economically dislocated workers in acquiring or continuing critical health care coverage during periods of economic distress. Under this credit, participants can elect to take a portion of their premium as a credit on their tax return.

Alternatively, participants can elect to receive direct reimbursements should they have insufficient tax liability against which to apply the credit.

Individual Alternative Minimum Tax (AMT) Credit

In 2007, the Individual Alternative Minimum Tax (AMT) Credit was established. This refundable credit is calculated by referencing specific timing items that produced an AMT liability in earlier years. Timing items involve certain transactions, such as incentive stock options and adjustments for accelerated depreciation. Non timing events, such as having a large number of exemptions or a large itemized deduction for state and local taxes, will not qualify for the credit.

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Other Information - Unaudited

For the Years Ended September 30, 2015 and 2014

Corporate Alternative Minimum Tax (AMT) Credit

Section 168(k)(4) allows a taxpayer to elect to claim a refundable credit for certain unused research credits in lieu of the special depreciation allowance for eligible property.

American Opportunity Tax Credit

The American Opportunity Tax Credit modifies the existing Hope Credit. The credit was extended to apply for tax years through 2017 by the *American Taxpayer Relief Act of 2012*. This tax credit makes the Hope Credit available to a broader range of taxpayers including many with higher incomes and those who owe no tax. Additionally, it adds required course materials to the list of qualifying expenses and allows the credit to be claimed for four post-secondary education years instead of two. Many of those eligible will qualify for the maximum annual credit of $2,500 per student.

Build America and Recovery Zone Bonds (BABs)

The BABs are a financing tool for state and local governments. The bonds, which allow a new direct federal payment subsidy, are taxable bonds issued by state and local governments to give them access to the conventional corporate debt markets. At the election of the state and local governments, the U.S. Department of Treasury (Treasury) will make a direct payment to the state or local governmental issuer in an amount equal to 35 percent of the interest payment on the Build America Bonds. This federal subsidy payment provides state and local governments lower net borrowing costs and allows them to reach more sources of borrowing than they can with more traditional tax-exempt or tax credit bonds.

Created by the ARRA, Recovery Zone Bonds are targeted to areas particularly affected by job losses and help local governments obtain financing for much needed economic development projects, such as public infrastructure development.

Qualified Zone Academy Bonds (QZAB) and Qualified School Construction Bonds (QSCB)

Congress created QZABs and QSCBs to help schools raise funds to renovate and repair buildings, invest in equipment and current technology, develop more challenging curricula, and train teachers. The tax credit portion of these bonds depends on the issuance date of the bonds, the number of bonds outstanding, and their redemption.

Qualified Energy Conservation and New Clean Renewable Energy Bonds

Qualified Energy Conservation Bonds (QECB) may be issued by state, local, and tribal governments to finance qualified energy conservation projects. A minimum of 70 percent of a state's allocation must be used for governmental purposes, and the remainder may be used to finance private activity projects. QECBs were originally structured as tax credit bonds. However, the March 2010 *Hiring Incentives to Restore Employment* (HIRE) *Act* (H.R. 2847 (Sec. 301)) changed QECB from tax credit bonds to direct subsidy bonds similar to BABs. The QECB issuer pays the investor a taxable coupon and receives a rebate from Treasury.

New Clean Renewable Energy Bonds (CREBs) may be issued by public power utilities, electric cooperatives, government entities (states, cities, counties, territories, Indian tribal governments), and certain lenders to finance renewable energy projects. CREBs were originally structured as tax credit bonds. However, the March 2010 HIRE Act (H.R. 2847 (Sec. 301)) changed CREBs from tax credit

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For the Years Ended September 30, 2015 and 2014

bonds to direct subsidy bonds similar to BABs. The issuer pays the investor a taxable coupon and receives a rebate from Treasury.

Adoption Tax Credit

Individuals qualify for the adoption tax credit if they have adopted a child and paid out-of-pocket expenses relating to the adoption. They may claim an adoption credit of up to $13,190 (for tax year 2014) per eligible child. The credit is phased out based on the individual's modified adjusted gross income. In tax year 2012, the credit changed from a refundable to a non-refundable credit. Therefore, amounts listed in the table below represent payments related to the credit for tax years 2012 and prior.

Small Business Health Insurance Tax Credit

Certain small employers are eligible for a tax credit, provided they contribute a uniform percentage of at least 50 percent toward their employees' health insurance. For nonprofit (tax-exempt) organizations, the credit cannot exceed the total amount of income and Medicare tax (i.e., hospital insurance) withholdings the employer must make and the related employer share of Medicare tax on employees' wages.

Therapeutic Discovery Grants

The Qualifying Therapeutic Discovery Project tax credit is provided under new Section 48D of the Internal Revenue Code (26 USC), enacted as part of the PPACA. The credit is a tax benefit targeted to certain therapeutic discovery projects. Such projects must show a reasonable potential to (1) achieve new therapies to treat unmet medical needs, (2) detect or treat chronic or acute diseases and conditions, (3) reduce the long-term growth of health care costs, or (4) significantly advance the goal of curing cancer.

Premium Tax Credit

Starting January 1, 2014, persons who purchase health insurance coverage through the Health Insurance Marketplace may be eligible for the premium tax credit. In general, a person is eligible for the credit if they (a) buy health insurance through the Marketplace, (b) are ineligible for coverage through an employer or government plan, (c) are within certain income limits, (d) do not file a Married Filing Separately tax return (unless they meet certain criteria that allow certain victims of domestic abuse to claim the premium tax credit using the Married Filing Separately filing status for the 2014 calendar year), and (e) cannot be claimed as a dependent by another person. Eligible individuals may elect to have some or all of their estimated credit paid in advance directly to their insurance company to lower the amount they must pay out-of-pocket for their monthly premiums or they may elect to receive all of the credit when they file their tax return. Each person who receives the benefit of a credit advance or who wishes to claim the credit must file an income tax return.

Other Outlays

Cost Sharing Reduction

In addition to receiving a premium tax credit, a person who obtains a Silver health care insurance policy through the Marketplace may be able to receive a government subsidy of their deductibles, copayments, and coinsurance costs depending upon their family size and family income. Unlike the premium tax credit, these subsidies are not tax credits and are not reported on the recipient's income

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For the Years Ended September 30, 2015 and 2014

tax return. These subsidies are administered jointly by the U.S. Department of Health and Human Services and the IRS and are outlays of the federal government.

Basic Health Program (BHP)

The PPACA gives states the option of creating a health benefits coverage program for low-income residents who would otherwise be eligible to purchase coverage through the Health Insurance Marketplace. The BHP gives states the ability to provide more affordable coverage for these low-income residents and improve continuity of care for people whose income fluctuates above and below Medicaid and Children's Health Insurance Program (CHIP) levels. These subsidies, which are federal government outlays, are not tax credits and are not reported on the recipient's income tax return.

Interest on Tax Refunds

The IRS pays interest on refunds sent later than 45 days from the filing deadline of the return. Additionally, interest is generally paid on amended returns that result in a refund. Returns that have been examined and show an overpayment also result in the payment of interest. The interest rate on overpayments is adjusted quarterly.

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The following table summarizes refundable tax credits in excess of tax liabilities and other outlays paid in FY 2015 and FY 2014.

(In Millions)	2015	2014
Earned Income Tax Credit	$ 60,084	$ 60,087
Additional Child Tax Credit	20,592	21,490
Health Care Tax Credit	-	23
Individual Alternative Minimum Tax (AMT) Credit	7	66
Corporate Alternative Minimum Tax (AMT) Credit	152	39
American Opportunity Tax Credit	4,153	4,244
Build America and Recovery Zone Bonds	3,499	3,596
Qualified Zone Academy Bonds	52	54
Qualified School Construction Bonds	643	621
Qualified Energy Conservation Bonds	34	32
New Clean Renewable Energy Bonds	29	29
Adoption Tax Credit	16	58
Small Business Health Insurance Tax Credit	38	74
Therapeutic Discovery Grants	-	1
Premium Tax Credit *	20,926	10,957
Cost Sharing Reduction	5,060	2,110
Basic Health Program (BHP)	1,228	-
Interest on Tax Refunds	1,061	1,038
Refundable tax credits and other outlays	**$ 117,574**	**$ 104,519**

*Includes advanced amounts for the Premium Tax Credit. Beginning in FY 2015, preliminary outlay amounts are adjusted upward or downward based on information from tax returns. In FY 2015 and FY 2014, total Premium Tax Credit advances disbursed by the Center for Medicare and Medicaid Services totaled $23,770 and $10,957, respectively. The FY 2015 advanced amount was adjusted downward based on tax return information.

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Social Security and Medicare Taxes

The Federal Insurance Contributions Act (FICA) provides for a federal system of old-age, survivors, disability, and hospital insurance benefits. Payments to trust funds established for these programs are financed by payroll taxes on employee wages and tips, employers' matching payments, and a tax on self-employment income.

A portion of FICA benefits involves old-age, survivors, and disability payments. These benefits are funded by the social security tax, which is currently 6.2 percent of wages and tips up to $118,500, and an employer matching amount of 6.2 percent, bringing the total rate to 12.4 percent for calendar year 2015. In calendar year 2014, the rate was 6.2 percent of wages and tips up to $117,000 and an employer matching amount of 6.2 percent, bringing the total rate to 12.4 percent. These benefits are also funded by a self-employment tax of 12.4 percent and 12.4 percent on self-employment income up to $118,500, and $117,000 for calendar years 2015 and 2014, respectively. Remaining benefits under FICA pertain to hospital benefits (referred to as "Medicare") and are funded by a separate 1.45 percent tax on all wages and tips (there is no wage limit) and the employer matching contribution of 1.45 percent, bringing the total rate to 2.9 percent. Self-employed individuals pay a Medicare tax of 2.9 percent on all self-employment income. Beginning in 2013, an additional Medicare tax of 0.9 percent was collected on earned individual income of more than $200,000 ($250,000 for married couples filing jointly). Social security taxes collected by the IRS were estimated to be approximately $778 billion and $743 billion in FY 2015 and FY 2014, respectively. Medicare taxes collected by the IRS were estimated to be approximately $236 billion and $225 billion in FY 2015 and FY 2014, respectively. Social security taxes and Medicare taxes are included in the Individual income, FICA/SECA, and other financial statement line on the Statement of Custodial Activity.

Tax Gap and Tax Burden

Tax Gap

The tax gap is the difference between the amount of tax imposed by law and what taxpayers actually pay on time. The tax gap arises from the three types of noncompliance: not filing required tax returns on time or at all (the nonfiling gap), underreporting the correct amount of tax on timely filed returns (the underreporting gap), and not paying on time the full amount reported on timely filed returns (the underpayment gap). Of these three components, only the underpayment gap is observed; the nonfiling gap and the underreporting gap must be estimated. The tax gap, estimated to be about $450 billion for tax year 2006 (the most recent estimate made), represents the net amount of noncompliance with the tax laws. Underreporting of tax liability accounts for 84 percent of the gap, with the remainder divided between nonfiling (6 percent) and underpaying (10 percent). Part of the estimate is based on data from a study of individual returns filed for tax year 2006. It does not include any taxes that should have been paid on income from illegal activities. Each instance of noncompliance by a taxpayer contributes to the tax gap, whether or not the IRS detects it, and whether or not the taxpayer is even aware of the noncompliance. Some of the tax gap arises from intentional (willful) noncompliance, and some of it arises from unintentional mistakes.

The collection gap is the cumulative amount of tax, penalties, and interest assessed over many years, but not paid by a certain point in time, which the IRS expects will remain uncollectible. In essence, it represents the difference between the total balance of unpaid assessments and the net taxes receivable

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reported on the balance sheet of the IRS. The tax gap and the collection gap are related and overlapping concepts, but they have significant differences. The collection gap is a cumulative balance sheet concept for a particular point in time, while the tax gap is like an income statement item for a single year. Moreover, the tax gap estimates include all noncompliance, while the collection gap includes only amounts that have been assessed (a small portion of all noncompliance) and have not yet reached their statutory collection expiration date. Also, the tax gap includes only tax, while the collection gap includes tax, penalties, and interest.

Tax Burden

The Internal Revenue Code provides for progressive rates of tax, whereby higher incomes are generally subject to higher rates of tax. The following pages present in both graph and table format various income levels and tax liability levels reported by individuals and corporations (that is, these amounts do not account for tax burdens that taxpayers do not report on their returns). This information is the most recent available for individuals (tax year 2013) and corporations (tax year 2012). The graphs and charts are representative of more detailed data and analyses available from the IRS Statistics of Income Office.

For individuals, the information illustrates, in both percentage and dollar terms, the tax burden that taxpayers bear by varying levels of Adjusted Gross Income (AGI). The corporate information illustrates, for varying corporate asset categories, the tax burden borne by these entities as a percentage of taxable income.

Tax Expenditures

Total tax expenditures are the foregone federal revenue resulting from deductions and credits provided in the Internal Revenue Code. Since tax expenditures directly affect funds available for government operations, decisions to forego federal revenue are as important as decisions to spend federal revenue.

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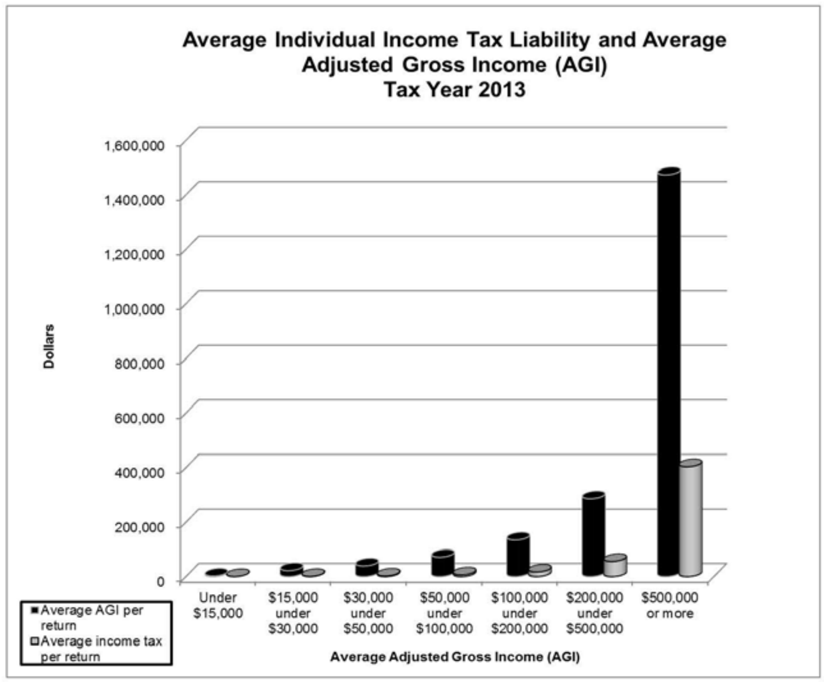
For the Years Ended September 30, 2015 and 2014



Adjusted gross income (AGI)	Number of taxable returns (in thousands)	AGI (in millions)	Total income tax (in millions)	Average AGI per return (in whole dollars)	Average income tax per return (in whole dollars)	Income tax as a percentage of AGI
Under $15,000	$ 37,255	$ 76,709	$ 2,093	$ 2,059	$ 56	2.7%
$15,000 under $30,000	30,556	671,851	18,614	$ 21,988	$ 609	2.8%
$30,000 under $50,000	25,753	1,008,621	55,379	$ 39,165	$ 2,150	5.5%
$50,000 under $100,000	31,803	2,272,956	198,233	$ 71,470	$ 6,233	8.7%
$100,000 under $200,000	16,426	2,209,424	278,504	$ 134,508	$ 16,955	12.6%
$200,000 under $500,000	4,488	1,277,489	250,646	$ 284,645	$ 55,848	19.6%
$500,000 or more	1,070	1,576,579	431,571	$ 1,473,438	$ 403,337	27.4%
Totals	$ 147,351	$ 9,093,629	$ 1,235,040			

(All figures are estimates and based on samples provided by the Statistics of Income Office.)

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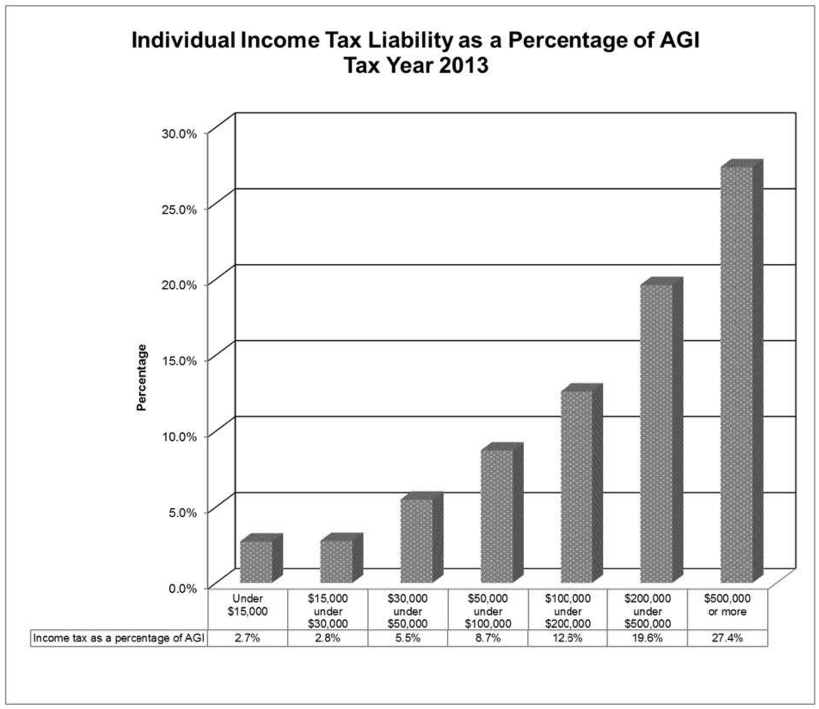
For the Years Ended September 30, 2015 and 2014



(All figures are estimates and based on samples provided by the Statistics of Income Office.)

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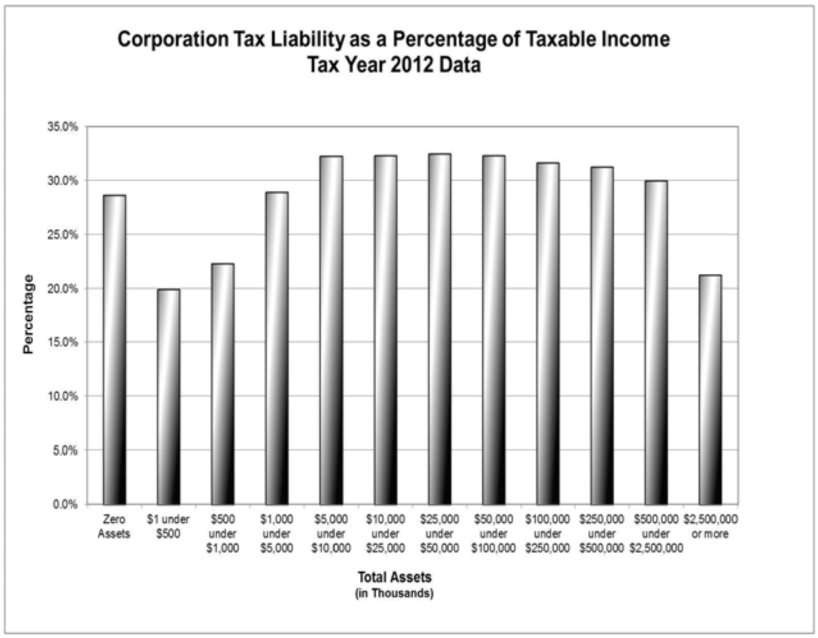
For the Years Ended September 30, 2015 and 2014



Total Assets (in thousands)	Income subject to tax (in millions)	Total income tax after credits (in millions)	Percentage of income tax after credits to taxable income
Zero Assets	$ 16,712	$ 4,788	28.7%
$1 under $500	7,196	1,433	19.9%
$500 under $1,000	3,521	785	22.3%
$1,000 under $5,000	11,870	3,433	28.9%
$5,000 under $10,000	7,557	2,438	32.3%
$10,000 under $25,000	12,705	4,107	32.3%
$25,000 under $50,000	11,352	3,690	32.5%
$50,000 under $100,000	14,208	4,595	32.3%
$100,000 under $250,000	25,864	8,190	31.7%
$250,000 under $500,000	29,767	9,297	31.2%
$500,000 under $2,500,000	122,526	36,757	30.0%
$2,500,000 or more	886,522	188,341	21.2%
Totals	**$ 1,149,800**	**$ 267,854**	

(All figures are estimates and based on samples provided by the Statistics of Income Office.)

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Appendix I: Management's Report on Internal Control over Financial Reporting

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

COMMISSIONER

November 10, 2015

Ms. Cheryl E. Clark
Director, Financial Management and Assurance
U.S. Government Accountability Office
441 G Street, NW, Room 5474
Washington, DC 20548

Dear Ms. Clark:

The Internal Revenue Service's (IRS) internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, the objectives of which are to provide reasonable assurance that: (1) transactions are properly recorded, processed and summarized to permit the preparation of financial statements in accordance with U.S. Generally Accepted Accounting Principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition; and (2) transactions are executed in accordance with provisions of applicable laws, including those governing the use of budget authority, regulations, contracts, and grant agreements; noncompliance with which could have a material effect on the financial statements.

IRS management is responsible for maintaining effective internal control over financial reporting, including the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. IRS management evaluated the effectiveness of the IRS's internal control over financial reporting as of September 30, 2015, based on the criteria established under 31 U.S.C. 3512(c), (d) (commonly known as the Federal Managers' Financial Integrity Act).

Based on that evaluation, we conclude that as of September 30, 2015, IRS has one material weakness in its internal control over financial reporting, specifically unpaid tax assessments. The IRS's financial management systems do not substantially comply with the requirements of the Federal Financial Management Improvement Act. On this basis, management provides qualified assurance that as of September 30, 2015, the IRS's internal control over financial reporting was effective.

John A. Koskinen
Commissioner

November 10, 2015
Date

Jeffrey J. Tribiano
Deputy Commissioner, Operations Support

November 10, 2015
Date

Jeffrey S. Wallbaum
Acting Chief Financial Officer

November 10, 2015
Date

Appendix II: Comments from the Internal Revenue Service

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

COMMISSIONER

November 5, 2015

Ms. Cheryl E. Clark
Director
Financial Management and Assurance
U.S. Government Accountability Office
441 G Street, NW, Room 5474
Washington, DC 20548

Dear Ms. Clark:

Thank you for the opportunity to comment on the draft report titled, *Financial Audit: IRS's Fiscal Years 2015 and 2014 Financial Statements*. We are pleased that the Internal Revenue Service (IRS) received an unmodified opinion on the combined financial statements for the 16th consecutive year. The unmodified opinion demonstrates that the IRS accurately accounts for approximately $3.3 trillion in tax revenue receipts, $403 billion in tax refunds, and $11 billion in IRS appropriated funds.

We are pleased the Government Accountability Office (GAO) recognized our continued focus on securing information systems and protecting sensitive taxpayer and financial information, including our efforts to further restrict access privileges on key financial applications and our continued migration to multifactor authentication across the agency.

The IRS finalized a long-term Unpaid Assessments action plan with linkages to key financial reporting issues and GAO open recommendations, with nine prioritized actions already added to the remediation plan for custodial financial management systems. In addition, the IRS finalized actions to ensure Affordable Care Act Basic Health Program payments were made to states from the Premium Tax Credit account, developed a reporting process, and established a Memorandum of Understanding with the Centers for Medicare and Medicaid Services to provide reasonable assurance that controls are operating effectively. The IRS also implemented new financial reporting to better identify risk relative to erroneous refunds under the Foreign Account Tax Compliance Act. The IRS is dedicated to continuing to improve its financial management, internal controls, and information technology security posture.

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I want to recognize the GAO's support throughout the audit. While challenges remain, the IRS has established its ability to consistently produce accurate and reliable financial statements. We have a solid management team dedicated to promoting the highest standard of financial management, and we continue to increase our focus on information security and internal controls. We look forward to working with the GAO in our efforts to continue to improve controls over financial reporting.

Sincerely,

John A. Koskinen

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